

Committee/Meeting: Cabinet	Date: 14 March 2012	Classification: Unrestricted	Report No: CAB 081/112
Report of: Corporate Director Children, Schools & Families Originating officer(s) Pat Watson, Head of Building Development, CSF David Tully, Interim Head of Finance, CSF		Title: Grouped Schools and Mulberry School PFI Contracts – Progress Report Wards Affected: All	

Lead Member	Cllr Oliur Rahman, Lead Member for Children Schools & Families
Community Plan Theme	A Prosperous Community
Strategic Priority	Priority 3.1 Support lifelong learning opportunities for all

1. SUMMARY

- 1.1. This report provides information on current issues relating to the Mulberry School and Grouped Schools PFI contracts.
- 1.2. For the Grouped Schools Contract, it is necessary to take action to adjust the financial provision made by the Local Authority (LA) and schools in order to address the potential for a deficit by the end of the contract term (2027). The report sets out the current position, consultation that has taken place with schools and a proposal to correct the position.

2. DECISIONS REQUIRED

The Mayor in Cabinet is recommended to:-

- 2.1 Note the contents of this report.
- 2.2 Endorse the plan of aiming for a surplus in the Grouped Schools PFI contract account of £10m to allow for additional inflationary and other unforeseen cost pressures arising in the last 16 years of the contract.
- 2.3 Endorse the principle that the on-going revenue costs of the PFI contracts, after taking account of PFI grant and the contributions of stakeholders, should be met from the Dedicated Schools Grant.
- 2.4 Agree that the basis of indexation to be used in reviewing annually each participating school's contribution to the Grouped Schools PFI contract be

the annual prevailing retail price index for the November prior to the financial year plus 1.2% (RPI +1.2%)

3. REASONS FOR THE DECISIONS

- 3.1. The Council entered into the Grouped Schools PFI Contract in 2002 for 25 years. At the time this was on the basis of advice that the contract was affordable whilst recognising the risks over the long term. The contract is funded by a mix of sources and the proposal seeks to share the additional funding requirement between the LA and the schools which benefit from the services.
- 3.2. If action is not taken to address the current projected financial shortfall, this position will worsen and become more difficult to recover. Moreover, it is important to ensure that the precise obligations of individual schools are clear otherwise, this may produce difficulties for the Authority in recovering costs should they choose to become Academies at a later date.
- 3.3. Schools Forum considered the details of this matter, including other options at their meeting on 11th January 2012. They believed that the option of RPI +1.2% best met their expectation about a fair settlement, both for PFI schools and non-PFI schools alike.
- 3.4. The 24 schools in the Grouped Schools PFI contract were advised by the Corporate Director that she was minded to recommend that their indexation be based on RPI +1.2% to Cabinet. Those schools were formally consulted on that proposal and had until 10th February 2012 to respond. 20 of the 24 schools either supported or would not oppose the introduction of the proposed basis for indexation. Of the remaining 4, 3 indicated that they may be willing not to oppose the proposals if certain conditions were met about transparency, financial management standards and that no more such requests be forthcoming in the future.

4. ALTERNATIVE OPTIONS

- 4.1. If no action is taken, the Council is projected to have a PFI deficit of **£34m** by 2027, with risks of it being even greater if inflation remains at its current level in the long term.
- 4.2. There is extremely limited scope to reduce the services provided under the contract and this would not address the current financial issues.
- 4.3. Officers have already approached central government about increasing the PFI grant because of inflationary pressures and were advised that it was not possible.
- 4.4. Members could determine that it was appropriate to subsidise schools from the General Fund, but this would affect the Medium Term Financial Plan with corresponding budget reductions in other service areas. The Dedicated

Schools Grant is the appropriate source of on-going revenue expenditure for schools (such as PFI payments).

- 4.5. Schools Forum considered 2 other options for the basis of indexation for the PFI schools. The first limited the change in annual contributions from the 24 schools to RPI only (RPI +0%), which would have required a greater subsidy from the DSG (£1.936m each year). The second was for the change in annual contribution from the 24 to rise by RPI +1.6%, which would have required a smaller contribution from DSG of £0.928m each year, rising by RPI +1.6%, too. Both of these options would have aimed for a £10m surplus on the PFI account by 2027.

5. BACKGROUND

- 5.1. In 2002 the Council entered into the Grouped Schools PFI Contract and the Mulberry School PFI Contract for terms of 25 and 26 years respectively. In both cases the contracts provided initial capital investment to improve the schools and then facilities management services and life cycle programmes for the remaining term. Initial capital investment was completed some time ago at all the schools and delivery of the long term services continues.
- 5.2. Cabinet has received separate reports on the deed of variation of the Grouped Schools Contract which has been entered into to allow the BSF investment to be undertaken at 4 secondary schools (Langdon Park, Central Foundation, Stepney Green and Phoenix Schools).
- 5.3. LA officers continue to monitor the performance of the contractors and to keep under review the financial implications of the long term affordability of the contract. The current review has shown that there is already a funding shortfall of £11m which is projected to increase to £34m over the remaining life of the contract. An agreed methodology for eliminating the projected shortfall now needs to be put in place.
- 5.4. The LA has recently consulted the schools concerned about how this potential deficit can be addressed. The proposals and the views of the school governing bodies are set out in the report and Cabinet's view is sought on the further action to be taken.
- 5.5. It should be noted that the Grouped Schools Contract originally included 27 schools and now includes 24 schools. This arises from school amalgamations (eg. Thomas Buxton Infant & Junior Schools becoming Thomas Buxton Primary School) rather than any sites being withdrawn from the contract.

6. BODY OF REPORT

Mulberry School PFI Contract

- 6.1. The contractor continues to perform well and there is generally a high level of satisfaction with the services provided.

- 6.2. The contract charges are adjusted by RPI. In addition, the contract allows for benchmarking of the charges for the soft facilities management services at 5 yearly intervals. The next benchmarking date is May 2012. Negotiations are taking place with the contractor and with the school on the review and adjustment proposed. Any increase in cost which is finally agreed will be met by the school.
- 6.3. A review of the long term affordability of the contract shows that the account remains in balance for the remaining term. There are no proposals to make adjustments to the basis of funding the contract charges or to seek any change on the basis of the contributions paid by the school.

Grouped Schools PFI Contract

- 6.4. The contract has been in an operational steady state for some time. The LA monitoring team continues to monitor performance of the contractor and to deal with a considerable number of changes to school accommodation, both small and large, and the associated implications for the contract services and costs. A joint review of the helpdesk operation operated by the contractor and an audit of the performance reports generated has resulted in achieving greater confidence in a robust reporting mechanism that accurately records performance and any financial penalties due where performance fails to meet the required contract standard.
- 6.5. The BSF investment works at the 4 secondary schools are on site and the PFI contractor will continue to deliver the FM services to the areas of these sites before and after the new works. The adjustment to the FM service costs that will be applied on completion of the BSF works has been agreed by the contractor and the schools.
- 6.6. The contract charges are adjusted by RPI throughout the term of the contract. There is also a benchmarking review of the costs of soft FM services at 5 yearly intervals. The latest benchmarking review is in hand in accordance with the contract to meet the review date of June 2012. Any additional costs arising from the review will be met by schools, following consultation with them.

Grouped Schools Contract – financial background

- 6.7. The funding of the contract costs is made up of contributions from schools, Government grant and other LA resources, principally an element of the DSG (dedicated schools grant).
- 6.8. The LA was satisfied on entering into the contract that it was affordable for the 25 year term, whilst recognising that any long term contract of this duration involved risks associated with the financial planning assumptions.. In a long term contract of this nature, the principal risk is inflation. The early period of this contract had to take into account the impact on the financial profiling of the failure of the construction partner, the withdrawal of the funder and the subsequent delay caused by the restructure. Although the Council

contributed no additional funding as part of the restructure process, additional professional costs were incurred by the Council and the profile of costs and income from schools was not as originally projected. The original financial model assumed that during the term there would be additional capital contributions made by applying the receipts from certain school premises managers' houses anticipated to become vacant over time. None of the properties identified at the time has yet been disposed of.

6.9. The contract includes a target for the contractor to achieve energy efficiencies from 2013 onwards. The drafting of the contract has been superseded by legislation and other requirements since 2002 and negotiation is proceeding with the contractor on how this can best be reflected without transferring the contractor's risk back to the Authority. At the start of the contract, the contractor took over payment of utility accounts and the costs of consumption were collected from schools by the LA. The intention was for annual reconciliation payments between projected and actual costs. Following the contract problems in 2003, however, the LA took back responsibility for payment of these accounts and agreed at the restructure that they would not pass back to the contractor. The LA has subsequently passed the responsibility for payment of accounts back to schools and ceased to collect funds from them. This element of the original financial model has therefore in practice not operated as projected.

6.10. There is currently an £11m deficit on the account (ie LA and school contributions have fallen short of the actual costs incurred). This situation has not happened suddenly, but has been getting progressively worse since the start of the contract itself. The main contributory factors have been:

- Higher than anticipated cost inflation, which has not been covered by a corresponding increase in contributions / funding from the LA or schools; and
- Additional costs relating to the failure of the construction partner.

6.11. Furthermore, with the retail price index (RPI) at 5.2% in November 2011 it is projected that even with the level falling back to 2.5% over the next two years, the shortfall by 2027 will increase to £34m unless urgent action is taken to increase contributions / funding levels.

6.12. The annual charge for the PFI services by Tower Hamlets Schools is being calculated appropriately, in line with the PFI contract. The issue is affordability. **Appendix 1** identifies the original, planned, aggregated income and expenditure on the PFI contract for the whole of the 25 year period from 2002 – 2027. It assumed that the annual charge from the PFI contractor would increase by 1.79% per year on those elements of the charge that were variable (ie the expected long-term RPI rate at the time). It also assumes that contributions from schools would rise by 3% each year, or RPI +1.2%. On this basis the PFI account was projected to be in surplus throughout the 25 year period, thus, generating interest on the unspent balances and ending the contract with £12m in hand.

6.13. The reality has been very different. Inflation has been running at nearly 3.2% on average over the first 9 years of the contract. The contribution from the LA and schools, however, has not been increased accordingly, but pegged to the original assumed average level of 3%. In addition to this shortfall, the PFI account had to take account of additional monitoring costs when one of the sub-contractors failed early in the contract. The subsequent revised arrangements also included the removal of utility costs from the PFI contract, which meant that the PFI account bore those costs directly, although schools continued to make contributions until September 2010 as though utilities were still part of the arrangement.

6.14. The original planning assumptions also projected interest earnings resulting from a growing surplus on the fund (which was designed to produce a contingency provision). Because the account went into deficit from the first year and is not expected to get out of deficit, earning interest has not been possible. Finally, the PFI grant was switched from a reducing balance method of calculation (ie the grant in the first year is large, but gets around 4% smaller each year) to an annuity basis (ie a flat rate every year for the whole of the contract). This switch benefited the account and helped limit the variance on all income activities to a **£3m** deficit on the original assumptions.

6.15. The net impact of all of these variances to the original planning assumptions is a current shortfall on the PFI account of £11m. Assuming that inflation continues at 5% for 2012-13 and then falls to an average of 2.5% over the remainder of the contract period, then the projected deficit on the account will grow to £34m.

Grouped Schools Contract – Options for resolving this situation.

6.16. Officers have been sharing the analysis of the account with the 24 schools in the PFI contract. The options for recovering the financial position are limited and are summarised in **Table 1** below.

Table 1: Options as the source for recovering a potential £34m deficit.

Possible source of £34m	Comment	Is this part of the proposed solution?
Council (not school) reserves	This would require Members agreeing to subsidise schools from General Fund resources, that are currently experiencing reductions through the changes to formula grant, rather than allow the Dedicated Schools Grant to meet this school revenue obligation. There is no barrier to using General Fund resources in this way, but Members would need to update the Medium Term Financial Strategy, which would involve a revisiting of priorities.	No
Terminate the PFI contract, or otherwise reduce the service provided	This is not likely to be practical. The PFI contract includes meeting the costs of capital investment that has already taken place, plus on-going facilities management costs. The Authority cannot avoid meeting the costs of the capital investment and if it	No

Possible source of £34m	Comment	Is this part of the proposed solution?
	decides to reduce the facilities management service, this would only be of benefit to the PFI account if schools continued to make the same level of contributions. There would also be substantial termination payments due to the PFI contractor which would need to be resourced	
Seek a larger PFI grant	Officers contacted Central Government in 2008 to explore the possibility that inflationary pressures could be taken into account, such that the PFI grant could be increased. This was not possible.	No
Increased contributions from the Dedicated Schools Grant	It is most likely that this will be a principal source of additional contributions to the PFI account, drawing on funding that would otherwise go to all 95 schools.	Yes
Increased contributions from the 24 participating schools (and three other stakeholders)	As the principal beneficiaries, it is appropriate that they be asked to contribute more. Officers have been in discussions with the 24 participating schools in the Grouped Schools PFI Contract since October 2011.	Yes

6.17. Inflationary pressures are the principal cause of the differences between the expected income and expenditure in the original affordability model and the updated version. Nonetheless, the true problem lies in the lack of an unambiguous basis on which the inevitable changes in the contract values would be managed for the full 25 years. In essence, it is not clear who was expected to bear the inflationary risk. So, while the Authority needs a plan for closing the potential **£34m** gap in the PFI account, it more fundamentally needs an agreed set of principles to operate on for the remaining 16 years of the contract.

6.18. Each of the 24 governing bodies entered into a Governing Body Agreement with the Authority in 2002 to indicate their willingness to participate in the PFI Contract and to acknowledge that they would make contributions to the costs. The Governing Body Agreement allows for an annual review of the contribution that each school makes, with reference to a baseline amount, pupil numbers, floor area, school hours and the relevant proportion of their budget share. Indexation is not explicitly mentioned, but it is reasonable to assume at this point that it is a relevant consideration because:

- it is not reasonable to expect that each of the 24 schools would make contributions to the PFI contract for 25 years at June 2002 prices; and
- indexation has been a feature of the annual reviews for each of the last nine years, so custom and practice has established it as a legitimate factor.
- The facilities management elements of the PFI contract (which is what schools are making contributions towards) are updated for RPI, refined by benchmarking.

6.19. The affordability model in June 2002, and the original Cabinet report in February 2002, are based on school contributions increasing by RPI +1.2%,

but this was not made explicit in the Governing Body Agreement. For the first seven years of the PFI contract, school contributions were increased by 3%, matching what was in the affordability model, rather than being linked to real indexation in the contract (ie RPI) or to reflect a growing contribution (eg RPI +1.2%). This reflects the lack of clarity about the basis of indexation in school contributions, which is now required.

6.20. The LA has put forward the following proposals and consulted the contract schools.

6.21. Action proposed by the LA:

- applied £1.7m of unallocated grant
- adjusted the balance of DSG support between the Mulberry and Grouped Schools contracts to add a further £2m over the term
- subject to consultation with Schools Forum, to increase the annual contribution from DSG by more than the rate of inflation for the remaining term
- subject to consultation with Schools Forum, include an element of DSG contribution from 2015/16 which is now earmarked for supporting the BSF programme implementation

6.22. Proposals subject to consultation with schools:

- consult relevant schools where premises managers' houses may be suitable for disposal when vacant
- that the schools' contributions should be adjusted by RPI plus 1.6% for the remaining term

6.23. The LA put forward the proposals as a shared response to the situation in an attempt for this to be addressed jointly by the schools included in the contract as well as using other resources applying to all schools. This was felt to be a balanced approach as the contract schools benefit from the contract investment and services.

6.24. Following meetings and correspondence with Headteachers and governors, the 24 schools were asked to indicate their views. As at the end of term in December:

Table 2: Views of the 24 Grouped School PFI schools on the Authority's proposal that their future contributions be based on RPI +1.6%, as at 11th January 2012.

School view	No of schools
Support the proposals	10
Non- committal, seeking further advice or required more time	9
Reject the proposal to increase the level of the school charges	5
Total	24

6.25. The schools which rejected the LA proposal to adjust the annual charges by 1.6% over RPI cited the following matters:

- that there should be a contribution from the overall Council resources to meet the shortfall as it was the Council that entered into the risk of the contract
- that the governing body agreements entered into by all the schools do not require them to pay the charges annually adjusted for RPI indexation, benchmarking and other changes to schools (which has been practice since the start of the contract)
- the schools understood that the nature of the contract protected them from future risks and cost adjustments

6.26. Schools Forum were presented with the issues at their meeting on 11th January 2012, including more details about the views of schools which did not support the proposal. Schools Forum were concerned about the need to resolve the matter swiftly and fairly. Fairly for the 24 schools, but also for those other schools outside the PFI contracts who would be indirectly affected by a growing subsidy from the DSG.

6.27. They considered three options, recognising that the lower the requirement from the 24 schools, the higher the requirement from the DSG for a subsidy, and vice versa. They recognised that the refinements of the model, since it was first developed in the summer of 2011, meant that RPI +1.6% (ie the option proposed to the 24 schools originally) was nearer to a 50:50 split of the shortfall, than the one-third: two-thirds that officers had originally suggested. They decided to support the option which required indexation for the 24 schools to be based on RPI +1.2%. 10 voted in favour, 8 abstained and 0 voted against.

6.28. They also believed that the risks of inflation being higher than 2.5% in the longer term and the potential for further unforeseen issues meant that aiming for break-even was not sensible. They supported an approach based on aiming for a £10m surplus, which would allow for up to 6% RPI in the longer term, which could give more leeway in the latter part of the contract if RPI is lower than that.

6.29. The RPI +1.2% options works on the principle that the contributions from participating schools are determined, using RPI +1.2% as the basis of indexation, and the DSG meets any resulting balance, such that the updated affordability model produces a £10m surplus by contract end in 2027. As **£1.7m** is to be met from grants and **£2m** from capital receipts on schoolkeeper houses, this leaves **£40.7m** to be recovered from increased charges for the 24 schools, the DSG subsidy and other stakeholders. **Appendix 2** summarises the changes that would result from this option.

6.30. RPI +1.2% would have the benefit of being linked to the implicit RPI +1.2% that was included in the original affordability model. Those original assumptions, however, are not ones that were either included in the Governing Body

Agreement or in the past practice of indexation. On the basis of current RPI rates for 2011/12 and 2012/13 then reverting to 2.5% in the long-term, this would imply an increased annual contribution from DSG of **£1.172m** for a £10m surplus, compared to current contributions, increasing by 1.2% more than the retail price index annually.

6.31. Schools Forum agreed the proposed Schools Budget for 2012/13 (which will be included in the overall 2012/13 budget setting paper for Cabinet and Council during February 2012), setting sufficient funding aside to allow for this new commitment.

6.32. For the 24 schools that are affected by Grouped Schools PFI contract, not all of them are supportive of a proposal to increase their contributions. In practice, if the proposed recommendations in this report are agreed, there will be a set of principles on how the Authority will conduct the annual review required by the Governing Body Agreements with each of the schools. A consistent approach across all 24 schools is imperative, rather than 24 separate arrangements. Schools will, annually, have the opportunity to comment on the proposed contributions for the following year, arising from the annual review, and if they do not agree with the basis on which they have been calculated, there are processes set out in the Governing Body Agreements about how appeals should be conducted.

6.33. Officers had a further meeting with the affected schools in January 2012. The Corporate Director indicated that she was minded to recommend to Cabinet that the proposal agreed by Schools Forum should be endorsed. Before she made that recommendation, however, she would formally consult the 24 schools on their position on that proposal. Schools were asked to comment by 10th February 2012 and responses so far have been as set out in Table 3 below.

Table 3: Views of the 24 Grouped School PFI schools on the Authority's proposal that their future contributions be based on RPI +1.2%, as at 9th February 2012.

School view	No of schools
Support the proposal	6
Not necessarily supportive, but will not oppose the proposal	14
May be willing not to oppose if certain conditions are met	3
Oppose the proposal	1
Total	24

6.34. Generally, the conditions articulated by 3 schools were ones that have been expressed at different points during the debate about how to resolve the shortfall in the PFI contract.

- The need for better consultative mechanisms with the PFI schools;
- More transparency and validation of the information;
- Managing the finances better
- Not letting this happen again;
- Capping increases if they get unmanageable

6.35. Regardless of the final decision on indexation, there are a few improvements to the arrangements for PFI that will be necessary. Communications on the PFI need to be more strategic and more regular. Consideration of school contributions for the year should be dovetailed with the budget setting process every year. If we can get a better process for engaging on the unavoidable contributions that schools have to make, we can minimize the surprises.

6.36. The key point about the proposals is that it creates a prescribed and mechanistic basis for calculating school contributions each year and, if the result of those calculations does not generate sufficient funding to balance the PFI account in the longer term, it would be to the Dedicated Schools Grant that the Authority would look for the shortfall.

7. COMMENTS OF THE CHIEF FINANCIAL OFFICER

7.1. The report itself explains the financial position and the proposed way of averting a shortfall. Action is necessary to address the accumulated £11m deficit on the Grouped Schools PFI contract to avoid an even greater deficit at the end of the PFI contract in 2027. This requires clarity on the principles the Authority will work to in the annual review of participating schools' contributions, recognising that the long-term plan will require on-going subsidy from the Dedicated Schools Grant, if Members have no plans to provide any subsidy from the General Fund.

7.2. On the basis of the proposed way forward, the increase in the DSG subsidy would be **£1.172m**. Currently, the DSG subsidises the two PFI contracts by **£1.002m**, so the grand total would **£2.174m** (0.7% of the overall schools budget). This, and the change to the basis of indexation in the PFI contributions for schools in the Grouped Schools PFI contract, would achieve a £10m surplus on the basis of current levels of RPI until the end of 2012/13, then long-term inflation running at 2.5% to the contract end.

7.3. On average, the 24 Grouped School PFI schools contribute **5.3%** of their overall budget to PFI. If school budgets increased at the same rate as inflation until 2027, a proposal based on RPI +1.2% would see their PFI contributions, on average, increase to **6.3%** of their overall budgets.

7.4. Deviations from the revised affordability forecast in **Appendix 2** are inevitable because of the complexity of the contract. Agreeing to the recommendations, however, will bring clarity on how budgets need to be adjusted each year to avoid a deficit in 2027. Moreover, by aiming for a

£10m surplus, this already gives some leeway for allowing some future problems (affecting either of the two PFI contracts) to be absorbed without having to change the model.

- 7.5. In the report to Cabinet in February 2012, Members were advised that the Schools Forum in January 2012 had set aside up to **£2.938m** within the budget to cover the possible cost of the PFI subsidy. This more than covers the actual requirement of **£2.174m**, if the recommendations in the report are agreed.
- 7.6. Officers have made some changes to operational accounting arrangements to tighten up procedures in managing and monitoring the PFI contracts. Billing processes will be greatly improved if there is clarity about the principles on which the annual review of the school contributions is to be made.

8. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL SERVICES)

- 8.1. This report deals with a PFI contract which was entered into by London Borough of Tower Hamlets in 2002 for a 25 year term. In PFI projects, the private sector consortium raises money to meet the cost of the works initially, and then the Council provides both capital and revenue funding. Grant support for the capital element of the Council's PFI is given by central government. Once a PFI contract is signed, the project receives financial support from the Government to assist with the cost of building and maintaining the premises. The private sector consortium receives a Unitary Charge in return for the availability of the school building, rather like a mortgage. However, the school's governing body is also required to agree to pay the Council an annual amount, usually the part of the Unitary Charge that relates to the facilities management content of the contract.
- 8.2. The PFI contract has the first call on the school's budget and so the Council must have written approval from a governing body to use its delegated budget in any way. This is done through a Governing Body Agreement which all of the schools have signed. The agreements provide for the schools to make payments each month from their delegated budget to contribute to the payments to the private sector consortium. The amount of these contributions is recorded in the schedule of each school's agreement. There are no specific provisions providing for the treatment of inflation but the agreement does provide for an annual review to be agreed with the governing body of the school. Formal disputes are to be resolved by the Secretary of State for education.
- 8.3. Under the School Standards and Framework Act 1998 (SSFA) school governing bodies have the power to enter into legally binding contracts although there is a legal view that one part of an organisation cannot enter into a binding legal contract with another part. This commitment is then reflected in a revised delegated budget for the length of the contract period.

- 8.4. The opinion of the Department for Education is that: “Arrangements between LEAs and governing bodies relating to the funding of PFI contracts, although they can be binding, are not contractual. They are simply part of the arrangements for the funding of the school by the LEA”.
- 8.5. The financing of maintained schools is dealt with in Chapter IV of Part II of the School Standards and Framework Act 1998. The Council is required to allocate a budget share to every maintained school and this is calculated by a process prescribed in the regulations. For the financial year commencing 1 April 2012, detailed provision is to be made in the School Finance (England) Regulations 2012 regarding the determination of these budgets. At the date of preparing this report, the 2012 Regulations had been the subject of consultation, but had not yet been made. For present purposes, the 2012 Regulations are not expected to make any significant changes to the 2011 Regulations.
- 8.6. The Council is required to decide upon a formula for determining school budget shares after consultation with the schools forum. In setting its formula, the Council may take into account any or all of the factors or criteria set out in Part 1 of Schedule 3. One of these criteria (paragraph 14) is: “Payments in relation to a private finance initiative (including actual or estimated cost)”. There thus appears to be a mechanism by which the Council may adjust a school’s budget by reference to the actual or estimated cost of a PFI contract. If the Council makes changes in the factors or criteria taken into account from the previous funding period, then it may put in place such transitional provision as is considered reasonable.
- 8.7. When taking any action to fund the PFI contract, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don’t. Information relevant to these considerations is referred to in section 9 of the report and may be the subject of discussion as part of the continuing consultation with the schools forum.

9. ONE TOWER HAMLETS CONSIDERATIONS

- 9.1. Sustaining the provision of safe and suitable education establishments remains an important element of improving achievement in schools.
- 9.2. The proposed increased contributions by schools to meet the costs of the PFI contract are not expected to be significant in budget terms for any individual school. Accordingly, there is not expected to be a reduction in the services or facilities offered by schools and, accordingly, there should be no reduction in opportunity and no discrimination contrary to the Equality Act 2010.

10. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 10.1. There are no specific implications arising from the recommendations of this report.

11. RISK MANAGEMENT IMPLICATIONS

- 11.1. The measures proposed to address the projected financial deficit on the payment of the Grouped Schools Contract are specifically to mitigate the risk of the problem becoming more difficult to address if left for a longer period. Inflation risk will continue, which is why it is recommended to aim for a surplus of £10m by 2027 to provide for such risks materialising.
- 11.2. Careful financial monitoring of the contract charges and the income collected from schools is carried out to ensure financial reconciliation.

12. CRIME AND DISORDER REDUCTION IMPLICATIONS

- 12.1. There are no specific implications arising from the recommendations of this report.

13. EFFICIENCY STATEMENT

14. APPENDICES

Appendix 1 – Comparison of original PFI model with the current position extrapolated to contract end.

Appendix 2 – Revised forecast position for whole Grouped Schools PFI contract to 2027, on the basis of the recommendations in the report.

Local Government Act, 1972 Section 100D (As amended) List of “Background Papers” used in the preparation of this report

Brief description of “background papers”	Name and telephone number of holder and address where open to inspection.
○ Correspondence with 24 Grouped PFI schools, October 2011 – February 2012	David Tully, Interim Head of Finance, 4 th Floor Mulberry Place. Tel 020 7364 4960.
○ Report to Schools Forum – “Schools PFI Contracts”, 11 th January 2012.	

Appendix 1

Comparison of original PFI model with the current position extrapolated to contract end.

Component	Original 2002 £'000	Current with no change 2011 £'000	Change	Comment
Unitary Charge	312,658	345,808	33,150	Changes arise from indexation, contract variations (ACRs), contractor performance failure, benchmarking, utilities removed, changed profile of the initial capital works. Principally, the additional costs arose in the first three years, where the initial capital works took longer than anticipated because of the contract restructure. Utility costs are a major component of the variation here, when they were originally expected to be cost-neutral.
Monitoring costs	2,636	6,153	3,517	
Other costs	17,050	23,713	6,663	
Total expenditure	332,344	375,674	43,330	
School contributions	121,612	109,688	-11,924	Changes arise from utilities being taken out of the payments, contract variations, contractor performance failure, benchmarking, changed profile of initial capital works, changes in pupil numbers, changes in floor area.
DSG contribution	23,068	23,069	1	
Other revenue contributions	5,303	4,969	-334	This includes £2.25m for disposal proceeds of vacant premises managers' houses that has not been realised. Interest was assumed on the basis of surplus balances, but it is only deficit balances that have existed, with no opportunity to earn any interest. The switch from a reducing balance PFI grant to an annuity PFI grant was beneficial to the value of nearly £21m.
Capital contributions	6,950	2,699	-4,251	
Interest	7,858	0	-7,858	
PFI Grant	179,902	200,821	20,919	
Total income	344,693	341,246	-3,447	
Total net expenditure / income	-12,349	34,428	46,777	Overall position is set to worsen over the 25 years from the original by £47m, leaving a £34m deficit forecast by 2027.

These figures are on the basis of 2.5% inflation on the PFI contract and 3% indexation on contributions from schools.

Figures previously advised to schools quoted a gap of £31m, but that was based on the model before the summer of 2011 and further refinements to the model, actual contract RPI during 2011 and the factoring in of potential changes at Bow in 2014 when they move premises have increased the gap to £34m, underscoring the need to aim for a surplus in the financial plan to allow for unforeseen circumstances and further inflationary movement.

Appendix 2

Revised forecast position for whole Grouped Schools PFI contract to 2027, on the basis of the recommendations in the report.

Component	Current with no change 2011 £'000	Revised after options £'000	Change £'000	Comment
Unitary Charge	345,808	345,808	0	
Monitoring costs	6,153	6,153	0	
Other costs	23,713	23,713	0	
Total expenditure	375,674	375,674	0	
School contributions	109,688	121,782	+12,094	This represents 27% of the total increase, based on £10m surplus and 35% of the increase, if break-even is sought, (which is around the one-third level proposed to the 24 schools). Children's Services Grants (£1.7m) and other stakeholders (£0.729m) Sale of surplus school-keeper houses.
DSG contribution	23,069	50,974	+27,905	
Other revenue contributions	4,969	7,398	+2,429	
Capital contributions	2,699	4,699	+2,000	
Interest	0	0	0	
PFI Grant	200,821	200,821	0	
Total income	341,246	385,674	+44,428	
Total net expenditure / income	+34,428	-10,000	+44,428	Aims for a £10m surplus.