

Financial Close Update on Risk and Optimism Bias

West Dunbartonshire Schools PPP

December 2007

Introduction

This note documents the adjustments made to the Risk and Optimism used in the Value for Money Analysis of the West Dunbartonshire Council Schools PPP immediately before the project reached financial close. It should be read in conjunction with the full Risk and Optimism Bias Report issued in March 2006 which is attached as Part 2 of this Appendix.

Optimism Bias

At ITN stage, Optimism Bias of 9.02% was added to the Capital costs of the project to reflect Optimism Bias on costs, and 1.24% to reflect the effect of Optimism Bias on the duration. The capital costs used in the CPAM in this Final Business Case have been adjusted to reflect increased certainty in some of the provisional costs which were included in the cost estimates at ITN stage. Accordingly, the amount Optimism Bias has been reduced to 5.28% on cost and 1% on duration. The Optimism Bias factors which have been reduced are:

- “Disputes and Claims”: previously 40% mitigated, now 80% mitigated (duration and cost);
- “Adequacy of Business Case”: previously 90% mitigated, now 100% mitigated;
- “Project Intelligence” previously 80% mitigated, now 90% mitigated;
- “Site Characteristics” previously 60% mitigated, now 80% mitigated.

More detail is provided below in Table 1.

Table 1

		Standard Buildings (1)			Capital Expenditure		
Traditional Procurement		Wks Duration			Capital Expenditure		
Contributory factors to Upper Bound Optimism Bias (%)		4	Mitigation Factor		24	Mitigation Factor	
Procurement Stage							
Complexity of Contract Structure	1	1	0.6	0.6	0	0.6	0
Late Contractor Involvement in Design	2	3	0.0	0	2	0.0	0
Poor Contractor Capabilities	3	4	0.0	0	9	0.0	0
Government Guidelines	4	0	0.0	0	0	0.0	0
Dispute and Claims Occurred	5	4	0.8	3.2	29	0.8	23.2
Information management	6	0	0.0	0	0	0.0	0
Other (specify)	7	0	0.0	0	0	0.0	0
Project Specific							
Design Complexity	8	3	0.8	2.4	1	0.8	0.8
Degree of Innovation	9	1	0.8	0.8	4	0.8	3.2
Environmental Impact	10	0	0.0	0	0	0.0	0
Other (specify)	11	0	0.0	0	0	0.0	0
Client Specific							
Inadequacy of the Business Case	12	31	1.0	31	34	1.0	34
Large Number of Stakeholders	13	6	0.9	5.4	0	0.0	0
Funding Availability	14	8	1.0	8	0	0.0	0
Project Management Team	15	0	0.0	0	1	0.5	0.5
Poor Project Intelligence	16	6	0.9	5.4	2	0.9	1.8
Other (specify)	17	0	0.0	0	1	0.7	0.7
Environment							
Public Relations	18	8	0.5	4	2	0.5	1
Site Characteristics	19	5	0.8	4	2	0.8	1.6
Permits / Consents / Approvals	20	9	0.9	8.1	0	0.0	0
Other (specify)	21	0	0.0	0	0	0.0	0
External Influences							
Political	22	0	0.0	0	0	0.0	0
Economic	23	0	0.0	0	11	0.8	8.8
Legislation / Regulations	24	9	0.8	7.2	3	0.8	2.4
Technology	25	0	0.0	0	0	0.0	0
Other (specify)	26	0	0.0	0	0	0.0	0
		98		80.1	101		78
Upper Limit Duration OB %				4.00			
Amount by which Duration OB should be reduced (% of UL)				80.10			
Resultant Duration OB %				0.80			
Lower Limit Duration OB %				1.00			
Amount of Duration OB to be applied to Financial Model				1.00			
Upper Limit Capex OB %				24.00			
Amount by which Capex OB should be reduced (% of UL)				78.00			
Resultant Capex OB %				5.28			
Lower Limit Capex OB %				2.00			
Amount of Capex OB to be applied to Financial Model				5.28			

Risk Adjustment

In addition to the OB factor, the Council also assessed the likely risk contingency that should be added to CPAM cost estimates. The figures assessed at ITN stage were made on the assumption that the balance of risk achieved would be in accordance with the Scottish Standard Schools Contract (a requirement of the Scottish Government Revenue Support), and that a typical 'market' position would be reached on the commercial balance of risk. This assumption remains valid and therefore it has been concluded that the risk adjustment values should remain as assessed at ITN stage:

- the total risk percentage on annual facilities management and LCM costs is 16.75%; and
- the total risk percentage on capital expenditure (capex) is 11.94%.

It should be borne in mind that, while the PPP procurement has been progressed to Financial Close, no similar development of a Conventional Procurement has occurred since submission of the Revised Outline Business Case. Therefore, were the PPP procurement option to be discontinued, the reality is that it would not be possible to progress a conventional procurement to commence in January 2008, leading to a significant delay in the date at which new schools would become available – and hence a loss of benefits – as well as cost escalation.