



LOCAL GOVERNMENT PFI PROJECT SUPPORT GUIDE (2005-06)

The Private Finance Initiative (PFI) enables local authorities to enter into a contract with the private sector for the provision of services involving new or improved capital assets. Support can be allocated by central Government departments towards the cost of the capital element of PFI projects. Notification that grant will be paid, the conditions and the level of capital investment which will be supported are set out by issuing a "PFI credit" in the form of a letter from the sponsoring department.

This guide is aimed at providing advice to those local authorities planning PFI projects or with projects in procurement, and who need to determine the likely level of support. Those authorities who wish to formally submit a grant claim should consult the *Local Authority PFI Annuity Grant Determination (No 1) 2005 [No 31/128]* or - if claiming grant on a declining balance basis - the *Local Authority PFI Declining Balance Grant Determination (No 1) 2005 [No 31/133]*.

The guide is arranged as follows:

- Section A: Administrative arrangements for PFI credits.
- Section B1: Endorsement letter
- Section B2: Promissory note
- Section B3: PFI credit letter
- Section C: Qualifying criteria.
- Section D: Calculation of PFI credits.
- Section E: Calculation of PFI grant.
- Section F: Administrative arrangements for PFI grant.
- Section G1: Annuity grant claim form.
- Section G2: Declining balance grant claim form.

The method of calculating PFI credits in 2005-06 has changed from that used in 2004-05. The main differences are the way in which the discount rate is set, the options for carrying out the calculation, and the possibility of "phased" PFI credits with different start dates.

The method of calculating PFI grant has changed significantly in 2005-06. All PFI grant in previous years has been paid on a declining balance basis. In 2005-06 a new annuity basis of grant is introduced. A number of local authorities with projects already receiving grant or with projects at an

advanced stage of procurement have chosen to continue to receive support on a declining balance basis.

The rate used as the interest rate in the calculation of grant and the discount rate in the calculation of PFI credits is determined to be 6.3% for 2005-06. The scaling rate is determined to be 1.0 for 2005-06.

This guide does not apply to the use of PFI in HRA housing. Such projects will receive revenue support through the HRA subsidy mechanism rather than through Local Government PFI grant.

SECTION A

ADMINISTRATIVE ARRANGEMENTS FOR CENTRAL GOVERNMENT SUPPORT

(1) First Approach. To reduce the risk of abortive work, authorities are recommended to discuss their proposals with the 4ps and the department concerned at an early stage. They should obtain an early indication of the realism of a project, which may involve soft market testing, and an assessment of the prospects for funding. The procedures for applying for central government support vary between departments. Some hold annual bidding rounds inviting Expressions of Interest, whilst others will assess proposals submitted at any time. Local authorities should check on the procedures at an early stage. However received, departments will prioritise proposals and inform local authorities whether they should develop them into an Outline Business Case (OBC). Sponsoring departments will benchmark capital cost estimates against other similar projects and query the costs if they are out of line. Authorities are advised to do the same and should describe any benchmarking exercises they have undertaken. Authorities should appreciate that no commitment on revenue support can ever be given until a scheme has been formally approved by Ministers and endorsed by the PRG.

(2) Outline Business Case. Departments will make an appraisal of whether the project meets their policy criteria and that the OBC also properly covers all other criteria. On the basis of that, they will decide whether to submit the project to the inter-departmental Project Review Group (PRG), seeking its endorsement that the case is sufficiently developed for the project to proceed to procurement (but see paragraph 7). Departments may differ in the level of detail they require and the extent to which they wish to see documentary evidence to support the statements in the OBC, and these requirements should be ascertained early on. However, OBCs should be as concise as possible. Authorities are advised to take account of the advice in the 4ps publication *The Outline Business Case*.

(3) Criteria Checklist. The OBC should always include as an Appendix a checklist indicating the paragraph numbers in the main documentation where information on each of the Qualifying Criteria (as at Section B) and any sector specific criteria is to be found. This will help authorities to ensure that all points have been covered and assist departments and the PRG when processing applications.

(4) Timetable. A timetable should be prepared covering all stages from submission of the initial proposal to start of service provision. In particular a realistic deadline should be proposed to reach contract financial close. This should be consistent with the model procurement timetables in 4ps procurement packs (where those are available). The stages of the procurement process should be kept to a minimum consistent with achieving value for money.

(5) Standard letters. Various letters will be issued to local authorities by Departments sponsoring PFI projects. Some of these may relate to specific issues. However, a number are common and so standard formats have been developed, examples of which follow. These provide a framework, and in some circumstances options, but each letter will be tailored to meet the specific needs of each project.

(6) Endorsement letter. (Section B1) If the project is endorsed by PRG, the sponsoring department (or major department in the case of a jointly sponsored project) will send an endorsement letter. Such a letter must always be sent and will include standard and specific conditions. One of these will be a target date for the project to reach financial close which has been agreed between the local authority and department. Intermediate targets may also be set out. The project will be subject to review should that target date be missed. Any subsequent action will be a matter for the sponsoring department. Under normal circumstances and providing there are no issues which need to be clarified, an authority should receive such a letter within two weeks of the PRG meeting at which the project was endorsed.

(7) Promissory note. (Section B2) This type of letter does not need to be sent if the authority does not require it, but is often requested to provide assurances to lenders. It will be used where the contract values have started to be firmed up and the level of PFI Credit required can be based on actual tendered costs. This is likely to be after the appointment of the preferred bidder.

(8) PFI credit letter. (Section B3) A formal PFI credit letter must always be sent issuing the PFI credits when the project reaches financial close. The letter must define the "start date" for PFI grant for the project (see Section C (1.6)). If the PFI credits are 'phased' (see Section C (1.5)) that must also be recorded.

(9) Final Business Case. Before finally issuing a PFI credit letter a sponsoring central Government department will request a FBC to provide reassurance that the final project continues to meet requirements (and written confirmation that financial close has been reached). The aim of the FBC is to provide re-assurance that the project continues to support the aims and outputs approved at OBC and that it continues to provide value for money. If some of that material has not changed from OBC there are two options: to repeat the material, but to highlight in the FBC what has not changed; or to refer back to the OBC and only include new material in the FBC. Both have advantages and an authority should consult with the sponsoring department in advance on which is preferred. As with the OBC, authorities are advised to take account of the advice in the 4ps publication *The Final Business Case*.

(10) NHS Local Improvement Finance Trust (LIFT) projects. Procedures for applying for support when taking out a leaseplus agreement with a LIFT Company vary in a number of ways. They do not need to be endorsed by PRG and some of the qualifying criteria vary. A separate note on this is available from the ODPM at www.local.odpm.gov.uk/pfi/lift.pdf.

(11) Building Schools for the Future (BSF) projects. Procedures for applying for support under BSF also vary in a number of ways, and authorities should discuss the differences with the Department for Education and Skills (DfES). Unlike LIFT projects endorsement by PRG is still needed.

SECTION B1

ENDORSEMENT LETTER

I am writing to inform you that consideration of the outline business case (OBC) you submitted on *[date]* for the *[name of project]* PFI project has been completed. Following recommendation by the Department, the project was assessed at the meeting of the inter-departmental Project Review Group (PRG) on *[date]*. The PRG has endorsed our recommendation that your project should receive central Government support. It will appear in the next revised list of endorsed local authority PFI projects, available at www.local.odpm.gov.uk/pfi/endorsed.htm.

On the basis of your OBC, we expect the PFI credits to be *[£... million]*. *[Whilst we will consider requests for increases to that amount, you should not assume that such requests will be agreed and should consequently plan the further stages of the project's procurement on the assumption that no more will be forthcoming.]*

Support for this project depends on the project continuing to meet all the published criteria in the ODPM Local Government PFI Project Support Guide, available at www.local.odpm.gov.uk/pfi/grantcond.pdf. *[Departments should also refer to any other criteria which may be relevant, eg those issued when inviting bids]*. In particular, you are reminded of the requirements to negotiate a contract based on standardised contract documentation; *[comply with the Government's commitment to achieving "Better Public Buildings";]* and share documentation with this Department or other local authorities procuring a similar project at no cost.

Standardised contract documentation should be taken to mean 'Standardisation of PFI Contracts' (Version 3), available at www.hm-treasury.gov.uk/sopc. *[Departments should also refer to any HMT approved sector specific contract if appropriate]* Any derogations are expected to be exceptional and must first be agreed with HM Treasury in line with its 29 April and 19 July implementation letters.

It is strongly advised that compliance with the standardised contract should be settled prior the appointment of a preferred bidder. You should note that a number of projects will be selected for a second stage review by PRG in the weeks leading up to selection of the preferred bidder. This review will cover the contract and continued affordability.

Your project should reach financial close by no later than *[date]*. Failure to achieve financial close by this date could mean withdrawal of support for the project and you must therefore notify this Department with an explanation of the reasons if you should need an extension to the deadline. *[Support is also subject to the following conditions specific to your project: ...]*

The Department must be informed immediately if the scope, contract, need for credits, timetable, or any other aspect of the project is changed in any

material way from the case agreed. If that happens you will need to obtain the Department's written agreement to all proposed changes in good time before the contract is signed. You will not be able to rely on existing letters as entitling your authority to a PFI credit and failure to secure prior agreement to deviations will invalidate any undertaking by the Department or PRG to support your scheme.

Please keep in touch with us about your project so that we can assess progress. *[We will monitor your progress during procurement and particularly at ITN and preferred bidder. We have agreed that you are aiming to reach these stages by and ...]*

Once you are clear about the value of the eligible expenditure under the contract you may request a promissory note confirming the level of support you can expect to receive from the Department.

We will formally issue PFI credits on the basis of an approved final business case (FBC) and a letter confirming the date the contract was signed. The FBC should be sent to the Department once you are confident that its contents will not markedly change further. *[It should take the form of a short document stating where the business case remains as set out in the OBC and where it has changed, with a fuller explanation for any changes.] [It should be a full business case, at the same time referring back to the OBC and noting where it has changed.]*

Revenue support will start to be paid once the *[first]* permanent asset is completed. For your project the *[first]* permanent asset has been agreed to be *[insert as appropriate]*. *[Completion has been agreed to occur when ...]* *[If PFI credits are to be phased this must be set out]*. Revenue support will be paid *[as set out in the Local Government PFI Annuity Grant Determination for the financial year in which grant is first claimed.] [as HRA Subsidy.]* Your authority will need to ensure that funds are available to cover that part of the payments to the contractor which will not be met by central Government.

Revenue support is not intended to match or correlate directly to the payments that arise under a PFI contract. However, the Government is committed to supporting good PFI projects and to assisting the development of PFI in the local authority sector. Its policy is therefore to maintain revenue for PFI projects in the long term, consistent with the long-term nature of PFI contracts, even though formally such support cannot be guaranteed as it forms part of the annual Local Government Finance Settlement. Variations or termination of a PFI contract would not of themselves lead the Government to reassess the level of revenue support due other than in exceptional circumstances. More information on this is available in Section C of the ODPM guide to Local Government PFI Project Support referred to above.

This letter is without prejudice to any other consent that may be required, for example, in connection with planning legislation.

SECTION B2

PROMISSORY NOTE

I refer to our earlier correspondence letting you know that the Project Review Group had endorsed this project. I note from your letter of *[date]* that your project continues to meet the relevant published criteria and the conditions set out in the endorsement letter of *[date]*. I confirm that if the transaction were entered into on these terms, this Department would issue your authority with a PFI credit letter for an amount of *[\£... million]*.

You should seek prior approval if, between now and contract signature, different terms are negotiated which affect either the nature of the scheme or the potential amount of the PFI credit, or if those terms differ from those in the relevant PFI standardisation documents. Any departure from these terms could affect your authority's entitlement to PFI credits, and will in any case risk delay to the project if PRG decides to have the proposed departures reviewed. Should we wish to support the revised project we would issue a further letter.

Revenue support will start to be paid once the *[first]* permanent asset is completed. For this project the *[first]* permanent asset should be taken to mean *[insert as appropriate]*. *[Completion should be taken to mean ...]* *[If PFI credits are to be phased this must be set out]*. Revenue support will be paid *[as set out in the Local Government PFI Annuity Grant Determination for the financial year in which grant is first claimed.]* *[as HRA Subsidy.]* Your authority will need to ensure that funds are available to cover that part of the payments to the contractor which will not be met by central Government.

SECTION B3

PFI CREDIT LETTER

Thank you for your letter of *[date]* confirming that the date of contract signature for the above transaction was *[date]* and that the contract was agreed on the terms set out in the endorsement letter of *[date]* *[and promissory note of [date]]*. This, together with the final business case, completes the documentation needed by this Department to formally issue PFI credits for this project for an amount of *[\£... million]*.

You are required to send a copy of the signed project agreements in electronic form to: PFIcontracts@hm-treasury.gsi.gov.uk. This will be used for compliance monitoring purposes.

Revenue support will start to be paid once the *[first]* permanent asset is completed. For this project the *[first]* permanent asset should be taken to mean *[insert as appropriate]*. *[Completion should be taken to mean ...]* *[If PFI credits are to be phased this must be set out]*. Revenue support will be paid *[as set out in the Local Government PFI Annuity Grant Determination for the financial year in which grant is first claimed.] [as HRA Subsidy.]* Your authority will need to ensure that funds are available to cover that part of the payments to the contractor which will not be met by central Government.

You must inform this department immediately if it becomes clear that a significant variation in the nature of the outputs required from the contract, or the capital assets being delivered by the Contractor will be necessary. This may, in some circumstances, result in a reduction in revenue support, although see Section D of the ODPM Local Government PFI Project Support Guide, available at www.local.odpm.gov.uk/pfi/grantcond.pdf for more details.

SECTION C

QUALIFYING CRITERIA

To qualify for PFI support a project must show that it meets the following qualifying criteria (though with some variations for NHS LIFT projects - see www.local.odpm.gov.uk/pfi/lift.pdf).

(1) Accounting Treatment

(1.1) Use of Financial Reporting Standard (FRS) 5. A project must be considered a PFI contract under standard accounting requirements. FRS5 provides the basis for determining whether projects should be accounted for as a PFI contract or as akin to a lease - when Statement of Standard Accounting Practice (SSAP) 21 should be applied. The determination is based on whether or not there is an associated service element which is not independent of payments for the property.

(1.2) Balance sheet treatment. Central Government sponsoring departments will have different budgetary considerations in considering whether they wish to support on or off balance sheet projects. Therefore, although projects may qualify for support whether or not they score on the authority's balance sheet, authorities will need to provide an "initial view" of the accounting treatment on seeking support, as set out in Section 2 of *Technical Note No. 1 (Revised) How to Account for PFI Transactions (June 1999)* available from the Treasury web site. The initial view must be supported by comments from the authority's external auditor as to whether it is reasonable.

(2) Contract

(2.1) PFI contract. A project contract must be based on accepted standardised contract documentation. With the exception only of projects noted in 2.2 below, this will be *Standardisation of PFI Contracts (SoPC)*, as well as recognised sector specific guidance, including Building Schools for the Future contracts and 4ps procurement packs. The version used, and possible agreement to any deviations, should comply with the instructions issued by HM Treasury.

(2.2) NHS LIFT. PFI support can also be given in respect of capital costs incurred under the alternative standard contract documentation used for NHS LIFT projects. A separate note on applying for PFI credits in this area is available from the ODPM at www.local.odpm.gov.uk/pfi/lift.pdf.

(2.3) Payment mechanism. As a result of following the standard contracts noted above, eligible projects will be structured so that the transaction includes payment of fees at annual or more frequent intervals. These fees will not be paid until services start, and the level of payment will at least partly be determined by performance standards or usage.

(2.4) Risk register. Projects must have supplied an acceptable risk register making a preliminary allocation of all the foreseeable risks associated with the scheme.

(2.5) Indemnity or guarantees. No indemnity or guarantees must be given by the authority to any person in respect of any liabilities of the contractor with whom they enter into the contract (whether those liabilities were incurred in respect of the contract or otherwise), and thus limit the risk exposure of the contractor.

(3) Options Appraisal

(3.1) Project options. Projects must show that they are value for money, firstly in terms of a project scoped to best meet the needs and outputs identified. This will be considered in the context of the benefits typically achieved (including secondary benefits), compared to costs. The methodology used should be in line with the Treasury guidance *Appraisal and Evaluation in Central Government* (the 'Green Book').

(3.2) Procurement options. Value for money must also be shown in relation to the best procurement option. This should be done using the Treasury standardised vfm assessment procedure. This includes both qualitative and quantitative elements, which should both contribute to informing a wider judgement. Local authorities need to complete a Stage 2 - project specific - assessment, which will build on the Stage 1 assessment produced by the relevant sponsoring department. They should comment on any areas where their assessment differs from the general programme assumptions. Any supporting material such as comparison with similar projects would also be useful.

(4) Outputs

(4.1) Output specification. The OBC should include a first draft of an Output Specification which should be set out as a clear definition of the objectives and outputs needed, with the standards required. This is a key characteristic of PFI contracts and allows for innovation and efficiency on the part of the private sector. An illustrative solution will generally be needed in order to undertake the necessary financial analysis, but it should be clear that this does not constrain the final solution.

(4.2) Planning and performance framework. Projects must be consistent with and flow from the authority's plans and priorities, including Best Value Performance Plan and Community Strategy, the Capital Strategy and Asset Management Plan and/or the relevant strategic service plan.

(4.3) Sustainable development. Projects must demonstrate an integrated approach to the social, environmental and economic well-being of the area, now and for future generations, in line with the OGC guidance note *Green*

Public Private Partnerships. This covers the promotion of sustainable development in location, design, construction, operation and maintenance.

(4.4) Design quality. Where relevant, projects must show that they contribute to the Government's commitment to achieving "Better Public Buildings". Evidence could include the possible appointment of a 'design champion'; involvement of stakeholders; use of Design Quality Indicators (available from Construction Industry Council); use of expert advice on design; and the extent to which design quality will be a key evaluation criteria for bidders. If the project involves construction work and life-cycle maintenance of buildings authorities should demonstrate how they intend to meet, as appropriate, the key objectives of the Egan Report. Authorities are expected to take account of the guidance on design quality in PFI projects available from OGC (*How to achieve Design Quality in PFI Projects*), CABE (*Improving Standards of Design in the Procurement of Public Buildings*) and 4ps (*Achieving Quality in Local Authority PFI Building Projects*).

(4.5) Diversity. Any project must take account of diversity issues and any application for support must demonstrate how these have been approached. Authorities will already have their own policies on diversity and their implementation will depend upon the particular scheme. However, obvious examples include addressing the requirements of people who are disabled or whose first language is not English.

(5) Deliverability

(5.1) Sponsorship and support. Projects must have support from all key sponsors (such as Councillors and Senior Officers) and other stakeholders such as School Governors. A project owner or 'local champion' who will be sufficiently well placed to promote and pilot the project and drive it to successful implementation should be identified. Typically this would be the Director for the relevant service area or the executive member who has the authority to negotiate and ensure that the project is completed.

(5.2) Affordability. Projects must be affordable to the local authority and the impact on budgets of the part of the projected service payments which the authority will have to meet itself must be accepted by members, senior management and budget holders. Any affordability tests should include sensitivity analysis on factors likely to change.

(5.3) Commercial interest. A project must be able to show evidence of commercial interest, based either on the authority's own soft market testing or on the experience of other authorities.

(5.4) Project team. A project manager and properly resourced project team with project management experience and the necessary range of skills and experience needs to be demonstrated. A project manager will normally be expected to be involved in the preparation of the outline business case. A project will also need to demonstrate that suitable arrangements, funding and means of demonstrating value for money are in place external advisers.

These are likely to need to cover legal, insurance, financial and technical matters. The project will be expected to be accessible to the involvement of the 4ps and departments.

(5.5) Statutory processes. The impact of statutory processes such as planning permission, public enquiry etc. on the project must have been considered, and an authority will need to indicate how any potential problems will be resolved in the procurement process.

(5.6) Sharing of Information. The local authority must confirm that they will be ready to share experience and final contract documentation, at no cost, with other local authorities procuring similar projects, with Government departments and with the 4ps. Any information of genuine commercial sensitivity may be withheld – but such material is normally expected to be minimal. Authorities should make clear to potential contractors that this information-sharing requirement is a formal condition imposed by the Government as a condition of support.

SECTION D

CALCULATION OF PFI CREDITS

PFI support is intended to be a contribution towards that portion of contract payments which could theoretically be attributed to the capital investment being undertaken - that is, the portion which would have been funded from capital resources if the asset had been procured traditionally, rather than by PFI. It is therefore necessary to calculate the capital value of a project which will be the maximum level of support which can be provided.

(1) Initial PFI credit

(1.1) Toolkits. In a number of sectors, including schools and housing, the sponsoring department uses a toolkit to calculate the level of capital support which will be supported. Street lighting projects are based on the difference between the capital costs of the PFI option and the 'do minimum' option over the first 5 years - more detail is available in the 4ps street lighting procurement pack.

(1.2) Capital value. Where a toolkit is not used, the basic capital value of the scheme will represent the upper possible limit of the PFI credit. This should be calculated as follows:

(Step 1) A total annual unitary charge - including capital, revenue and financing costs - should be estimated based on the reference project. The costs should be set out in nominal / cash terms taking into account inflation for the relevant portion of the costs.

(Step 2) The annual costs should be discounted by the prescribed PFI discount rate set out in the PFI Support Guide for the financial year in which the OBC is expected to be endorsed by PRG. The discounting should use the anticipated start date (see below) as the base date. The first 12 months of payments should therefore be Year 1, rather than actual or financial years.

(Step 3a) Since the discounted unitary charge value will include both capital and revenue elements a method needs to be agreed with the sponsoring department to determine the proportion which is capital. In some cases there will be a prescribed 'abatement' figure. For buildings this is generally 70%. Separate abatement factors are available for transport projects.

(Step 3b) In many cases the prescribed 'abatement' figure may not be appropriate, or there may not be one for the particular type of project. In these cases, the elements used to build up the estimated unitary charge need to be separated out and identified as either capital or revenue. The classification of items as capital or revenue should follow general accounting practice but also be agreed with the sponsoring department.

It may often be easiest to identify and deduct the discounted cost of the revenue items as these will usually be the smaller proportion, although any method which demonstrates the split to the sponsoring department may be acceptable. The revenue items are likely to include soft and hard FM, relevant insurance costs, utility or similar pass-through costs, plus a proportion of bid costs and SPV costs.

(1.3) Prescribed discount rate. The prescribed discount rate for 2005-06 will be 6.3%.

(1.4) Supported Capital Value. In many cases the PFI credit agreed may be lower than the capital value of the project. Ministers may offer a sum lower than that sought, for example, where several schemes of similar quality cannot all be accommodated within a department's allocation. A number of departments also operate a cap on levels of PFI credits which will be considered.

(1.5) Start date. When agreeing the value of the PFI credit sponsoring departments must, in addition to the value of the PFI credit being awarded, state how the "start date" will be recognised, i.e. when the authority will become eligible to claim PFI grant for that project. This should be when the asset becomes operational, defined as completion of acceptance testing or equivalent. It should not be determined by payment to the contractor for interim services or temporary assets (e.g. site security or assets used for decanting purposes).

Where permanent assets are transferred and there is a distinct refurbishment period, these should be treated in the same way as new build and the start date will be when the asset returns to being operational. However, where a network of assets is transferred along with responsibility for maintaining them in an operational state, and a programme of investment (e.g. a street lighting or roads maintenance project), the start date will be when the assets are transferred.

Sponsoring departments will need to initially agree the start date in respect of the project as set out in the OBC, and any requests for changes between then and the FBC should be treated in the same way as any other similar requests, e.g. to change the total value of PFI credits.

If a project has made significant progress in procurement - reaching at least the point at which ITN documentation is issued - before this Support Guide is published it would not be reasonable for there to be a large change in the basis on which the authority would expect to receive PFI grant. Therefore, when issuing the PFI credit letter, the department should take into account the wording used in the earlier endorsement letter, which prior to 2005-06 was "Revenue support will start in the first year in which your authority's payments under the contract are made."

(1.6) 'Phased' PFI credits. The sponsoring department must determine whether there should be one "start date" for the project or whether it should be

considered to consist of more than one "phase" and that grant should start at different times for each of these phases. In doing this the department should take account of the following general principles:

- Government Accounting requires that grant should not be paid in advance of need, which in the case of PFI project should be taken as the level of unitary charge being paid at any particular stage by the local authority in respect of the use of capital assets;
- As a consequence of the above, PFI credits should follow the capital value added in the project; and
- The pattern of "phases" should be designed so that no significant clawback of PFI grant would be necessary should anticipated work be cancelled (see 2.6 below).

As projects become more complex with more assets being delivered (and even phased delivery of one asset) the above guidelines need to be balanced with the need for the PFI grant regime to be manageable. Thus the sponsoring department will need to consider whether a number of assets can be grouped together and considered as one "phase" for these purposes. The specifics of each project are likely to vary widely, but the following factors should be borne in mind:

- The sponsoring department should be sure that the phasing of the project is for good operational and VfM reasons;
- The number of "phases" should be limited and appropriate to the overall size of the project;
- The pattern of start dates should be considered to see whether there are distinct groupings in relation to the overall timescale.

Assets which are the subject of different "waves" within LIFT or BSF projects would be considered different phases. Projects consisting of a network of small assets (e.g. street lighting or similar) will not be considered to have distinct phases.

If there are different phases, the PFI credits which apply to each phase must be stated in advance. It is for the sponsors to decide the level to be assigned to each phase up to a maximum of the discounted capital value of that phase - they do not have to be evenly distributed. The capital value of each phase should be calculated separately as each will be a different base date for discounting. If there are different contract end dates for different phases these should be quoted when claiming grant.

(2) Post contract signature changes

Changes may be made to the contract after the PFI credit has been issued, ie after the contract has reached financial close.

(2.1) Increases. The most likely change will be one which will increase the capital value of the project. If a sponsoring department wishes to support such

an increase it will be treated as if it were a separate contract. The discount rate in force at the time the increase is agreed should be used to calculate the level of the PFI credit. Grant will be paid separately in respect of the increase.

(2.2) Decreases. A variation may also be agreed which reduces the local authority's costs. This could be due to changes in the service element or financing costs. Neither of these would result in any reduction in support. It is established policy that in the case of refinancing the benefits will be shared on an equal basis between the contractor and the local authority, and not by central government.

However the variation could also involve reduced capital investment by the contractor, for example if it became clear that planning permission could not be obtained. This may lead to a reassessment of the PFI credit as set out in paragraph 2.3 below. It should be noted that there can be no reassessment once the assets are delivered and liabilities incurred by the local authority, even if those assets are subsequently destroyed or are no longer needed (unless there were exceptional circumstances as set out in paragraph 2.5 below). The effect of revising the PFI credit would depend on whether grant has started to be paid or not. Under the revised arrangements it should not be possible for grant to have been paid, but that would have been possible under previous arrangements.

(2.3) Changes in the capital / revenue balance. The overall level of expenditure under the contract may remain the same but there might be a shift from capital to revenue. If that is the case then the sections above on reassessment still apply. It is recognised that this does impose considerations other than strict value for money on the freedom which the contractor has in responding to an output specification. Despite this it is felt important to maintain the principle that capital support should be for capital expenditure. In other cases the nature of the assets may change, eg a change in the number or location, but the overall PFI credits remain about the same. In such circumstances an authority should notify the sponsoring department who will consider whether the alternative proposals are acceptable to them. If they are, support will continue without interruption.

(2.4) Reassessment. It is intended that reassessment should only be made where the nature of the assets has varied in a "significant" way. The initial estimate of the capital element may be based on fairly broad assumptions and it would not be reasonable to try to make changes at the margins. This could also be seen as unduly restricting the contractor's freedom to innovate in meeting the outputs. Where a single building is involved, a reduction of more than 20% should be notified. A similar scale of reduction in other types of asset should be treated in the same way. Any reassessment of the level of support for any PFI project would be made by the sponsoring department, which should be the first point of contact. Reassessment will always be made on a scheme-by-scheme basis after considering all the relevant circumstances.

(2.5) Exceptional circumstances. In exceptional circumstances, such as, for example, where continuation of support would unduly enrich or reward a deliberate abuse of the PFI contract, there could be a reassessment even if the capital assets had been delivered. In such a case, however, the Government would expect to take steps to ensure that the local authority was not thereby prevented from meeting in full the resulting liabilities to the PFI contractor and its funders for capital assets already delivered.

(2.6) Recovery. If the PFI credit figure is reassessed a calculation will be made to determine the amount of grant actually paid in excess of the amount which would have been paid based on the revised level of PFI credits. That will be recovered by deducting the amount from subsequent grant payments. Actual recovery of grant already paid would only be necessary where the excess was larger than could be recovered from future payments. Where an overpayment has been made the Secretary of State shall specify such an amount due to him by notice in writing before any recovery is made.

SECTION E

CALCULATION OF PFI GRANT

(1) Determinations. The following description of the way in which PFI annuity grant will be calculated is intended to supplement and interpret, but in no way to override the express terms of the formal 2005 determination - the *Local Government PFI Annuity Grant Determination (No 1) 2005 [No 31/128]* - available at www.local.odpm/pfi/index.htm.

(2) Annuity grant. All schemes endorsed after 1 April 2005, or which did not expect to reach ITN by 1 April 2005, will receive grant on an annuity basis. Other schemes were given the option of either switching to an annuity system or continuing to receive grant under the previous declining balance grant regime. That was a one-off exercise and there are no current plans to allow future switching between the two options.

(3) Annuity calculation. A formula is provided in the determination as the means of calculating the annual annuity grant payments. However, in practice this will be done by using the Excel PMT spreadsheet function. The annuity calculation includes some simplifying assumptions:

(3.1) the interest in the annuity is calculated annually, using the opening balance to calculate interest for the whole year, even though payments are quarterly.

(3.2) the length of the annuity is based on using mid-month points for the start and end dates rather than being accurate to the day. This is consistent with the way in which the level of grant is calculated in the first and last years.

The latter point does mean that the length will not always exactly match the contract length, for example where the start is early in the month and the end late in the month (or vice versa).

(4) PFI credit 'uplift'. The PFI credits will normally be the figure agreed between the sponsoring department and the authority, as set out in Section C. However, in some cases "uplift" is applied as described in the determination. This was intended to compensate for discounting applied to years between contract signature and service commencement, since contract signature was used as the base date for discounting. After 1 April 2002 the discounting methodology changed so that service commencement was used as the base date. "Uplift" is now only applied to those projects where the original contract signature base date was used. That will be those projects endorsed by the PRG before 1 April 2002; but also some schools (and possibly other) projects endorsed later. In the latter cases confirmation will be sought from the sponsoring department that the final PFI credit figure (whether determined in the OBC or at a later agreement to an increase) was calculated using a contract signature base discounting date.

(5) Interest rate and scaling factor. The interest rate continues to match the interest rate for the debt charges element of FSS in the financial year in which the project is endorsed, the main difference being that the rate does not vary for any particular project during the period it is paid grant.

The scaling factor, which has been introduced for PFI annuity grant, will also match the rate for the debt charges element of FSS, but with a maximum rate of 1.0. It will operate in the same way as the interest rate, in that it will be set at the same time and will not vary for a project.

(6) Setting interest rate and scaling factor. From 2005/06 the interest rate and scaling factor for new projects will be set when the endorsement letter is sent. This has two effects which authorities should note:

6.1. It means that the interest rate matches the discounting rate for any project. The interest rate - and therefore the level of support - is no longer affected by when the contract is signed. As a result of this there is no longer any reason to recognise the concept of 'commercial close' within the PFI support system. Contract signature should now be taken to mean financial close.

6.2. The annuity calculation depends on the length of time between the start date and the end date. For new projects the conditions which will trigger eligibility for PFI grant, i.e. the start date, will be set out in the PFI credit letter. For more detail on this see paragraph 1.4 of Section C.

The interest rates and scaling factors which will apply to projects which received some grant under the declining balance method are set out in the relevant determination.

(7) First and last years. Grant is reduced in the first year so that a proportion of a complete financial year's grant is paid based on the month in which start date is reached. The calculation assumes a mid-month point so that a project starting in March will attract 1/24th grant (i.e. ½ month), one starting in February 3/24th grant (i.e. 1½ months), etc. The same approach will be taken to grant in the final year with the factors reversed.

(8) Declining balance grant. Payment of PFI declining balance grant will be restricted to 18 schemes in the local authorities listed in the *Local Authority PFI Declining Balance Grant Determination (No 1) 2005 [No 31/133]*. The methodology for this grant is the same as that used for PFI grant in 2004-05.

SECTION F

ADMINISTRATIVE ARRANGEMENTS FOR GRANT

(1) Legal basis of payments. Grant will be paid under section 31 of the Local Government Act 2003 to receiving authorities listed in Local Government PFI Grant Determinations.

(2) Claim forms. The conditions for payment of grant are set out in Annex C of the relevant determination and include receipt by the Secretary of State of a valid claim. A valid claim is one which is made on the form PFIG1 or PFIG2 signed by the authority's Chief Finance Officer, copies of which are at Annex F, but which can also be printed from the ODPM website at www.local.odpm.gov.uk/pfi/sg.htm. Once a claim has been accepted, the ODPM will notify the authority and will confirm the amounts of grant and the dates on which each instalment will be paid.

The normal practice is for a claim form to only be submitted when a project first claims grant. Subsequent years' grant will be based on that original claim form. That will continue to be the pattern for declining balance PFI grant. However, for annuity PFI grant some additional data is required and a new claim form is therefore being requested for all projects. This will be a one-off exercise and in subsequent years authorities can expect not to need to submit claim forms each financial year.

(3) Audit requirements. The completion of audit forms follows the practice for claim forms. Audit forms will only be required for those financial years in which claim forms were submitted.

SECTION G1



Office of the
Deputy Prime Minister
Creating sustainable communities

PFIG1 (2005/06)

LOCAL GOVERNMENT PRIVATE FINANCE INITIATIVE CLAIM FORM FOR PFI ANNUITY GRANT IN 2005/06

This claim form should be completed with reference to the Local Government PFI Annuity Grant Determination (No 1) 2005 [No 31/128]. All references below are to Annex B of that document.

Local authority	
Sponsoring department	
PFI project name	

A. PFI credits - see paragraph 2:

£

B. Uplift factor (if appropriate) - see paragraph 2:

C. Interest rate - see paragraph 3:

D. Scaling factor - see paragraph 5:

E. Start date - see paragraph 4:

F. End date - see paragraph 4:

G. Date of first payment to the contractor:

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CONTACT DETAILS:

Please give details of the officer who may be contacted in case of any queries:

Name:	Telephone:
Address:	Fax:
E-mail:	

CHIEF FINANCE OFFICER'S CERTIFICATE

I certify that the information given on this form is correct, and has been determined in accordance with the terms set out in the Local Government PFI Annuity Grant Determination (No 1) 2005 [No 31/128].

Signed:

(Chief Finance Officer)

Print Name:

Date:

This claim form, together with a copy of the PFI credit letter issued by the sponsoring department should be sent to:

Paul Andrews, Office of the Deputy Prime Minister, LGF4, Zone 5/H3, Eland House, Bressenden Place, London SW1E 5DU.

On receipt of this form, ODPM will confirm total PFI grant due.

For queries about the completion of this form, please contact either:
Paul Andrews: Tel. 020 7944 4244 (E-mail: paul.andrews@odpm.gsi.gov.uk) or
Lily Ghosh: Tel: 020 7944 4243 (E-mail: lily.ghosh@odpm.gsi.gov.uk)

SECTION G2



Office of the
Deputy Prime Minister
Creating sustainable communities

PFIG2 (2005/06)

LOCAL GOVERNMENT PRIVATE FINANCE INITIATIVE CLAIM FORM FOR DECLINING BALANCE GRANT IN 2005/06

This claim form should be completed with reference to the Local Government PFI Declining Balance Grant Determination (No 1) 2005 [No 31/133]. All references below are to annex B of that document.

Local Authority	
Sponsoring Department	
PFI Project Name	

A. PFI credits - see paragraph 2:

£

B. Uplift factor (if appropriate) - see paragraph 2:

C. Opening balance = A x B:

£

D. Value of interest rate- see paragraph 3

E. Start date – see paragraph 4

F. Value of factor 'X' - see paragraph 4:

G. Item A (notional interest) = C x D x F - see paragraph 1:

£

H. Item B (notional reduction of the balance) = $C \times 0.04 \times F$ - see paragraph 1:

£

I. Grant claimed = G + H:

£

CONTACT DETAILS

Please give details of the officer who may be contacted in case of any queries:

Name:	Telephone: Fax:
Address:	
E-mail:	

CHIEF FINANCE OFFICER'S CERTIFICATE

I certify that the information given on this form is correct, and has been determined in accordance with the terms set out in the Local Government PFI Declining Balance Grant Determination (No 1) 2005 [No 31/133].

Signed:

(Chief Finance Officer)

Print Name:

Date:

This claim form together with a copy of the PFI credit letter issued by the sponsoring department should be sent to:

Paul Andrews, Office of the Deputy Prime Minister, LGF4, Zone 5/H3, Eland House, Bressenden Place, London SW1E 5DU.

On receipt of this form, ODPM will confirm total PFI grant due.

For queries about the completion of this form, please contact either:

Paul Andrews: Tel. 020 7944 4244 (E-mail: paul.andrews@odpm.gsi.gov.uk) or

Lily Ghosh: Tel: 020 7944 4243 (E-mail: lily.ghosh@odpm.gsi.gov.uk)