

Appendix 1

Ashburton Private Finance Initiative (PFI) – Oasis Academy Shirley Park Pros and Cons of Market Testing

Issue

Should the Council initiates the Market Testing process following the Benchmarking exercise / report?

Introduction

The objective of this paper is to consider whether, based on the Benchmarking exercise, market testing should be initiated by the council and whether it is likely to contribute to the value for money.

Relevant research papers, including the NAO - Benchmarking and market testing the ongoing services component of PFI projects – have been examined. Feedback from PFI Forum, comprising of councils with PFI projects, has been used to complement this work.

“Benchmarking is the process by which the project company contractor compares either its own costs or the costs of its subcontractors against the market price of equivalent services.

Market Testing means the re-tendering by the project company of the relevant service so that the Authority can test the value for money of that service in the market.” (*NAO - Benchmarking and market testing the ongoing services component of PFI projects*)

In line with the Project Agreement, every five years, the prices for soft facilities management (FM) services are supposed to be amended to reflect current market rates for similar services. The FM provider is required to compare the cost of soft FM services and then benchmarked against the cost of comparable services. The result of the Benchmarking exercise could result in an adjustment of price upward or downward.

Soft and Hard FM Services

Soft FM Services

Soft facilities management (Soft FM) services are those services which are required for the operation of the building or facility. They include services such as cleaning, catering, and ground maintenance.

This is subject to Market Testing

Hard FM Services

Hard facilities management (Hard FM) services are those services responsible for the maintenance of the building or facility.

This is not subject to Value Testing

PROS AND CONS OF MARKET TESTING

PROS	CONS
Price will be adjusted down	Price will be adjusted up
Option to carry out informal or soft market testing to see whether companies are likely to bid	<p>If a new provider wins one of the services, the two providers – soft & hard FM -will have to work together which can be problematic.</p> <p>Service users will suffer from any disputes between the two providers.</p> <p>Lack of market appetite to bid</p>
Current FM provider will want to avoid losing any of the services	Current provider could bid with a higher price in the market testing.
Opportunity for both parties. to decide on which service elements will go to tender.	Need to carry out tendering exercise to find out if more cost effective service providers are available
Changes to the specification may not need to go through the variation procedure. Any changes to the service spec requires a deed.	The price changes initially proposed reflect market factors, which had not included increase in salary costs, e.g. recent increase in national minimum wage which could result in further rise in price than originally submitted.
Responsibility for managing the market testing process rests with the contractor. The FM is only responsible for the market test. Additional costs for mobilisation of a new contractor is not an FM responsibility.	<p>For the potential benefits of market testing to be realised there needs to be strong competition.</p> <p>The ability of market testing to deliver its potential benefits depends on effective competition between alternative suppliers.</p>
Post-realignment price could offer value for money and opportunities for improved service. Only against the contract spec currently in place	Demand for services evolve, e.g. COVID requirement for more cleaning and infection prevention measures which mean more costly to provide soft FM services.

<p>Help keep the cost of delivering service changes in check</p>	<p>Any savings may be lost as a result of legal costs</p>
<p>LA could commission an independent benchmark report to see how the service costs compare against the market</p>	<p>LA independent benchmark could be expensive, time consuming and no guarantee findings will result in price reduction. LA could undertake a consultant's review on the BM. The FM are unlikely to accept any further extension of time though.</p>
<p>Good practice to consult service users on the proposed changes in market testing to re-shape the services to meet their needs.</p>	<p>Service users may be happy with the current provider.</p> <p>Current provider have consistently scored 95% and above on their KPI performance this reporting year.</p>
<p>Use of LA Advisors / consultants with the following expertise to help with the market testing:</p> <ul style="list-style-type: none"> - Commercial - Legal expertise - Access to better quality data. 	<p>Might need to engage consultants with experience of PFI to get an independent opinion, which would be time consuming and expensive.</p> <p>LA need to resource the market testing process both in terms of staff and staff hours.</p>
<p>LA represented on evaluation of bids panel to ensure that the selected bidder provides the best price while adhering to the service specification</p>	<p>LA Officer might not have experience of market testing with PFI-related tendering experience to represent the council's interests.</p>
<p>Complexity of PFI contract may deter potential bidders.</p>	<p>Possibility of getting only one bidder which could be from the current provider.</p> <p>Other bidders might not be successful in the competition.</p>
	<p>The FM would only be responsible for the market test itself. If another provider was selected there may be associated costs to this.</p>
<p>LA can review of market testing tender pack</p>	<p>This will be resource intensive and costly.</p>

<p>Market testing could yield better value for money.</p>	<p>If scope of the tendered service has been changed, will incur legal fee.</p>
	<p>Market testing can be a lengthy process, 2 years or more to complete.</p> <p>Could experience difficulties in finding suitable benchmark data with which to compare the services.</p>
<p>FM services may improve but no issues report with current providers.</p>	<p>Potential loss of jobs by current provider</p> <p>Change of personnel could result in a drop in standards / service</p> <p>Changing FM services could be disruptive to the contract.</p> <p>There may be TUPE to undertake (clause 29 onward of Project Agreement)</p> <p>Redundancy to consider.</p>
<p>Feedback from other Local Authorities</p>	
<p>This was considered it earlier in the year, however in the end we came to an agreed benchmark position.</p> <p>There is clearly a risk that few tenders are received, that the costs are even higher and including whatever the current contractor might bid, etc; and if there is a change of contractor then all the churn associated with the current contractor leaving, new contractor mobilising, etc. So in short I would advise that you should be pretty certain that a market test will deliver cheaper prices.</p>	
<p>Price has gone up by RPI/inflation measure since it was last benchmarked.</p>	
<p>SPV has urged consideration there may be an uplift to costs due to National Living Wage & minimum wage increases as well as general market conditions.</p>	
<p>We consider a negotiated settlement better value than any comparable market test, not least because of avoidable tender and commissioning costs and the added uncertainty and cost of service transition and mobilisation if another contractor were to be involved as an outcome. These costs may become material</p>	

for a school particularly if any service disruption were to ensue as part of the process, something to be borne in mind perhaps.

I think the key point to bear in mind is that if you wish to push for market testing, then it is wiser to do so knowing the probability/likelihood of the result i.e. you want to have an idea what other similar contracts in your region are being priced at.

A market test would invariably (1) be an expensive tendering process involving the incumbent and other contractors and (2) would lead to a de-facto obligatory price increase from the SPV without much leeway for local council negotiation. There would be no guarantee of cost continuity from the existing provider either, quite likely the opposite in fact.

The Authority and the SPV felt that going to market test, at the start of covid, carried far too great a risk and that we had to avoid this if at all possible. There were significant concerns about the contractors pricing for risk – understandably – or that contractors would fail during the contract period because of the volatility of the market. The two services at greatest risk of both of these was catering and cleaning – the two most important services in the schools during the pandemic.

Ultimately we agreed a cost neutral benchmark report – no price increase overall – and retained the existing sub-contractor. This was not an easy or quick process! I remain convinced it was the correct decision.

Table 1

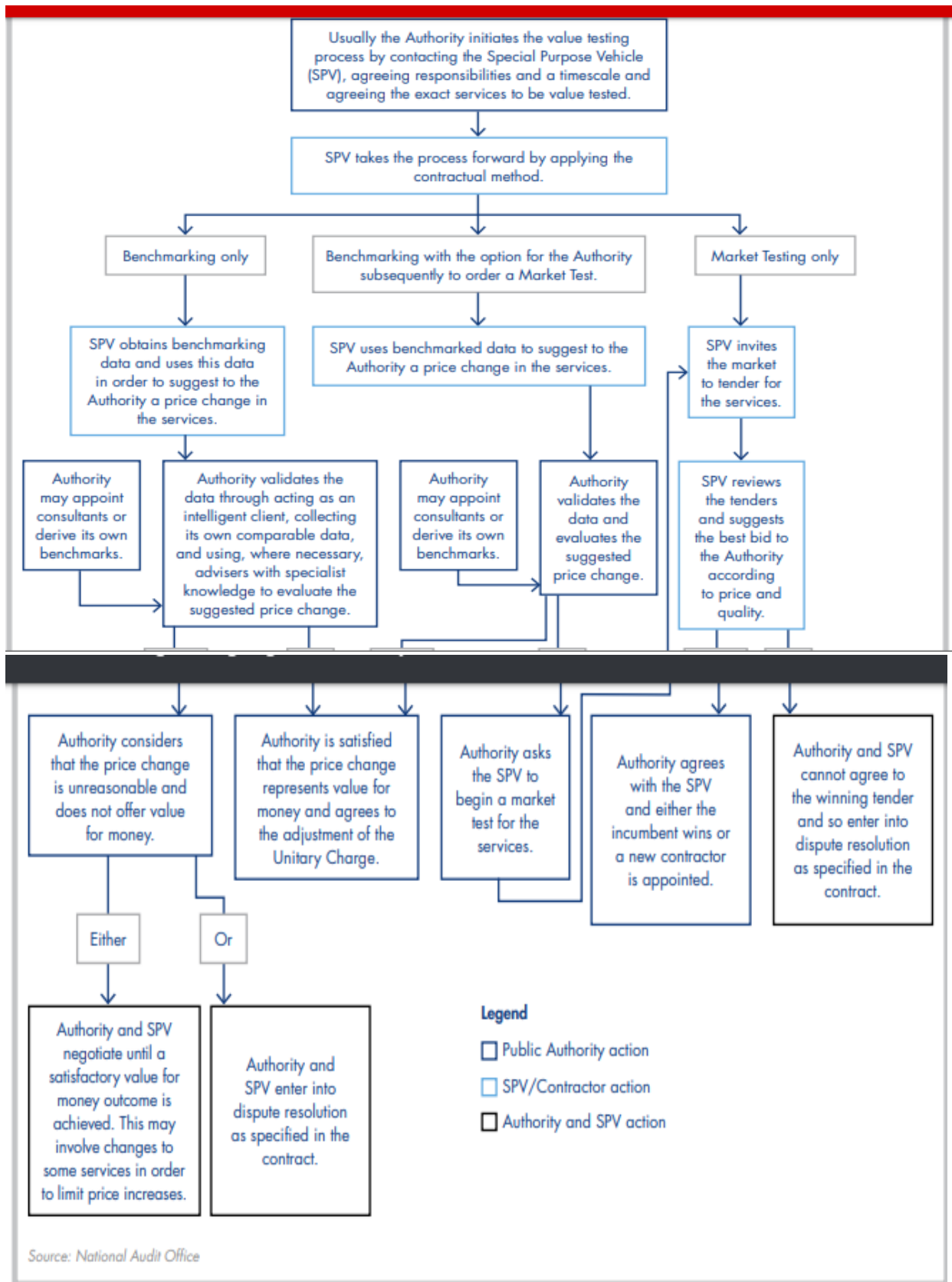


Table 2 - The Alternative Methods of the Value Testing Process (NAO)

	Benchmarking	Market Testing
Advantages	<p>Cheaper and quicker to implement.</p> <p>Maintains the spirit of partnering through negotiation with the incumbent.</p> <p>Stability in provider is a catalyst for process improvement.</p> <p>Avoids potential problems with the handover to a new service provider.</p> <p>Avoids further TUPE transfers.</p>	<p>Competitive process.</p> <p>More transparent process.</p> <p>Flexibility for reassessing the service provision and also performance measurement system since they can be drawn up anew without recourse to variation discussions.</p> <p>Can mean the start of new relationships and new ideas if someone other than the incumbent wins.</p> <p>May reduce the cost if a new service provider has a cost effective innovation to offer.</p>
Disadvantages	<p>Comparable data may not be available or be expensive to access.</p> <p>Expectations gap between the authority and the private sector over the cost of services may make agreement on the outcome difficult to achieve.</p> <p>Difficulties in finding suitable benchmarking data make it less credible as a transparent and accountable process and therefore harder to justify the value for money outcome.</p> <p>Audit trail not always clear. Private sector may limit benchmarking information due to commercial confidentiality.</p>	<p>Lengthy preparatory time and usually a more costly process.</p> <p>The incumbent may be in a powerful position to win the market test and so the process may not be as competitive as initially thought.</p> <p>Lines of communication can become complicated when the replaced incumbent had provided both hard and soft FM.</p> <p>Requires a sufficient number of alternative suppliers to make it a competitive market.</p>
	<p>Potential for disagreement/dispute to drag on.</p> <p>Can strain current relationships.</p> <p>No opportunity to replace an unsatisfactory incumbent.</p>	<p>Tendered price may be non-negotiable.</p> <p>Process improvement opportunities can be lost.</p> <p>There is uncertainty for the incumbent's staff and possibly TUPE issues.</p>
<p>Source: National Audit Office, ARUP and Norfolk and Norwich University Hospital</p>		

Table 3 -The advantages and disadvantages of benchmarking compared with market testing (NAO)