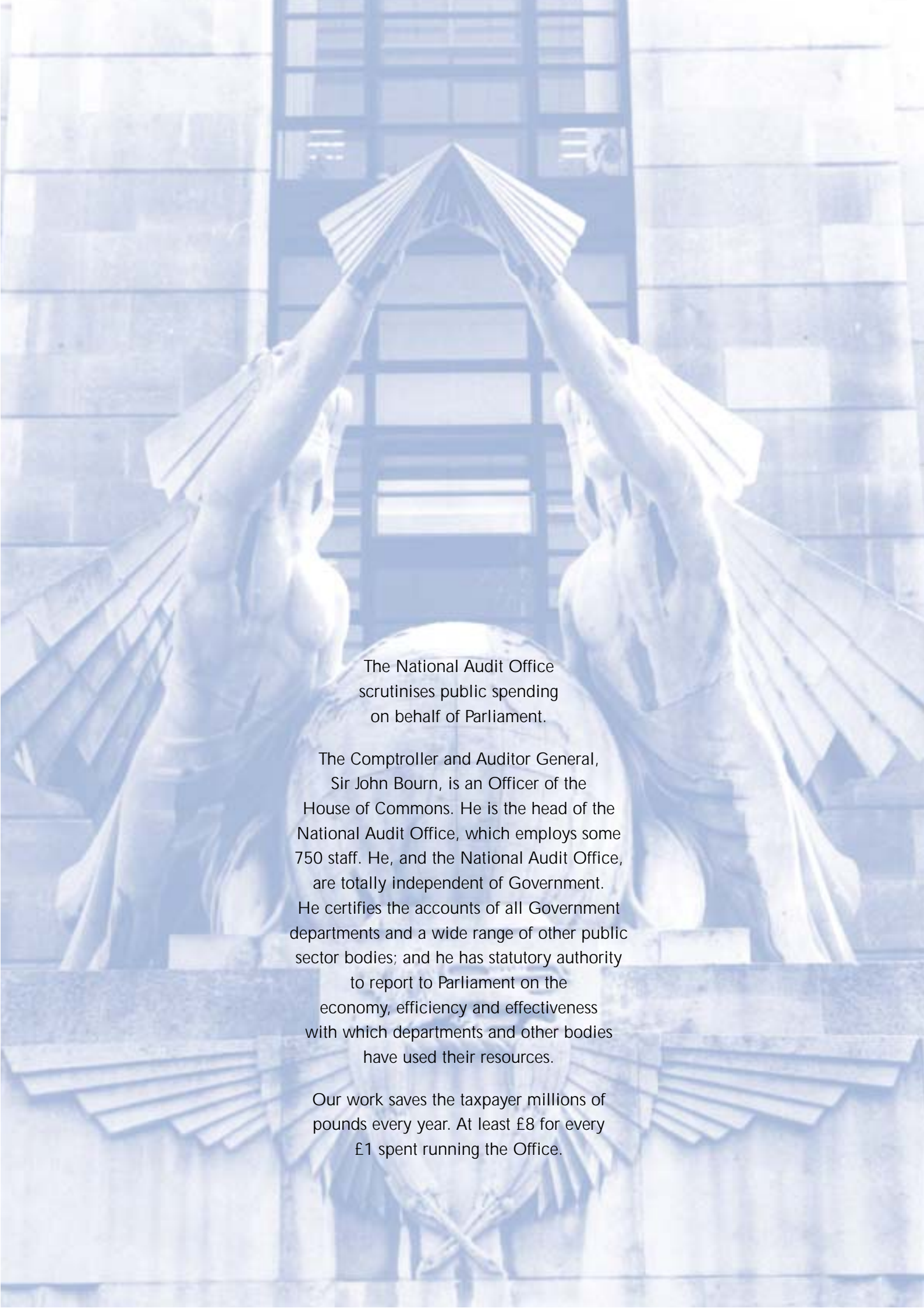


Northern Ireland Court Service
PFI: The Laganside Courts

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 649 Session 2002-2003: 4 June 2003





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Northern Ireland Court Service
PFI: The Laganside Courts



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This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

John Bourn
Comptroller and Auditor General

National Audit Office
9 May 2003

The joint National Audit Office and Northern Ireland Audit Office study team consisted of:

Phillip Airey, Chris Bedford, Eddie Bradley,
Christine Burns and Raymond Jones

This report can be found on the National Audit Office web site at www.nao.gov.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Email: enquiries@nao.gsi.gov.uk



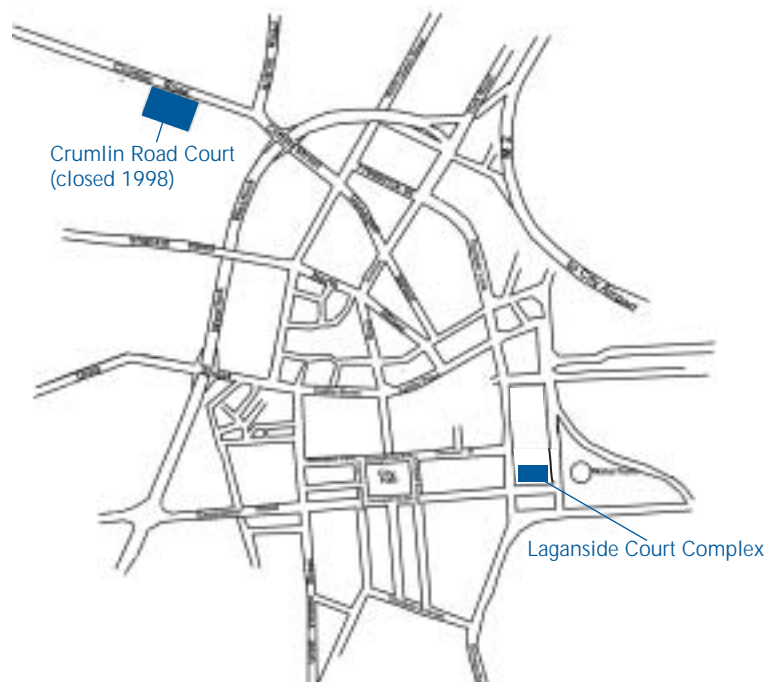
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executive summary

- 1 The Northern Ireland Court Service (the Service), a Department of the Lord Chancellor, is responsible amongst other things for facilitating the conduct of the business of the Supreme Court, the County Courts, the Magistrates' Courts, Coroners' Courts and certain Tribunals. In addition to providing administrative support to the Judiciary in the conduct of court business the Service also provides suitable accommodation where proceedings can be heard. The Belfast Courts handle the bulk of business in the criminal and civil courts.

1 Locations of the Crumlin Road and Laganside Courts



- 2 In the early 1990s it was clear to the Service that the court buildings in Belfast would need to be updated or replaced and that a radical solution was needed to provide for the operational needs of the Service into the Millennium and beyond. A number of measures were contemplated, including the feasibility of refurbishing the Crumlin Road Courthouse to deal with increasing Crown Court business arising in large part from the impact of civil unrest and terrorist related offences. The courts themselves were not immune from terrorism and several were badly damaged or destroyed in attacks.
- 3 By the end of 1996 the Service was convinced, following an independent market study, of the feasibility of a Private Finance Initiative (PFI) project to provide a new courts complex in Belfast to deal with Crown and County Court business. Advisers were appointed to assist in the procurement and by the end of 1997 the Service issued an Invitation to Negotiate for a larger complex, incorporating Belfast and Newtownabbey Magistrates' Courts, to three consortia.

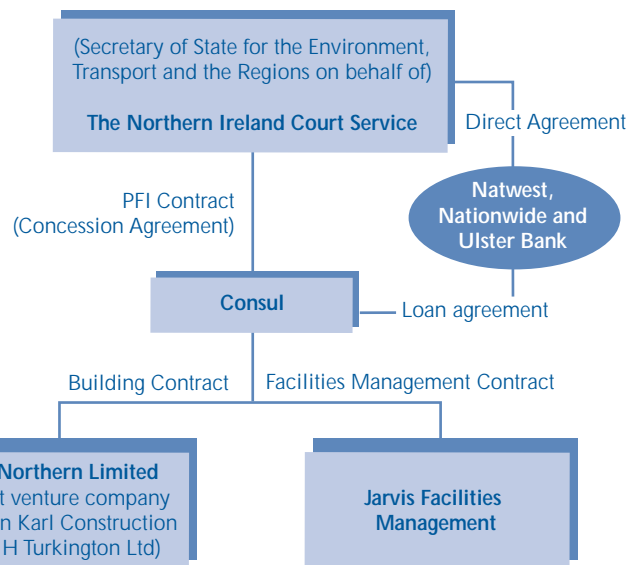
In February 1999 the Service let a PFI contract (see Figure 2) to Consul Services Ltd (Consul) to design, build, finance and operate a 16 court complex (now known as Laganside Courts). The contract is for 25 years at a cost, in net present value terms, of £40 million. This was the first major accommodation PFI contract signed in Northern Ireland and the first of its kind to reach financial close in the court sector in the United Kingdom. The Service occupied the new complex in January 2002. A chronology of key events is at Appendix 1.

- 4 We examined the extent to which this PFI deal is likely to deliver value for money. Our report *Examining the Value for Money of Deals Under the Private Finance Initiative* (HC 739, 1998-99) provides an outline of the general methodology, which acts as the starting point for PFI examinations. The detailed methodology adopted for this study is set out in Appendix 2.

Although the courts are delivering benefits, the Service needs to improve on contract management

- 5 The Service considers that it has a modern building which meets all its operational needs. The combination of Crown, County and Magistrates' Courts at Laganside Courts has improved upon the previously dissipated nature of court provision in Belfast. Initial reactions from court users have been positive and a preliminary review of throughput has indicated increased availability and efficiency of the courts. Nevertheless, the Service did not undertake all the actions it might have prior to occupying the new complex. Performance monitoring was not fully operational and consequently, for an initial period, there were limited means by which performance against service standards could be measured.
- 6 The contract has in place a number of mechanisms which should help to protect value for money in the future, but there are limitations with the way availability and performance of the new building are reflected in the payments made to Consul. The monthly unitary charge of £300,000 paid to Consul includes fixed elements that limit the total abatement for unavailability to 44 per cent of the total amount due, even if the entire building is out of action.

2 Deal structure



In addition, the abatements to the unitary charge if one of the Courts is unavailable appear relatively small. For instance, the non-availability of a standard Crown Courtroom would reduce the service payment by approximately £18 an hour, less than £150 a day. Such a deduction for non-availability seems limited and unlikely to be commensurate with the abortive costs associated with the postponement of proceedings for a day. In such circumstances, however, the Service would take action to ensure business continuity. The performance element of the monthly unitary charge is also proportionately small. An unacceptable standard of performance for a range of services, such as reprographics or cleaning, would result in a deduction of only some £6,000 a month.

- 7 The Service secured a reduction in the unitary charge from £4.2 million to £3.6 million a year in return for agreeing to limit the size of any abatement for non-availability or poor performance. The negotiated reduction was closely linked to what could be afforded for the new courts and ensured that a hard bargain on price was negotiated with Consul. The Service considers that the level of abatements is appropriate in relation to the estimated profitability of the facilities management element of the deal.

This early PFI deal illustrates a range of key issues that departments must continue to bear in mind

- 8 The procurement process was handled well. The Service put together a business case, established an appropriate project management structure and appointed advisers after open competition. An initial market-sounding exercise was undertaken to gauge interest in the project. Expressions of interest were received from four consortia and, following a pre-qualification assessment, an Invitation to Negotiate was issued to three of them. The subsequent bids were evaluated against a range of criteria and, although the Consul bid was not the cheapest, it scored most highly across the selection criteria.
- 9 Although a traditional procurement was ruled out at an early stage because of insufficient capital funding, the Service prepared a nominal public sector comparator to test the cost of a PFI deal. This indicated that the overall cost of the preferred bid was marginally less than a conventional procurement. The comparator included substantial costs for carrying out remedial work and then mothballing the Crumlin Road Courthouse, a listed building, throughout the 25 years of the project. This made a material difference to the net present cost of a conventional procurement, increasing it by about £7 million relative to the PFI bid. If these costs are excluded, the comparator would have been considerably less expensive. The Service believes that there would have been no private sector interest, other than through the proposed PFI deal, in taking on the building. The Service considers that it would have been obliged to incur such costs for the Crumlin Road Courthouse throughout the 25-year period, if a conventional procurement had been possible, and that it was legitimate to include all the costs in the Public Sector Comparator.
- 10 The Service considered the issue of risk allocation from an early stage in the procurement process and achieved an allocation similar to other private finance contracts of this nature - transferring design, construction, commissioning and operating risks to the private sector. Nevertheless, there is no evidence that the Service quantified the respective risks transferred and retained to enable a like for like comparison between the Public Sector Comparator and the PFI deal.

Recommendations



11 This was one of the earlier PFI deals and the new courts have only been up and running since February 2002. Nevertheless, it is apparent to us that the new Courthouse is an example of imaginative and successful design of a building that is providing a vastly superior service to its users than the nineteenth century Crumlin Road Courthouse, good no doubt in its time, that preceded it. There are, however, a number of points relevant to the forward management of the deal and the development of the PFI generally, that are worth highlighting.

A) The Service should resolve the remaining problems with the building as soon as possible

Problems with water ingress, the outstanding negotiations on price adjustments for changes to sight lines in the Crown Courts and the indexation of the unitary charge have been known about for some time and the Service is working to resolve them.

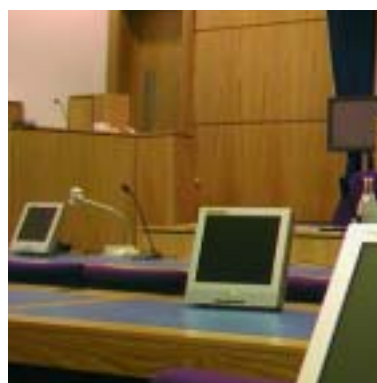
B) Performance monitoring should be kept under review

Putting in place adequate arrangements to measure performance took a back seat to getting the courts operational. As a result the Service was exposed to the risk that it might be paying in full for what was sub-standard service delivery although there have been no significant examples of unavailability or performance issues to date. Formal contract management arrangements are now in place and the Service must make sure that it keeps a close watch on performance monitoring in the future.

C) The payment mechanism must be agreed and tested before service delivery begins

To achieve a good price and keep the deal affordable, the Service agreed to limit the amounts that could be deducted for unavailability or poor performance. As the details of the payment mechanism had not been fully worked up at the time the deal was being negotiated, the Service was not in a position to consider fully the potential effect on the incentives to the private sector to provide acceptable standards throughout the 25-year term of the contract. In the circumstances, the Service should now ensure that the longer term benchmarking and market-testing provisions contained in the contract are used fully.

Recommendations



D) Public Sector Comparators are subject to inherent uncertainty

Public Sector Comparators tell departments nothing about the benefits of alternative procurement methods and are subject to inevitable uncertainty, given the long timescales involved. Although public capital was not available to the Service to build the new courts, a nominal public sector comparator was prepared. The comparator showed that the cost of a PFI deal was marginally less than a traditional procurement. The difference, of less than 0.4 per cent, depended on whether responsibility for the Crumlin Road Courthouse, which was not needed for operational purposes, might have to remain with the Service. The uncertainty inherent in a Public Sector Comparator is illustrated in this deal by what might or might not happen to the Crumlin Road Courthouse over the next 25 years. The Service considers that the site is unlikely to be developed by the private sector without substantial subsidy from public funds.

E) The Service should have in place an agreed negotiating strategy if the deal is refinanced

The Service and its financial advisers believe that the deal was tightly negotiated and, as currently structured, the opportunities for a refinancing appear limited. However, an initial meeting has taken place between the parties and Consul may develop a proposal on refinancing for the Service's consideration. If a refinancing is proposed the Service should ensure, taking full account of guidance issued by the Office of Government Commerce, that an appropriate proportion of any gain made by Consul is returned to the taxpayer.



Part 1

Although the courts are delivering benefits, the Service needs to improve on contract management

The Service is confident it has a high quality, modern building which meets in full its operational needs, has improved efficiency and increased court usage. However contract management procedures have not been fully operational from the start and need to be more rigorously applied to measure performance.

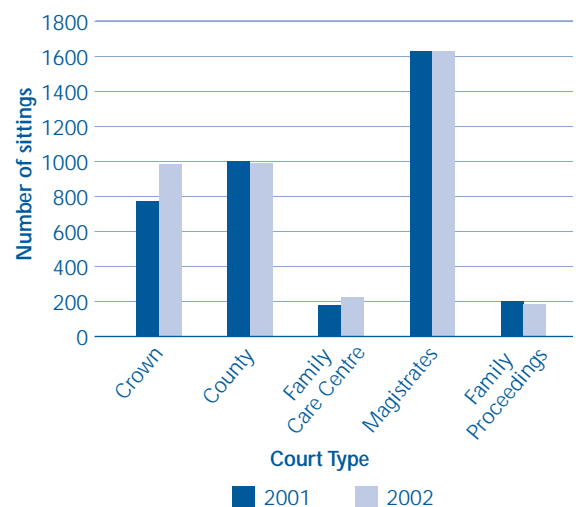
The new courts are delivering benefits

1.1 Since it opened in early 2002, reactions to the new building have been very positive and court users are appreciative of the facilities and environment created. The Service considers that the use of space, flexibility and quality of light in public spaces have provided an environment which exudes customer focus, efficiency and functionality, while capturing the seriousness and dignity required for Court business. The Service told us it had worked extensively with Consul to establish Laganside Courts as its solution and was very proud of the result. The concept, facilities and financial structure had taken first place in the accommodation section of the UK Nationwide PFI awards in 2000 and the building also won the Royal Society of Ulster Architects design award for Building of the Year 2002.

The dissipated nature of court provision in Belfast has been improved

1.2 The new 16 courts complex was the first major PFI scheme to be completed in Northern Ireland and the first courts project to reach financial close in the United Kingdom. For the first time Crown, County and Magistrates' courts business in Belfast is combined in one location, supported by a common administrative support team. The scheme resolved the intractable problem of the Crumlin Road Courthouse when it and two other sites were sold as part of the overall agreement. The project also enabled the closure of Newtownabbey Magistrates' Court and the transfer of business to Belfast, resulting in a more efficient and effective service throughout the petty sessions districts. The Old Townhall Courthouse adjacent to Laganside Courts was also converted to a much-needed family court centre, a Coroner's Court and a Youth Court, which was needed to keep youths separate from adult criminals.

3 Court usage



Source: The Service

There has been an increase in the throughput of cases

1.3 A preliminary review by the Service of the throughput of the business from January to December 2002 (**Figure 3**) has indicated increased availability and efficiency together with higher business levels and an increase of some six per cent in the number of court sittings, compared with the corresponding period a year earlier. The additional sittings are concentrated in the Crown Courts, where cases are often high profile and involve lengthy trials. Laganside Courts provides the opportunity to call larger panels and swear juries all in one secure suite, which in turn has a positive effect on business performance. Efficiency gains in each of the other courts have also been noted by the Service. In the magistrates' courts, anticipated efficiency savings have resulted from the partial amalgamation of business within Newtownabbey and Belfast Petty Sessions Districts, which is evidenced by the constant number of sittings within fewer days. In the County Court, including Family Care business, the judiciary make use of the benefits of mixing various types of business within the courthouse. It is in this context that the Service considers that the new complex is delivering major operational benefits.

Other operational benefits are apparent

1.4 Backlogs of Crown Court business are being reduced as a result of the five or six Crown Court sittings which can be accommodated at Laganside, on average, each day during term time. The modern facilities provide distinct separation routes for all court user groups, within a secure yet comfortable environment. Juries, witnesses, defendants, child witnesses, witnesses in fear, victims and families all have special needs to be catered for. The Service considers that these advantages are becoming increasingly apparent to court users. The high-tech courtrooms have already been used to full advantage while a re-trial, which had originally taken five months at hearing in a conventional courtroom, ran only eight weeks at Laganside, because of the efficiencies of new digital evidence facilities. A recent High Court Judge family proceeding was transferred to Laganside where the modern facilities provided separate, comfortable waiting, digital recording facilities and video links.

But some problems with the building remain unresolved

1.5 Although the Service has identified a number of benefits, there are a number of unresolved issues with the building:

- **Water ingress** - the Service has expressed ongoing concern about the roof and the number of defects occurring. The roof has been patched several times and a major leak has occurred over Court 12. An electronic survey of the roof reported a number of minor puncture holes. Although the courts continue to be used despite the water ingress and some difficulties with the damp proof course in the curtain wall, over £1,200 has been abated from the unitary charge for unavailability.
- **Sight lines** - some jury members were obstructed from viewing witnesses by the location of Senior Counsel's benches. The obstructed view applied to all 6 Crown Courts. The Service continued to use the courts, but declared the courtrooms to be technically unavailable as they did not meet requirements. Consul claim that the courtrooms were used and therefore the non-availability abatement does not apply. The Crown Courts have now been reconfigured by Consul at a cost of some £90,000. The Service and Consul are in discussions but have not as yet agreed a financial settlement.

Contract management arrangements were not in place early enough

1.6 Departments should put in place arrangements for monitoring the contractor's performance once the service is operational.

The indexation of the unitary charge was not agreed prior to service commencement

1.7 Under the terms of the contract, the Service should have agreed the baseline Unitary Service Charge to be applied from the date of occupation of the building. To do so, parts of the Unitary Service Charge agreed at contract signature needed to be increased to take account of inflation by applying actual RPI¹ and GDP² deflators as appropriate. The Service did not apply the actual deflators. Instead, Consul applied an indicative rate of three per cent a year and increased the Unitary Service Charge by this amount. In the event, actual inflation was lower than three per cent a year and consequently the Service has been paying a higher Unitary Service Charge than it should have. It was only in October 2002 that the Service identified the correct Unitary Service Charge applicable on occupation and it is now seeking to recover £5,000 overpaid.

Performance monitoring was not fully operational when the courts opened

1.8 Three months prior to practical completion, the Service should have finalised the basis upon which service standards were to be reviewed and how Consul intended to monitor performance against the contract. This required the Service to detail the key performance indicators and how they would be measured. Consul did not supply a service standard report in advance but the Service set up a "help desk" to monitor performance issues.

¹ Retail Price Index.

² Gross Domestic Product.

1.9 Six months after occupation of the new building, the Service asked its external advisers to examine the extent to which the facilities management services being provided by Consul complied with the contractual requirements. The advisers noted that during the initial months of occupation, the Service had focused on getting the building operational. Because of this, the development of systems and procedures had taken a back seat and considerable effort would be needed to ensure that all contractual obligations were put in place. The advisers reported that certain elements of the performance measurement system were operational. For example, processes were in place to measure the availability of the Courts complex and to report service failures to the Consul Help Desk for input to the payment mechanism to ensure appropriate deductions from the monthly Unitary Service Charge could be made.

1.10 The contract also required Consul to produce self-monitoring reports on the service standards achieved against those established in the output specification. However, Consul had not regularly marked the services as required. There was no method by which the performance standards for day-to-day services in the building could be measured and subsequently there could be no abatement of payments if those standards were not being met (Figure 4).

1.11 A team in Laganside has been established to consolidate fault logging procedures in conjunction with a fully operational helpdesk. In addition, working in association with Consul's Facilities Management Team, the Service has agreed and developed a series of monitoring reports. Formal plans are now in place to ensure that all service management and contract management requirements are fully engaged. The Service's Resource Management Team have logged every item reported to the helpdesk in the new building, monitored Consul's workplace facilities management performance reports each month and have instigated a full quarterly inspection regime. There have been no significant examples of unavailability or performance issues.

4 Performance Monitoring as at February 2003

- There have as yet been no abatements for service performance - the only deductions to date (just over £1,200) have been for non-availability.
- Overall service performance has been in excess of 97 per cent for each month since occupation.
- Three services are currently being reported through Consul's Help Desk facility (Management of Services, Service Maintenance and Fabric Maintenance). In addition, a number of services are being managed through the internal Court Service Helpdesk. These include reception, portage, postroom, reprographics and cleaning.
- Other services are not being monitored and automatically receive a score of 100%.
- On a number of occasions, the three services being monitored have individually scored less than the acceptable standard (i.e less than 95%).
- Because the abatement process is based upon the total demerit marks for all services combined, and because non-monitored services are receiving a score of 100%, the acceptable position for non-monitored services can cancel out an unacceptable standard for the three monitored services.
- In February 2003, the three monitored services were unacceptable, all scoring less than 95%. Because service monitoring was not operational for other services, these all scored 100% and the overall performance score was 97.06%. Consequently there was no performance abatement.

The payment mechanism could have been developed further before contract signature

1.12 Because PFI deals involve the provision of services over the long-term by the private sector, the payment mechanism lies at the heart of any PFI contract. It puts into effect the allocation of risks between the public and private sectors and establishes incentives for the private sector to deliver the services agreed in a manner that provides value for money. Payment mechanisms should not contain an element of payment that is absolutely fixed regardless of the availability, timeliness or quality of service delivery. Any such fixed element would not be results-orientated, reduces risk transfer and may indicate a lack of confidence in the project by private sector funders.

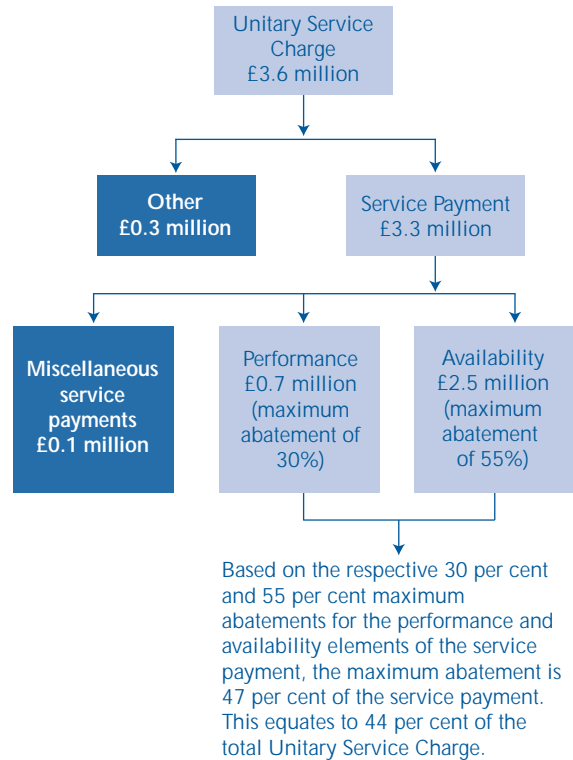
The major part of the unitary charge is fixed even if the courts are unavailable

1.13 The annual unitary charge of £3.6 million (as at October 2002) has two main components: an availability element of £2.5 million and a performance element of £0.73 million. The contract stipulates that the maximum abatement would be 55 per cent of the availability element and 30 per cent of the performance element in any calendar month, even if no services are delivered. The maximum abatement in any one month is therefore limited to 44 per cent of the entire unitary charge (Figure 5). This did not follow PFI guidance at the time, and currently, which recommends that payment should not be made if the service as a whole is unavailable³. The underlying concept of the payment mechanism should be one of no service, no payment. The Service does not envisage a high incidence of non-availability in relation to the 16 courts, as every attempt has and will be made to avoid disruption of court business.

The abatement for non-availability of the courts themselves is limited

1.14 The mechanism for calculating the abatement for non-availability is based on the number of rooms and zones in the Laganside Courts complex. Three months prior to practical completion the precise floor areas should have been calculated to include the area per room, weighted area per room and total weighted area. This was not finalised until November 2001, only a month before the new Courthouse was delivered to the Service. Figure 6 shows the typical abatement to the availability element of the unitary charge if a particular type of room is unavailable for one hour after being reported. The non-availability of a standard Crown Courtroom would reduce the service payment by approximately £18 an hour, less than £150 a day. Such a deduction for non-availability seems limited and unlikely to be commensurate with the abortive costs associated with the postponement of proceedings for a day.

5 The unitary service charge



6 Hourly abatements for non-availability

Room Type	Typical Hourly Abatement
Standard Crown Court	£18.06p
Large County Court	£16.79p
Small County Court	£8.18p
Judge's Lounge	£5.99p

The maximum abatement for poor performance is small

1.15 If the level of performance abatement is too low, it reduces the extent to which the Service has actually transferred this risk to Consul. The payment mechanism should be sufficiently sensitive to different levels of performance so that the supplier has a clear incentive to perform at the required level. **Figure 7** shows the abatement from the monthly service payment at each of the standards of performance, using the designated formulae in the PFI contract. The maximum monthly abatement when the performance score is 0% amounts to only £18,274. The Service considers that the level of abatements is appropriate in relation to the estimated profitability of the facilities management element of the deal.

1.16 The Service has a number of step-in rights and has told us that it secured a reduction in the unitary charge from £4.2 million a year to £3.6 million a year in return for agreeing to limit the size of financial deductions for non-availability and poor performance. The negotiated reduction in the unitary charge was closely linked to the Service's view on what it could afford for the new courts over the term of the contract and ensured that a hard bargain on price was negotiated with Consul. Nevertheless, the levels of performance abatement appear proportionately small for even poor and unacceptable standards of performance. This may limit the incentive for Consul to remedy any failures and the Service will need to monitor performance carefully in the early years of the contract.

Longer term partnering arrangements were not developed until late on

1.17 Familiarity with the project and how the contract is intended to operate are essential requirements for any staff engaged in managing PFI contracts and staff continuity between the procurement and the subsequent management of the contract is desirable. Where this is not possible, there should be a gradual hand-over between staff who negotiated the deal and those responsible for managing it to ensure continuity in a department's knowledge and understanding of the project.

7 Performance abatement values

Performance Score	Description of Standard	Percentage Abatement	Monthly Abatement (at mid point)
95% to 100%	Acceptable	Nil	Nil
85% to 95%	Marginal	2.5%	£475
70% to 85%	Poor	13%	£2,375
45% to 70%	Unacceptable	34.4%	£6,286
0% to 45%	Default	74%	£13,599

1.18 Due to unforeseen staffing difficulties, the Service was hard pressed, ahead of the start of court operations, to put in place a fully-developed formal structure to manage the contract in the long term. The Project Sponsor, who was involved in the negotiation of the Laganside Courts project, has been retained for the first year of operation and is involved in ongoing contract management with Consul. In this role, he is working alongside the Laganside Courts' business manager, who is responsible for the scheduling of court business.

1.19 The Service has developed a planned programme of activities to transfer responsibility for contract and service management to a central unit responsible for existing PFI and Facilities Management contracts. This team will work closely with the Project Sponsor during the transfer period reviewing the existing procedures, identifying the contractual requirements, agreeing the current programme of activities, transferring knowledge and acquiring an understanding of the project. To aid the transition of responsibility, the Resource Management Team responsible for logging faults and non-performance at the Laganside Courts, has been further supplemented with the appointment of a member of the Project Team.



Part 2

This early PFI deal illustrates a range of key issues that departments must continue to bear in mind

The Service established a clear need for new court provision in Belfast and adopted good practice in its tendering of the PFI contract and selection of the preferred bidder. Nevertheless there are a number of points for the future.

There was a clear need for the project

2.1 The Service carried out a feasibility study in 1993 to examine the scope for extending and refurbishing the Crumlin Road site. This study indicated that such a development was too expensive (£35 million for six courts), would involve the acquisition of land outside the existing site and would not meet the Service's anticipated needs. In July 1994, the Service was minded to close Crumlin Road because of:

- the age of the building and its natural deterioration;
- the likely future increase in jury trials (scheduled offences, mostly relating to terrorism, were tried by a judge sitting without a jury) and the inability of a number of the existing courts to accommodate jury trials;
- unacceptable circulation routes for judiciary, jurors, witnesses, staff, public and prisoners;
- the generally unsatisfactory or non-existent facilities for a variety of court users.

2.2 In 1995, the Service established a Working Group to review all court requirements in the Belfast area. This Group concluded that a new court complex should be developed, catering for six Crown Courts, one County Court and one Coroner's Court. The Crumlin Road Court was closed in June 1998, following a condition report that demonstrated increased safety risks from falling masonry both internally and externally.

The Service's requirements changed

2.3 In October 1997, arising from consultation with key stakeholders, the Service's advisers reported that it was feasible to add in Belfast and Newtownabbey Magistrates' Court to the project brief because they were inadequate for current needs and there was a growing requirement to deal with family matters in separate and confidential accommodation.

2.4 The increase in the number of courts matched those being lost from the demolition of Belfast Magistrates' Courts and the sale of Newtownabbey Magistrates' Courts.



The former Crumlin Road Courthouse

The Project Board considered the implication of these changes. The 16 court complex was more costly than the 8 court complex originally envisaged (Figure 9). Estimates prepared by the Service's advisers indicated that the capital cost was some £16 million and the annual Unitary Service Charge was £1.2 million a year greater than the original proposal. However, the Service was also mindful of the fact that the estimated cost of a larger complex of courts was still within the cost of refurbishing and providing six courts at the existing Crumlin Road Courthouse. The Project Board subsequently decided, in November 1997, that a 16 Court Complex comprising 6 Crown Courts, 4 County Courts and 6 Magistrates Courts should be developed on the site.

9 Initial cost estimates

	8 Court Complex	16 Court Complex
Capital Cost	£18.6 million	£34.6 million
Unitary Service Charge	£2.8 million	£4.0 million

Source: The Service

Traditional procurement was ruled out because capital funding was unavailable

2.5 The Service ruled out traditional procurement as a means of delivering the new courthouse because it was clear from the outset that funds would not be available. When the PFI was introduced in the 1990s, uncommitted capital allocations were removed from the

Service's expenditure plans and monies earmarked for the project were lost. The Service believed there was an obligation to go down the PFI route and arguments against doing so would not be accepted without the PFI market being tested.

Project Team which comprised external professional advisers appointed by the Service together with one of its own staff who acted as Project Sponsor. In addition, the external professional advisers attended all Project Board meetings and had direct access to senior management as necessary.

The procurement itself was handled well

2.6 Procuring a PFI deal is a major project in its own right which needs to be managed as such. The procurement process needs to be planned thoroughly, it must establish the conditions for a successful competition and there should be a framework for controlling the costs of procurement.

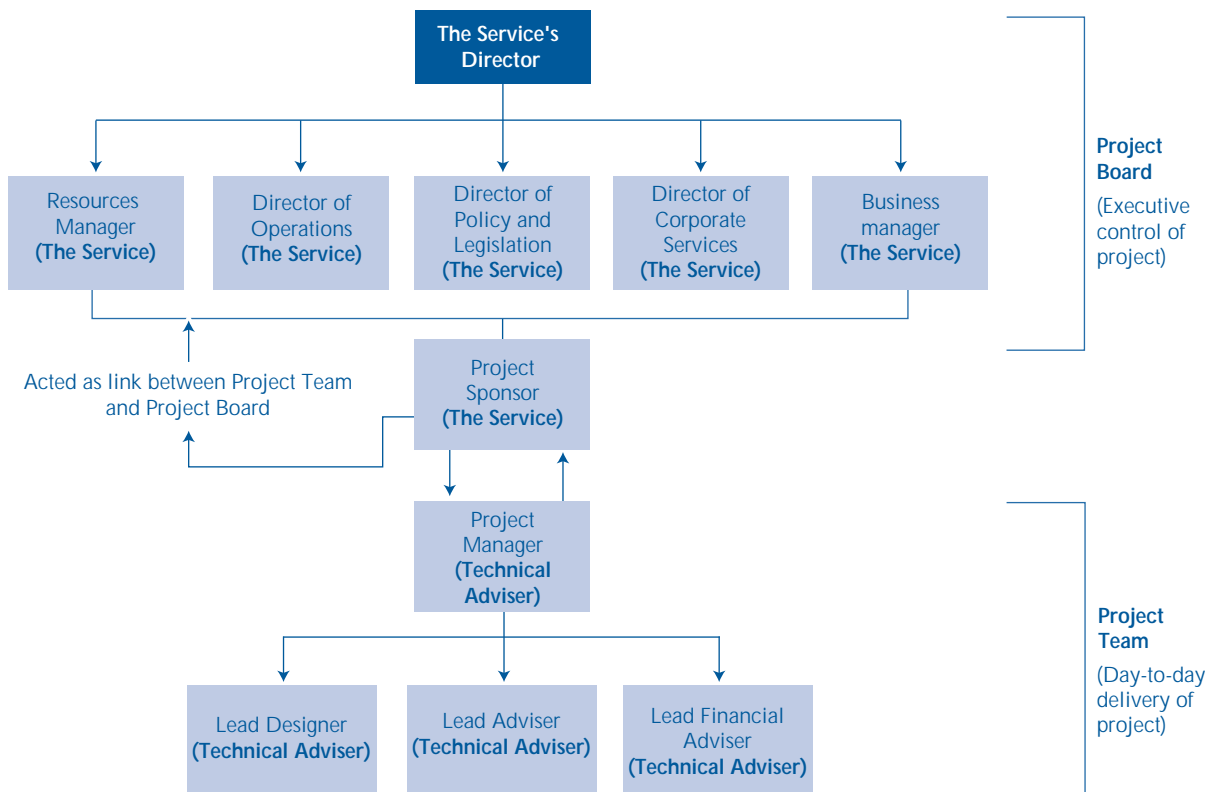
Advisers were appointed after open competition

2.8 The competition for the appointment of advisers was managed on behalf of the Service by the Procurement Service (formerly known as the Government Purchasing Agency). The Service sought to appoint a lead technical adviser who would be responsible for the provision of both legal and financial advisers. It required advice on project management and on the content, award and negotiation of an initial Design, Build, Finance and Operate contract. Government policy is that all procurement should be on the basis of value for money and not lowest price alone. The evaluation of the advisers' bids followed this policy - it was based upon 70 per cent quality and 30 per cent price with the most economically advantageous bid being accepted.

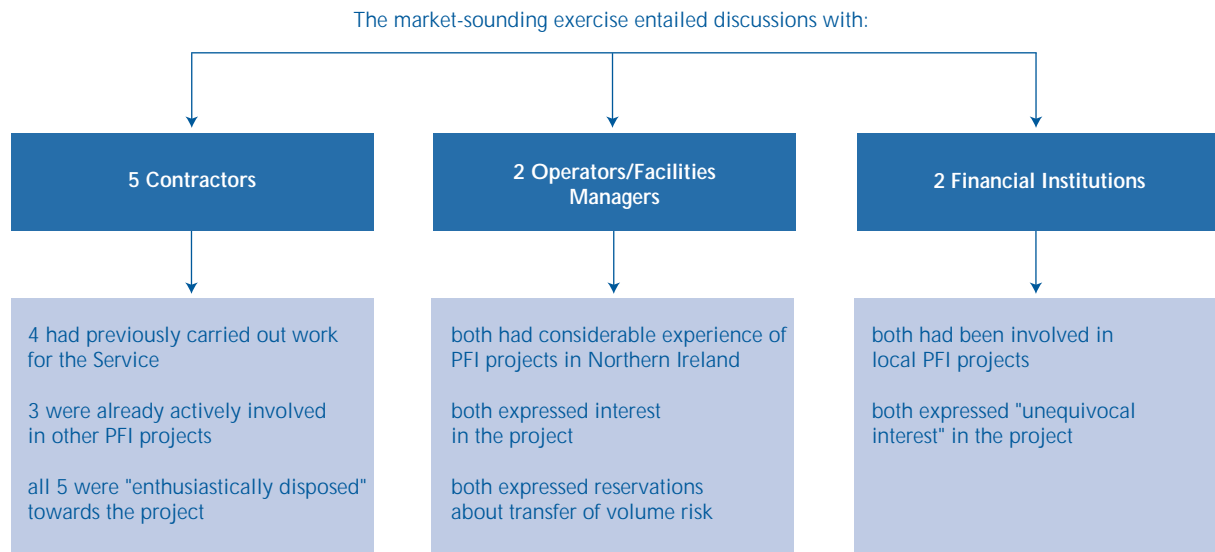
An appropriate project management structure was established

2.7 The Service established an appropriate structure for the management of the project. It set up a Project Board, chaired by the Service's Director. The Project Board devolved day-to-day responsibility for the project to a

10 Project Management Structure



11 Results of the Service's market-sounding exercise



The Service subsequently re-appointed the advisers without further competition

2.9 Once the PFI contract award had been completed in February 1999, the Service re-appointed the advisers, without competition, for a lump sum of £176,000 for post-contract advisory services. This fee excluded some facilities management services and all legal and financial services which would be available on a call-off basis as necessary. The Service ensured that the contract terms for the follow-up work followed the original terms and that the fees were related to those originally approved.

2.10 The Service considered that the existing advisers were the only ones capable of performing the assignment, given their acquired experience and knowledge of the project. This suggests that advisory needs may have been underestimated at the outset. The Service told us it had always been intended to deal with post-contract advice as a separate issue later in the project, given the complexity of the initial brief. Nevertheless, the Service might have given greater consideration to the inclusion of post-contract advisory services in the initial client brief and contract.

A market-sounding exercise to gauge interest in the project was undertaken

2.11 Because of the security situation in Northern Ireland during the civil unrest, there had only been a small number of contractors who had tendered for contracts for the provision of court buildings in the past. Accordingly, the Service considered it important to conduct a thorough market-sounding exercise to explore the possibility of obtaining active support from the private sector.

2.12 The market-sounding exercise, undertaken in October 1996, tested the degree of interest among potential bidders to undertake a PFI project, identified their relative experience in PFI and helped identify prospective constraints with taking forward a PFI deal. The exercise involved discussion of the project and the facilities management services to be provided. It also included initial discussions with potential bidders on the PFI process, including issues such as risk transfer and the proposed payment mechanism.

2.13 Overall, the market sounding exercise concluded that there was considerable interest in the project (Figure 11). In light of this the Service considered that there was a viable PFI option for the procurement of the new courthouse complex. An advertisement was placed in the Official Journal of the European Communities (OJEC) in August 1997, inviting interested parties to submit an expression of interest. Pre-qualification questionnaires were issued to 26 respondents, comprising a range of contractors, facilities managers and financial institutions. Four submissions were received from consortia that included the majority of the 26 individual contractors, facilities managers and financial institutions who had responded to the OJEC invitation for expressions of interest.

An appropriate basis was established to assess and evaluate submissions

- 2.14 It is common in PFI deals to choose a shortlist of bidders following the pre-qualification competition. The Service undertook a two-stage assessment process. First, written answers from each consortium to the Qualification questionnaire were assessed against criteria for a range of financial and technical issues. The second stage of the process involved interviews with each consortium. Following this stage the Service and its advisers agreed that Consul was the most integrated and impressive team and ranked it as the best of the four consortia.
- 2.15 The Service decided not to invite all four consortia to tender due to the costs of preparing and submitting bids and the potential weakening of the individual consortia's interest should all four be chosen. An Invitation to Negotiate was issued in December 1997 to three of the consortia and bids were received from all three in April 1998. The Service established five criteria - Technical, Facilities Management, Financial, Legal and Presentation - against which it would weight and score each of the bidders.

A Best and Final Offer stage of bidding was considered unnecessary

- 2.16 The selection of a winning bid would be based on a balance of all the criteria. Although the Consul bid was not the cheapest, it scored most highly overall against the five criteria. It also scored highest in three of the individual criteria (specifically the technical, financial and legal criteria). Following the evaluation process, the Service decided to by-pass the stage of Best and Final Offer. The Service considered that it would not gain any benefits from a further round of bidding because one of the other two bidders did not meet the required standard while the remaining bid was judged to be too expensive.
- 2.17 Consul was selected as the provisional preferred bidder and one of the other bidders was chosen as a reserve. The purpose of naming a reserve bidder was to maintain the element of competition within the process. The Service issued Consul with an agenda for action to be addressed over an eight week period which, upon successful completion, would remove its provisional status. Over the negotiation period, the unitary charge was reduced from £4.2 million a year to £3.6 million a year and the Service considers that the specification for the new courts was improved.

A notional Public Sector Comparator was calculated

- 2.18 A public sector comparator is a part of the financial evaluation of proposed PFI projects. Although not a pass or fail test, it is an aid to forming a judgement about the cost of a proposed PFI deal relative to a conventionally financed project that delivers the same benefits. It can also help a department to understand the economics of PFI bids, since a comparison of the respective costs and revenues can show where and how a PFI bid differs from a conventional procurement. There was, however, no realistic option of proceeding with a conventional public sector procurement for the Laganside Courts project. Nevertheless, the Service commissioned its advisers to produce a nominal public sector comparator. This provided key capital and annual operating costs and helped in the evaluation of the PFI bids.

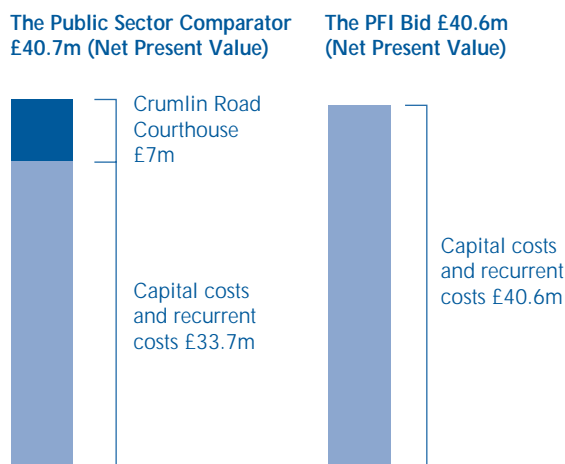
The cost of the preferred bid was marginally less than a conventional procurement

- 2.19 The public sector comparator had a cost, in net present value terms, of £40.732 million while the successful PFI bid was £40.566 million; a difference of some £165,000 (or 0.4 percent) over the 25 year contract period. The Service provided us with a summary of the key comparator costs. The Public Sector Comparator used data on cost overruns in other court facilities in order to estimate the likely risks. It also identified a major additional sum to account for the security risk associated with the particular location. In total, the public sector comparator included quantified risks of £4.2 million. However, the Service was unable to provide a breakdown of the values of risks transferred, shared or retained. Although it is not possible to determine whether the methodology was correctly applied there is no reason to doubt that the basis of the figures was reasonable.

The PSC included substantial costs for the Crumlin Road Courthouse

- 2.20 The PSC included an annualised cost of £600,000 for the Crumlin Road Courthouse. This was based on the assumption that, if Crumlin Road remained in the Service's ownership, there would be pressure for the full restoration of such a landmark building for Belfast. The inclusion of the carry costs for the Crumlin Road Courthouse increased the cost of the public sector comparator by some £7 million in net present cost terms (Figure 12).

12 Comparative costs of the PSC and the preferred PFI bid



Source: The Service

2.21 The (former) Construction Service Agency provided an estimate of the costs for Crumlin Road as follows:

- £420,000 to close down the building and to make it safe until the Service could secure further capital;
- £1.5 million for structural repairs to the envelope of the building to reduce water ingress and strengthen the stonework; and
- £4.65 million for the restoration of the building to its listed status

2.22 The Service considered that, had Crumlin Road been retained in public ownership, these costs were the minimum required to restore the courthouse to a safe condition and to retain its listed building status. In effect, the building had a net negative value. On this basis, the Service considers that the transfer of the building to Consul represented excellent value for money.

2.23 The Service believes that it would almost certainly have had to bear the costs but for the completion of the PFI deal. The assumption was that Crumlin Road Courthouse would not have any interest for the private sector, was likely to remain in the Service's ownership and therefore the costs in the PSC would have been a legitimate call on the Service's resources. There was no public sector interest in taking over the Courthouse and the PFI scheme effectively tested the open market interest for the building - in the event only Consul made a viable proposal.

Risk allocation was considered from an early stage in the process

2.24 The Service was conscious, from an early stage in the project that risk transfer needed to be carefully considered and its market-sounding exercise in 1996 took initial soundings. This helped identify what risks the private sector was likely to accept, together with those which were likely to be shared and/or retained. The private sector expressed reservations about accepting the transfer of any volume/usage, malicious damage or security risks. The Service used these findings in drawing up its Invitation to Negotiate, and in establishing the proposed allocation of risk and Heads of Agreement. This in turn helped to inform the selection process for the PFI contract.

The allocation of risks was similar to other PFI contracts of this nature

2.25 The Service assessed and evaluated the PFI bids against the following key areas of risk: construction risks; force majeure/uninsured events/terrorist incidents; changes in legislation; and compensation payments required by the bidder in the event of termination of the concession. The remainder of the risk profile and miscellaneous items were bundled into one category and examined as a whole. The Service considered that Consul offered the best approach to risk transfer. Among other things, the Service's advisers noted that:

- Consul adopted an approach to construction risks which was highly favourable to the Service by agreeing to accept the risk of adverse ground conditions (including archaeological finds), the obtaining of statutory consents and rights of way and the risk of pollution occurring during works;
- during the construction period Consul would accept the risk of all changes in the general law (but not 'discriminatory' legislation). During the operating period, Consul's proposal for the risk of changes in law was in line with solutions adopted on healthcare PFI/PPP projects elsewhere. It would accept the risk of changes in general legislation up to a threshold of 2% above the original works cost; thereafter, increased costs would be on a shared basis;
- in the event of termination of the concession due to force majeure or terrorist incident, Consul sought the return of its original investment, but not any profit which would have been earned on it.

2.26 The Service was satisfied that it achieved a high degree of risk transfer, while retaining a balanced contract which provided a workable basis for a long-term relationship with Consul. Appendix 3 details the agreed allocation of risk following the conclusion of negotiations.

There was no formal quantification of the risks transferred and retained

2.27 It is good practice for the public sector comparator to identify, quantify and assess the timing and likelihood of risks occurring. The public sector comparator should be prepared on a comparable basis to the PFI bid and should explicitly take account of and compare the differential costs of risks between the two.

2.28 However there is no evidence that the Service formally quantified the respective risks of the public sector comparator and the successful PFI bid. The Service should have derived monetary values for as many risks as possible and explicitly calculated the value of risks which were being transferred to the private sector and those which were being retained by the public sector under the PFI deal.

The contract has in place mechanisms to protect value for money in the future

2.29 The contract with Consul has in place a number of procedures which should protect the Service in the future and which will help to deliver value for money. These include:

- **Benchmarking** - every five years, Consul is obliged to undertake a benchmarking exercise for the services detailed in the contract. If, based on these results, Consul is no longer providing a reasonable standard of service, negotiations will take place to achieve better value. Where the benchmarking exercise indicates the cost of providing the services has changed (either an increase or decrease), the Unitary Service Charge would be amended accordingly. Consul will bear 75 per cent of any such change and the Service 25 per cent.

- **Market-testing** - where either party is unhappy with the results of the benchmarking exercise, they can require the soft services (for example, ground maintenance, cleaning, waste disposal, catering, security) to be market-tested. Any cost increase or decrease arising from this process will be applied in the same way as for the benchmarking exercise. Where negotiations are not successful for hard services (e.g maintenance of the building fabric), these can be addressed through a dispute resolution procedure.

- **Service variation** - the Service can request a change in the method of delivery or in the scope of the services provided by Consul. It will trigger the procedure by issuing a preliminary notice of the proposed variation. Consul will then provide a cost of the variation in advance and proposals for implementation. The Service will decide whether or not to proceed within 10 working days. If there is any dispute about the valuation of the service variation, the matter can be referred to the disputes procedure.

- **Step-in rights** - where Consul has failed to deliver to certain standards, the Service can exercise its right to step-in and perform (or procure from a third party) a particular service or services for a temporary period. Where Consul performs certain services at or below an agreed Default Level for six consecutive months, the Service can terminate Consul's right to provide that service.

- **Dispute resolution procedures** - there are a number of steps in the dispute resolution procedure. These are: negotiation in good faith between the Project Managers; meeting of the Joint Project Board (involving Consul's Chief Executive, the Service's Director and Deputy Directors and the Project Managers); and, if there is a failure to reach agreement, adjudication followed by arbitration.

2.30 As part of the deal, the Service sold three sites to the private sector property company involved with the successful consortium bid, two of them for more than their market valuation. The Service negotiated a clawback arrangement for one of these sites, the Crumlin Road Courthouse (which had a net negative value and was sold for a nominal sum). The clawback arrangement stipulated that should the site be sold at a profit within five years, without redevelopment, the Service will be entitled to 25 per cent of the net profit.

The Service will seek to share in the benefits of any future refinancing

2.31 In PFI deals, risks are greatest during the construction phase and reduce considerably thereafter as the project moves into its operational phase. For this reason, it is often possible, post-construction, for private sector consortia to negotiate more favourable financial terms with their lenders which take account of the reduced risk. The Service's concession agreement with Consul did not include any clauses covering the situation where Consul would refinance the deal. This is not surprising since, at the time of the Laganside Courts procurement, there had been no specific guidance on the issue of refinancing and why the public sector should be concerned to share in refinancing gains.

2.32 The Office for Government Commerce (OGC) has subsequently introduced new guidance on the issue of refinancing. OGC's revised guidance on standardisation of PFI contracts seeks to encourage the open and above-board refinancing of PFI deals. For new deals, all gains made through refinancing should be shared on a 50/50 basis. For older deals, such as Laganside Courts, where there is no specific refinancing clause, OGC expect contractors to sign up to a voluntary agreement to allocate 30 per cent of any refinancing gains to the public sector.

2.33 The concession agreement between Consul and the Service is based on a 13.7 per cent return on equity and subordinated debt and a fixed interest rate on senior debt of 7 percent a year. Given the reduction in risk associated with the project, there may be some scope for Consul to refinance the deal. However, the Service and its financial advisers believe that the deal was tightly negotiated and, as currently structured, the opportunities for a refinancing appear limited. An initial meeting has taken place between the parties and Consul may develop a proposal on refinancing for the Service's consideration.

Appendix 1

Key stages during the procurement process

Date	Key event
October 1996	Market-sounding exercise
August 1997	Notice in Official Journal of European Communities (OJEC)
October 1997	Outline Business Case
December 1997	Invitation to Negotiate
April 1998	Bids received by the Service
December 1998	Full Business Case
February 1999	Contract Signed
December 2001	Laganside Courts delivered to the Service
February 2002	Laganside Courts become operational

Appendix 2

National Audit Office methodology

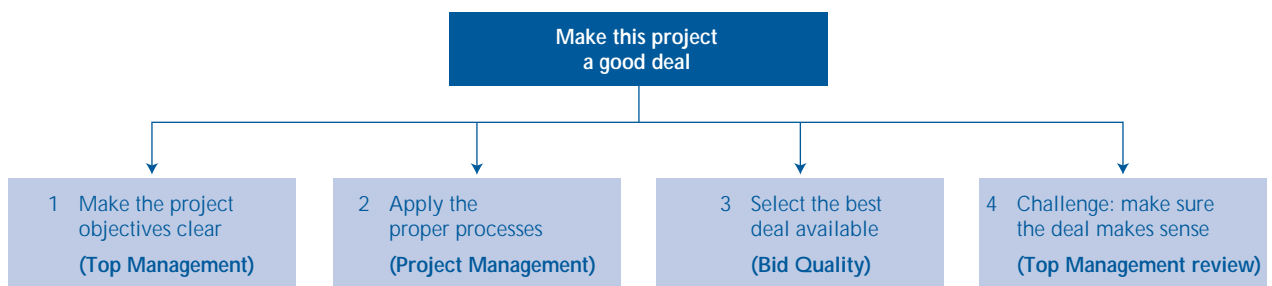
Analytical Framework

- 1 Our report *Examining the value for money of deals under the Private Finance Initiative* gives details of how we examine PFI projects. In the course of our examination of PFI deals, we have developed an analytical framework which seeks to cover comprehensively the key value for money issues to which these projects give rise.
- 2 Our analytical framework is presented below. This illustrates that the aim of procuring departments should be to get a good deal for the taxpayer. This overarching aim needs constantly to be kept in view during what can be a very long procurement process. The overarching aim of getting a good deal is supported by the four pillars of:
 - setting clear objectives;
 - applying proper procurement processes;
 - getting the best deal available; and
 - ensuring that the deal makes sense.

Study Design

- 3 In undertaking our examination of Laganside Courts, we employed a technique known as Issue Analysis to determine a detailed approach to the study. We established a series of high level audit questions that we considered it would be necessary to answer in order to assess, within our overall analytical framework, whether the Northern Ireland Court Service obtained a good PFI deal. For each of the top-level questions, we developed subsidiary sets of questions linked logically to the top level question and directed our evidence collection and analysis accordingly.
- 4 The top level issues that we addressed for this project were:
 - Did the Service establish a clear need for this project and assess whether PFI was the most appropriate method of procurement?
 - Did the Service manage the procurement effectively?
 - How did the Service ensure that the project represented value for money?
 - How is the deal operating in practice now that the building is complete?

The National Audit Office's analytical framework



Information Gathering

5 We gathered the relevant information for our study in a number of ways.

- **Document review.** We undertook an examination of key documentation relating to this PFI deal. This included the outline business case, the full business case, documentation prepared by advisers and the Project Board papers.
- **Review of the concession agreement.** The concession agreement between Consul and the Service represents the key PFI contractual document. We reviewed this contract to examine how risk had been shared between the respective parties and to consider the appropriateness of the payment mechanism.

- **Discussions with key players in the deal.** We interviewed key people from the following stakeholders involved in the deal:

The Northern Ireland Court Service

Consul Service Limited

North Consulting (the Service's financial advisers for the deal)

Appendix 3

Allocation of risks

Type of Risk	Risk Retained by the Service	Risk Transferred to CONSUL	Risk shared between the Service and CONSUL	Comments
Planning and Building Regulations			✓	At date of contract signature, the Service was only obliged to procure outline planning permission. Consul was responsible for obtaining and satisfying all other planning consents, together with any other licences or statutory approvals that were required.
Design		✓		Consul bear all aspects of design risk, other than changes in design due to a change of specification approved by the Service or a material change in government policy in relation to the administration of justice in Northern Ireland which increases the cost of the works.
Construction		✓		<p>Consul to bear all of the risks associated with the construction process. These include:</p> <ul style="list-style-type: none"> ■ Ground conditions ■ Time/cost overruns (except in the case of delay events and any changes approved by the Service) ■ Archaeological artefacts and antiquities ■ Site safety ■ Damage to neighbouring property ■ Injury to persons ■ Pollution ■ Labour dispute ■ Environmental Contamination ■ Defective work and materials
Financial			✓	The Service bears some financial risk since the Service Charge payable to Consul may rise following a benchmarking or market testing exercise. However, only 25% of any cost increase due to market testing is payable by the Service. The same cost share basis is assumed for cost reductions.
Demand /Volume	✓			The Unitary Service Charge does not vary in accordance with court usage patterns. When the courtrooms are available for use the Service is required to pay the full USC regardless of whether the courts have been used.

Type of Risk	Risk Retained by the Service	Risk Transferred to CONSUL	Risk shared between the Service and CONSUL	Comments
Availability			✓	The availability element of the Unitary Service Charge is payable to Consul provided that the facilities are available for occupation and use by the Service. Where the facilities are not available (for reasons other than Force Majeure, Terrorist Incident or default by the Service), the availability payment is abated in accordance with an agreed schedule. Persistent failure to make the facilities available, subject to the Funder's step-in rights, entitle the Service to terminate the concession. As a result, availability risk is predominately borne by Consul, however, because the availability element is subject to a maximum abatement of 55%, the Service retains a material element of the risk.
Service Provision			✓	The service payment is that element of the Unitary Service Charge for facilities management services which Consul is required to provide. The payment is subject to abatement where Consul fails to provide the service to the required standards. The Concession Agreement also gives the Service the right to terminate any or all of the services where performance falls short of a prescribed standard. As with the availability element, the permitted abatement is limited, in this case to 30% of the service payment.
Change of Law			✓	<p>Costs and delays arising from a discriminatory change of law are borne by the Service. This covers a change in law that discriminates against the operation of courtroom facilities, projects under PFI or similar schemes, or Consul or similar facilities management companies.</p> <p>For general changes in law, Consul will assume the costs in connection with such changes up to a maximum sum of £434,000 over the length of the Concession Period. The Service will be responsible for any residual costs thereafter.</p>