

Date - 10 November 2017  
Report of the - Lead Director, Dr Anthony Leonard  
Subject - Contract Matters: Financials

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**Recommendation:** It be **RESOLVED:** That the following key decisions be incorporated into the Specification and Conditions of Contract documents, as appropriate:

- 1) tenders are invited on the basis of Consumer Price Index linked indexation, with this item marked for possible negotiation, if required;
  - 2) tenders be invited using a detailed schedule of prices to support a Cost Sharing Agreement which enables accurate cost apportionment and stabilisation for each partner Council; and
  - 3) tenders are invited on the basis that Contractors fully fund their vehicles, with this item marked for possible negotiation, if required.
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**Report Author: Madeleine Gorman, Partnership Manager**

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### **Introduction**

1. The Partnership need to have a predetermined position and a full suite of complete documents at the point of placing the Official Journal of the European Union (OJEU) Notice for tender. There are a number of key contract decisions that need to be taken urgently for procurement. The financial matters dealt with in this report have a potentially significant impact on council budgets over the term of the Contract.
2. Officers have consulted with the Chief Finance Officers for Hastings Borough Council, Rother and Wealden District Councils to make the recommendations detailed in this report.

### **Approach to Indexation**

3. The contract price is increased each year to deal with the effect of inflation. The current contract uses a Consumer Price Index (CPI) based mechanism to deal with inflation but an alternate approach could be taken for the next Contract. The use of CPI has not been identified by the current contractor as having had a negative impact on the contract. The aim of the indexation mechanism is (a) to protect the Councils from the risk of over inflated contract pricing and (b) to protect the Contractor from the risk of under inflated resource costs.
4. Fuel and labour account for the highest proportions of total resource cost so Contractors are sensitive to the factors which affect these costs. Fuel inflation (prices) remains volatile with a high likelihood of significant variances in cost during the Contract Period. Labour (wages) related inflation is more stable

but costs are significantly affected by legislative changes to pension requirements, minimum wage requirements and employers contribution requirements (e.g. changes to National Insurance rates). UK legislation and employment policies are expected to change (as a result of “Brexit”) but the inflationary impact cannot yet be quantified. An indexation mechanism that does not effectively deal with increases and decreases to fuel and labour costs could result in a higher contract price due to contractors attempting to ensure their costs will be covered in the medium to long term. There are genuine risks to service performance in the event that inflation becomes a significant cost factor, as the Contractor can be expected to make reductions in the resources available to deliver the Contract.

5. Ricardo AEA and waste officers have also considered use of a ‘basket’ of suitable indices as an alternative to a single index (e.g. CPI) approach. The basket could include indices specific to fuel, labour and general costs (e.g. CPI).
6. The tables below details the advantages and disadvantages to each approach.

<b>CPI (or other single index)</b>	
<b>Advantages</b>	<b>Disadvantages</b>
Likely to incur less increase in cost year on year.	Likely to incur a higher initial contract price due to contractor attempts to ensure inflationary risks are covered.
	Likely to incur in year financial stress (and consequently poor service performance) if contractor does not allow enough to cover the inflationary risk.

<b>Basket / Range of Indices</b>	
<b>Advantages</b>	<b>Disadvantages</b>
Assuming the split of costs over labour, fuel and other is accurately identified, the selected indices will match the main areas of expenditure and more better assess the impact of inflation.	Likely to incur greater volatility of costs year on year.

7. The implications of the above have been considered by waste officers and Chief Finance Officers who appreciate that both of the approaches have potential advantages and disadvantages which could vary depending on the financial strategy of each Contractor. At this stage it is proposed to adopt CPI as the measure of inflation but with the caveat that the Councils are prepared to discuss an alternative approach to dealing with changes in cost.
8. Recommendation:
  - 1) Tenders are invited on the basis of CPI linked indexation, with this item marked for negotiation, if required.

## **Approach to Bidder Pricing**

9. In 2012, the Councils needed a mechanism to apportion the anticipated savings from a joint contract arrangement. In 2019, the councils will need a mechanism to apportion the extra costs that are anticipated.
10. The 2012 Cost Sharing Agreement (CSA) was developed from 2011/12 operational statistics. To refresh the agreement requires analysis of current resource levels deployed by Kier and consequently the productivity rates for rural and urban geographies. However, the Kier operation should not be considered an entirely accurate reflection of the resources needed to efficiently deliver the services required. For this reason, a new CSA would need to be based on resource information provided in the winning tender/bid for the new Contract and potentially use a cost stabilisation mechanism.
11. Recommendation:
  - 2) Tenders be invited using a detailed schedule of prices to support a CSA which enables accurate cost apportionment and stabilisation for each partner Council.

## **Capital Vehicle Funding**

12. The highest initial investment for a waste services Contract is the funding arrangement for the vehicles required to deliver the services. The scale of funding required means that the Contract Price would include the financing costs the Contractor must pay each year. The Councils might therefore reduce the annual Contract Price if they are able to provide capital funding for the vehicles that are required by the Contractor at a lower cost.
13. In 2012, bidders were offered this option for the Councils to provide capital funding for the vehicles. Ultimately, this option was not taken up by Kier because they had made commercial decisions on their asset lives, residual values and financing costs that obviated the advantages of using Council funding. It is proposed that the same funding facility is offered to the bidders to see if it is financially advantageous for the Councils.
14. Recommendation:
  - 3) Tenders are invited on the basis that Contractors fully fund their vehicles, with this item marked for possible negotiation, if required.

## **Conclusion**

15. Decisions on the approach to be taken with regard to these matters need to be made before placing the OJEU Notice so that initial bids/tenders can be accepted if affordable. However, the Competitive Procedure with Negotiation procedure allows for an element of negotiation with regard to the delivery of the solution. This means that if the recommendations of this report have a negative financial impact on the solutions proposed, we can open up these elements for negotiation during the tender process and seek to improve the contractual position.

Dr Anthony Leonard  
Lead Director

**Risk Assessment Statement**

Due to the mobilisation requirements, the OJEU Notice must be placed by the end of December 2017 with a comprehensive suite of complete documents. The recommendations within this report have significant financial impact and decisions need to be taken to allow approval for the final Specification and Conditions of Contract at this meeting.

Delay in taking decisions, will impact the final documentation and significantly increases the risk of service disruption in 2019.