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The Private Finance Initiative (PFI)

The PFI is one of a range of government policies designed to increase private sector involvement in the provision of public services. This paper looks at the origins of the PFI, expenditure on PFI projects and discusses the arguments for and against the PFI by looking at some of the current topics of interest.

It updates Library Research Paper RP 01/117 and looks at the Government's latest thinking about the future of the PFI.

Grahame Allen

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Summary of main points

The Private Finance Initiative (PFI) was announced in the 1992 Autumn Statement with the aim of achieving closer partnerships between the public and private sectors. It was one of a range of policies introduced by the Conservative Government to increase the involvement of the private sector in the provision of public services. Following two reviews of the PFI by Sir Malcolm Bates, the present Government has continued to pursue the delivery of some public services through this means.

PFI entails transferring the risks associated with public service projects to the private sector in part or in full. Where a private sector contractor is judged best able to deal with risk, such as construction risk, then these responsibilities should be transferred to the private sector contractor. Where the private sector is deemed less able to manage the project's risks, such as whether demand will be high enough, then at least some of the responsibility must remain within the public sector.

The PFI has meant that more capital projects have been undertaken for a given level of public expenditure and public service capital projects have been brought on stream earlier. As at 4 April 2003 there had been almost 570 PFI deals signed with a total capital value of almost £36 billion. The increased level of activity must be paid for by higher public expenditure in the future, as the stream of payments to the private sector grows. PFI projects signed to date have committed the Government to a stream of revenue payments to private sector contractors between 2003/04 and 2028/29 of over £110 billion.

The Paper includes a consideration of whether the PFI offers value for money, using examples of specific PFI projects where possible. However, due to the long length of some PFI contracts it will be a number of years before a complete analysis is possible.

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I What is the Private Finance Initiative (PFI)?

The Private Finance Initiative (PFI) was announced by the then Chancellor, Norman Lamont, in the 1992 Autumn Statement with the aim of increasing the involvement of the private sector in the provision of public services. The PFI is a form of public private partnership (PPP) that marries a public procurement programme, where the public sector purchases capital items from the private sector, to an extension of contracting-out, where public services are contracted from the private sector. PFI differs from privatisation in that the public sector retains a substantial role in PFI projects, either as the main purchaser of services or as an essential enabler of the project. It differs from contracting out in that the private sector provides the capital asset as well as the services. The PFI differs from other PPPs in that the private sector contractor also arranges finance for the project.

Under the most common form of PFI, the private sector designs, builds, finances and operates (DBFO) facilities based on 'output' specifications decided by public sector managers and their departments.[1] Such projects need to achieve a genuine transfer of risk to the private sector contractor to secure value for money in the use of public resources before they will be agreed. The private sector already builds most public facilities but the PFI also enables the design, financing and operation of public services to be carried out by the private sector. Under the PFI, the public sector does not own an asset, such as a hospital or school but pays the PFI contractor a stream of committed revenue payments for the use of the facilities over the contract period. Once the contract has expired, ownership of the asset either remains with the private sector contractor, or is returned to the public sector, depending on the terms of the original contract.

A. The scope of PFI projects

Table 1 below shows that by 4 April 2003 there had been almost 570 PFI project contracts signed with an estimated value of almost £36 billion, 60% of which has been accounted for by the Department for Transport. The Department of Health has signed the most PFI deals, 126, with a total value of just under £3 billion. The largest of these in monetary terms is the University College London Hospitals NHS Trust PFI project. The £422 million project includes a development in Euston Road, London to house the University College Hospitals (UCHs), the Middlesex Hospital and the Hospital for Tropical Diseases on one site.

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[1] For reference, a step by step guide to the PFI process appears in Appendix 1 of this Paper.

Table 1: PFI signed deals by department, as at 4 April 2003

	Number	£ million
Transport[a]	36	20,526
Health	126	2,891
Defence	45	2,359
Scotland	80	2,092
Education and Skills	93	1,858
Home Office	44	1,767
Work and Pensions	7	930
Inland Revenue[b]	10	491
Wales	26	439
Northern Ireland	28	366
Environment, Food and Rural Affairs	11	349
GCHQ	1	330
ODPM	27	302
Lord Chancellor's Departments	11	256
Trade and Industry	9	194
Treasury	1	118
Foreign and Commonwealth Office	2	91
Customs & Excise	2	83
Northern Ireland Court Service	2	65
Culture, Media and Sport	3	44
National Savings	1	37
Cabinet Office	1	12
Office of Government Commerce	1	10
Public Record Office	1	-
Total[ab]	568	35,610

Notes: [a] estimate as excludes Channel Tunnel Rail Link (CTRL)
[b] Excludes NIRS 2

Source: Based on Office of Government Commerce data

PFI deals have ranged from small projects, such as the £100,000 Littlehampton Community School ITC facilities project in West Sussex, to the combined £15.5 billion contracts for modernising the London Underground. Table 2 below shows the largest PFI projects, in value terms, as at 4 April 2003.

It is worth noting that tables 1 and 2 of the previous edition of this Paper (RP 01/117) suggested that the £4.2 billion deal for the Channel Tunnel Rail Link (CTRL) was the largest PFI project to date. However, HM Treasury have decided that the capital investment undertaken by London and Continental Railways does not occur under the PFI. Therefore CTRL data has been omitted from tables 1 and 2 of this publication.[2]

[2] HM Treasury, *PFI: meeting the investment challenge*, July 2003

Table 2: PFI projects (signed deals) over £200 million, as at 4 April 2003

	Department	Year signed	£ million
London Underground modernisation[a]	Dept for Transport	2002/03	15,500
NATS PPP	Dept for Transport	2001	800
PRIME (buildings)	DWP	1997	665
Public Safety Radio and Communication Project	Home Office	2000	500
M6 Toll Road	Dept for Transport	1992	485
Rationalisation of sites	DoH	2000	422
Main Building	MOD	2000	415
Northern Line Trains	Dept for Transport	1995	409
Connect (Integrated radio system)	Dept for Transport	1999	357
Second Severn Crossing	Dept for Transport	1990	331
New build of GCHQ headquarters	GCHQ	2000	330
Armed Forces Personnel Administration Agency (AFPAA)	MoD	2000	264
A1 Darrington to Dishforth	Dept for Transport	2003	245
Project 2002 (Glasgow Schools Project)	Scotland	2000	225
Employment Service IT and telephony services	DWP	1998	217
M1/A1 Link Road	Dept for Transport	2000	214
Croydon Tramlink	Dept for Transport	1996	205
DLR Extension - Lewisham link	Dept for Transport	1996	202
Central London Accomodation Strategy (HOCLAS)	Home Office	2002	200

Note: [a] estimate

Source: Office of Government Commerce

A full list of all signed deals as at 4 April 2003 can be found at the Office of Government Commerce (OGC) web site.[3]

The Government has recently committed itself to improve the availability and scope of PFI statistical data in future such that it

> intends to treat the publication of statistics on PFI differently in future, beginning with the Autumn 2003 Pre-Budget Report (PBR). The aim is to present more comprehensive statistics that are transparent with regard to the kind of transaction – PFI contract or PPP joint venture – to which they refer. This will include publishing biannually, in the Budget and PBR, more data on:
>
> - signed projects;
> - future PFI transactions;
> - the level of expected payments to the private sector under unitary charges; and
> - other information which could be of use to all participants in PFI.

In consequence, the database of PFI projects maintained by the OGC will transfer to the Treasury website in autumn 2003.

[3] OGC web site as at 20 October 2003: http://pfi.ogc.gov.uk/statsView.asp?id=708

II The Origins of the Private Finance Initiative

Prior to 1989, governments were not keen to allow private capital in the financing of public sector projects. Their position was set out in the so-called 'Ryrie-Rules'. The Rules presupposed that some projects, such as road building, should be undertaken by the public sector and that, where private sector finance was involved, public expenditure cover would usually be required.

A. The Ryrie Rules

The Ryrie Rules were formulated by a National Economic Development Council (NEDC) working party in 1981 under the chairmanship of Sir William Ryrie, then Second Permanent Secretary to the Treasury. The Rules sought to establish criteria under which private finance could be introduced into the nationalised industries. The Ryrie Rules said that:

> (i) decisions to provide funds for investment should be taken under conditions of fair competition with private sector borrowers; any links with the rest of the public sector, Government guarantees or commitments, or monopoly power should not result in the schemes offering investors a degree of security significantly greater than that available on private sector projects;
>
> (ii) such projects should yield benefits in terms of improved efficiency and profit from the additional investment commensurate with the cost of raising risk capital from financial markets.[4]

The Rules were revised in February 1988 to take account of the privatisation of the previously nationalised industries and the introduction of schemes such as contracting out, opting out, mixed funding and partnership schemes. The two fundamental principles of the guidelines were:

- private finance could only be introduced where it offered cost effectiveness; and
- privately financed projects for public sector programmes had to be taken into account by the Government in its public expenditure planning (ie such projects had to have public expenditure cover).

In a speech to the Institute of Directors in May 1989, John Major, then Chief Secretary to the Treasury, formally retired the Ryrie Rules on the grounds that they had outlived their usefulness.[5] The retirement was intended to further encourage "the private sector to bring forward schemes for privately financed roads, which offer value for money for the user and the taxpayer". In the same speech Mr Major gave an "explicit assurance" that he "would not

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[4] HC Dep 3639

[5] HM Treasury, *Private Finance for Roads*, news release 41/89, 5 May 1989

seek reductions in the [public] road programme on a scheme by scheme basis to offset privately financed projects".

B. The Private Finance Initiative (PFI)

The Ryrie Rules were superseded by the Private Finance Initiative (PFI) announced by Norman Lamont in his 1992 Autumn Statement:

> I said in my Mansion House speech that I was examining ways to increase the scope for private financing of capital projects. Obviously, the interests of the taxpayer have to be protected, but I also want to ensure that sensible investment decisions are taken whenever the opportunity arises. I am now able to announce three significant developments.
>
> In the past, the Government have been prepared to give the go-ahead to private projects only after comparing them with a similar project in the public sector. This has applied, whether or not there was any prospect of the project ever being carried out in the public sector. I have decided to scrap this rule. In future, any privately financed project which can be operated profitably will be allowed to proceed. […] Secondly, the Government have too often in the past treated proposed projects as either wholly private or wholly public. In future, the Government will actively encourage joint ventures with the private sector, where these involve a sensible transfer of risk to the private sector. […]
>
> Thirdly, we will allow greater use of leasing where it offers good value for money. As long as it can be shown that the risk stays with the private sector, public organisations will be able to enter into operating lease agreements, with only the lease payments counting as expenditure and without their capital budgets being cut.[6]

The aim of introducing the PFI was to achieve closer partnerships between the public and private sectors at both central government and local authority levels. The guiding principles of the PFI are similar to those underlying the Ryrie Rules: ventures established under the PFI need to achieve a genuine transfer of risk to the private sector and secure value for money in the use of public resources. The new policy had a limited impact in the early months and, when he became Chancellor, Kenneth Clarke decided it needed further impetus. In autumn 1993 he announced the creation of a Private Finance Panel (PFP) whose role was:

- to encourage the greater participation in the initiative by both public and private sectors;
- to stimulate new ideas;
- to identify new areas of public sector activity where the private sector could get involved; and

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6 HC Deb 12 November 1992 vol 213 c998

- to seek solutions to any problems that might impede progress.

In a speech to the CBI Conference on 8 November 1994 Mr Clarke reiterated the two guiding principles of the PFI:

- the private sector must genuinely assume risk without the guarantee by the taxpayer against loss; and
- value for money must be demonstrated for any expenditure by the public sector.[7]

The Chancellor told the CBI conference that "private sector finance would be the main source of growth" in public investment projects and that the Treasury would not approve capital projects unless private finance options had been explored. Mr Clarke also stressed that for projects conducted under the PFI no target rates of return or profit caps existed or would be introduced. He made it clear that he wanted to maximise the scope for and use of private finance, reserving public capital provision for those areas where private finance was considered inappropriate or could not be expected to provide value for money.

In the 1995 Budget, the Chancellor announced another re-launch of the PFI and a £9.4 billion list of "priority" projects.[8] Michael Jack, then Financial Secretary, sought to allay widespread scepticism as to the ability of the government to proceed with PFI contracts and the readiness of the private sector to participate. He published a new PFI handbook; *Private Opportunity Public Benefit, progressing the Private Finance Initiative*[9] drawing together lessons that had been learnt from key PFI projects. He also pledged to eliminate unnecessary bureaucracy and promote a more favourable climate for the initiative across Whitehall.

C. Changes introduced by the Labour Government

On 8 May 1997 Geoffrey Robinson, then Paymaster General, announced that Sir Malcolm Bates would conduct a speedy review of the PFI process. Mr Robinson also announced an end to universal testing - the rule that capital projects had to be tested for private finance potential.[10] This first 'Bates review' reported on 26 June 1997, making twenty seven recommendations to streamline and improve delivery of PFI projects.[11] One consequence was the creation of a PFI Taskforce inside the Treasury, drawn from the City, to help foster PFI expertise within government.

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[7] HM Treasury, *Private Finance: Overview of progress*, news release 118/94, 8 November 1994

[8] HM Treasury, *Financial Statement and Budget Report*, HC 30 1995/96, November 1995

[9] HM Treasury/PFP, *Private Opportunity Public Benefit, progressing the Private Finance Initiative*, November 1995

[10] HM Treasury, *Paymaster General announces kick-start to PFI (Public/Private partnerships) - Review of Private Finance Machinery - End of Universal Testing*, news release 41/97, 8 May 1997

[11] HM Treasury, *Robinson re-invigorates the PFI*, news release 69/97, 23 June 1997

1. Treasury Taskforce

The Treasury Taskforce was set up in September 1997 as the focal point for PFI activity across government. The Taskforce focused on a number of significant projects, helping departments to set priorities while trying to ease negotiations and gain value for money. The Taskforce published a series of guidance documents, policy statements, technical notes and case studies. These are still current and are available on the web site of the Office of Government Commerce (OGC).[12] *Partnerships for Prosperity* was published on 4 November 1997 to report on progress in meeting the recommendations contained in the Bates review. The document set out the role of the Treasury Taskforce, fundamental PFI policy principles, the procurement process and a list of further reference areas.[13]

2. Partnerships UK

A second review of the PFI by Sir Malcolm Bates was published in July 1999.[14] Among other things, Sir Malcolm recommended that a permanent organisation, Partnerships UK, be formed to replace the Taskforce, whose two-year life was drawing to a close:

> The ground breaking Partnerships UK will itself be formed as a partnership, with the private sector taking a majority stake in a joint venture with central government and with a Board Chairman drawn from the private sector. Public sector bodies thinking of entering into PFI deals will be able to use Partnerships UK on a voluntary basis. It will have no monopoly and will seek to win business on the strength of its expertise.[15]

Partnerships UK,[16] launched in June 2000, replaced the projects arm of the Treasury Taskforce, provision for which was made by the *Government Resources and Accounts Act 2000*. Partnerships UK work with both public and private bodies on specific PPP transactions to improve the process of planning, negotiating and completing PPPs. Its board comprises members from both the private and public sectors. The public's interest is represented through an advisory council, consisting of the main public sector stakeholders in Partnerships UK, such as Peter Gershon, Chief Executive of the OGC.[17] In March 2001, Partnerships UK became a public private partnership (PPP) in its own right following the sale to private investors of a 51% stake, the remaining 49%[18] being retained by the public

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[12] Office of Government Commerce web site as at 20 October 2003: www.ogc.gov.uk/sdtoolkit/reference/ogc_library/PFI/

[13] HM Treasury, *Partnerships for prosperity - a new framework for the PFI*, news release 132/97, 4 November 1997

[14] HC Dep 99/1433

[15] HM Treasury, *Treasury Taskforce, Treasury, Shake-up for PFI and Government procurement plans will save up to £1 billion*, news release 124/99, 22 July 1999

[16] More information on the role and structure of Partnerships UK can be found on their web site: www.partnershipsuk.org.uk.

[17] A full list of members of the board, the advisory council, the private sector investors and the values of Partnerships UK as at May 2003, appears in Appendix 2 of this Paper.

[18] 44.6% HM Treasury, 4.4% the Scottish Ministers.

sector. Alan Milburn, then Chief Secretary to the Treasury, said this "would provide the public sector with the key commercial skills to forge increased and better partnerships with the private sector on equal terms."[19]

3. The Office of Government Commerce (OGC)

The creation of the Office of Government Commerce (OGC)[20] was announced following a review of procurement in central government by Peter Gershon in July 1999.[21] The OGC was established in April 2000, replacing the policy arm of the Treasury Taskforce. Its stated aim is to modernise procurement throughout government. OGC also represents the UK on procurement matters in Europe, at the World Trade Organisation (WTO) and in other international fora.

The OGC reports to the Chief Secretary of the Treasury. It has a supervisory board chaired by the Chief Secretary, and made up of Permanent Secretaries, including the Chief Executive of OGC, the Head of the National Audit Office (NAO), and senior external representatives. The OGC Chief Executive has an advisory group (CEAG) comprised of representatives from a wide range of Government departments, executive agencies and non-departmental public bodies (NDPBs) whom, in the course of their duties, undertake a full range of civil government commercial activities.[22]

4. HM Treasury Private Finance Unit

Until April 2003 the Private Finance Unit (PFU) within OGC had responsibility for developing and promoting PFI policy for public bodies. In a letter to departmental Heads of Private Finance Units and other relevant parties in March 2003, Justin Slater, Head of Private Finance Policy and Practice at OGC, announced that "An expanded HMT PFU under the leadership of Geoffrey Spence will now carry out all those responsibilities presently carried out by the OGC PFU."[23] The responsibilities transferred included:

- Ministerial and Parliamentary business on generic PFI policy matters;
- Ownership of *Standardisation of PFI Contracts* - written guidance for authorities on how to agree PFI contracts;
- Ownership of the *PFI Network* - the public sector's on-line access to comprehensive information about PFI;
- PFI statistics disclosed to Parliament;

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[19] Partnerships UK, *Successful Capital Raising for Partnerships UK*, news release, 3 April 2001
[20] More information about the OGC can be found on their web site: www.ogc.gov.uk
[21] HM Treasury, *Chief Executive–Office of Government Commerce*, news release 15/00, 11 February 2000
[22] A full list of members of the supervisory board and the CEAG of the OGC, as at 1 August 2003, appears in Appendix 3 of this Paper.
[23] Available on the OGC web site as at 20 October 2003: http://pfi.ogc.gov.uk/Download.asp?id=852&field=5&filename=2003%2D03%2D21+transfer+letter%2Edoc

- Ownership of the Project Review Group (PRG) Secretariat - the process by which projects are reviewed. A project goes to PRG when there is a full Business Case and is reviewed. The PRG Chairperson is selected by the Head of HMT PFU;
- Single point responsibility for managing the Government's Framework Agreement with Partnerships UK; and
- Communication with Departments through the Inter Departmental Group (IDG) - a forum for the officials of different departments to meet and discuss business.

In line with the policy changes, press responsibilities have also been transferred from the OGC communications team to the Treasury's press office. As a result of the move, Gus O'Donnell replaces Peter Gershon as the officer in charge of PFI policy.

III Public finance and the PFI

A. Has the PFI increased Public Expenditure?

Before the late 1980s, increased PFI spending occurred alongside planned falls in public sector capital spending, leading to suggestions that public sector investment was being crowded out by PFI spending.[24] By retiring the Ryrie Rules in 1989 it seemed that the Treasury was introducing an 'additionality' principle into public sector projects (funding from the private sector should be additional to public sector funding and not instead of it). The new policy was clarified further in the 1990 Green Paper *New Roads by New Means*:

> There has been much misunderstanding about additionality. Many have claimed that privately funded schemes must be additional to those funded by the Exchequer if private finance is to attract the construction industry […].
>
> The private financing of a scheme already in the road programme, and for which public expenditure resources have been allocated, will not free that public expenditure for other projects. For these reasons the Government, in roads as in other fields (such as housing), has to take account of the provision being made by the private sector in considering the size of its public sector programme. But it is not practical - the timescales are wrong - in the great majority of cases to decide whether individual schemes are additional or not. The Government therefore gives the assurance that it will not subtract privately financed roads from public sector provision on a scheme-by-scheme basis. The Government believes that in practice private sector schemes will provide the opportunity for more roads than would otherwise have been built.[25]

The 1990 Transport Select Committee Report; *Roads for the Future* commented on the additionality principle and the retirement of the Ryrie Rules:

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[24] According to the 1995 Red Book, the government's net capital spending programme over the planning period 1995/96 to 1998/99 public sector capital expenditure was set to fall by £2.5 billion.

[25] Department of Transport, *New Roads by New Means,* Cm 698, 1990

> Additionality is a term that refers to the issue of whether attracting private sector finance will lead to an addition to the roads programme, or displace public sector expenditure, with little or no net addition.
>
> Our witnesses all welcomed the recent retirement by the Government of the Ryrie Rules. These were interpreted in such a way as to limit the conditions under which privately financed schemes would be allowed by the Treasury. In the Green Paper the Government "gives the assurance that it will not subtract privately financed roads from public sector provision on a scheme-by-scheme basis. The Government believes that in practice private sector schemes will provide the opportunity for more roads than would otherwise have been built." We welcome this clarification.
>
> But the same paragraph creates ambiguity in the Government's position: "But the annual level of expenditure on the roads programme is determined by the Government in the light of the economy generally and the needs of that programme; a different method of financing it does not make more resources available ... The Government ... has to take account of the provision being made by the private sector in considering the size of its public sector programme." **Will private sector funding be allowed to lead to a net increase in the long run, or is the spirit of the Ryrie Rules still in evidence?**[26]

The Transport Committee's report highlighted an ambiguity in the Government's position, as set out in the above extract from the Green Paper, suggesting that the additionality principle would be applied only to individual schemes. For example, a contribution from the private sector to an individual transport project would not displace public sector funding for that particular transport project but might be subtracted from total public expenditure on transport.

B. Is PFI capital expenditure additional or substitutional?

According to the 2003 *Financial Statement and Budget Report* (FSBR), public sector capital expenditure is projected to rise from £26.0bn in 2002/03 to £41.3bn in 2005/06. As a proportion of GDP, public sector capital expenditure will rise from 2.3% of GDP to 3.2% over this period. It is expected that the rise in public sector capital expenditure will be supplemented by capital expenditure under the PFI, raising total publicly sponsored capital expenditure from £29.7bn in 2002/03 to £45.0bn in 2005/06. The figures are set out in table 3 below:

[26] Transport Select Committee, *Roads for the Future*, 1 February 1990, HC 198-I 1989/90, para 154-156.

Table 3: Public sector capital expenditure
£ billion

	Outturn	Estimates and projections			
	2001/02	2002/03	2003/04	2004/05	2005/06
Total public sector capital expenditure[a]	**23.0**	**26.0**	**33.4**	**38.2**	**41.3**
(As % of GDP)	2.2%	2.3%	2.8%	3.1%	3.2%
Estimated capital expenditure under PFI	**3.5**	**3.7**	**4.8**	**4.1**	**3.7**
(As % of total public capital expenditure)	13.2%	12.5%	12.6%	9.7%	8.2%
Total publicly sponsored capital expenditure	**26.5**	**29.7**	**38.2**	**42.3**	**45.0**
(As % of GDP)	2.5%	2.7%	3.3%	3.4%	3.5%
Memo					
Public sector gross investment	23.0	26.0	33.4	38.2	41.3
less depreciation	-13.4	-13.8	-14.4	-15.2	-15.9
Public sector net investment	9.6	12.2	18.9	23.0	25.4
(As % of GDP)	0.9%	1.1%	1.6%	1.9%	2.0%
GDP	1,056	1,108	1,173	1,239	1,301

Note: [a] Net of fixed asset sales. Source: Derived from HM Treasury

These figures suggest that PFI capital spending may be additional to public sector capital expenditure as both public sector capital expenditure and total publicly sponsored capital expenditure are set to rise over the period. In reality it is difficult to demonstrate that something is additional to what would have happened anyway. As a first round effect, some PFI capital expenditure is clearly substitutional as some public capital spending is replaced. This was explained in evidence to the Treasury Committee during a 1996 enquiry into the PFI when an official outlined the difficulties but stated that in the current spending round:

> there has been a deletion against previous capital plans of certain sums which the Government have planned to spend because the PFI can be seen to provide an alternative way of procuring those services.[27]

Investment through the PFI may be additional when second round effects are taken into account. For example, public funds that are released from a department's capital programme, by an injection of PFI investment, could be used elsewhere to create additional activity. This could be additional spending compared with what would have been the case in the absence of the PFI. A second way in which PFI could provide additional spending is through efficiency savings that again would release public funds for other purposes.

[27] Treasury Committee, *The Private Finance Initiative*, 1 April 1996, HC 146 1995/96

C. How are PFI projects accounted for?

If a DBFO project is financed under the PFI, the capital expenditure does not normally score as public expenditure, although the charges levied by the private sector operator for the use of the building and services that are provided do. This is because under the PFI the private sector contractor arranges the finance. This idea is better known as 'off-balance sheet' financing as the liability for the debt is not recognised on the public sector balance sheet.[28] As Philip Stephens commented in the *Financial Times*:

> The most obvious effect [of the PFI] on the public finances is to reduce spending now and replace it with a stream of future liabilities. A private contractor picks up the bill for the construction of, say, a new prison, while the taxpayer guarantees it an income spread out over the lifetime of the asset. Today's capital investment thus becomes tomorrow's current spending.

And later;

> We know that, like all off-balance sheet spending, the PFI flatters the official accounts. Future liabilities do not show up in the accounts.[29]

In an article critical of the PFI, the *Economist* magazine expressed concern about the scope for a government to use the PFI to disguise the underlying position of public finances. They commented that although it was plausible that a private operator could minimise future management costs, such advantages should be:

> set against the potential which the PFI offers governments for creative accounting designed to disguise their spending commitments. In particular, the timing of spending can be obscured. If a project, such as a road, is publicly financed, the construction costs are counted as public spending as they occur; if it is privately financed, they are added to public spending years later, when the road is complete and the government starts to pay the contractor for it, […] The temptation is obvious. Economic commentators watch public spending and borrowing closely, not only to judge the government's own finances but as indicators of how well it is managing the economy as a whole. The PFI can lower both these numbers, at least for a time.
>
> To 'prove' that the government is not using the PFI as an accounting scam, the Treasury constantly stresses that PFI projects involve genuine transfers of risk to private investors. Likewise, the private finance Panel publishes apparently detailed analyses of the efficiency gains achieved by recent projects. [...] Yet these attempts at explanation raise more questions than answers. For instance, private contractors appear to be willing to bear risks over which they have no control - in the case of the national-insurance computer, the supplier will bear much of the risk of demand

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[28] UNISON, *Public Services Private Finance*, March 2001

[29] "Buy now, pay later", *Financial Times*, 19 April 1996

> volumes being lower than expected because of, say, the impact of new social-security legislation. This seems hard to swallow. Moreover, it is impossible to assess the financial impact of any risk transfer because contracts between the government and its suppliers are usually kept secret to protect commercial confidentiality. [30]

In a 1996 report, the Treasury Committee made clear its concern about the absence of systematic recording of PFI commitments in the public accounts. Sir Christopher Bland of the Private Finance Panel (PFP) giving evidence to the Committee noted:

> […] the Treasury do not centrally total those forward commitments for every government department, and it is the case that not all government departments themselves total those forward commitments [...] and if you ask some departments "What are the revenue implications of the PFI contracts they have signed in the year say, 2005?", they would not readily be able to give you an answer, and if you asked the Treasury "What is the sum total of the PFI commitments in the year 2005?", they would not readily be able to give you a total, but the information is there and it needs to be codified, organised and assembled fairly speedily in our view. [31]

In response to a recommendation from the Treasury Committee the Treasury now publishes forecasts of the committed expenditure for public services flowing from private sector investments signed under the PFI. Table 4, from the 2003 *FSBR*, sets out estimated future payments to the private sector for signed PFI deals:

Table 4: Estimated payments under PFI contracts, signed deals as at April 2003

£ million

2003-04	5,400	2012-13	5,100	2021-22	3,200
2004-05	5,700	2013-14	5,000	2022-23	3,100
2005-06	5,800	2014-15	4,900	2023-24	3,100
2006-07	6,000	2015-16	4,800	2024-25	3,100
2007-08	6,000	2016-17	4,800	2025-26	3,000
2008-09	5,800	2017-18	4,100	2026-27	1,600
2009-10	5,800	2018-19	3,600	2027-28	1,300
2010-11	5,600	2019-20	3,400	2028-29	1,200
2011-12	5,300	2020-21	3,600		

Note: The figures between 2003-04 and 2016-17 include estimated payments for the Tubelines LUL PPP contracts. These contracts contain periodic reviews every 7.5 years and therefore the service payments are not fixed after 2009-10.

Source: HM Treasury, *Budget 2003* , HC 500 Session 2002/03, 9 April 2003, Table C20

[30] "Cooking the books", *Economist*, 28 October 1995

[31] Treasury Committee, *The Private Finance Initiative*, 1 April 1996, HC 146 1995/96,xi, para 29.

The figures represent departments' best available estimates. Actual expenditure in future years arising from deals will depend upon payment mechanism details for each contract. However, these figures do not tell the whole story: as more PFI deals are signed the size of payments to the private sector will increase further. The Treasury also publishes capital spending by the private sector by sponsoring department. The relevant estimates for 2003/04 to 2005/06 appear in Appendix 4.

In September 1998, the Accounting Standards Board (ASB) stated the capital value of PFI schemes should appear on the Government's 'balance sheet'. However, following negotiations between the ASB and the Treasury, the Treasury issued a new version of their note *How to account for PFI transactions*[32] that allowed most PFI transactions to be excluded from Government borrowing figures on the grounds that they were "operating leases", not "finance leases". The guidance states that the "property" and "service related risks" (staffing costs) of PFI deals should be separated out. If done properly, it should be clear that property related risk has been transferred to the private sector, and hence should not be on the Government balance sheet. The ASB has said that the revised accounting guidance is to be kept under review and updated as necessary in the light of developments in the PFI to ensure that it remains both "useful in practice and is consistent with the ASB's application note".[33]

D. Fiscal dilemma

The PFI helps government overcome a perceived fiscal dilemma: it enables the government to increase public investment through higher capital spending while maintaining a tight fiscal stance. The 2001 *FSBR* highlighted the two fiscal rules, against which the performance of fiscal policy is currently judged:

> ***the golden rule***: over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
>
> ***the sustainable investment rule***: public sector net debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level. Other things equal, net debt will be maintained below 40 per cent of GDP over the economic cycle.[34]

Under the golden rule, today's taxpayer pays for public services provided today. By contrast, if current spending is financed through borrowing tomorrow's taxpayers finance it through the cost of additional capital and interest payments. Therefore, the golden rule requires the current budget to be in balance or surplus over the economic cycle, allowing

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[32] HC Dep 99/1259

[33] HM Treasury, *More Private Finance Initiative (PFI) deals expected as clarity of accounting standards is resolved*, news release 103/99, 24 June 1999

[34] HM Treasury, *Financial Statement and Budget Report 2001,* HC 279, 2000/01

the Government to borrow only for capital spending, that is "borrowing is permitted to finance public investment". It ensures "fairness between generations…" in that:

> the Government does not pass on the costs of services consumed today to the taxpayers of the future – each generation is expected to meet the current cost of the public services from which they benefit.[35]

The sustainable investment rule limits government borrowing to a stable and prudent level, other things being equal, lower than 40% of GDP.[36] However, a briefing note from the Institute for Fiscal Studies; *The Government's fiscal rules*, points out:

> There is nothing sacrosanct about these two rules, nor are they necessarily optimal. While it is true that meeting them would mean that the public finances were kept in good shape, a failure to do so would not automatically render the public finances unsustainable, and meeting them does not even necessarily imply generational fairness.
>
> The government has provided no justification for a net debt target of 40 per cent of GDP – it could just as easily have chosen 38 per cent or 42 per cent. The Maastricht Treaty, for instance, allows UK gross general government debt of no more than 60 per cent of GDP, which is consistent with net public debt being considerably higher than 40 per cent of GDP. [37]

The economic rationale for the fiscal rules is that they promote economic stability by ensuring sound public finances while at the same time allowing flexibility. The fiscal rules are set over the economic cycle, allowing fiscal balances to vary between years in keeping with the cyclical position of the economy. This allows automatic stabilisers in the economy, such as income tax receipts and unemployment payments, to operate freely, dampening the effects of fluctuations away from trend by boosting or dampening aggregate demand. The interaction of the two rules promotes capital investment while ensuring the sustainability of the public finances in the longer term.

The golden rule is not broken by funding projects through the PFI, as the capital cost of the project is allocated to the private sector, and so is not discussed in detail here.[38] However, it is worth noting that supporting a project using conventional methods of public funding does not break the golden rule either, as the borrowing for such a project could count as capital investment and not as funding for current spending.

As for the sustainable investment rule, the recent state of the public finances could remove any incentive for government to seek private sector finance through the PFI.

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[35] HM Treasury, *Financial Statement and Budget Report 1999,* HC 298, 1998/99

[36] HM Treasury, *Financial Statement and Budget Report 2001,* HC 279, 2000/01

[37] Institute for Fiscal Studies, *The Government's fiscal rules*, Briefing Note No. 16, April 2001

[38] For a discussion of the PFI and the golden rule see: IPPR, *The Private Finance Initiative: Saviour, Villain or Irrelevance?* Working Paper, April 2000.

Since the beginning of the last economic cycle[39] Public Sector Net Borrowing (PSNB), the finance needed to meet current and capital spending over and above that raised in taxes, has been negative (in surplus) in four of the six financial years to the tune of almost £33 billion.[40] Over the same period, public sector net debt as a percentage of gross domestic product (GDP) has fallen by eleven percentage points, from 42% in 1997/98 to 31% in 2002/03.[41]

GDP in 2002/03 is an estimated £1,056 billion.[42] 9%, the unused margin up to 40% of GDP suggested by the sustainable investment rule, in 2002/03 amounts to £98 billion and capital expenditure under PFI between 1997/1998 and 2002/03 can be estimated to have been just over £35 billion. This suggests that all the PFI projects signed since the beginning of the last economic cycle could have been funded by public expenditure in 2002/03, without raising public sector net debt as a percentage of GDP above 40%, thereby not breaking the sustainable investment rule.

The calculations do not include interest payments on the national debt that would be incurred had it not fallen over the period or the reduction in interest and capital payments by the public sector. However, even using a generous estimate of these deductions, it is apparent the all the PFI projects that have been signed could have been funded by public sector finance without breaking either the golden rule or the sustainable investment rule.

IV Does the PFI offer value for money?

Proponents of the PFI argue that it is an improved form of public procurement that, under the right circumstances, yields efficiency savings and greater value for money for public services than projects that have been wholly dependent upon the public sector for finance and management. Under such qualifications, the PFI provides better value for money by achieving lower construction costs, transferring risk, lower operating costs and perhaps more efficient maintenance in the long term, than comparable public sector projects.

A. Competition and the costs of construction

The value of involving the private sector in providing services for the public has been widely accepted by governments. Commercial organisations have been involved in building, maintaining and sometimes operating assets for the public sector for some time. Recent governments in the UK and the EU have seen competition for public services as

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[39] 1997/98 to 1998/99, Source: HM Treasury, *Financial Statement and Budget Report 2003,* HC 500, 2002/03 p243

[40] National Statistics, *Public sector finances September 2003*, First Release, 20 October 2003

[41] ibid

[42] HM Treasury, *Financial Statement and Budget Report 2003,* HC 500, 2002/03

central to public procurement either to help guard against corruption, or the appearance of it, and as a means of securing value for money.

Under EU legislation,[43] PFI contracts above a certain monetary threshold are subject to competitive tendering. For the Bridgend and Fazakerley PFI prison projects the Prison Service received sixty expressions of interest in response to their required notice of the tender in the Official Journal of the European Communities (OJEC). Of these, five were invited to submit bids, including four bidders who had overseas partners, importing knowledge of prison PFI projects from abroad.[44] For the Bridgend contract, the eventual wining bid of the Securicor/Costain consortium of £266 million was over £50 million less than that of a similar public financed scheme as shown by the public sector comparator (PSC).[45]

The cost to the taxpayer of a bid is not the only consideration made by the public sector when awarding contracts. In the case of Fazakerley Prison, the contract did not go to the lowest bidder, again Securicor/Costain, but instead went to the Group4/Tarmac consortium. This was due to Prison Service concerns about the capability of one contractor to simultaneously undertake two prison projects using a prototype design. Although not the lowest bidder, the Group4/Tarmac consortium had come first in quality evaluations and second to Securicor/Costain in innovation assessment for both prisons.

The consortiums made further savings during the design and build phase of these PFI projects. In respect of the Fazakerley Prison, estimated savings of just over £3.4 million were achieved by reducing construction and commissioning costs. The prison opened five months ahead of schedule allowing the Police and Prison Services to divert resources away from housing prisoners in police cells.

B. Cost overruns

The Treasury Taskforce Technical Note No 5, *How to construct a Public Sector Comparator* highlights "…some dramatic cases of public procurement going wrong in terms of both time and cost overruns".[46] Figures for the initial and final cost estimates of the highlighted projects are shown in the top half of table 6:

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43 Directive 92/50/EEC, Directive 93/36/EEC and Directive 93/37/EEC. Implemented in the UK by: the *Public Supply Contracts Regulations 1995, Public Services Contracts Regulations 1993* and *Public Works Regulations 1991*.

44 NAO, *The PFI Contracts for Bridgend and Fazakerley Prisons*, HC 253 Session 1997/98, 31 October 1997

45 HC Library, *What is a Public Sector Comparator?* SNEP1017, 13 December 2001

46 Treasury Taskforce, *How to construct a Public Sector Comparator*, Technical Note No 5, undated

Table 6: Comparison of increases in public procurement and PFI project costs

£ million

	Initial cost	Final cost	Percentage increase
Public procurement			
Trident submarine shiplift and berth, Faslane	100	314	214%
Woodhill Prison	78	102	31%
Limehouse link, London	142	293	106%
PFI projects			
Norfolk and Norwich NHS Trust	90	144	60%
Greenwich Healthcare NHS Trust	35	84	140%
Benefits Agency-Computers	200	1,400	600%

Sources: Treasury Taskforce, *How to construct a Public Sector Comparator,* Technical Note No 5
Treasury Committee, *The Private Finance Initiative*, Supplementary memorandum from TUC, HC 147, 1999/2000, p66.

The figures show that the Trident submarine ship-lift and berth at Faslane in Scotland, Woodhill prison near Milton Keynes, and the Limehouse link in London overran their initial cost estimates by 214%, 31% and 106% respectively. The technical note also suggests that 'typical' overruns average 12% across a wide range of traditional procurement projects.[47] The technical note suggests that the reasons for these overruns were that:

> public sector procurement has tended to be deficient in appreciating risk and, as a result, budgets for major procurement projects have sometimes been prone to optimism bias, ie a tendency to budget for the best possible (often lowest cost and earliest completion) outcome rather than the most likely. This has led to frequent cost and time overruns. Optimism bias has also meant inaccurate prices have been used to assess options. Such biased financial (ie price) information early in the budget process can result in real economic costs resulting from inefficient allocation of resources.

Evidence from the National Audit Office (NAO) also criticises traditional public sector construction projects. Their 2001 report; *Modernising Construction*[48] suggested that the final cost of construction in 73% of departments' construction projects examined were over tender price.

PFI projects themselves are no strangers to cost overruns as we can see from the lower half of table 6. Three PFI projects, the Norfolk and Norwich NHS Trust, the Greenwich Healthcare NHS Trust and the Benefits Agency Computers have seen the final cost of the projects rise above initial cost estimates by 60%, 140% and 600% respectively. In other

[47] Original source: CUP, *Government Procurement -Progress Report to the Prime Minister*, 1995-96
[48] NAO, *Modernising Construction*, HC 98 Session 2000/01, 11 January 2001

words, cost overruns can and do occur under both private sector and public sector management. The CBI suggested that:

> this rise in cost is largely due to the Public Sector procurers changing their minds about what should be in the contract. The implication is that the rise in costs can be attributed to the extra capital investment and services which have been added to the contract because of this change of mind or, less benignly, because uncertainty is adding to the cost of the bid. [49]

This was backed up more recently by evidence from a survey carried out by the NAO of thirty seven PFI projects in 2002.[50] Their census of thirty seven projects showed that 88% were delivered with no overrun on construction cost and that of the remaining eight projects cost overruns were not due to the contractor but mainly down to the sponsoring department changing the specification of the project.

There is no indication that the specification of the traditionally procured schemes in table 6 or in the NAO reports changed between the initial estimate of cost and delivery of the project. However, in 1996 the Treasury Committee made the point that:

> There is no a priori reason why public procurement should not run to time and cost. Indeed many of the assumed benefits of PFI would appear to be available to better-managed and controlled conventional procurement.[51]

The PFI should reduce the burden on the public sector from the risk of cost overruns, provided that contracts stipulate that this risk is transferred to the private sector contractor, thereby introducing incentives to avoid such problems.

C. The transfer of risk

With the PFI, as with many other types of PPPs, value for money is achieved through the transfer of risk to the private sector that is perceived to have an advantage in handling risk. Risks that can be transferred to the private sector can be divided into two groups, *general risks* that are common all types of public/private projects and PFI *specific risks* that are PFI public services project specific. Examples of some of the general risks that can be identified and transferred are the subject of a Library Standard Note.[52]

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[49] Treasury Committee, *The Private Finance Initiative*, Supplementary memorandum from TUC, HC 147 1999/2000, pp66.

[50] NAO, *PFI: Construction Performance*, HC 371 Session 2002/03, 5 February 2003

[51] Treasury Committee, *The Private Finance Initiative*, HC 146 1995/1996, para 33.

[52] HC Library, *The PFI and the transfer of risk*, SNEP 1014, 10 August 2001,

1. PFI specific risks

Risks come in many forms that often depend on the characteristics of a particular project. The risks involved in providing a school playground are sure to differ from the risks associated with a large scale transport project. The transfer of risk differs with PFI public services contracts in that it enables the transfer of project financing risk to the private sector. Therefore, an essential condition of any PFI project is that sufficient financial risk is transferred to the private sector to secure value for money.

The main benefit of transferring financial risk to the private sector is that it is perceived to have an advantage over the public sector in handling financial risks. Most successful private sector firms have risk analysts, especially in the financial sector. Public services project financing risk, the risk of delivering an economically viable financial package, can be divided into two main types, internal *disposal risk* and external *financing risks*.

Disposal risk is the risk that the expected value of surplus departmental assets, detailed for disposal in a PFI contract to fund public services, is lower than expected. Departments can reduce their exposure to this risk by transferring assets, such as redundant hospital buildings and grounds, that have, or are to become, surplus to requirement to the private sector contractor as part of the PFI contract. *External financing risk* is the risk that the private sector contractor fails to raise sufficient funding for a public services project on the market. As with any contract, the ability of the private sector contractor to secure the finance required to complete a PFI project, must be determined by the sponsoring department before a deal is signed. External financing risks are also related to *interest rate risk*, the risk that the interest rate will change between the time a bid is tendered and the time a contract is signed. Adverse movements in the interest rate during this time would mean that private sector contractors have to pay more to service their debt. This may reduce the attractiveness of a PFI contract.

The transfer of project financing risk generates incentives for the private sector to supply services on time and of a higher quality as they only start to receive service payments when a flow of public services starts. Continued payment also depends on meeting specified performance criteria.[53] A further effect of transferring a project's financing risk to the private sector is that it reduces the general risks of public service projects retained by the public sector. However, risk and reward go hand in hand: the higher the perceived risk that is being transferred to the private sector, the greater the risk premium required by the contractor from the public sector to compensate them for their exposure. Given that some risks are difficult to quantify it is difficult to determine whether a private sector contractor, for accepting a particular risk, is charging a suitable risk premium for either party.

[53] Treasury Taskforce, *Partnerships for prosperity*, 1997

2. The optimal allocation of risk

Once the risks associated with a PFI project have been identified, the next task is to share the risks between the public and private partners. The Government recognises the principle that "risk should be allocated to whoever is best able to manage it"[54] not risk transfer for its own sake. *Private opportunity, Public benefit* states that:

> As a general rule PFI schemes should always transfer to the supplier design, construction and operating risks (both cost and performance). Demand and other risks should be a matter of negotiation with the value for money impact being tested out, where appropriate, through bids on alternative risk transfer bases against minimum and conforming requirements.
>
> Risks retained by the public sector include:
>
> - the risk of a wrongly specified requirement. Where it is known that requirements cannot be specified in their entirety initially, as in some IS/IT projects, it may be possible to share with the supplier the risk of defining remaining requirements during developments and implementation. The public sector still retains the risk in respect of the initial specification;
>
> - risk of criticism. A failure of a public service, even if entirely the responsibility of a supplier, may result in criticism of the Government or local authority along with the supplier.[55]

Public services project risks should only be transferred to the private sector if, and to the extent that, the private sector is capable of managing such risk. Where the private sector is best judged able to deal with risk, such as construction risk, then the public sector should transfer this responsibility completely. Where the private sector is deemed less able to manage project risk, responsibility for these risks should remain within the public sector.

Given that some risks are difficult to quantify, such as the liabilities that would be transferred back to the public sector in the case of a collapsed hospital project, it is difficult to assess to what extent the transfer of risk can be deemed optimal. The small amount of available evidence on risk transfer suggests that at least in some sectors PFI contracts have transferred to the private sector a substantial degree of responsibility for some of the risks involved in constructing, operating and maintaining public services and financing the assets that support them. The NAO surveyed public and private partners involved in 121 PFI projects.[56] Over 95% of both partners agreed that the allocation of risk was either "wholly or partially appropriate". However, the views of the partners varied when asked whether they

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[54] HM Treasury, *Private Opportunity, Public Benefit Progressing the Private Finance Initiative*, November 1995.

[55] ibid.

[56] NAO, *Managing the relationship to secure a successful partnership in PFI projects*, HC 375 Session 2001/2002, 29 November 2001

believed the projects' risks had been "allocated optimally". 80% of public sector partners thought the allocation of risk "wholly appropriate" while only 50% of the private sector partners agreed.

Efficiently designed PFI project contracts should involve the optimum transfer of all relevant types of risk. Where the financial risks of a public services project cannot be transferred to the private sector, different forms of public private partnerships (PPPs) other then the PFI should be investigated such as design, build and operate (DBO) projects. With all this in mind, the main argument put forward by proponents of the PFI, that it provides value for money through the transfer of risk, would be better defined as value for money through an 'optimal allocation of risk'.

D. Evidence of value for money

The NAO has published a series of reports dealing with specific PFI deals. However, there is still relatively little detailed information available on performance over the long term. By the end of 2001, the NAO reported on the value for money aspects of a sample of large PFI projects of particular interest but that may not have been representative of the full range of projects undertaken.[57] The NAO produced value for money reports on:

- Skye Bridge;
- *Bridgend and Fazakerley Prisons*;
- *NIRS2 - The Replacement National Insurance Recording System*;
- *The First Four DBFO Roads*;
- *The A74(M)/M74*;
- *Dartford and Gravesham Hospital*;
- The Immigration and Nationality Directorate's Casework Programme;
- The Passport Agency's Initial Processing and IT Support System :
- *The DSS PRIME accommodation project- the transfer of the then DSS estate to the private sector;*
- *RAF non-combat vehicles*;
- Defence Fixed Telecommunications System;
- The Contributions Agency - Newcastle Estate Development;
- Defence Fixed Telecommunications System;
- British Embassy in Berlin; and
- Channel Tunnel Rail Link.

Of the fifteen projects, or groups of projects above, the seven italicised projects have been judged for value for money purposes against a public sector comparator (PSC). This enables the present value of PFI projects to be compared with the public sector

[57] The NAO approach to auditing deals under the PFI is detailed in: NAO, *Examining the value for money of deals under the Private Finance Initiative*, 13 August 1999, HC 739 Session 1998/99

alternative, allowing the likely cost savings from, or the value for money of, such PFI deals to be estimated. It has been calculated that the total present value of the PSCs of the seven PFI projects is just over £4.6 billion compared to the total present value of the winning bidders of just over £3.7 billion.[58]

This suggests that the total cost savings of these projects was 20% or just under £1 billion. If the NAO sample is representative of PFI projects, then an estimate of the savings from the PFI projects signed up to 4 April 2003 would be in the region of £7 billion. Two of the projects make a significant contribution to total savings - NIRS 2 and PRIME - accounting for almost 81% of the total savings. If the NAO sample excluding NIRS 2 and PRIME was thought of as more typical, then the estimated savings would be 10% or £3.5 billion. This is the same percentage the NAO has estimated of the combined aggregate savings over the lifetime of the Bridgend and Fazakerley Prisons PFI schemes, when compared to prisons built using public finance and operated by the private sector.

A 2000 report commissioned by the Treasury Taskforce found that among a sample of twenty nine PFI projects a PSC was available for, the average saving was closer to 17%.[59] However the report also suggests that:

> The operational benefits of PFI will take much more time to establish. […] The long term value for money of PFI projects will depend on how well the private sector manages the risks transferred to it and on the public sector's success in managing the contracts over their duration, a significant proportion of which are for 25 to 30 years.

Since the end of 2001, the NAO have published a further twelve value for money reports on the PFI. These are available on their web site: [60]

- Government Communications Headquarters (GCHQ): New Accommodation Programme
- PFI: The New Headquarters for the Home Office
- The Operational Performance of PFI Prisons
- Northern Ireland Court Service - PFI: The Laganside Courts
- PPP in practice: National Savings and Investments' deal with Siemens Business Services, four years on
- PFI: Construction Performance
- The PFI Contract for the redevelopment of West Middlesex University Hospital
- PFI Refinancing Update

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[58] Arthur Andersen and Enterprise LSE, *Value for Money Drivers in the Private Finance Initiative*, 17 January 2000
[59] ibid.
[60] NAO web site as at 20 October 2003: www.nao.gov.uk/publications/vfmsublist/vfm_ppp.htm

- Ministry of Defence: Redevelopment of MOD Main Building
- Managing the relationship to secure a successful partnership in PFI projects
- Innovation in PFI Financing: The Treasury Building Project
- The Financial Analysis for the London Underground Public Private Partnerships

When asked about the value for money of PFI projects, most public sector managers have agreed that the PFI deals they have signed provide value for money. In a NAO survey of public sector managers,[61] 100% perceived at the time the contract was let that the PFI option offered "marginal" or "better" value for money than traditionally procured alternatives. None thought the value for money "poor". When asked for their current perceptions 4% changed their views and thought the value for money aspect of the PFI deal was "poor".

Not all parties agree that PFI projects offer value for money. Professor Allyson Pollock of University College London suggests that PFI does not deliver value for money in health projects.[62] Her research shows that some schemes have escalated in both cost and scale so that greater efficiencies or levels of risk transfer have not offset the very high financing costs and the costs of private sector borrowing. There have been some cases where health authorities and the government have had to put in extra subsidies and extra services have been contracted, to bridge the gap. An example of the gap that she cites is the decision of Worcestershire Health Authorities to finance the Worcestershire Royal Infirmary through the PFI:

> […] using PFI means that increased costs of the new hospital will be met in part from the closure of 219 inpatient beds at Kidderminster Hospital without alternate provision. But since the catchment area of the new hospital will increase by 100,000 to 380,000, the population served will have almost one-third fewer acute beds under the PFI […][63]

She continues:

> The first NHS Trust to sign a PFI contract, Dartford and Gravesham, stated in its outline business case that 'at no additional cost to commissioners [the scheme] delivers vitally important strategic objectives'. But by the time West Kent Health Authority was asked to approve the full business case, a £2m-a-year contribution was required (on top of a new contribution from central government). This led to the withdrawal of funding for proposed community health service developments, some of which were required to provide services displaced by the PFI scheme.

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[61] NAO, *Managing the relationship to secure a successful partnership in PFI projects*, HC 375 Session 2001/2002, 29 November 2001

[62] LGIU, *Public Private Partnership: Opening the public private debate*, June 2001

[63] Allyson Pollack, "PFI is bad for your health", *Public Finance*, 6 October 2000, pp30-31.

The evidence suggests that some types of public service projects may be more suited to the PFI than others. While road and prison projects have achieved reasonable efficiency gains, projects in other sectors such as schools and hospitals have shown minimal gains. The main reason for this is that for road and prison projects, there is no partition of core and ancillary services, enabling the private sector contractor to make design and build decisions on the basis that they will also operate the services. This does not tend to happen in health and school PFI projects where core services are still operated by the public sector.

A second reason is that for road and prison schemes a single, central government agency, the Highways Agency and Prison Service respectively, is involved as the contracted purchaser, while the multi-agency dimension of hospital and school purchasers may present problems. For example, for school PFI projects it is generally speaking the Local Education Authority (LEA) that sponsors a PFI scheme. However, they have to get the agreement of the school's governing body who, should the contract go ahead, have to release control of part of their budget to finance future payments to the private sector contractor.

V Current issues

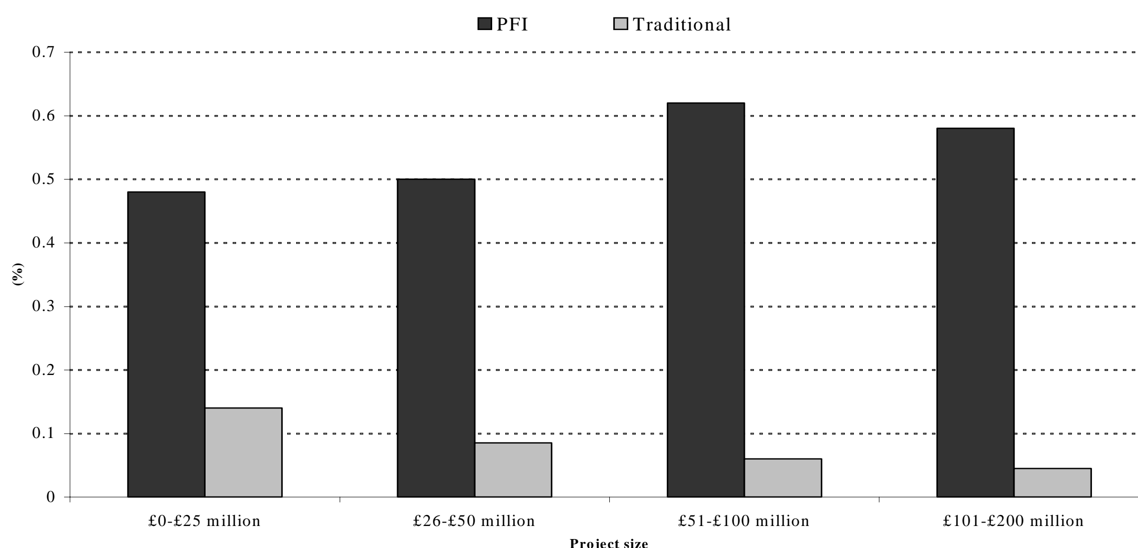
A. Private sector bidding costs

1. High bidding costs

Private partners have often criticised the high cost of organising bids for PFI projects. It is argued that private sector contractors who tend for PFI project bids have to cover higher 'front-loaded' costs when drawing up detailed specifications and contract terms than when preparing bids for public services projects under conventionally tendered contracts. There is little hard evidence for the cost of the tendering process as it is usually considered confidential. The evidence that does exist appears to support the argument. A 1996 report from the Adam Smith Institute[64] found average tender costs expressed as a percentage of expected total costs, across projects of all sizes, to be higher for PFI public services projects than for traditionally procured projects, as can be seen in the figure below:[65]

[64] Dr Eamonn Butler & Allan Stewart MP, *Seize the Initiative*, Adam Smith Institute, 1996

[65] Source: Original source: BEC and Sir Michael Latham, *Constructing the team*, reproduced in Dr Eamonn Butler & Allan Stewart MP, *Seize the Initiative*, Adam Smith Institute, 1996



The report suggests that on the basis of these figures:

- PFI tendering costs are far greater than the average tender costs of other procurement methods; and this remains true no matter what the project size.
- These tendering costs are likely to be underestimated, since many of the contractors approached revealed only the cost of achieving *preferred tenderer status*. The full costs [including the contract negotiation stage] are greater – perhaps not 0.5 percent, but one percent more.
- Unlike other procurement methods, where tender costs diminish as a percentage of the total, there are no economies of scale with PFI tendering. There is instead a tendency for costs to increase as a percentage of the total.[66]

The report finds the total cost of tendering for a PFI project to all potential contractors to be just under 3% of expected total costs while for traditional procurement the total costs accounted for just under 1%.

One reason for the higher cost of tendering for PFI projects is that the time taken between offering public services projects to the private sector and the final signing of the deal can be protracted, especially for particularly intricate and technical projects. The average time taken to complete PFI deals has been estimated at twenty six and forty two months for local government and NHS projects respectively.[67] There is some evidence to suggest that the relatively more expensive time spent negotiating PFI contracts with preferred bidders is longer than the time taken to initially select the bidder. If this time is not specifically included in either private or public sector cost estimates, it increases total

[66] ibid.

[67] Audit Commission, *Building for the Future. The Management of Procurement Under the Private Finance Initiative*, 2001

expected costs. These costs can be disproportionately high when a PFI project is small scale, such as a school's sports hall or GP's surgery.

To address these concerns, the Government has for some years been involved in consultations on establishing greater standardisation of the tendering process. On 14 July 1999 the Treasury Taskforce published new contract guidelines designed as "a platform for generating increased Private Finance Initiative deal flow and reducing the costs of tendering".[68] The aim of the guidelines was to allow PFI contracts across different public services to follow a consistent approach by incorporating standard conditions into all contracts. The Audit Commission has also produced guidance for local government managers aimed at reducing the time taken to close PFI deals:

> *If purchasers are to reduce the length of time taken to close PFI deals, they should*:
>
> - demonstrate a clear purpose and a strong vision of the desired outcomes from the scheme;
> - translate that vision into a simple output specification and resist the temptation to make regular changes to that specification;
> - get early commitment to the scheme from key stakeholders;
> - set up a project management structure that allows for an appropriate level of delegation to key officers and is integrated with existing decision-making processes;
> - agree a clear project plan, establish project milestones and monitor progress against the plan on a regular basis;
> - agree the key contractual terms, including payment mechanisms and risk transfers, prior to issuing the invitation to negotiate, in order to force bidders to indicate their position early on in the negotiation process; and
> - be clear about how they are going to evaluate bids.[69]

The increase in the number, size and complexity of PFI projects led the Government to ask OGC and Partnerships UK to revisit the Treasury Taskforce guidance. After a lengthy consultation process involving the public and private sectors, revised guidance on the standardisation of PFI contracts was published in July 2002. The revised guidance took effect from 1 August 2002 and detailed guidance on its application to projects that were, at the time, in procurement was also given. A clean version of the revised guidance is available on the OGC web site[70] while a version showing all of the changes made to the original 1999 Treasury Taskforce guidance is available on the Partnerships UK web site.[71] The revised general guidance should further help reduce the time taken to close PFI deals, reducing bidding costs for the private sector.

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[68] HM Treasury, *PFI standard contract guidance launched*, news release 118/99, 14 July 1999

[69] Audit Commission, *Building for the Future. The Management of Procurement Under the Private Finance Initiative*, 2001

[70] OGC web site as at 20 October 2003: http://pfi.ogc.gov.uk/newsView.asp?id=754

[71] Partnerships UK website as at 3 October 2003: http://www.partnershipsuk.org.uk/news/index.htm

2. Accounting issues

Bid cost accounting issues for private sector companies have arisen due to the release of a consensus by the Urgent Issues Task Force (UITF).[72]

The UITF was concerned about private sector bidders accounting for bidding costs in their company accounts, essentially as assets that meant they did not appear in company profit and loss accounts. This made their trading profits appear higher then they actually were. At the end of 2001, the UITF issued a draft abstract for comment suggesting:

> Some entities, in bidding for and securing contracts to supply products or services, are spending significant sums before any contract is signed. There is uncertainty over whether costs incurred before a contract is obtained should be recognised as an asset (and charged as expenses over the life of the contract) or charged as immediate expenses. Diverse accounting treatments have developed in practice.[73]

The draft abstract proposed that:

> costs that are directly attributable to obtaining a contract should be recognised as an asset only when there is a high degree of certainty supported by sufficient evidence that a contract will be obtained. Only costs incurred after that point should be recognised as an asset—costs that are incurred before then (for example, during the competitive tendering stage) should be charged as immediate expenses and should not be reinstated as an asset later.

Signs that the principle would be adopted by private sector PFI contractors appeared in March 2002 with the release of the trading accounts of WS Atkins and Amey.

WS Atkins deferred its proposal to 'capitalise' part of its pre-contract bid costs for the Metronet London Underground PPP consortium it is a twenty percent shareholder in.[74] In their results, Amey, a Tube Lines London Underground PPP consortium shareholder, highlighted the fact that they were undertaking "New accounting policies to reflect treatment changes and the strategic focus upon large-scale opportunities" including "pre-contract and similar costs written off in accordance with UITF Information Sheet 51".[75]

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[72] The main role of the UITF is to assist the Accounting Standards Board (ASB) where unsatisfactory or conflicting interpretations have developed about a requirement of an accounting standard or the *Companies Act 1989*. The UITF seeks to arrive at a consensus on the accounting treatment that should be adopted, in such cases, in the context of the ASB's declared aim of relying on principles rather than detailed prescription.

[73] ASB/UITF, *Information Sheet No 51*, 6 December 2001

[74] WS Atkins, *Trading Update*, news release 27 March 2002. Available on the Investis web site as at 20 October 2003: http://production.investis.com/wsatkins/wsa_financialnews/2002-03-27

[75] Amey, *preliminary results for the year ended 31 December 2001*, news release 19 March 2002. Available on the Amey web site as at 20 October 2003: www.amey.co.uk/

By including bidding costs when they occurred, rather than deferring them until it was named preferred bidder, it has been estimated that Amey revealed a shortfall of £70 million in its accounts.[76] By July 2002 Amey's share price had fallen by 75% from the beginning of the year and in September it was announced that "PFI/PPP activity [was] to continue in new partnership formats but equity investments [were] to be divested".[77]

In January 2003 the Board of Amey announced they had signed a conditional sale contract in relation to the disposal of PFI projects to Laing Investments Limited:

> The investment portfolio consists of Amey's interests in eight existing PFI concession companies all of which are in the UK road and accommodation sectors. The London Underground investment rights and the Croydon Tramlink investments are excluded from this transaction. Other Amey Group companies retain the valuable long term maintenance and service contracts that support the concession companies.[78]

The UITF issued their final consensus in May 2002, to be adopted in financial statements relating to accounting periods ending on or after 22 June 2002:

> (a) Pre-contract costs should be recognised as expenses as incurred, except that directly attributable costs should be recognised as an asset when it is virtually certain that a contract will be obtained and the contract is expected to result in future net cash inflows (i.e. future revenues less attributable costs) with a present value no less than all amounts recognised as an asset.
>
> (b) Costs incurred before the asset recognition criteria in (a) above are met should not be recognised as an asset then or later.
>
> (c) Directly attributable costs are costs that relate directly to securing the specific contract after the asset recognition criteria in (a) above are met, if they can be separately identified and measured reliably.
>
> (d) The accounting by consortium members for the recovery of pre-contract costs from a special-purpose entity should reflect the principles set out in (a) to (c) above.[79]

It remains to be seen if full implementation of the consensus leads to a further reduction in the number of PFI contractors willing to bid for projects in the future.

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[76] Unison, Company Update, September 2002. Available on the Unison web site as at 20 October 2003: www.unison.org.uk/bargaining/doc_view.asp?did=503

[77] Amey, *preliminary results for the six months to 30 June 2002*, news release 10 September 2002. Available on the Amey web site as at 20 October 2003: www.amey.co.uk/assets/asset_250.pdf

[78] Amey, *Agreement for disposal of PFI Equity,* news release 21 January 2003. Available on the Amey web site as at 20 October 2003: www.amey.co.uk

[79] ASB/UITF, *Abstract 34 Pre-contract costs*, 21 May 2002

B. The cost of borrowing

Under PFI, a public sector body may gain access to private financing but the cost of such funds is unlikely to be as low as loans from the National Loans Fund (NLF). The PFI does not provide a cheaper source of finance to public sector bodies but simply provides them with another source of possible funding, probably at a higher capital cost than traditional procurement. Under present Treasury rules, most public (profit-making) corporations cannot borrow and invest like private sector enterprises as their borrowing is treated as public expenditure. Comparisons of the cost of borrowing by government and the private sector are very difficult to make. The cost of borrowing at any time is determined by a variety of factors, although the main determinants are likely to be the risk of default and the expected returns.

Government borrowing through the NLF is backed by tax revenues and so is virtually risk-free, and is hence the cheapest way of raising funds. Private sector companies, that have no such guarantees, are inherently riskier propositions and borrow on less advantageous terms. City, or local authority, borrowing may be somewhere between these two, although some companies might be able to borrow money more cheaply than a public authority, especially if the authority is relatively new or has a less than perfect reputation for financial rigour.

Due to the difficulties involved in comparing the actual costs of public and private financing of PFI projects, disparities in the yields of bonds issued by public, private and public/private organisations have often been looked at as proxies. In this cost hierarchy the cheapest source of funds comes from government. Next, it is suggested, would be a government/fare revenue backed body such as London Underground. Next are large public limited companies many of whom are PFI players. However, this does not take us very far since a plc is likely to raise capital by a cost-minimising combination of a new share issue, bank finance and commercial bonds rather than just through a bond issue alone.

The crucial aspect here is the cost differential between the alternatives and, although it is dangerous to generalise from the evidence of a few borrowers, the following figures are nevertheless helpful. According to figures in the *Financial Times*[80] the yield on government bonds at the close of play on 3 October 2003 was 4.5%. Similarly dated corporate bonds ranged between 5.2% for Boots and 4.9% for Halifax. This suggests that the extra borrowing cost of corporate bonds could be at least half a percentage point above government bonds. The differential between the returns on public funds and private equity is likely to be much greater. This was demonstrated in the NAO report on the Skye Bridge.[81] The NAO calculated that the extra financing cost of the Skye Bridge was some £4 million on a total project cost of £28 million, or one-seventh. The cost of

[80] *Financial Times*, 13 September 2003

[81] NAO, *The Skye Bridge*, HC 5 Session 1997/98, 23 May 1997

(private) equity was some 18.4% in real terms, compared with the cost of public capital of 6%. In this case the private finance option required more than 12% percentage points per year above the public finance rate. But a 2000 report by Arthur Anderson/Enterprise LSE on the PFI found that:

> The [financing costs] difference on the average PFI project is now typically in the range of only 1-3 percentage points. This gap between the cost of private sector capital and public borrowing has been narrowing as PFI matures and the public and private sectors gain in experience, and is not as high as some of the literature suggests. The additional cost is not so significant that value for money is inherently likely to be imperilled, provided the private sector is able to deliver savings in other aspects of the project. The business cases we have examined suggest these savings are deliverable.[82]

David Currie of the London Business School has challenged the proposition that private sector borrowing costs are higher, calling proponents "naïve". He has suggested that when evaluating projects:

> efficiency savings are the significant factor in any decision between the two options as adopting a more appropriate approach to the evaluation of the costs of a project shows that the differences between the costs of borrowing are illusory.
>
> One of the most fundamental points in using cost benefit analysis to evaluate projects is to account for their impact on *all* individuals in a community […] in the private sector, investors carry the risk of default and are rewarded accordingly but in the private sector, taxpayers carry the risk but receive no commensurate reward. In other words, although the public sector can borrow at the risk-free rate to finance investment, this imposes a residual risk on taxpayers in much the same way as private sector investors but without a reward. Clearly the contingent liability being imposed on taxpayers is a cost that ought to be accounted for in any cost–benefit analysis. Unfortunately it is not normal practice to quantify in the public balance sheet these contingent liabilities faced by the public. Once taken into account, the true cost of borrowing is the same for the public and private sector if the underlying risk of the projects is the same.[83]

More recently the Treasury has suggested that:

> A simple comparison of the combined returns on debt and equity earned by the private sector with the non-risk rate on gilts would show that the cost of public debt was lower, but this single cost comparison does not adequately capture the different methods of costing for risk in the public and private sector, nor does it

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[82] Arthur Andersen and Enterprise LSE, *Value for Money Drivers in the Private Finance Initiative*, 17 January 2000

[83] David Currie, *Funding the London Underground*, London Business School, March 2000

> reflect the value for money benefits which whole-life costing and appropriate risk-sharing in PFI bring to projects.[84]

It acknowledges that there is a difference in the cost of borrowing that arises from the private sector securing funds from the market but that there is a greater difference that arises due to the different approaches taken with regard to risk:

> In PFI, the project discount rate, or expected rate of return for the private sector, takes into account the costs associated with procuring private capital and also seeks to price the wider risks associated with lending to the project.
>
> The gilt rate, on the other hand, does not make any attempt to calculate risks. This does not mean that the Government is able to borrow and spend money free of risk. Instead it means that, with publicly financed procurement, the taxpayer underwrites the associated risk, and this is reflected in a lower price of capital to the public sector. The taxpayer takes on the risk attached to the project, and where it materialises, bears the cost as a result. It is therefore inappropriate to compare a "risk free" cost of gilts with the cost of private finance: PFI projects provide value for money through the private sector taking on, pricing, and managing more effectively these project risks.
>
> Instead of reflecting risk in a risk premium on capital, Government investment decisions reflect risk by calculating the present value capital sum it regards as the necessary contingency for the risks inherent in a project. […]
>
> Risks are therefore priced individually, for each project option. The discounted costs of these risk-adjusted options can then be compared with each other, or with the cost of a PFI project, in a PSC, to determine which procurement option represents best value for money taking account of risk and uncertainty. This approach is consistent with the fact that in conventional procurement the public sector pays for risk not in its borrowing – which for the public sector is at non-risk rates – but when risks crystallise and must be covered in publicly funded projects.[85]

This suggests that the risk to the public sector is factored into value for money decisions on PFI projects in a risk adjusted PSC.

C. European Commission Procurement Directive

Under present European Commission rules for public procurement, contracts above a certain financial threshold are put out to competitive tender in the Official Journal of the European Communities (OJEC). With regard to the PFI in the UK, these rules allow the Government to choose a preferred bidder from the tenders they receive on the basis of the

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[84] HM Treasury, *PFI: Meeting the Investment Challenge*, July 2003

[85] ibid

most economically advantageous bid. The preferred bidder then negotiates the detailed proposals for a specific project, with two reserve bidders also chosen in case negotiations with the preferred bidder break down before a contract is signed.

Under proposals for a new European public procurement directive, the public sector will no longer be able to select a preferred bidder under the PFI. At least three bidders will be required to continue negotiations until the final contract is signed. The debate on public procurement rules in the EU has been facilitated by the European Commission Green Paper; *Public Procurement in the European Union: Exploring the Way Forward*.[86] The main theme to emerge from the Green Paper was "the need to simplify the legal framework and adapt it to the new electronic age while maintaining the stability of its basic structure"[87] in order to help create a genuine single European market. After consideration of the responses to the Green Paper, the Commission published its plans for future action in the Communication; *Public Procurement in the European Union*.[88]

The proposed directive[89] on the co-ordination of procedures for the award of public supply contracts, public service contracts and public works contracts aims to consolidate three existing directives. With respect to the selection of tenderers for PFI projects, the proposals strengthen the legal framework in two respects. The first strengthens the legal framework for "combating organised crime, corruption and fraud" while the second "introduces an obligation, in restricted and negotiated procedures, to apply objective criteria announced in advance so as not to limit the number of candidates invited to tender".[90] It is the second of these proposals that has caused the most worry amongst those involved with the PFI.

Article 45 of the proposed directive (consolidating Article 27 of Directive 92/50/EEC,[91] Article 19 of Directive 93/36/EEC[92] and Article 22 of Directive 93/37/EEC[93]) proposes that:

> Where contracting authorities award a contract by restricted procedure and by negotiated procedure with publication of a contract notice, namely in those cases referred to in Article 29, they may prescribe the minimum number of candidates which they intend to invite to submit a tender or negotiate. This minimum number shall be five candidates in restricted procedures and three in negotiated procedures. They may also set a maximum number of candidates which they intend to invite to submit a tender.[94]

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86 Com(96)583 final, 27 November 1996
87 ibid.
88 Com(98) 143 final, 11 March 1998
89 COM(2000)275 final, 12 July 2000
90 COM(2000)275 final, 12 July 2000
91 Implemented in the UK by: The Public Supply Contracts Regulations, SI 1995/201
92 Implemented in the UK by: The Public Services Contracts Regulations, SI 1993/3228
93 Implemented in the UK by: The Public Works Contracts Regulations, SI 1991/2680
94 ibid.

Concern has been raised in the UK by PFI contractors and others, who are worried that public sector managers will no longer be able to select a preferred bidder to negotiate contract details on an exclusive basis if the directive goes ahead. Instead, three bidders will be asked to produce completed schemes in an effort to reduce 'anti-competitive behaviour'. This could lead to the cost of bidding becoming prohibitive for the private sector that is already worried about the high cost incurred by preferred bidders.

The chief executive of the Association of Consulting Engineers (ACE) Nicholas Bennett has said: "[the directive] may mean that firms will be unwilling to bid for PFI work, as they may have to spend £5 million or more on projects which they are ultimately not awarded."[95] In an article in *The Independent* the Construction Confederation's European affairs director John Bromley also expressed concern that "the directive would deter many contractors from working on public sector deals. You couldn't risk losing £6m on a bid. This [he said] is a serious problem". Arthur Moore of the John Mowlem construction group said:

> This is not good news at all. If it goes through unamended we would have to completely reconfigure the PFI initiative in the UK. The PFI initiative would come to a halt… Clients and contractors would have to spend huge amounts designing projects up front. It would move us back in procurement terms 10 years.[96]

In the same article, Robin Herzberg, chairman of the CBI Committee on European Public Procurement is quoted as saying:

> We are extremely concerned about the adverse implications of this for the PFI. It would slow the initiative down and make it far more expensive, no doubt about it at all. It would make it unworkable.

The Government commented about the consequences of the directive for the PFI in reply to a WPQ in the Lords:

> **Lord Dixon-Smith asked Her Majesty's Government**: What impact the ruling by the European Commission in Brussels that "preferred bidder" status should not be awarded until a full and open tender process has been completed will have on the private finance initiative process. [HL391]
>
> **Lord McIntosh of Haringey**: The Commission has not made a "ruling" in this respect but has made proposals for revising the EC public procurement directives. The proposals are the subject of continuing discussions in the Council and the European Parliament and the Government are optimistic that the final version will

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[95] Pan-Utility Brussels' Costs a Threat to PFI, *Utility Week*, 20 July 2001

[96] Brussels Threatens to Scupper Blair's Private Finance Schemes, *The Independent*, 14 July 2001

> make express provision for best practice in the award of PFI and other major contracts.[97]

The directive is subject to the co-decision procedure. Second reading of the directive took place in the European Parliament in July 2003. This and any proposed amendments to the Council's common position are available on the Europa web site.[98] The opinion of the Commission on the European Parliament's amendments to the Council's common position has also been published.[99]

Adoption of the Consolidated Directive is now envisaged towards the middle of 2004 at the earliest, with UK implementation taking place a maximum of twenty one months thereafter.

D. Refinancing of PFI contracts

Critics of value for money arguments for the PFI have highlighted the perceived loss to the public purse from public managers failing to negotiate clauses in the original contracts, where the public sector client receives money back if a contractor subsequently refinances their borrowing.

The scope for substantial refinancing benefits has arisen mainly from the unfavourable funding terms offered on early PFI deals when the PFI market was less mature than today. For example, funders were willing to lend for a maximum term of eighteen years for twenty five year PFI projects due to their perceptions of risk. Following the construction phase of such a PFI project (when construction risk is reduced towards zero) and an apparent increased willingness of the Government to invest in the PFI (reducing political risk) funders have become more amiable to lending over the entire period of a project. The reduction in risks has enabled contractors to reduce their annual financing costs as funders are prepared to offer them improved terms.

1. Treasury guidance on refinancing

Guidance on the Standardisation of PFI Contracts[100] published in 1999 highlighted the need for public sector managers to make provision to protect departments' interests should the private sector seek to benefit from refinancing opportunities. However, departments do not need to have an explicit sharing mechanism or rights in a PFI contract to seek to negotiate a share of such benefits. General approval rights over changes in contracts or financing arrangements, such as termination liabilities, should put departments in a strong negotiating position.

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97 HL Deb 24 July 2001 c197WA

98 Europa web site as at 20 October 2003: http://europa.eu.int/eur-lex/en/com/pdf/2003/com2003_0503en01.pdf

99 COM(2003) 503 final, 14 August 2003

100 OGC, *Guidance on the Standardisation of PFI Contracts*, 1999

The NAO suggested the refinancing of PFI projects under present arrangements was more likely to occur only to the benefit of shareholders:

> There can be important consequences for departments arising from refinancings, and departments should consider what provisions they should make to share in some of the financial gains and whether their consent should be required before a refinancing can proceed.[101]

While the Public Accounts Committee in their report on the refinancing of the Fazakerley (Altcourse) prison PFI project stated:

> There may be a good case for the public sector to make payments to the external financiers on termination of a PFI contract. It is, however, unacceptable that a department should accept without full compensation any risk of having to meet higher termination liabilities as a result of a refinancing which would greatly benefit the private sector shareholders (paragraph 14).[102]

And furthermore:

> No department in a PFI deal can afford to relax its guard against perverse incentives which might tempt the private sector side, in adverse circumstances, to cut and run. In this case, such a risk might theoretically arise because the Prison Service's greatest exposure to additional termination liabilities would occur at a time when the private sector shareholders would have received most of the benefits of the refinancing and their company would be facing additional costs. In such a situation, the shareholders might become less concerned about their company's performance at a time when the costs to the Service of terminating the contract would be at their highest (paragraph 18).

Provisional revised guidance from OGC to the public sector in 2001 stated that:

> It is implicit in PFI that contractors should benefit from effective management of projects. But departments must be alert to the very significant increase in rates of return to shareholders which refinancing may provide.
>
> […] consistent with the existing guidance, in considering any refinancing proposals that are put to them, and where the contract does not state otherwise, departments should seek an equitable outcome which will protect the interests of the taxpayer and be defensible publicly. However, it is for Accounting Officers to make decisions on their own department's projects.
>
> In practice, this means that where a department's consent is required to a refinancing proposal (and where the contract does not cover the terms of that

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[101] NAO, *The refinancing of the Fazakerley PFI*, HC 584 Session 1999/2000, 29 June 2000

[102] Public Accounts Committee, *The refinancing of the Fazakerley PFI*, HC 372 Session 2000/01, 4 July 2001

> consent) before giving its consent, the department should stipulate that it be compensated for any increased risks or liabilities it might be exposed to and should also seek to share the relevant benefits on a 50/50 basis with the private sector partner. [103]

OGC and the Government have also realised that, in certain cases, departments may become aware of refinancing that contractors are implementing but that does not require their approval and for which they do not have explicit sharing rights. In such cases OGC's guidance suggested that:

> they [the public sector client] should seek to ensure with the contractor that such benefits reflect reward for management of risk and costs rather than pure windfall gain.

OGC commissioned Partnerships UK to draft new guidance on the refinancing of PFI projects with a view to creating guidance that would more comprehensively protect the public interest. Following consultation, OGC published a *Code of Conduct* setting out the basis that individual authorities should approach refinancing by their private sector contractors of early PFI transactions. The Code is voluntary and should enable private sector contractors to share refinancing gain with the public sector on a consistent and equitable basis such that:

> Where there is no existing contractual entitlement for an Authority to share in Refinancing Gains, the Authority will be given a 30% share of the Refinancing Gain arising from Qualifying Refinancings.[104]

The Code also states that where contracts contained specific sharing mechanisms this should be honoured, whether or not they stipulated a 30% share for the authority. OGC has also produced refinancing guidance to update their *PFI Contract Guidance on Standardisation of PFI Contracts* that states future project contracts should be negotiated so that "The Authority shall be entitled to receive a 50 per cent share of any Refinancing Gain."[105]

E. Evidence of refinancing

In 2002, the NAO produced a report that greatly increased the available evidence on the refinancing of PFI projects by surveying almost two hundred PFI projects in England

[103] OGC, *Guidance for Government Departments: Refinancing of PFI projects*, 13 December 2001

[104] OGC, *Refinancing for early PFI transactions Code of Conduct*, October 2002. Available on the Treasury web site as at 20 October 2003:
http://www.hm-treasury.gov.uk/media//924E0/PPP_Refinancing_Code_of_Conduct.pdf

[105] OGC, *Guidance Note on Calculation of the Authority's Share of a Refinancing Gain*, July 2002. Available on the OGC web site as at 20 October 2003:
http://pfi.ogc.gov.uk/Download.asp?id=697&field=5&filename=Refinancing+Guidance+Note%2Epdf

signed prior to May 2002.[106] They found that fifty four (39%) projects, of those that responded to the survey, included specific mechanisms for sharing refinancing gains in their contracts. They were advised that departments were aware of twelve PFI projects, with an estimated capital value of £880 million, where refinancing had occurred. Details of eleven of the projects are shown in table 7 below. In the twelfth, new office accommodation in Sheffield sponsored by the ODPM, refinancing gains were included in the original unitary payment charges:

Table 7: Selection of completed refinancings notified to NAO as at June 2002

PFI project	Department	Contract signature	Refinanced	Public sector share	
				%	£ million
Colfox School	DfES	1997	1999	25%	0.4
Altcourse (Fazakerley) Prison	Prison Service	1995	1999	9%	1.0
A19/A168 Dishforth-Tyne Tunnel	Highways Agency	1996	2001	33%	1.5
Parc Prison (Bridgend)	Prison Service	1996	2001	0%	0.0
Newcastle Estates	IR	2008	2001	60%	8.5
IT Infrastructure PFI	C&E	1999	2001	0%	0.0
M1-A1 Link	Highways Agency	1996	2001	0%	0.0
M40 Denham-Warwick	Highways Agency	1996	2001	31%	1.7
Cambridge Site	DEFRA	2001	2002	50%	0.4
Calderdale Hospital	DoH	1998	2002	30%	3.6
Joint Services Command and Staff College	MoD	1998	2002	30%	0.4
Total					17.5
Average public sector share from refinancing				*24%*	

Source: Based on NAO, *PFI Refinancing Update* , HC 1288 Session 2001-02, 7 November 2002, Table 7

The table shows that the average public sector share of refinancing gains for the eleven projects was just over 24% suggesting that total refinancing gains to both sides were in the region of £68 million, or 8% of the capital value of the projects. On this basis we can estimate the loss to the public sector of not including refinancing sharing arrangements for these projects, on the current preferred 50% share basis, to be around £18 million. However, if we assume that all the projects from the start of the PFI were refinanced on a similar basis, the figure could be as high as £0.7 billion.

The real loss to the public sector may never be known. The NAO have suggested that there is some evidence that not all the PFI projects that have been refinanced have been reported to departments. The main reason for this appears to be PFI project team's lack of information of their contractor's financial relationships.

[106] NAO, *PFI Refinancing Update*, HC 1288 Session 2001/02, 7 November 2002

1. Fazakerley Prison scheme

One of the first of the reported refinancings shown in table 7, the Altcourse (Fazakerley) Prison PFI scheme, was the subject of an NAO report in 2000.[107] In November 1999 Fazakerley Prison Services Limited (FPSL), the PFI project consortium formed by Group4 and Tarmac, refinanced the public services project it had been awarded by the Prison Service to design, build, finance and operate (DBFO) Fazakerley Prison.

FPSL was able to refinance the project due to its success in delivering the project four months ahead of time, establishing a track record in its operation and because of increased confidence in the financial markets towards PFI projects generally. The refinancing of the project improved the expected returns to FPSL's shareholders, both through the early repayment of their original investment and the expectation that the flow of dividends would be higher than projected. In total, the expected returns to FPSL's shareholders were increased by £10.7 million (61%) as a result of the refinancing of the project, compared to their originally projected level of £17.5 million at the time the contract was signed.

The Prison Service did not consider that FPSL would refinance the project and had therefore not negotiated, as part of its contractual rights, a share in any benefits from refinancing. However, the lenders to FPSL considered it prudent for Prison Service consent to be obtained, as the refinancing proposals would create additional liabilities for the Service. The Service decided that it should be compensated for agreeing to accept these additional liabilities and negotiated an up front payment from FPSL of £1 million, or 9% of the gains from refinancing. This sum was consistent with the Prison Service's estimate of the extra financial risk it was taking on.

The Prison Service acknowledged that the success of the project contributed to the opportunity for a refinancing to take place and that it was therefore reasonable for FPSL to benefit from refinancing as a reward for taking risks in successfully developing the first PFI prison project. The Service also did not wish to deter FPSL or other consortia from bidding in future PFI prison competitions by removing opportunities for them to benefit in this way.

2. Further refinancing of PFI projects

The NAO have suggested that greater refinancing of PFI projects is likely to occur in the future, to the benefit of private sector shareholders and the public sector alike. In its 2002 survey on refinancing the NAO was informed by departments of eleven more PFI projects where refinancing was planned:

[107] NAO, *The refinancing of the Fazakerley PFI*, HC 584 Session 1999/2000, 29 June 2000

- Forest Bank (Agecroft) Prison
- Dartford and Gravesham Hospital
- South Manchester University Hospitals - Wythenshawe Hospital
- Sheffield City Council - Group Schools Projects
- London Underground Power
- Newcastle Estate Development Scheme
- ELGAR (DTI)
- Manchester High Powered Computing
- Croydon Tramlink
- Enfield New School
- Norfolk and Norwich Health Care NHST - New hospital

There is also some suggestion that Connect will refinance two roads DBFO PFI projects: the A50 Stoke to Derby link road and the A30/A35 Exeter to Bere Regis road.[108] If the refinancing of all these projects proceeds, anticipated refinancing gains for the public sector could be in the region of £17 million.

F. The future of the PFI

The Treasury published *PFI: Meeting the Investment Challenge* on 15 July 2003.[109] As well as reviewing the progress of the PFI in the UK to date, the document outlines the Government's commitment to the PFI in England over the three years to 2005/06. In a Written Statement to the House announcing its publication Paul Boateng, Chief Secretary to the Treasury, stated that the document:

> gives a detailed picture of the role of PFI in delivering this investment and presents a rigorous examination of the performance of PFI based on the evidence drawn from research by Her Majesty's Treasury and other bodies, in particular the National Audit Office. This evidence shows that, where it is properly used, PFI has delivered better infrastructure, on time, on budget and to a high standard throughout its life. Of the projects studied almost 90 per cent. were completed on time, and in every case the public sector has paid what it expected to pay. The document also reaffirms the Government's commitment that value for money in PFI projects should not be obtained at the expense of employees' terms and conditions.[110]

The document is the most comprehensive and candid assessment of the PFI carried out by the Treasury to date. The measures contained within the document can be divided into four main areas for debate: increasing the private sectors funding options, shifting the value for money appraisal emphasis, the end of PFI as a procurement option for

[108] Connect bundled roads out, *Private Finance*, 1 October 2002
[109] HM Treasury, *PFI: Meeting the Investment Challenge*, July 2003
[110] HC Deb 15 July 2003 c21WS

Information Technology (IT) projects and individual projects with a small capital value, and expanding the scale and scope of the PFI.

1. New funding regimes

Contractors finance PFI projects through: bank finance; debt raised through the capital markets, with or without a credit guarantee; through the European Investment Bank (EIB); from their own accounts; or a mixture of these options. As suggested earlier in this Paper,[111] this has led to criticisms that borrowing costs are higher for privately funded PFI projects than for more traditional procurement routes, where the government is the financial backer.

PFI: Meeting the Investment Challenge contains proposals to increase PFI contractors' funding options that will reduce their cost of finance without increasing the public sector's exposure to risk. The Government is to pilot a *Credit Guarantee Finance* scheme, where it acts as senior lender, for a limited number of PFI projects. The Treasury will essentially raise funds from the market, through gilts issued in the usual manner, but will then on-lend proceeds to PFI contractors. The risk exposure of the public sector will not increase as contractors will still be responsible for finding credit providers willing to guarantee to pay the principal and interest in the event of default.

The Treasury also proposes *Framework Funding* for bundled smaller schemes such as the 'Building Schools for the Future' programme, introduced following negative perceptions of some early school buildings provided through the PFI.[112] The document states the aim of the *Framework*:

> will be to provide a faster, cheaper funding solution, which maintains the benefits of third party finance but reduces its inherent inefficiencies when applied to smaller schemes. The finance would continue to be provided by the private sector, with the same advantages for the PFI project this brings.[113]

Fundamentally, the document is suggesting not that Government will increase overall financial support for PFI projects but that it will increase the funding options available to private sector contractors.

2. Value for money appraisal

To identify whether the PFI is the best value for money option available to a public sector manager, a competition involving a comparison with a conventionally procured alternative, a Public Sector Comparator (PSC) is necessary. It has been argued by critics

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[111] See section V of this Paper, p31
[112] DfES, *Building Schools for the Future Programme,* available on the DfES website as at 10 October 2003: www.teachernet.gov.uk/docbank/index.cfm?id=3611
[113] Op cit p107

of the PFI that such a process is "flawed and biased towards the PFI route"[114] and "a government-sanctioned financial fiddle".[115] To improve the present assessment process, a three pronged strategy was announced in *PFI: Meeting the Investment Challenge*:

> The Government will:
>
> - institute a new assessment of the potential value for money of procurement options when overall investment decisions are made, to ensure that PFI is used in those sectors where it is appropriate in accordance with the Government's approach and understanding of the evidence;
> - reform the Public Sector Comparator (PSC) to ensure an economically rigorous appraisal of a project's outline business case prior to its procurement, to allow an alternative route to be chosen at this stage if it offers better value for money; and
> - set up a final assessment of competitive interest in a project, and the market's capacity to deliver, at the procurement stage.[116]

The Treasury has also suggested the economic case for value for money should not be the single reason for deciding to take the PFI route. Value for money should include wider social benefits to ensure "the value for money delivered by PFI does not come at the expense of employees' terms and conditions".[117]

a. *Investment programme assessment*

In future, departments will have to make an appraisal of the procurement options at the time investment decisions are made, most likely around the time of the Spending Reviews. This first stage involves a meticulous appraisal of project suitability based on the Government's assessment of similar projects already undertaken through the PFI in the sector and whether the PFI process takes into account wider procurement policy through "equity, efficiency and accountability".[118]

b. *The Public Sector Comparator (PSC)*

The actual calculation of the PSC generally remains the same, bar the incorporation of guidance from the revised *Green Book*,[119] such as the use of a revised discount rate of 3.5% instead of the previous 6%. The main change is that the PSC will not remain the one-stop value for money exercise it is at present. However, it is envisaged that in all but

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114 Declan Gaffney et al, "PFI in the NHS – is there an economic case?" *BMJ*, No 7202, 10 July 1999
115 Re-appraising the appraisal, *publicprivatefinance*, September 2003
116 HM Treasury, *PFI: Meeting the Investment Challenge*, July 2003, p77
117 ibid
118 ibid p80
119 HM Treasury, *The Green Book, Appraisal and Evaluation in Central Government*, January 2003

a few cases, projects appraised at this stage will come out in favour of the PFI, due to the prior investment programme assessment.

c. *The final assessment*

Prior to going out to competitive tender, the final assessment stage will appraise market interest for a PFI project. There has been speculation that the number of contractors willing to bid for PFI contracts has fallen, mainly due to the high bidding costs looked at earlier in this Paper.[120] A fall in market participation would undermine the value for money aspect of some PFI projects, as fewer contractors bidding for projects would reduce the benefits of competition. Under the new proposals, if a department finds there is insufficient competitive interest of an adequate quality for the PFI route then they will have the independence to move to another procurement route.

The three stages of assessment also introduce increased 'budgetary flexibility' into the PFI appraisal process. If at any stage the PFI route does not look like it will provide the best procurement option then public sector capital will be made available for an alternative option to be used.

3. PFI for low capital value and IT projects to end

There has been a long running debate of the suitability of applying the PFI to some types of projects.[121] *PFI: Meeting the Investment Challenge* suggests that development and transaction costs to both the private and public sector of PFI projects with a low capital value are disproportionally high:

> The Government's policy is to use PFI only where it represents the best procurement option […] this is unlikely to be the case for projects with a small capital value.[122]

The actual minimum capital value for PFI procured projects is expected to vary from department to department and will be published at the time of the next Spending Review.[123] The Treasury have suggested that the minimum capital value is unlikely to be above £20 million. They have also proposed that including transaction cost analysis in the PSC will show where smaller projects will not offer value for money.

The document provides evidence that the performance of the PFI in IT projects has not proved:

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[120] See section V of this Paper, p32
[121] See section IV of this Paper, p32
[122] Op cit p87
[123] ibid

> able to consistently offer value for money benefits. In particular many aspects central to IT procurement do not fit well with the central requirements of PFI".[124]

The Treasury has suggested that in future "PFI in the IT sector will be replaced by a set of procurement options appropriate for different types of IT project".[125] The full range of implications for IT PFI is expected to be revealed with the publication of the results of an OGC/Treasury project to draw up guidance on IT partnering later in the year.

4. Expanding the scale and scope of PFI

PFI: Meeting the Investment Challenge outlines an expansion of the PFI in each major sector in England by 2005. The majority of the increase, on a capital value basis, is expected in the health and defence sectors. The DoH is to sign a projected fifty five deals by the end of 2005 with an estimated capital value of £6.5 billion while the MoD is expected to sign fourteen deals with a similar capital value. There is also to be increased investment in secondary schools through programmes such as the 'Building Schools for the Future' programme and 'Partnerships for Church of England Schools' programme.

The Treasury is also looking at piloting the expansion of the PFI into other sectors such as social housing, urban regeneration, waste recycling and prisons:

- **Social housing** – The Government has set a target to make all social housing 'decent' by 2010. There is already PFI involvement in reaching this commitment but it believes that the PFI could be expanded to assist with the provision of affordable and keyworkers housing;

- **Urban regeneration** – Regeneration generally involves funding from many different sources that can cause delay towards prescribed outcomes. The Treasury has suggested that the PFI could be expanded to incorporate these streams to deliver projects more quickly;

- **Waste and recycling** – There are increasingly rigorous targets facing local authorities to reduce waste and increase recycling. The PFI is ideal for this sector as the public sector can clearly define their required outcomes. Given these outcomes, the private sector could then be left to design, build, fund and operate the large capital assets required; and

- **Prisons** – Investment in new prisons is already undertaken through the PFI, with the private sector constructing and managing facilities. The Treasury believe that extending PFI involvement in the running of the existing prisons estate could bring further benefits.

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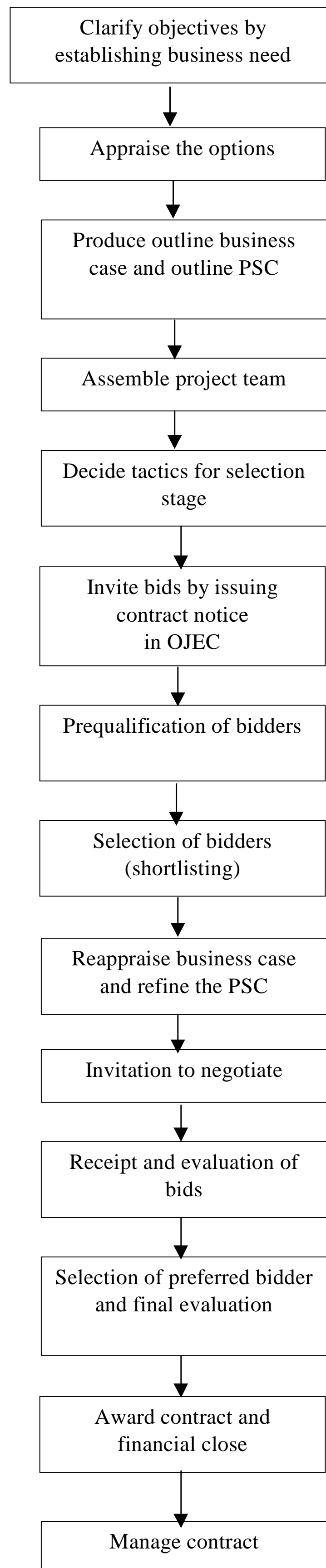
[124] ibid p54
[125] ibid p88

Appendix 1 A Step by Step Guide to the PFI Process



Source: Based on Treasury Taskforce, *Step by Step Guide to the PFI procurement Process*, November 1999

Appendix 2 Partnerships UK

Members of the Board

Executive Directors:

Chief Executive	James Stewart
Deputy Chief Executive	Michael Gerrard
Finance Director	David Goldstone

Non-Executive Directors:

Chairman	Derek Higgs
	James Sassoon (Treasury Nominee)
	Sir Steve Robson (Treasury Nominee)
	Gren Folwell
	Judith Hanratty
	Tim Stevenson

Members of the PUK Advisory Council

Government Departments:

Sir Andrew Turnbull	Cabinet Secretary
Richard Douglas	Department of Health
Stephen Crowne	Department for Education and Skills
Colin Balmer	Ministry of Defence
John Yard	Inland Revenue
William Nye	Home Office
Suma Chakrabarti	DFID
Rachel Lomax	Department for Transport
Mavis McDonald	Office of the Deputy Prime Minister

Devolved Administrations

Sandy Rosie	Scottish Executive
David Richards	National Assembly for Wales
Pat Carvill	Department of Finance Northern Ireland

Public Sector Stakeholders

Peter Gershon	Office of Government Commerce
Brian Briscoe	Local Government Association
Jeremy Colman	National Audit Office

Dr John Bridge	One North East
Ken Gillespie	Kirklees Council
Kieran Preston	Leeds Supertram Project
Paul White	Barts & the London NHS Trust
Dr. Doug Yarrow	BBSRC

Partnerships UK value statement

The Government has established Partnerships UK to accelerate the development, procurement and implementation of public private partnerships. We work exclusively with and for the public sector, committing human and financial resources in pursuit of high quality, cost effective and sustainable public services and investments. Partnerships UK is as joint venture between the public and private sectors and so is itself a PPP.

Our commitment is to:

- Put the interests of our public sector clients first
- Act with integrity, fairness and transparency
- Help set best practice in developing, procuring and implementing PPPs
- Develop new models and applications for PPPs
- Deploy our human and financial resources where they provide additionality to the public sector
- Serve all parts of the public sector in delivering Government priorities
- Earn an appropriate and sustainable return on our shareholders' investments
- Invest in and develop the skills of our people to maintain Partnerships UK as a centre of expertise in PPPs.

Investors in the 51% stake taken by the private sector in March 2001

AXA Investment Managers
Bank of Scotland
British Land
Halifax
Prudential
Serco
Abbey National
Barclays
Group 4 Falck
Jarvis
Royal Bank of Scotland

Appendix 3 The Office of Government Commerce

Members of the Supervisory Board

Rt Hon Paul Boateng MP (Chair)	Chief Secretary to the Treasury
Sir Andrew Turnbull	Cabinet Secretary
Sir Brian Bender	Permanent Secretary, DEFRA
Sir John Bourn	Comptroller and Auditor General
Clive Mather	Shell UK
Air Marshal Sir Malcolm Pledger	Deputy Chief of Defence Logistics, MoD
Sir Nigel Crisp	Permanent Secretary, Department of Health
Peter Gershon	Chief Executive, OGC
John Gieve	Permanent Secretary, Home Office
Martha Johnson	External Member
Sir Nick Montagu	Chairman of the Board, Inland Revenue
Sir Richard Mottram	Permanent Secretary, DWP
David Normington	Permanent Secretary, DfES
Sir David Omand	Security & Intelligence Co-ordinator
Sir Hayden Phillips	Permanent Secretary, Constitutional Affairs
Andrew Pinder	E-envoy
David Rowlands	Permanent Secretary, DfT
Sue Street	Permanent Secretary, DCMS
Gus O'Donnell	Permanent Secretary, HM Treasury
Sir Robin Young	Permanent Secretary, DTI

Chief Executive's Advisory Group Members

Peter Gershon (Chair)	(OGC)	Chief Executive
Michael Acheson	(DfT)	Head of Procurement Services Division
Bryan Avery	(OGC)	Executive Director of Corporate Services
Nick Bowd	(SE)	Procurement, Scottish Executive
Sue Budden	(CO)	Head of Finance, Cabinet Office
Bernadette Cass	(HMT)	Head of IT and Infrastructure
John Cavell	(HMPS)	Head of Procurement
Stephen Chard	(DFID)	Head of Procurement
Barry Cotterill	(DCMS)	Head of Procurement
Mark Davies	(NAO)	Director of Better Public Services
Julia Douch	(Wales)	Head of Procurement, Welsh Assembly
Mark Forth	(IR)	Head of Procurement
Yvonne Gallagher	(DTI)	Director Information Workplace Services
Michael Gower	(FCO)	Director of Purchasing
Dr. Andrew Holt	(DoH)	Head of Information Systems Division
Colin Lyne	(DCA)	Purchasing & Contract Management
John McMillen	(DFPNI)	Director of Central Procurement Directorate
Dave Mooney	(C&E)	Head of Logistics

Paul Neill	(DfES)	Head of Commercial Services
John Oughton	(OGC)	Deputy Chief Executive
Mark Pedlingham	(MoD)	Defence Logistics
David Rabey	(DEFRA)	Purchasing & Supply
Steve Rowsell	(HA)	Head of Procurement
Robert Scotland	(HO)	Head of Procurement
David Smith	(DWP)	Commercial Director
Mark Yeomans	(EA)	Head of Procurement

Appendix 4 Estimates of capital spending by Department

The following table sets out estimated capital spending by the private sector, by sponsoring department, for the financial years 2003/04 to 2005/06. The table shows that over the period estimated capital spending by the private sector will be just under £17bn:

Table 5: Departmental estimate of capital spending by the private sector (signed deals)

£ million

	Projections			
	2003-04	2004-05	2005-06	Total
Education and Skills[a]	0	0	0	0
Health	338	210	89	637
Transport[b]	6,624	552	370	7546
Local government[c,d]	1,940	2,330	2,700	6970
Home Office	186	150	46	382
Lord Chancellor's Department	52	6	11	69
Defence	175	0	0	175
Foreign and Commonwealth Office	5	5	5	15
Trade and Industry	6	2	0	8
Environment, Food and Rural Affairs	3	0	0	3
Work and Pensions	14	22	0	36
Scotland	381	330	1	712
Wales	43	34	0	77
Northern Ireland Executive	13	3	0	16
Chancellor's departments	49	24	11	84
Cabinet Office	12	4	0	16
Total	9,841	3,672	3,233	16746

Notes:

[a]projects funded through Revenue Support Grant are included in the local government figures.

[b] Includes the capital expenditure for Tubelines (part of the London Underground Limited Public Private Partnerships (LUL PPP) contracts) in 2003-04. Such investments that are found to be on balance sheet also score as public sector net investment.

[c] Figures represent spending on projects supported by central government through Revenue Support Grant.

[d] PFI activity in local authority schools is included in the local government line.

Source: Office of Government Commerce.