

STREET LIGHTING PRIVATE FINANCE INITIATIVE – MEMBER LED REVIEW

To: **Cabinet**

Date: **15th March 2011**

From: **Environment and Sustainability Issues Scrutiny Committee**

Electoral division(s): **All**

Forward Plan ref: **N/A**

Purpose: **To present the findings and recommendations from a scrutiny review of the Council's response to the Coalition manifesto and the emergency budget.**

Recommendation: **That Cabinet:**

- 1 Consider the Committee's findings**
- 2 Support the recommendations set out in the report**

<i>Officer contact:</i>	<i>Member contact:</i>
Name: Rob Jakeman Email: robert.jakeman@cambridgeshire.gov.uk Post: Scrutiny and Improvement Officer Tel: 01223 699143	Name: Councillor Mandy Smith Email: mandysmith310@btinternet.com Portfolio: Street Lighting PFI Review Group Member Tel: 01223 699173

1.0 BACKGROUND

- 1.1 A report regarding the Council's proposed Street Lighting Private Finance Initiative (PFI) project was presented to the Scrutiny Committee on the 27th September 2010.
- 1.2 The Committee agreed to establish a review group to examine the business case for the project, comprising Councillors John Clark (Chairman), Mandy Smith and Graham Wilson. Given the project was at an advanced stage, the group agreed to conduct a short review, focussing on the strategic objectives of the proposed contract and its affordability. They are aware that a more in depth review is also being conducted by the Internal Audit function, and it is hoped that this report can inform that work.
- 1.3 The group met Chris Capps, Head of Transport Asset Management, to discuss the contract proposals on the 10th January 2011. The group were reassured about most aspects of the contract, but had some concerns which they decided warranted submission to Cabinet. This report summarises those findings and recommendations.

The Nature of the Contract

- 1.4 The report to the Committee on the 27th September provides details about the benefits and operation of the PFI contract. However, in summary, the PFI contract involves a 25 year binding contract between the Council and the service provider for the replacement of the majority of the Council's street lighting stock and the maintenance of all street lights within the Council's current inventory. It does not include street lights that will be built in new developments such as Northstowe, though they will be accrued into the contract once they have been 'adopted'.
- 1.5 The contractor is expected to fund and replace 80% of the Council's street lights within the first five years of the contract. The Council will pay an annual sum, known as the unitary charge to the Service Provider for this service over the 25 year period. Because the Service Provider will be replacing the obsolete columns over a period of 5 years, the unitary charge gradually builds up over this period. The full unitary charge only being payable in year five. On the other hand, The Council will receive an annual grant payment from Government to cover these capital costs. This payment will be fixed throughout the length of the contract (i.e. will not change in line with inflation). The consequence of this is that in the early years of the contract the council will receive more income (grant) than it spends (unitary charge). The councils' budget contribution will therefore build up over the first five years of the contract.
- 1.6 The combination of the capital and revenue costs make up the 'unitary charge' which the Council will pay the service provider over the duration of the contract (subject to the achievement of performance standards). It is anticipated that the revenue element of the unitary charge will represent efficiency savings in comparison to existing revenue expenditure on street lights largely because of improved energy efficiency.

2.0 STREET LIGHTING POLICY

- 2.1 Members queried whether the contract would have sufficient flexibility to ensure that the county's street lights can be updated to reflect technological improvements and changes to policy (such as dimming or turning off).
- 2.2 The group were advised that there is provision within the contract to ensure that the service provider provides high quality maintenance and improvements to the street lighting stock throughout the length of the contract. As the contract nears its end, there will be a requirement that all new street light columns shall have a minimum of five years life following the end of the contract. There will also be a change protocol within the contract which will provide the Council with the flexibility to amend the contract if so desired.
- 2.3 Members were reassured by the flexibility that these provisions within the contract will provide. However, they are of the view that it is important that Cabinet examines the Council's current street lighting policy to ensure that it sets out clear parameters for the contract before it commences. This is because a strategic policy change part way through the contract (to remove 30% of the county's street lights, for example) could present challenging administrative and contractual negotiations for the Council because the service provider would then receive a lower unitary payment for a reduced service, even if this is theoretically simple to enact through the change protocol. In other words, Members believe it makes sense to revisit the current street lighting policy to ensure it meets the Council's objectives prior to committing to a long term contract.
- 2.4 The group are aware that the Council's Growth and Environment Policy Development Group recently commented on a revised street lighting policy relating to the proposed output specification linked to the PFI project. This is in line with the groups' thinking, but they believe that the Cabinet should provide a clear steer in advance of the contract implementation. It is probable, for example, that the street lighting policy will need amending to reflect the likelihood of a significantly lower budget, in real terms, for the foreseeable future. It will also need to take into account within the Integrated Planning Process, a fair distribution of additional budget through demography to allow for the ongoing maintenance and energy from the significant increases in street lights in new developments, such as Northstowe, in the mid term.

RECOMMENDATION 1 – STREET LIGHTING POLICY

The Cabinet should review and determine whether any changes are required to the Council's street lighting policy prior to the formal agreement of the Street Lighting PFI contract with the service provider.

3.0 MANAGING INFLATIONARY RISKS

- 3.1 As previously stated, the unitary charge paid to the Service provider is made up of two elements; a contribution from the Council covering revenue costs, and an annual grant funded by Government for capital improvements. The Council's contribution each year increases each year to match inflation, whilst the funding from Government is only sufficient to cover the capital cost of the replacement programme.
- 3.2 Members were advised that the current calculations for the contract show that the Council would benefit from a relatively small surplus by the end of the 25 year period. However, this is, to some extent, based on the assumed level of inflation over the 25 year period. Given that inflation changes frequently, there is a risk that the assumptions are incorrect and the provisions will be inadequate (or, in a more positive scenario, overly generous). In the event of higher than anticipated inflation, the Council would be forced to call on other funds from other services or to borrow money in order to pay the service provider.
- 3.3 The risk of higher than expected inflation is present across all areas of the Council. However, clearly the risks are more pronounced in a longer term contract. Given that the street lighting PFI will be one of the Council's strategic contracts, Members felt that it would be useful to highlight this risk and to recommend that the Council's Internal Audit function should provide assurance that the inflation assumptions are prudent and appropriate given current information and future inflationary projections.

RECOMMENDATION 2 – INFLATION

The Cabinet should commission the Council's Internal Audit function to assess whether the inflation assumptions within the PFI contract are prudent and reasonable given current information and inflationary projections.

4.0 COUNCIL FUNDING FOR THE FULL LENGTH OF THE CONTRACT

- 4.1 As previously stated, the way that the contract is funded will result in surplus income in the early years of the contract. This surplus income will be banked and will increase with interest. It will then eventually be called upon towards the end of the contract as the value of Government funding contributions reduces in real terms, and the banked money will make up the shortfall.
- 4.2 However, the group are conscious that there may be a temptation in future years to withdraw money from the surplus fund if general Council funding becomes even more constrained than currently anticipated. Members therefore felt that they should highlight that this would result in greater financial difficulties as there would be insufficient money available to pay the service provider in later years of the contract, and that this fund should therefore be ring fenced throughout the length of the contract so that it can be used for its intended purpose.

RECOMMENDATION 3 – USE OF SURPLUS INCOME

Temporary surplus income should be ring fenced throughout the duration of the contract so that it can be used to make up shortfalls in the unitary charge to the service provider towards the end of the contract.

5.0 SIGNIFICANT IMPLICATIONS

Resources and Performance

- 5.1 This report includes a recommendation to review whether the inflation assumptions within the PFI are reasonable as the financial consequences of under estimating inflation could be significant.
- 5.2 The report also includes a recommendation that surplus income should be ring fenced throughout the duration of the contract as Members believe that failing to do this would result in significant financial difficulties in paying the service provider towards the end of the contract.

Statutory Requirements and Partnership Working

- 5.3 There are no significant implications arising from the recommendations.

Access and Inclusion

- 5.4 There are no significant implications arising from the recommendations.

Engagement and Consultation

- 5.5 There are no significant implications arising from the recommendations.

Source Documents	Location
Environment and Sustainability Scrutiny Committee Minutes and Street Lighting PFI report – 27 th September 2010	Room 221, Shire Hall, contact Robert Jakeman (01223 699143)