



**SCOTTISH EXECUTIVE**

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Finance and Central Services Department  
Financial Partnerships Unit

Victoria Quay  
Edinburgh EH6 6QQ

To those on attached circulation list

Telephone: 0131-244 7497  
Fax: 0131-244 7499  
Sandy.rosie@scotland.gsi.gov.uk  
[www.scotland.gov.uk/fpu](http://www.scotland.gov.uk/fpu)

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**SE/STUC PPP STAFFING PROTOCOL  
SUPPLEMENTARY TECHNICAL GUIDANCE ON SCOPING OF FM SERVICES AND IN  
HOUSE BIDS**

During the discussions in the Working Group of SE/STUC which led to publication of the SE/STUC Staffing Protocol in November 2002, it was agreed that there was need for supplementary technical guidance. This related to the Protocol's confirmation that public sector organisations could consider variations to the manner in which public private partnerships had previously evolved generally using only private sector suppliers of facility management services.

In February 2003 SE issued for consultation draft supplementary technical guidance. Comments were received over the Summer, with the process extended to accommodate some because of the Election process. In the meantime the draft guidance has been referred to and used in relation to several live projects, giving useful insight into, and generally confirmation of, the practicality of its advice.

Most of the comments received welcomed the guidance and supported the flexibility it offers, as well as the processes which were generally recognised as necessary to ensure that public sector organisations establish the best arrangements to offer required outputs and best value. A number of valuable points were made which have been incorporated into adjustments to the final version. We are grateful to all those who took the time to respond and offer their knowledge and experience.

Also during the Summer we issued standard contract clauses which should be used to cover those elements of the Protocol which are to be delivered by PPP consortia.

The three key documents on this topic – SE/STUC Protocol on Staffing Matters in PPP; standard contract clauses; and Supplementary Technical Guidance on the Scoping of FM Services and In-House Bids can be found on our website – [www.scotland.gov.uk/fpu](http://www.scotland.gov.uk/fpu). If you require assistance gaining access to this material, please contact Fiona McLellan (0131 244 7500 or [fiona.mclellan@scotland.gsi.gov.uk](mailto:fiona.mclellan@scotland.gsi.gov.uk)), or write to FPU at the above address.

Yours sincerely,

Sandy Rosie  
Director



# **Guidance Note on Public Sector Involvement in PPP Facilities Management (FM) Delivery**

**Scottish Executive Financial Partnerships Unit**

**September 2003**

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## Introduction

1. The guidance explores and develops a principle raised in the Scottish Executive Staffing Protocol. The Protocol states, in paragraph 3(b) – “Where a Public Sector Organisation (PSO) decides that a PPP should include services which are currently being provided by directly-employed staff, the PPP process is, in principle and in practice, open to bids incorporating the use of such staff, for example Direct Service (DSO) or Direct Labour (DLO) Organisations. Such bids would be considered on the same value for money criteria as other bids and overall the PPP would have to meet all the requirements of extant PPP guidance and any Scottish Executive funding requirements.”

2. This guidance explores the issues that Public Sector Organisation’s (PSOs) should consider when developing their strategy for delivering facilities management (FM) services through their PPP projects. It also provides more detailed practical steps related to specific procurement options and the PPP process. It is not intended to be prescriptive but aims to support PSOs in their decision making on service delivery options. In seeking Scottish Executive funding for PPPs PSO will be asked to demonstrate that they have followed this guidance.

3. The note takes account of the many interrelated aspects of PPP that comprise the broader context of a successful PPP. PSOs need to remain aware of that wider picture when considering FM delivery: for example, the appetite of the prevailing PPP market, the requirement to deliver value for money (VfM), the impact on project scope of hard and soft FM services, and the need to secure sufficient risk transfer. The issues and processes may seem daunting, but since the Protocol has recognised that there are options in service delivery it is important that proper assessment is made of these in advance of settling a long-term partnership relationship. This process should strengthen, rather than weaken, any decision to pursue an in-house bid.

4. The note emphasises the need for early decision making whilst also reviewing options and steps within the procurement stages. The need for early resolution of FM service delivery issues is important because of -

- the impact that uncertainty and delay can have on procurement timetables,
- the desire to reduce stakeholder anxiety,
- the potential increase in procurement costs, as a result of delay or uncertainty, for both the private and public sectors,
- the public sector requirement to prepare a management strategy in relation to staffing options,
- the opportunity to give in-house interests sufficient time to organise and prepare itself properly for any involvement in the procurement process,
- the SE’s stated objective of meaningful consultation with all stakeholders, employees, and constructive involvement of the Trades Unions.

### Key PPP Procurement Issues

5. PSOs developing their strategy for delivering FM services should retain a focus on the benefits of PPP procurement demonstrated in PPP projects to date. Those benefits, and the main purpose of PPP procurement, are founded on the search for sustained and improved quality of service delivery whilst achieving VfM. Improved VfM in a PPP procurement is delivered by optimal transfer of risk, but what does that actually mean in practice? The key transfer areas are -

- transfer of the risk for design, build and service delivery should bring a rigour and quality to the project. The Contractor<sup>1</sup>, who has whole life maintenance responsibility for the facility over the life of the concession, must ensure an integrated approach to design, specification, service delivery and ongoing interface management with the PSO.
- integration of the many facets of design and delivery of a PPP project means that the Contractor will provide a clearly understood and defined interface with the PSO. That interface is typically through a single door approach to management of the project, allowing no ambiguity for responsibility or required management action.
- the Contractor operates under a payment regime where non-performance equates, simply, to non-payment.

6. In addition, when reviewed in detail, the transfer of risk ultimately forms the basis of a project's balance sheet position. Demonstrating sufficient transfer of risk is an important element of any project's Business Case and is necessary to secure Revenue Support funding from the Scottish Executive.

### Guidance Note Structure

8. The guidance note is structured in four main sections, relating to three key stages of PPP procurement -

Summary of procurement options and issues for consideration  
Section A : Option appraisal to OBC,  
Section B, pre-OJEC to ITN, and  
Section C, The Operational Stage.

9. In addition, at the end of the guidance paper, there are four supporting information notes which explore in more detail some of the issues raised in the main text.<sup>2</sup>

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<sup>1</sup> Contractor is used here to describe the SPV who contract directly with the PSO.

<sup>2</sup> The notes are cross-referred to throughout the text, for example (**Note No.1**)

## Summary

### *Soft and hard FM*

1. The SE/STUC Staffing Protocol clarifies that PPP projects can include an element of public service delivery in FM, subject to certain criteria and requirements of the PPP process. The potential impact on full service integration, combined with the loss of VfM, potential major changes to commercial terms and problems with balance sheet treatment, weigh against provision of hard FM by the public client.

2. It is for individual PSOs to evaluate if any proposed soft FM service delivery option being considered by them would affect the benefits of integrated service delivery, design and construction anticipated under a full services PPP. When scoping a PPP and considering any in-house bid, it should be seeking to match or better that state of efficient service delivery, and be able to justify its decision on objective grounds.

### *Options*

3. PSOs should review carefully the pros and cons of an in-house FM service delivery option. Do the solutions being reviewed deliver the spectrum of project objectives set, and benefits sought, by the PSO, particularly in respect of:

- an integrated approach to design, build and services delivery,
- single point accountability,
- simple and cost effective contract management,
- improved and sustained performance,
- affordability and,
- VFM?

4. It is the challenges set by these objectives a PSO must test when assessing options for public sector involvement in the FM delivery of their PPP project.

5. Those options are likely to be:

- Exclusion of a service/s from the project pre-procurement,
- Exclusion a service/s from the project via a “Best Value” review,
- An in-house team bidding to become a sub-contractor to the PPP bidder,
- Secondment of staff

### *Effect on Market Interest*

6. A successful long term PPP project is linked clearly to an initial, strong procurement competition.

In considering their strategy for FM delivery, PSOs must consider the market conditions they are operating within and the impact any option for FM delivery may have on attracting sufficient, and good quality bidders, to their project.

### **Bidder Issues**

7. To ensure strong competition with good quality bidders who are fully committed to their project's procurement, PSOs must ensure bidders entering their procurement process are fully aware of the PSOs procurement intentions.

8. Bidders will consider carefully, before committing to a project, the procurement process being proposed, as well as the scope and critical mass of the FM services included in a project. They will also assess interface issues and how these are likely to impact on risk and the contractual payment mechanism.

### ***Timing***

9. PSOs must consider any FM delivery options early in the procurement process, preferably setting out their conclusions as part of their OBC. Early consideration of options, and market research to support any decision made, are essential. Leaving consideration, and decisions, to after the project has gone to the market exposes the project to potential for delay and the PSO to increased costs.

### ***Managing the process***

10. If a PSO pursues an option of including the public sector in FM delivery, they must ensure that they have an agreed bid from their proposed Preferred Bidder which is fully scoped and priced prior to announcing Preferred Bidder. In particular, it is essential that the many interface issues are understood and scheduled in detail, and that the payment mechanism is agreed by all parties.

### ***Looking Ahead***

11. The questions PSOs must consider are not just about structuring and closing the deal they have in front of them, but the future impact of any procurement decisions taken on FM delivery.

## 1. Section A - Option Appraisal to OBC

Under the heading of Option Appraisal to OBC, it is assumed the following pre-procurement stages are included -

- Establish Business Need
- Appraise the Options
- Outline Business Case and Reference Projects
- Market Sounding

### 1.1

At this stage PSOs have identified a business need, are reviewing options to address that need, with a view to formalising an Outline Business Case, shaping a PPP project, and securing funding. It is at this stage that the strategy for delivering FM services should be examined and clarified as far as possible.

#### A.1 Option Appraisal and the OBC – Important Early Issues

**PSOs wishing to consider alternative FM service delivery options should include a detailed review of their FM proposals as part of their OBC project option appraisal.**

In carrying out the option appraisal, and subsequent drafting of the OBC, there should be understanding and exploration of key issues relating to FM delivery within their PPP project:

- The option appraisal should review and inform the PSO of the FM services to be included in their PPP project. Clarification of the hard and soft services will be a structural part of that review. It is anticipated that the option appraisal will explore any opportunities the public sector may have to be involved in soft FM delivery. *(Note No 1)*
- In considering VfM within the option appraisal, and subsequent OBC, there should also be an awareness of the wider commercial impact various procurement options may have. A PSO proposing FM delivery options will be expected to demonstrate in their OBC understanding, and proposed management, of key commercial issues relevant to their projects. *(Note No 2)*
- The option appraisal should engender understanding of the relationship between Value for Money and FM services delivery within a PPP context. At this stage there should be sufficiently detailed work undertaken to rule out any options which will not deliver clearly a strong VfM position. *(Note No. 3)*
- In reviewing VfM, and associated commercial issues, it is important that PSOs retain a clear vision of the benefits of PPP. Any FM delivery options must be analysed and quantified for those benefits, and that analysis should be expressed clearly in the OBC. The choice of in-house over contracted service provision is likely to affect the balance of risk transfer in a PPP to some degree, and advisers should provide sensitivity tests on the risk matrix to assist the PSO arrive at the optimum vfm position.
- Any internal efficiency or other ‘Best Value’ reviews will be relevant to this analysis. If a PSO considers scoping a PPP on the basis of continued in-house provision of a service, then it should have justification in the form of such a review. However, it is unlikely to provide all the evidence needed for a PPP vfm test. For the same reason, it is not recommended that in-house teams be put forward as ‘nominated sub-contractors’.

## A.2 Consultation

**Good practice consultation should be evident as part of the OBC and, as a minimum, consultation on staffing issues should be at a level set out in the SE/STUC Staffing Protocol.**

PSOs are expected to demonstrate in their OBCs that there is an operational consultation and communication strategy in place for their PPP project.

It is important to pay particular attention to consultation and communication with FM staff whose employment is likely to be affected directly by the proposed PPP project. It is important, even at this early stage, that the issues set out under section A.1 should form part of content of the consultation strategy.

A consultation framework also presents an opportunity to establish early dialogue with any in-house provider who may be considering involvement in a PPP procurement, allowing sharing of information, particularly on specification and payment mechanism issues. This early dialogue should also facilitate the in-house provider examining their readiness to undertake involvement in a PPP procurement.

## A.3 FM Service Delivery – Options

***PSOs must set out clearly in their OBCs any FM service delivery options either being pursued, or to be tested, through the procurement process.***

To date PPPs have generally included transfer of most FM services to the Contractor, supported as appropriate by staff transfers. This has proved necessary to achieve sufficient transfer of risk to establish a VfM position, maximise operational efficiency, and to avoid subsequent interface and cost problems. PSOs following this option are encouraged to plan their strategy for managing this process, well in advance of the actual procurement.

If other options utilising direct public sector involvement in FM service delivery are to be considered by a PSO, the proposal is likely to fall within one of four generic options, namely:

- excluding FM service/s pre-procurement
- excluding FM service/s by Best Value (BV) testing at ITN,
- in-house team bidding to become a sub-contractor to the Contractor, or
- secondment of staff to the Contractor

## A.4 Market Context

**It is a keystone to the success of any PPP project that bidders, in sufficient numbers and quality, are prepared to bid for it.**

*A PPP project embracing FM delivery involving the public sector requires consideration of the context and buoyancy of the current Scottish PPP market.*

*Prior to OBC stage, PSOs should have considered and reviewed the position of their PPP project within a broader market context and established whether, and if so what are, the*

*likely implications of promoting direct public service involvement in delivery of FM services. The OBC should describe this process and set out the subsequent market response.*

## 1.2

**1.3 It is likely that contractors will be more attracted to PPP projects that demonstrate clarity on service provision and offer a critical mass of services to bid for. Potential bidders will have views as to whether any public sector involvement in services offers advantage or disadvantage to them, and the PSO has to understand these issues and attitudes and interpret them for their own interest in service delivery and value for money. The crux of the contextual matter for PSOs to consider and explore is; in proposing any FM service delivery model, will they engender sufficient competition and, in effect, encourage or discourage bidder involvement.**

## 1.4

### A.5 Managing the Procurement Process

**PSOs considering FM delivery must review, and manage, any related delivery risks to the project procurement. *(Note No 3)***

One way of managing procurement risk, related to FM service delivery options, is to set out the intended procurement process, in relation to any FM delivery option, as early as possible within the overall project procurement timeframe. Any timetable must allow sufficient time to support the work involved in scoping, and then delivering, the chosen FM service delivery option.

In PPPs PSOs are working to demanding pressure and deadlines, but any temptation to underestimate, or unrealistically condense, the time required to fully explore FM service delivery options, or the impact on the project programme, must be resisted. This is not time wasted – good consultation and planning will secure greater consensus for the proposals and may avoid even lengthier delays and cost implications at a later point in the procurement.

It is expected generally that OBCs will set out the procurement process and programme in detail and, in particular, any part relating to FM service delivery options should be detailed and realistic.

This early focusing will ensure not only clarity and understanding of the process for all the project stakeholders, but also sets out a clear and understood way forward for Bidders who may be interested in the project. Whatever bidders' views on how FM services are to be delivered, they will always be more interested in working with PSOs which have done their homework well and those who can present a clear picture of their requirements once the procurement commences.

### A.6 The Scottish Executive OBC Review

**OBCs will be reviewed for clarity in respect of FM service delivery proposals under the established headings of; Risk transfer and Vfm, affordability, deliverability, and balance sheet position.**

As part of the OBC review the SE will look for evidence that PSOs have explored FM service delivery options and in particular that they have:

- Set a realistic and manageable programme,
- Planned, and agreed at the appropriate Council level, a clear and detailed process for any procurement option to be tested,
- Identified and quantified the position on risk transfer,

- Considered all aspects of, and impact on, VFM,
- Identified all service delivery interface issues,
- Addressed any erosion of single point accountability,
- Tested appropriately, deliverability and market acceptability of any proposals,
- Considered the readiness and ability of in-house providers to engage fully in any procurement process,
- Followed relevant SE / PPP guidance.

## **Section B - Pre-OJEU to Invitation To Negotiate (ITN)**

Under the heading of Pre-OJEU to ITN, it is assumed the following procurement stages are included:

- OJEU Notice
- Pre-qualification
- Shortlist
- ITN issue
- ITN responses

At the pre-OJEU juncture PSOs have secured funding and are progressing towards the formal launch of their projects with the issue of an OJEU notice. Strategy for FM delivery should be as firm as possible at this stage to ensure that the project is advertised on the correct EU procurement basis and to instil confidence in the market, and potential bidders, that they are progressing on a firm basis.

From OJEU onwards, if any significant part of the project that remains uncertain it will open the door for qualified bids, increased costs and later procurement problems.

Depending on the procurement options being considered for FM services delivery a number of issues require to be considered. In the following four sections the procurement options are covered in turn with the main issues relevant at pre-OJEU and post- OJEU stages listed. The list is not exhaustive and there may be many project specific issues that PSOs will need to consider.

### **Options and Process**

#### **B.1 Exclusion of FM Service/s from the Project pre-Procurement**

A PSO may decide to exclude a FM service from the project scope pre-procurement. In an Education context, early exclusion in successful PPPs has to date related only to services which do not impact significantly on risk transfer or balance sheet treatment, such as catering. In terms of VfM and balance sheet issues, such a decision should be supported by appraisal. Any inter-dependence between such a service and others which might affect management interfaces or financial penalties, should also be examined carefully.

By the pre-OJEU stage, building on research and appraisal at earlier planning stages, a PSO should have explored and satisfied themselves of:

- the projects' attractiveness to the market particularly in relation to scope and critical mass of FM services,
- the project's risk transfer and overall VfM position,
- the robustness of the decision from a Best Value perspective.

By the post-OJEU stage, a PSO should have:

- drawn-up detailed interface schedules to regulate the relationship between the in-house provider and the preferred bidder,
- agreed the interface schedules with the in-house provider,
- included the interface schedules in the ITN documentation.

## **B.2 Exclusion of FM Service/s from the Project by ‘Best Value’ Testing at ITN**

Issues related to the exclusion of service/s option by BV testing are set out in (*Note No 4*)

If it is intended to carry out a BV test to determine an exclusion of service, then at the pre-OJEU stage:

- A BV procurement strategy should be made available setting out in detail how the process will be structured and managed. Ideally, this information should accompany the OBC and be included in the Information Memorandum.
- The in-house provider must be in a position to construct and provide a comparative submission to bidders at ITN stage. To do this they must be in an informed position of the commercial aspects of PPP, in particular, they may require detailed briefings on the principles of the output specification and payment mechanism.
- The in-house provider must be sufficiently resourced to take part in the procurement process. It is likely that in-house management expertise will require to be bolstered by external specialist advice.
- The in-house provider must take into account the exposure to risk they are undertaking. As they are submitting on the same price and quality basis as the main bidders, then there is an inherent assumption, should they be successful, that payment deductions will be applied for non-performance. PSO financial advisers should cover this aspect in their appraisal of project risk factors and vfm, including sensitivity testing to establish the parameters of choice for the PSO.
- The BV procurement strategy drawn up should address any conflict of interest issues and, in particular, confidentiality of the respective bidders’ proposals. It is essential to protect the public sector position and maintain the integrity of the competition. As the in-house provider does not have the same access to the design development process as the bidders, they must be given the opportunity to refine their submission following receipt of the bidders ITN submissions.<sup>3</sup>

It is at this stage, in particular, that the PSO must take steps to avoid any charges of wrongdoing. The PPP bidders’ submissions, and prices therein, are known to the PSO PPP team and perhaps others within the PSO, before the in-house provider finalises their submission and price. PSOs are advised to seek the advice of their Internal Auditors, as well as legal advice, in drawing up these arrangements.

- The procurement strategy should ensure that the in-house provider has the same level of dialogue with the PPP team, and access to relevant information, as bidders.

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• <sup>3</sup> For example, different bidders may have different overall gross internal floor areas (GIFA`s), or have specified extensive external glazing or have specified radically different internal finishes, all of which could affect the in-house provider`s cleaning price.

By the ITN issue stage:

- PSOs should consider carefully the number of Mandatory Variations (MV) they request from bidders. As the number of MVs increases, the longer and more onerous the evaluation period will be, and the greater bidders' costs become.
- A full and detailed procurement strategy for FM service delivery must be set out as part of the ITN documents. It is likely that the ITN documentation will ask for MV bids excluding the service/s being Best Value tested. The MV bids must take into full account the interface schedules provided. The MV bids can then be evaluated and compared against the in-house providers evaluated submission.
- Evaluation criteria to be applied to the in-house submission should mirror, as far as possible, that used to evaluate the main bids. There will, inevitably, be some differences. Consideration should also be given to risk equalisation, typically used in PPP evaluation to adjust bids to allow equal comparison, as this may also be relevant to, and affect, the in-house submission.
- Interface issues relating to security, utilities, equipment and so on, should have been fully explored, relevant schedules drawn up in detail and included as part of the ITN documentation.
- PSOs should also consider the additional ongoing monitoring and management resource that will be required to manage two direct FM providers, and their interfaces, once the project is operational.

### **B.3 Sub-contracting of an in-house team**

Issues related to the sub-contracting FM service/s to an in-house team (DSO/DLO/etc) are set out in *Note No 4*.

If a PSO is to pursue a sub-contracting model, whereby an in-house team sub-contracts to the Contractor or FM Sub-contractor to provide a FM service, VfM will be best determined by testing the cost and quality of that option through the ITN bid process. In short, the bidders are asked to bid with their own sub-contractors and then, as a mandatory variant bid with the in-house team as a sub-contractor. The contrasting bids can then be compared for differences in quality or price.

If this model is to be pursued, then the following should be in place at the pre-OJEU stage:

- A procurement strategy should be drawn up, setting out in detail how the process will be structured and managed. Ideally, this information should be contained in the OBC. The intention to test this FM service delivery option through the project procurement, and the methodology to be used, must be set out in detail in the Information Memorandum.
- The PSO and the in-house team should confirm the legality of the latter being able to contract in this way with the private sector, taking account of changes in the Local Government Acts.
- The in-house team must be in a position, both in terms of structure and resources, to engage fully in the procurement process. It is recommended that they take specialist advice, particularly in relation to the commercial terms they are likely to be required to sign-up to by the Contractor/FM Sub-contractor.

- The in-house team should be treated equally with other sub-contractors and enjoy the same access to information. This is likely to mean they will seek information or clarification via the Contractor and will not have a direct link to the PPP team.
- The PSO must ensure the confidentiality of bidders' commercial information released to the in-house team and should take legal advice in this regard.
- The PSO and in-house team must understand fully the commercial risks they will run as a sub-contractor to a PPP Contractor/ FM Sub-contractor.
- The evaluation strategy should include evaluation and quantification of any changes made by the bidders to the PSOs desired commercial terms.

At the issue of ITN:

- The full and detailed procurement strategy should be set out as part of the ITN documents. It is likely that bidders will be asked to bid for the FM services in question with their own sub-contractors and, as a MV bid, with the in-house team as a sub-contractor.
- The evaluation strategy, and criteria, must be clear on the process and selection criteria for choosing the winning bid, mandatory or otherwise. Procurement advice should be taken from legal advisers to ensure compliance with European and domestic procurement rules.
- The PSO may have to facilitate meetings between the bidders and the in-house team and answer any clarifications arising from the discussions. Management of the in-house team, as it relates to their sub-contract, is a matter for the bidders but the interface will have to be carefully considered and presented in the bid. The PSO will have to give careful consideration as to how it will relate to any subsequent issues arising during the PPP contract as regards its responsibilities towards the in-house team, for example as employer.
- There should be no direct contact between the PPP team and in-house team planning to be a sub-contractor to a PPP bidder. Support and management of the in-house team should be kept separate from the PPP team and PSOs are advised to ensure compliance with their own Standing Orders as well as taking specialist advice in relation to procurement rules.
- Following the announcement of Preferred Bidder there should be no reopening of the sub-contract issues as they relate to the in-house team.

#### B.4 Secondment of Staff

The secondment model is untested in the schools sector, and is only recently being piloted in the health sector, so there is little best practice to draw on as regards mainstream PFI-type arrangements. This is probably a reflection of the long-term nature of PPP service contracts. Secondments may be more suited to wholly-owned subsidiaries and other forms of PPP where risk does not pass across to an external funder and a shorter-term arrangement is envisaged. Where management control and risk effectively continues to rest with the PSO, secondment of staff under the PSO's employer responsibility may represent a sensible option to consider alongside contracted solutions.

In a PFI-type situation, there are, however, concerns about the many interface issues which could arise as a result of the secondment approach. It would also give the PSO a greater profile and involvement in service delivery than would appear to be consistent with the usual benefits of a PPP

project. In addition, there is the fundamental issue of secondment being a voluntary undertaking for affected staff, unless their existing contracts of employment specifically allow for it.

The SE / STUC Protocol has addressed many of the issues which secondment seeks to resolve. : two tier workforce, wage levels, continuity of pension rights and so on. PSOs are encouraged to consider the benefits of applying the Staffing Protocol, as a first option, if these are the particular areas of concern they wish to address.

## **Section C - The Operational Stage: Looking Forward**

1. It is important that PSOs should always keep a broader view on the longer term implications of any procurement decisions they make. Typically the challenge they face is that they are making decisions that will impact for the 25 or 30 years of a PPP project's concession period. Some elements of FM services are usually periodically re-let, but nevertheless the interface and other framework arrangements of the partnership set out at the outset will form the basis of the long-term success or otherwise of the project.

If a PSO decides to offer a service role to an in-house team in a PPP, it must consider and devise arrangement to ensure that the team takes on the same responsibility regarding performance and liability as a contracted provider. The PSO itself would then be in the position of a 'parent company' to a service provider, and must also accept its responsibilities as regards action in the event of unsatisfactory performance, including acceptance of financial penalties.

2. It may be helpful for PSOs who are looking forward, to workshop, or brainstorm, a range of what-if scenarios relevant to their particular circumstances. This process will assist provide clarity and understanding within a PSO of some of the difficult issues that could arise during the lifetime of the PPP project. There is no certainty that any of these problems will materialise, but a PSO must be in an informed position of the worst case scenarios to enable them to secure the most robust position possible for the public sector. The results of this exercise should inform financial advisers regarding sensitivity testing of risk effects on costs and vfm.

3. A PSO must consider the impact and management of the risk should any of the following situations materialise.

- If the Contractor, or FM sub-contractor, removes an in-house team sub-contractor from the PPP project for poor performance, will the PSO respect that decision and be able to support it publicly?
- If the Contractor, or FM sub-contractor removes an in-house team sub-contractor as a result of poor performance, the PSO must be aware of the financial penalties the in-house team are likely to suffer as a result of this situation. Penalties are routinely applied to PPP sub-contracts for poor performance and often equate to one or two years fee. In addition, it is not uncommon for the costs of any remedial works required as a result of sub-standard delivery to be applied to the outgoing sub-contractor.
- If an in-house team sub-contractor suffers financial deductions for poor performance as a result of action by the PSO, to what extent would this reduce or remove its viability and how would the PSO react?
- If a service excluded from the contract, and being provided separately by the PSO, causes the Contractor to be excused from performance deductions, what action will the PSO take?

- If the PSO introduces any of the options for FM service delivery involving the public sector, how much greater will the PSOs contract management responsibilities become and what additional resources will the contract management team require over the life of the concession?

4. It is also important to draw on the considerable experience, and seek the views, of the project stakeholders who will use, or deliver, directly the PPP FM services. Their views on the practicality of management options being considered for FM delivery will be extremely valuable. If there is an increase in the number of operational interfaces within a project without any addressing of the management of arising interface issues, a PSO may have created the opportunity for increased contractual disputes and potentially costly dispute resolution procedures.

## 1. Information Notes

### Note 1 Hard and Soft FM services

A PSO considering public sector involvement in the delivery of FM services will first need to consider into which services it may be appropriate to introduce a public sector dimension. A number of factors will shape that decision, not least the scope of hard FM and soft FM which will likely play a large part in any decision making process. The scope of hard and soft FM, and some key related aspects, which are commonly found in PPP proposals are set out below. In less common areas – for example specialist service areas and those involving technology support services – individual consideration of the PPP scope will be required.

#### Hard FM

Hard FM services are generally held to be services directly linked to the facility and grounds fabric: security, handyman, churn, reactive and planned building maintenance, grounds and environmental maintenance, energy management and so on. Were these services to be included in any public sector delivery option there would be erosion of not just performance risk transfer, but blurring of the responsibility for latent defects risk, life cycle maintenance, handback provisions and so on. It is very unlikely that satisfactory justification or an off-balance sheet position could be achieved for a PPP proposal were these services to remain with the public sector.

#### Soft FM

Soft FM services are generally held to be catering and cleaning (including external window cleaning, pest control and waste management). Whilst both contribute to the overall risk transfer position, catering has remained with the public sector in several recently concluded education PPP deals. In all known cases cleaning has been included within the scope of the PPP. Janitorial services have also been included, although some PSOs are examining the scope for dividing this function into ‘hard’ and ‘soft’ elements.

PSOs should be aware that cleaning has a direct interface with the facility, and other FM services. There is a genuine relationship between cleaning and the risk transfer position in respect of performance, security, vandalism, latent defects, whole life costing and so on. Introducing another direct service provider for cleaning will create additional interfaces within a PPP project and that may have implications for single point accountability, service integration and VfM.

Some aspects of cleaning are “softer” than others, as the service has many functional parts. Extracting the “softer” functions from areas such as cleaning and janitorial services for direct public sector delivery has been examined by some PSOs, resulting in proposed changes to internal posts. The ‘harder’ elements have been included in the PPP, whilst ‘softer’ elements are excluded or bid for by in-house teams. However, although this may provide an acceptable or even improved definition of what are the respective responsibilities for the PSO and PPP contractor, it still leaves the PSO to consider the move away from single point accountability, loss of critical mass of service, and VfM. It also introduces a different set of interfaces to be managed.

For the purposes of considering public sector involvement in FM service delivery, this guidance has focussed on soft FM.

## **Note 2 Relationship between Key Commercial Issues and FM Services**

The following are some of the principle commercial issues that PSOs are likely to encounter when considering alternative FM delivery models. These are general commercial points which can be affected in different ways by different approaches to FM delivery. They are given here as a general framework to test FM service delivery solutions against.

### **1.1 Standardisation of PPP Contracts**

In considering any variant models for FM delivery in PPP, the degree of commercial risk in the project to the public sector plays a major role and must be understood. Throughout the UK, Government has encouraged standardisation of PPP procurement in order to lift general market confidence in PPP proposals placed into the market, and to ensure that past experience is converted into ‘best practice’ advice.

PSOs are encouraged to follow the standard guidance issued by the Office of Government Commerce (a), which is supplemented by particular sector-specific guidance as appropriate – for example The Scottish Executive requires use of the Standard Scottish Schools Contract in relation to its funded PPP schools programme.

Standard contracts set out the public sector commercial position agreed either across sectors or in cases which form a benchmark for the commercial basis of all similar PPP deals. The Scottish Executive has adopted such standards for funding purposes; also in order to bring stability and confidence to the PPP market; and to speed up the procurement process and lower advisory costs to public and private sectors alike. PSOs must guard against reopening the key aspects of these standard contracts in their projects. Significant changes to the provision of ‘soft’ services could require review of these arrangements in a particular project, leading to possible delay and cost.

The Scottish Standard Schools Contract is constructed and presented to allow project specific drafting in a number of areas. Any changes to the SSSC are subject to a SE control process. Should a PSO examining FM delivery options perceive any conflict with the SSSC, then they should discuss the matter with the SE at the earliest opportunity.

### **1.2 Whole Contract Termination and Contractor Default**

Performance risk sits at the heart of PPP/PFI. It is a fundamental of the commercial balance and risk transfer within a PPP deal that poor performance results in financial deduction, and ultimately whole contract termination. This is what gives the private sector incentive, and the public sector teeth, in PPP contracts.

The threat of whole contract termination is one of the major concerns of funders. For funders, and the contractors they fund, the best way of managing and avoiding the risk of termination is to perform well. Were anything to impinge on the private sector's ability to manage performance then it is likely that funders will seek relaxation of the contractor default termination provisions.

To enable funders to accept the termination provisions as they stand in the Standard Scottish Schools Contract means that the contractor must retain the ability to manage performance: in particular the right to remove, and replace, poorly performing sub-contractors. Termination risk transfer could be eroded if the Contractor's ability to remove a poorly performing sub-contractor, public or private sector, was to be constrained. This approach is embedded within PPP and operates at several levels, for instance funders similarly expect the Direct Agreement to allow them to step-in to replace the Contractor, prior to reaching the point of termination.

#### Performance Management (Termination Triggers)

The Scottish Standard Schools Contract contains protocols for warning notices, and associated termination triggers, which are almost entirely based on poor performance. There is a risk that the private sector would look for relaxation of these terms if it did not have control of all the levers for managing FM performance as discussed above.

This reinforces the situation in the in-house team sub-contract FM delivery option - that the team must be prepared to sub-contract on the same commercial basis as a private sector FM provider.

### **1.3 Compensation events**

The Standard Scottish Schools Contract allows for Compensation Events during the Service Period. There is already an inherent risk to the procuring PSO of school based staff - for example teaching staff - getting drawn into a situation which the contractor claims as a Compensation Event. If a greater number and range of PSO employed staff were to be involved in the running of a PPP project, then that interface, and risk, would increase proportionately.

If an in-house team is sub-contracted to the Contractor, or sub-contractor, then PSOs should ensure that their Project Agreement insulates the PSO from any compensation event claims made as a result of any in-house team actions.

### **1.4 Performance Management / Payment Mechanism**

Performance management is delivered via the project payment mechanism and usually - as part of the ITN bid and subsequent commercial negotiations - the contractor agrees to rectification times and associated deductions for non-performance. It is critical that, should there be any PSO involvement in the delivery of FM, that the project is bid on this basis, with a fully worked up and agreed payment mechanism.

Even taking these steps, in the run up to financial close, there may be commercial pressure to undermine the payment mechanism, because of the public sector involvement in performance delivery.

## 1.5 **“Shadow” pressure**

If a project proceeds with public sector involvement in the delivery of FM services, the PSO should guard against pressure to set aside payment deductions for poor performance, on the basis that the Contractor may simply seek to deduct these from the in-house service provider. This could stem from the Contractor as well as in-house interests. To accede to this could weaken the core PPP contract and materially alter the balance of risk between the PSO and Contractors. This could have implications for vfm and balance sheet treatment. PSO Directors of Finance should take an interest in how such accountability is established and operated strictly.

It is possible that having an in-house service provider could result in a less clearly defined interface between the PSO and the contractor, thus increasing the potential for disputes on performance responsibilities, PSOs should consider further protections against this in the contract, possibly with the inclusion of provisions for external auditing of performance deductions.

### **Note 3 Relationship between FM Services and Value for Money (VfM)**

#### 1.6

A PSO considering public sector involvement in the delivery of FM services should be aware of how FM service delivery is interrelated to VfM. Soft FM is likely to only contribute a relatively small percentage to the overall risk value although this will vary across projects, but where VfM percentages are narrow any risk not transferred to the private sector could be significant.

#### 1.6.1 How FM impacts on VFM

Soft FM contributes to the VFM position in several ways:

- by being an integrated part of a project`s whole life costing,
- by being part of a simple management interface with the PSO,
- by providing less expensive services,
- by transferring risk away from the public sector.

#### 1.6.2 How are more cost-effective services delivered?

A number of factors influence the shape and level of the initial price agreed for the project. Some of the benefits of lower soft FM costs come from innovations made at the design stage<sup>4</sup>. Innovations arise from building and FM service designers working in tandem to optimise the interfaces between the built solutions, the materials and fabric used, the investment life cycle and operating staff.

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<sup>4</sup> Although the PSO benefits from a fixed price initially some of those benefits can be lost through benchmarking. It is essential that the benchmarking regime agreed in the contract is fully explored and understood by the PSO.

The scope for efficiency is enhanced by the fact that by leading and managing the transferred workforce the Contractor can, over a reasonably short time, optimise the way in which the project facilities operate. PPP projects present a unique opportunity for looking afresh at services delivery and operation and were that opportunity to be constrained, or the level of design innovation curtailed, associated efficiencies can be expected to reduce.

#### Transferring Long Term Pricing Risk

Currently in full service PPP, the PSO benefits from having a firm price for soft FM services that deliver to its output specification requirements for the life of the concession. The price is usually periodically benchmarked. Price and quality risk is accepted by the contractor now and into the future.

This ongoing pricing risk is absorbed and managed by the Contractor. The Contractor accepts that, through management action, it (and/or its nominated sub-contractors) can ensure that earnings inflation is compensated for by productivity or efficiency increases. In turn, this ensures that the costs remain at or below the annual RPI uplift paid by the PSO through the unitary charge.

If any factor should affect the ability of the Contractor to absorb ongoing performance and pricing risk, by providing a fixed (albeit indexed) price, then VfM must be carefully reviewed.

### **1.7 Price Certainty and Contractor Control**

Before promoting any FM delivery option a PSO must consider what scope and controls the Contractor has at his disposal to accept and manage performance risk to enable him to deliver price certainty within a VfM envelope.

The less control a Contractor has over performance, the greater the risk he will assume, plan and price for.

#### **Note 4 Options for in-house FM service delivery during procurement**

The two main options for determining FM service delivery during procurement are reviewed in the following sections.

##### **1. Exclusion of FM Service/s by Best Value (BV) Testing**

These “BV tests” have been run in various forms in several of the first and second tranche schools PPP projects in Scotland. If successful in favour of the public sector provider, the FM service is carved out of the project and continues to be delivered by the in-house provider.

A series of interface schedules are required as part of the Project Agreement to regulate the relationship between the Contractor and the in-house provider.

#### *Mechanism for Determining “Best Value”*

The mechanism for determining Best Value for soft services, to date, has taken the form of a price and quality submission prepared by the in-house provider (on the basis of accepting the PPP specification and payment mechanism) being compared to Mandatory Variant ITN bids (excluding the soft services in question) provided by the short leeted bidders.

### Key issues

A good level of detail on interface issues at ITN is required to give clarity and certainty to the in-house provider as they construct their submission. It is also needed to enable bidders to be held to their variant bid price, preventing problems arising later in the commercial negotiations. The necessity for detail at an early stage cannot be overstated. The interface issues range over many issues including security, access, cleaning, utilities and so on.

There are other difficulties in the practical application of this model. At ITN the in-house provider has no sight of the proposed bidder solutions and will have to base their assumptions, initially, on the PPP project's reference project. This means the Best Value assessment has to follow ITN responses, to allow the in-house bidder an opportunity to detail out their costs and proposals accurately and with knowledge of the short leeted bidders design solutions.

The situation could raise conflict of interest concerns, as the in-house provider is preparing a submission at a point when the in-house PPP team knows what the corresponding bidders' prices are. At the very least, the process for determining Best Value should be clearly expressed in the project ITN, along with an explanation of how the in-house FM bid team will be kept separate from the PPP team. It is recommended that PSOs take legal advice on the exact process to be followed

### Impact

A combination of resolving interface issues and allowing the in-house provider to prepare their costs, post-ITN responses, may lead to a lengthened procurement timetable.

If a service such as cleaning is excluded, there is a risk that the Contractor will subsequently reduce the scope of design innovation and investment in build quality, as he no longer carries the risk for performance in that service.

Without the normal integrated interfaces inbuilt into PPP service provision, there is also a potential for less scope for broader inter-service flexibility, for instance in some areas cleaners carry out a security or access function, opening facilities in the morning or securing them at night.

The risk profile of the project has to be adjusted for the outcome of any Best Value test and any impact on the whole project VFM position, or affordability gap, investigated and made clear.

### FRS 5

The exclusion of soft FM services which are not relevant to the accounting consideration under the relevant Application Note (Accounting Standards Board's Application Note on Accounting for PFI and Similar Transactions) and FRS 5, appears to raise no obvious accounting issues.

If it is possible for the PSO to ensure that there is no significant erosion of the performance, relevant costs and availability risk transfer, an off-balance sheet result should be no less likely to be achieved than if a full service PPP had been adopted.

However, PSOs should take early, and specialist, advice in relation to the project specific circumstances, to avoid encountering any accounting problems late in the procurement.

The Scottish Executive requires audit verification of balance treatment as part of its funding assessment procedures.

### *Sub-contracting of an in-house team* Contract Structure

The practical application of any sub-contracting of an in-house team is likely, although not exclusively, to be via a second tier sub-contracting agreement between the FM sub-contractor and the in-house team. The in-house team and PSO must have the powers to enter into such a sub-contracting agreement (the legalities of that are not covered in this note).

To determine the outcome of this option, bidders would be asked to take part in a secondary competition via a Mandatory Variant (MV) bid. The MV bid would require that bidders submit a bid presenting the in-house team as a sub-contractor for the service, alongside their core bid using their own preferred sub-contractors.

It is essential that bidders who have entered the procurement, and sought pre-qualification, have done so on the basis of a clearly set out procurement process.

### Performance

Payment deductions, resulting from under-performance in soft FM services, would, in all probability, be passed down to the in-house team through the sub-contract chain. If the in-house team performs poorly, income from the sub-contract may not cover unavoidable costs, resulting in a loss within the in-house team.

The Contractor, or FM sub-contractor, must retain the right to remove and replace the sub-contractor (in-house team or otherwise) if under-performance persists. In this situation any sub-contractor is likely to suffer penalties under the terms of the sub-contract.

### Price

For long term price and performance risk to transfer, the Contractor should agree to underwrite a price/service offer for FM which would remain extant throughout the life of the contract. In other words, at any point during the life of the contract, the PSO must be in a position to require the contractor to replace the FM sub-contractor with another sub-contractor on the same terms the bidder proposed at the time of the bid, whether that was with an in-house team sub-contractor or not.

#### 1.8

If, in fact, the in-house team is the sub-contractor for a particular service it can be expected that the Contractor will accept price and performance risk only to the extent that either the in-house team sub-contractor carries all of the risk related to that service (i.e. the result being

that no risk transfer away from the public sector is actually achieved). Alternatively, that the Contractor has sufficient levers available to it to make sure that it can manage the risks being transferred by exercising firm control over the performance of the sub-contractor.

### Benchmarking

The FM services would be benchmarked at regular intervals (approximately every five years), irrespective of whether they are delivered by an in-house team sub-contractor or are provided by a private sector sub-contractor. This process may include market testing and could ultimately lead to the removal and replacement of a sub-contractor.

### Innovation

The PPP bidders must be encouraged to continue to innovate in terms of design solutions and to develop efficiencies that ensure that the design solution will work at the price bid. For instance, the PPP bidders must continue to optimise whole-life costing in respect of choice of surfaces, quality of materials etc.

The PSO should guard against any temptation for the preferred bidder to scale back his proposed specification, if the in-house team sub-contract option is successful and the in-house team is to take the performance risk attributable to the service they provide.

### Perverse Incentives

The primary procurement competition will identify the PPP bidder providing the required level of service at the lowest, risk adjusted, price. The price quoted will be an aggregate of building costs, interest on the funds raised to pay for the construction and the ongoing service costs of hard and FM services (including life cycle replacement), all wrapped up into a single unitary payment.

The fact that a secondary competition via a Mandatory Variant bid process will then take place will expose the PSO to some of the interface issues which would normally arise between private sector parties within the PPP Special Purpose Vehicle, adjusted to deal with an in-house bid. For example, bidders may skew the overall cost of FM services between soft FM and hard FM. They might do this for two reasons.

1. The lowest cost, risk adjusted, compliant bid for the soft FM service will win the secondary competition; and
2. If the Contractor loses the secondary competition, it has nevertheless retained more of the unitary payment to set against its hard FM service, whilst having a contractual guarantee that the in-house team will provide soft FM services at a matching price. The Contractor has the additional protection that it will retain the right to remove the in-house team for poor performance.

### Blurring of the Interface

Single-point responsibility, that is such a key feature of “full service” PPP’s, may be reduced under the in-house team sub-contract model. Risks that do crystallise and for which the Contractor/FM sub-contractor is ostensibly responsible, but which can be influenced by the

performance of FM service providers, may become fertile ground for claims and counter-claims between a PSO and their Contractor. PSOs should consider the impact this may have on the resourcing of their contract management arrangements.

### 1.8.1 Contract Issues

The in-house team will need commercial expertise to negotiate a service contract with a Contractor/FM sub-contractor and understand the potential liabilities they are undertaking. There is a risk of a commercial imbalance with an experienced Contractor/sub-contractor making an agreement with a first time PPP in-house team. The risk is manageable but requires a clear strategy in place at an early stage of the procurement. The in-house team may have to factor in the cost of specialist advice to their bid costs.

#### FRS 5

Superficially, as long as it is restricted to soft FM services which are not relevant to the accounting consideration under the Application Note (Accounting Standards Board's Application Note on Accounting for PFI and Similar Transactions) and FRS 5, the public sector sub-contract model should not present significant problems for determining the balance sheet treatment of a project, and an off balance sheet result should be no less likely to be achieved than if a full service PPP had been adopted.

However, PSOs should take early, and specialist, advice in relation to the project specific circumstances, to avoid encountering any accounting problems late in the procurement.