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The Committee of Public Accounts

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Summary

PFI has been used as a finance vehicle to fund public infrastructure off balance sheet for reporting public debt. The initial gain has been to the Treasury as the expenditure has been kept off the books. However the ongoing costs to the institutions at the front line have been high and the contracts inflexible, and the subject of much public debate. Yet the Treasury has no plans to assess the value for money of PFI and there is little evidence of a strategy for working with local public sector bodies to co-ordinate sharing of best practice about managing existing PFI deals. The PAC raised concerns in 2011 and it is disappointing that so little progress has been made.

Liverpool City Council is paying £4 million a year for an empty school which underlines the worst extent of the inflexibility of PFI. This flawed deal will see almost £55.5million of taxpayer funds wasted since the school became empty in 2014.

Offshore funds have bought up about half of the equity in PFI and PF2 projects so that the projects' owners are increasingly remote from the public service being delivered. In addition, offshore owners of these projects pay little tax, thereby reducing one of the benefits used to justify the contracts in the first place.

Add to this the additional costs (and profits) generated by variations to the contract and the deal is not working for the taxpayer.

The Government's reform of PFI was ultimately fairly limited, with the new PF2 only allowing greater transparency on a method that didn't change fundamentally.

We note that there are only a handful of PF2 projects in the pipeline which suggests that the Government has lost faith in its own usage of PFI. If this is the case the Government should provide a clear explanation of its position. The Infrastructure and Projects Authority has identified a need for the UK to spend £300 billion on infrastructure by 2020/21, yet PF2 is only being proposed for two projects which require total public and private investment of up to £7.8 billion.

The Treasury needs to be much clearer about its position on PFI—it maintains that the UK's level of debt and accounting treatment of PFI and PF2 do not form any part of the decision about whether to use PFI, but it is changing the design of PF2 to prevent capital costs of future projects from counting towards UK national debt statistics.

Introduction

The government has been using the Private Finance Initiative (PFI) for over 25 years to build public infrastructure assets (particularly schools, hospitals and roads) and deliver services linked to the asset. In PFI deals the public sector enters into a contract with a private company specifically created to deliver the asset. The private company raises the finance needed to fund the asset from debt and equity investors. Once the asset is constructed and available for use, the taxpayer makes annual payments to the private company over the length of the contract, typically 25 to 30 years. These annual payments cover debt and interest repayments, shareholder dividends, asset maintenance, and in some cases other services like cleaning.

There are currently over 700 PFI and PF2 contracts in operation, with around £60 billion of assets built using them. Public bodies paid £10.3 billion to private companies under these contracts in 2016–17. Even if the government does not enter into any new PFI-type deals it will pay private companies a further £199 billion between April 2017 until the 2040s for existing deals, in addition to some £110 billion already paid. In 2012, the Treasury replaced the PFI model with PF2 to address some of the previous Committee's criticisms of PFI, including inflexibility and lack of transparency. So far only six PF2 projects have been commissioned, with another two projects in the pipeline.

Conclusions and recommendations

1. **It is unacceptable that after more than 25 years the Treasury still has no data on benefits to show whether the PFI model provides value for money.** PF2 is fundamentally the same model as PFI, with some improvements around the transparency of returns to equity investors. Treasury claims that PFI and PF2 provide a range of benefits, including greater certainty over construction costs, improved operational efficiency, and higher quality and well maintained assets, although these benefits can also be achieved with methods other than PFI. PFI and PF2 deals can only be value for money if these claimed benefits exceed the higher financing and other costs of the PFI model. When asked whether the benefits have justified the higher financing costs, the Treasury acknowledged that it is "an impossible question answer" because it does not have the facts needed. The Treasury told us that it considers collecting data on the benefits of PFI to be the responsibility of individual departments. It acknowledged that it has not attempted to quantify the benefits of using PFI, despite telling the previous Committee in 2011 that it would introduce benefits realisation assessment into its value for money guidance, for PFI projects that are underway. Without quantifying the benefits it is impossible to know whether PFI offers value for money, yet the Treasury continues to assert that it does. IPA told us that they have recruited a single member of staff, to look across the entire stock of PFI and PF2 projects and see what data exists, but the exercise will only collate rather than create data, and it is unclear how the Treasury and IPA will use the results. The Treasury wrote to the Committee after the hearing to say that this work will not culminate in a published report or a review. The Department for Education has been collecting data as part of the Priority School Building Project comparing PF2 and conventional public financing, and the Treasury expects this will be completed in summer 2018.

   Recommendation: ***The Treasury and IPA should, by April 2019, publish the results of their work in collecting data on the benefits of PFI, and set out what they will do to evaluate the value for money of PFI projects currently in operation in the absence of benefits data.***

   In addition to the Priority School Building Programme (PSBP), the Treasury and IPA should take a representative sample of PFI projects with a public sector comparator, for example roads and hospitals, and undertake in depth analysis of the suggested benefits of PFI. They should publish their findings by December 2018.

2. **Some private investors have made large returns from PFI deals, suggesting that departments are overpaying for transferring the risks of projects to the private sector, one of the Treasury's stated benefits of PFI.** Private investors expect a financial return as reward for taking on risks transferred to the private sector under PFI deals. Investors in the M25 PFI deal made an estimated annual return of over 30% after selling their stake in the project after 8 years, more than double the 12%–15% annual returns expected over the life of most PFI deals. Equity returns this large may reflect errors in the pricing of risk transfer to the private sector at the time contracts were signed. We previously recommended that the Treasury should introduce arrangements to share the profits from PFI deals between private

investors and the public sector, which the Treasury rejected. It instead sought to limit excessive returns to investors through equity funding competitions, which are relatively untested, and do nothing about the rate of returns from the existing stock of PFI projects. We received written evidence from Professor Whitfield, Director of the European Services Strategy Unit, who told us that offshore infrastructure funds owned around half of the equity in PFI and PF2 projects, with the five largest of these offshore funds paying less than 1% in tax on their PFI profits. The Treasury told us that public procurement rules prevent discrimination against non-UK domicile investors. The amount of tax an investor pays is relevant, however, because the assessment of whether a prospective PFI deal is likely to provide value for money should include the corporation tax an investor is expected to pay as a benefit of PFI. The assessment may therefore overstate the benefits of the deal, and could lead to an incorrect value for money decision, if equity is subsequently purchased by offshore investment funds and corporation tax receipts are lower as a result.

Recommendation: ***The Treasury should calculate the returns to originating PFI equity investors when they sell on their stake and use the information to inform pricing for future projects. This should include the domicile of project equity holders, and what impact a reduced tax take would have had on the original project value for money tests.***

3. **The Treasury and IPA are not doing enough to identify or address the impact of individual PFI projects on local budgets.** Treasury has focused its attention on making changes to the PFI model for the rollout of PF2, rather than addressing continuing problems in the existing stock of over 700 PFI deals. PFI contracts are inherently inflexible, which can have considerable impact on budgets at a local level and in some cases wastes taxpayers' money. Despite being empty since 2010, the Parklands School in Liverpool continues to cost the Council £4 million a year in PFI costs, and a total of £47 million by the end of the contract, unless a solution can be found. IPA has accepted that this is a "very unfortunate situation", but asserted that PFI costs in general only represent a small fraction of departmental budgets. However, inflexible PFI costs can create immense pain at a local level. Departments and other public bodies have intervened in some cases where they decided that terminating the PFI contract represented value for money and best protected taxpayers' money. The Treasury and IPA do not intervene in this way, and do not actively monitor where their intervention might be helpful, for example looking across all PFI contracts for other potential buy-out candidates. There are few signs of the Treasury and IPA adopting a centralised approach to addressing the problems of legacy PFI deals to help local bodies and benefit the taxpayer. For example the Treasury told us it was not specifically looking at the Barts Health NHS Trust's PFI deal, where the Trust committed to payments of £7 billion over the contract, and paid £143.6 million in 2015 while running a deficit of over £90 million in the same year. The Treasury has taken no action to help local bodies recoup savings in insurance costs that PFI providers owe them, or to identify the scale of this problem.

Recommendation: ***The Treasury should publish how it monitors the impact of PFI at local level, how it shares good practice in contract management, and the circumstances in which it would proactively intervene to help those public bodies struggling with their PFI legacy.***

4. **The Treasury's obvious desire to keep PF2 projects excluded from government debt statistics has created risks to value for money for the taxpayer.** For a public body to use PFI and PF2, Treasury rules require it to demonstrate that this financing route provides better value for money than conventional government procurement. However, accounting rules create incentives for public bodies to use PFI for reasons other than value for money, and these incentives remain under PF2. Under national accounting rules, most PFI debt is recorded off balance sheet and excluded from public debt calculations, which is advantageous for the Treasury. The Treasury told us that the UK's level of public debt played no part in departments' decision to use PF2. Despite this, Treasury is nonetheless making changes to PF2 to ensure it remains off-balance sheet in the National Accounts. PF2 includes gain-share arrangements which entitle the public sector to a percentage share of any savings made when private PFI companies reduce their costs of borrowing through refinancing, reflecting recommendations of previous Committees. Under the National Accounts rules, the higher the percentage the public sector is entitled to, the more likely PF2 will be recorded on-balance sheet, and count towards UK debt. To avoid this, the Treasury is significantly reducing the amount the public sector will receive if savings are made, and it accepts that this will negatively impact the value for money of PF2.

    Recommendation: ***If it is no longer a Treasury requirement to keep PFI contracts off balance sheet for reporting public debt, it should revisit the original plans for PF2, and the subsequent adjustments made to keep it off balance sheet, and ensure the focus is on value for money and not accounting treatment. The Treasury should write to the Committee before any new PF2 deals are signed, demonstrating how the changes introduced under PF2 are not influenced by balance sheet treatment.***

5. **PF2 is hardly being used, and IPA hasn't made clear when its use is appropriate.** PFI has been used less over time, falling from a peak of around 60 PFI projects in 2007–08 to no new contracts at all in the last two years. Some departments say this is because of concerns about the cost efficiency and value for money of the model. Since its introduction in 2012, PF2 has only been used for six projects, with a combined capital cost of £920 million. IPA has identified a need for the UK to spend £300 billion on infrastructure by 2020–21, with over 50% of this to be privately financed. The Treasury and IPA were unclear about the scale of the pipeline and money involved. They subsequently wrote to us saying government has plans to invest between £6 billion and £7.8 billion in two new projects using PF2. It is therefore unclear how PF2, and other private finance sources, will meet the needs that the IPA identified. IPA told us that the decline in the use of PF2 is in part because government is getting better at designing and constructing projects on time and to budget, and therefore the hurdle for PF2 projects to demonstrate better value for money than public sector procurement is higher than it was for PFI. It is unclear which projects are suitable for PF2 investment, if the benefits of transferring the risks of delivering projects have fallen and only a small number of low-risk projects are being considered. If the public sector can borrow more cheaply as well as manage the risk of project overruns and delays more effectively than before, then the future scope of PF2 investment appears limited.

Recommendation: ***The Treasury and IPA should set out more clearly the nature and level of risk they consider appropriate to transfer to the private sector in PF2 projects, and outline a clearer view of how it expects public bodies to use PF2 and other types of private finance in future.***

1 The Impact of the PFI Legacy

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from HM Treasury (the Treasury) and the Infrastructure and Projects Authority (IPA) on the Private Finance Initiative (PFI) and Private Finance 2 (PF2).[1]

2. The government has been using the Private Finance Initiative (PFI) and its successor PF2 for over 25 years to build public infrastructure assets (particularly schools, hospitals and roads) and deliver services to the public. In PFI deals the public sector enters into a contract with a private company specifically created to deliver the asset. The private company raises finance from equity investors and borrowing. Once the asset is constructed and available for use, the taxpayer makes annual payments to the private company over the length of the contract, typically 25 to 30 years. These annual payments cover capital and interest repayments, shareholder dividends, asset maintenance, and in some cases other services like cleaning.

3. There are currently over 700 PFI and PF2 contracts in operation, representing around £60 billion of assets. Public bodies paid £10.3 billion to private companies under these contracts in 2016–17.[2] Even if the government does not enter into any new PFI-type deals it will pay private companies a further £199 billion between April 2017 until the 2040s for existing deals, in addition to some £110 billion already paid.[3] We examined the PFI model in 2011 as part of our inquiry into "Lessons from PFI and other projects". We concluded that taxpayers could get a much better deal from PFI deals, which looked better value for the private sector than for the taxpayer, and that in the prevailing public expenditure climate there were legitimate concerns being expressed about the continuing financial cost of PFI for public organisations such as NHS Trusts.[4]

Quantifying the benefits of using PFI

4. It costs more for public bodies to raise finance through PFI than through conventional procurement.[5] The cost of private sector borrowing can be as much as 2% to 3.75% more expensive than the cost of government borrowing.[6] To represent value for money for the taxpayer, the benefits of using the PFI model must be greater than the higher financing costs.[7] The Treasury told us that the PFI model provides a range of benefits for the public sector, including greater certainty over construction costs, improved operational efficiency,[8] and well-maintained, higher quality assets which are usually returned to public bodies at the end of the contract period.[9] These benefits are also achievable through methods other than PFI–for example, fixed contracts have been used to reduce cost overruns in publicly-financed projects.[10] The Treasury told us that the delivery of more than 700 projects was the main benefit of the model, and that using PFI had resulted in more schools, hospitals

1 Report by the Comptroller and Auditor General, PFI and PF2, Session 2017–19, HC 718, 18 January 2018
2 C&AG's Report, para 2.4
3 C&AG's Report, para 2.4; NAO briefing, The choice of finance for capital investment, March 2015, para 2.9
4 Committee of Public Accounts, Lessons from PFI and other projects, 44th Report of Session 2010–12, HC 1201, 1 September 2011
5 C&AG's Report, para 1.5
6 Q 59
7 C&AG's Report, para 1.24
8 C&AG's Report, para 1.5
9 Q22
10 C&AG's Report, para 1.8

and public infrastructure. It told us that another benefit was that these projects were being maintained using Special Purpose Vehicles (SPVs), which it asserted meant they were being maintained to a higher standard compared to the backlog of maintenance work often found in publicly funded projects.[11]

5. Despite these assertions, after more than 25 years since the first PFI contracts, the Treasury has not attempted to quantify the benefits of using PFI.[12] This is despite the Treasury telling the previous Committee in 2011 that it would introduce benefits realisation assessment into its value for money guidance, for PFI projects that are underway.[13] The Treasury recognised that PFI projects have a "mixed record" of success but told us that ministers had decided not to request the work required to look back at the historic legacy.[14] The Treasury told us that it considered collecting data on the benefits to be the responsibility of individual departments, and told us that its own focus is forward-looking to ensure that future PF2 projects work effectively rather than looking back over the historic stock of PFI deals.[15] The IPA told us that data on the benefits of PFI doesn't exist, and to collect retrospective data against credible counterfactuals across the entire stock of projects would be a huge amount of work and a significant expense.[16] We were concerned that this lack of historical data has left a large gap in the Treasury and IPA's understanding of the benefits of PFI.[17] IPA accepted that this was frustrating and that in an ideal situation, it would have an asset register for each Department and each devolved authority, tracking the costs, benefits and status of PFI contracts, as might happen in the private sector.[18] When we asked whether the benefits of PFI have justified the higher financing costs, the Treasury told us that this was "an impossible question to answer", because it did not have the facts needed.[19] We were concerned that without any data quantifying benefits, the Treasury and IPA cannot assess whether PFI has been value for money,[20] and the taxpayer cannot have confidence in PFI projects.[21]

6. The IPA told us that it had recruited a single member of staff, "pretty much on a full-time basis", to identify what data on the benefits of PFI exists across all 700 projects in the PFI portfolio.[22] This exercise will only collate rather than create data. The Treasury and IPA told us that this is on-going analysis to inform future investment decisions, which will not result in a report.[23] IPA told us that the other area it will focus on will be schools and hospitals nearing the end of their PFI contracts and comparing them against publicly–financed assets to see if the whole life benefits of PFI are materialising, for example how well maintained they are.[24] It is entirely possible to collect data on benefits and undertake these exercises: the Department for Education is already collecting data, as part of the Priority School Building Programme, comparing the value for money of privately

11 Q22
12 Q45
13 Committee of Public Accounts, Lessons from PFI and other projects, 44th Report of Session 2010–12, HC 1201, 1 September 2011, oral evidence Q 200
14 Q23
15 Q23
16 Qq 45, 50
17 Q49
18 Q51
19 Qq 59, 63
20 C&AG's Report, para 1.24
21 Q51
22 Q46
23 Correspondence with HM Treasury, 11 April 2018
24 Q48

financed schools on PF2 contracts against public financed ones.[25] The Treasury told us that the Department for Education's review was not initiated by either the IPA or HMT, and expects it will be completed in the summer of 2018.[26]

There Returns to PFI investors

7. The financing structure of a PFI contract typically consists of 90% debt, in the form of bank loans, and 10% equity provided by investors.[27] Private investors require a return on their investments to compensate for risks transferred to them under a PFI deal. Investors fall into two categories: primary investors and secondary investors. Primary investors usually invest during the construction stage of a project, and typically sell after construction to secondary investors who want to invest in an operational project, because the risk of project failure is much lower after the asset has been built.[28] In some PFI deals equity investors have been able to generate high returns, particularly when equity is sold after construction.[29] Shareholders in the M25 PFI deal, for example, made estimated returns over an eight-year period equivalent to 31% a year when selling their stake in the project.[30] This is more than double the typical 12–15% returns investors can expect to receive over the life of a PFI project.[31] In written evidence, Professor Dexter Whitfeld, Director of the European Services Strategy Unit, told us that returns to investors in excess of 25% are not uncommon in PFI projects. His analysis of 118 transactions that involved the sale of equity revealed an average return to investors of 28.7%.[32] Equity returns this large may reflect errors by departments in their pricing of risk transfer to the private sector at the time they entered into the contracts.[33] We examined equity returns in 2010 and concluded that excessive gains may indicate overpriced PFI contracts.[34]

8. The previous Committee suspected in 2011 that initial investors were able to make excessive profits from selling PFI shares, but lacked the information to be sure. It believed that there was a strong case for sharing these gains with the government. The Committee recommended that the Treasury should introduce arrangements for sharing in investors' gains.[35] The Treasury partially accepted this recommendation saying that consideration would be given to the sharing of gains from PFI equity investors.[36] However, the Treasury told us that it had decided against introducing sharing arrangements, despite other countries using such arrangements.[37] Instead the Treasury sought to address the problem by introducing equity funding competitions.[38] These competitions are intended to drive down the price of equity by creating competitive tension between bidders seeking to

25 Q24
26 Qq 24, 84, 88
27 C&AG's Report, figure 1
28 C&AG's Report, para 3.12
29 C&AG's Report, para 3.12
30 C&AG's Report, para 3.12
31 Professor Dexter Whitfield (PFI0001) para 1.1
32 Professor Dexter Whitfield (PFI0001) para 1.1
33 C&AG's Report, para 3.12
34 Committee of Public Accounts, Financing PFI projects in the credit crisis and the Treasury's response, 9th Report of Session 2010–11, HC 553, 9 December 2010
35 Committee of Public Accounts, Financing PFI projects in the credit crisis and the Treasury's response, 9th Report of Session 2010–11, HC 553, 9 December 2010
36 HM Treasury, Government responses on the Twenty Eighth and the Forty Second to the Forty Fifth Reports from the Committee of Public Accounts, Session 2010–12, Cm 8212, October 2011
37 Qq 71–75
38 Qq 29, 76

invest in a portion of the project equity.[39] Government has only used an equity funding competition in one PF2 deal to date, and while this successfully resulted in lowering the returns to equity investors, the approach is relatively untested.[40] Moreover, the changes only affect future PF2 deals, and do nothing about excessive returns investors can make on the historic stock of over 700 projects. The public sector will also invest as minority equity stake in all future PF2 deals, which should increase transparency to these returns as the public sector will have a seat on the PFI provider's Board.[41]

9. We were concerned to hear of high profile cases where the equity element of PFI contracts have been sold to offshore investment funds that pay little or no corporation tax in the UK, which we first drew to the Treasury's attention in 2011.[42] The previous Committee highlighted the potential for tax avoidance through the sale of equity in the secondary market to investors non-domiciled in the UK.[43] The Treasury told us that, while the vast majority of PFI companies are UK tax domiciled and pay corporation tax, public procurement rules prevent discrimination against non-UK domiciled companies and investors.[44] As a result, the Treasury cannot control where secondary PFI investors are located, and can only take action if there is evidence of inappropriate tax evasion.[45] Professor Whitfield told us that offshore infrastructure funds owned around half of the equity in PFI and PF2 projects, with the five largest offshore infrastructure funds making profits of £2.9 billion in the 5 year period between 2001–2017, and paying less than 1% in tax on their PFI profits.[46] The Treasury's rules require departments to undertake a value for money assessment of a PFI or PF2 deal, and the amount of corporation tax a private company is expected to pay is one component of this. The higher the amount that the company is expected to pay, the more likely that the PFI option will be judged value for money. These tax adjustments have historically been criticised for being too high.[47] If the calculations do not reflect the reality that offshore investors dominate the secondary market, then the estimated benefits will be overstated.[48] We were concerned that this could lead to an incorrect conclusion that the PFI or PF2 deal offers better value than the project being financed by the public sector.[49]

Consequences of PFI at local levels

10. The Treasury and IPA have focussed on introducing PF2 and making changes to the private finance model as part of this, rather than looking at the much larger historic stock of 700 PFI projects, where the biggest problems persist.[50] The Treasury accepted that the success of PFI projects has been a "mixed record", and told us that one of the main problems with PFI has been the "rigidity and inflexibility" of contracts and their associated

39 Qq 29, 76
40 C&AG's report, para 3.13
41 Q122
42 Q 26
43 Committee of Public Accounts, Equity Investment in privately financed projects, 81st Report of Session 2010–12, HC 1846, 2 May 2012
44 Qq 26–27
45 Q27
46 Professor Dexter Whitfield (PFI0001) para 2.2 and 3.1
47 C&AG's Report, para 1.31, C&AG's Report, Review of the VFM assessment process for PFI, October 2013, para 3.30–3.35 and Figure 8
48 C&AG's Report, para 1.31
49 Public Accounts Committee, Equity Investment in privately financed projects, 81st Report of Session 2010–12, HC 1846, 2 May 2012, para 12
50 Q89

long term costs.[51] For example, Liverpool City Council is currently paying around £4 million each year in PFI fees for Parklands High School, which has been empty since 2014. The Council is contracted to pay a further £47 million until 2028.[52] IPA told us that this is a "very unfortunate situation" but asserted that PFI expenditure only represents a very small percentage of departmental budgets.[53] But inflexible PFI costs can create immense pain at a local level. For example, the National Audit Office reported in 2010 that for one Health Trust, PFI payments represented more than 20% of turnover. Pressures on public finances have increased since then, so this figure could be even higher now, given PFI payments increase with inflation.[54]

11. The Treasury told us that unless contracts can be terminated on a voluntary basis, which does not always provide value for money, or renegotiated, then there is not always a solution to the problem of large payments under inflexible PFI contracts.[55] The Treasury told us that this is especially true in older contracts (particularly those signed before 2000), where public bodies have no other choice but to pay for an asset even if it is not being used.[56] Public bodies have terminated contracts where they considered it value for money to do so. In 2017, for example, the Greater Manchester Waste Disposal Authority terminated its recycling and waste management PFI contract.[57] In 2014 the Northumbria Healthcare NHS Foundation Trust terminated its PFI contract for Hexham hospital, although the IPA has expressed significant doubts about the value for money of buying out that contract.[58]

12. The Treasury told us that it is the combined responsibility of the Treasury, IPA and the procuring department to ensure that demand forecasts are reliable to reduce the likelihood that a new school or hospital is left empty part way through a PFI contract, as in the case of Parklands School.[59] The Treasury and IPA do not actively monitor struggling PFI deals to assess whether intervention might be helpful.[60] The Treasury explained that it only becomes involved when departments present a proposal to buy out a PFI contract, or to renegotiate it in a way that was novel or contentious.[61] The Treasury and IPA do not, for example, look across the entire stock of PFI contracts to see if there are any contracts that would be suitable for voluntary termination.[62] For example the Treasury told us it was not specifically looking at the Barts Health NHS Trust's PFI deal, where the final cost of the project will be £7 billion over the life of the contract, with the hospital trust making payments until 2049. The Trust paid £143.6 million in PFI payments in 2015 while running a deficit of over £90 million in the same period, causing significant budgetary pressures.[63]

13. Another problem currently affecting many public bodies relates to PFI insurance. PFI contracts require the cost of insurance to be agreed at the start of the contract. Public bodies then are entitled to share in any savings should the cost of insurance fall. However

51 Qq 23, 89
52 Qq 92–93, C&AG's Report, Figure 1.21
53 Qq 89, 90, 92–93
54 C&AG's Report, para 2.5–2.6
55 Q 93
56 Qq 92, 93
57 Qq 89, 112
58 Q 109, C&AG's Report, para 2.20
59 Q 95
60 Qq 112–120
61 Qq 111, 117–118
62 Qq 112–113
63 Qq 99, 101–104

there are examples whereby private companies are deliberately withholding money owed to public bodies following a fall in insurance costs. We questioned the IPA on how they are addressing this problem and they told us it was undertaking a review of the PF2 standard contract guidance looking specifically at the costs of insurance.[64] This review fails to address problems being faced in existing PFI contracts, and the full extent of this issue remains unquantified. It remains unclear what the Treasury is doing to help local bodies recoup insurance cost savings PFI providers owe them.[65]

64 Q 128, C&AG's report, para 2.10

65 Q 128

2 Decisions about future investments and PF2

14. In 2012, the Treasury replaced the PFI model with PF2 as part of efforts to address some of the previous Committee's criticisms of PFI, including inflexibility and lack of transparency. PF2 is not fundamentally different to the PFI model. Treasury told us that it considered PF2 to be a valuable means of delivering public assets and services, but only when it is used for the right projects with the right type of risks. It told us that it was being more selective in its use of PF2 to ensure that projects represented value for money.[66] So far only six PF2 projects have been commissioned, with another two projects in the pipeline.[67]

15. The public sector can borrow more cheaply than the private sector.[68] According to Treasury rules, any decision to invest using PFI or PF2 needs to be supported by an assessment demonstrating that PFI provides better value for money than conventional public sector procurement.[69] Prior to 2012, this assessment comprised of a qualitative and quantitative component, however, following a number of criticisms (such as adjustments favouring PFI that lacked an empirical basis) the Treasury withdrew the quantitative model and guidance.[70] The Treasury told us that for PF2 deals it would work with the IPA and relevant departments to assess whether a deal meets the criteria set out in the government's Green Book, including assessing the reliability of demand forecasts, and the affordability of the proposed deal.[71]

16. Aside from value for money assessments, there remain budgeting and accounting incentives that encourage the use of PFI in preference to other procurement approaches, and are unaddressed under the new PF2 model. In 2012 the previous Committee found that PFI projects rarely scored against scarce departmental budgets, giving departments an incentive to use PFI to provide public assets and services, particularly in times of public expenditure constraints.[72] The UK produces National Accounts, recording and describing economic activity in the UK, which include important statistics such as Gross Domestic Product (GDP) and the UK's headline debt statistics such as Public Sector Net Debt (PSND). The National Accounts are produced using internationally agreed rules. Under these rules, most PFI debt is not recorded on the government balance sheet and is excluded from calculations of the level of debt within the public sector (often described as "off balance sheet"), which is advantageous to the Treasury.[73] Departmental budgets are set using the same principles as the National Accounts. When departments use PFI, the payments are spread over the life of the contract, with no large upfront payment as there would be if government borrowing was used. This is beneficial for departments that have limited capital budgets but, for example, need to build a school or a hospital, and departments have said that they were only able to build certain assets through PFI as there was no other finance available.[74] The National Accounts are different to the Whole

66 Q 123
67 Qq 39, 127
68 Q 121
69 Q 30; C&AG's Report, para 1.27
70 Q 23; C&AG's Report, para 1.32
71 Qq 95, 123
72 Committee of Public Accounts, Equity Investment in privately financed projects, 81st report of Session 2010–12, HC 1846, 2 May 2012
73 Qq 56, 131–132
74 C&AG's Report, para 1.14

of Government Accounts (WGA), which consolidate all financial statements across the public sector and are produced using a different set of accounting rules that recognise most PFI projects as on the government balance sheet.[75]

17. The Treasury told us that PFI and PF2 is only used if it demonstrates value for money compared to conventional public sector procurement, and that the UK's level of debt and the balance sheet treatment had no bearing on a decision to use PFI and PF2.[76] Despite this, Treasury is making changes to PF2 to ensure it remains off balance sheet in the National Accounts. For example, private companies can reduce costs and make gains by refinancing debt if the cost of borrowing has fallen since the PFI deal was originally signed. Previous Committees emphasised the need for the taxpayer to share in these type of gains, saying that a refinancing can greatly increase the returns to the private sector and change the balance of risks and rewards.[77] In response, the Treasury established "gain–share arrangements" allowing public bodies to take 50% of any savings made by private companies in refinancing the PFI or PF2 debt.[78] Under the National Accounts rules, the higher the percentage the public sector is entitled to, the more likely PF2 will be recorded on the balance sheet and count towards UK debt. In 2016, Eurostat, the statistical office of the European Union, made changes to the rules governing the National Accounts, meaning that the PF2 model would be recorded on balance sheet and count towards UK public debt.[79] To avoid this, the Treasury is significantly reducing the percentage that the public sector will receive if savings are made, from 50% to just 33%.[80] Ministerial submissions have stated that the Treasury has recognised that this change will have a negative impact on value for money.[81]

Use of Private Finance 2 (PF2)

18. The public sector has used PFI less and less over time, falling from a peak of over 60 projects in 2007–08 to no new PF2 contracts at all in the last two years.[82] IPA told us there are other ways of involving the private sector in infrastructure investment, and over the last five years the government has secured more infrastructure investment using these other methods than through PF2.[83]

19. Since its launch in 2012, only 6 projects have used PF2: the Priority School Building Programme (PSBP), which will build 46 schools in five batches, and the Midland Metropolitan Hospital.[84] The projects have capital costs of £623 million and £297 million respectively.[85] The Treasury and IPA were unclear in evidence to us about the scale of the pipeline of PF2 projects, or the money involved. In subsequent written evidence, the Treasury told us that there are only two projects that are expected to be financed by PF2: an upgrade of the A303 Stonehenge tunnel and the approach roads to the Lower Thames

75 C&AG's Report, para 1.16
76 Qq 57, 58
77 Committee of Public Accounts, The Refinancing of the Fazakerley PFI Prison Contract, 13th Report of Session 2000–01, HC 955, 4 July 2001, para 5; Committee of Public Accounts, Lessons from PFI and other projects, 44th Report of Session 2010–12, HC 1201, 1 September 2011, para 3
78 C&AG's Report, para 3.18
79 C&AG's Report, para 3.18
80 C&AG's Report, para 3.18
81 C&AG's Report, para 3.18
82 Q 32; C&AG's Report, Figure 6
83 Q 134, C&AG's Report, para 3.22
84 C&AG's report, para 3.19
85 C&AG's Report, para 3.19

Crossing.[86] The Treasury expects investment in the two projects will amount to between £6 billion and £7.8 billion.[87] When questioned on the future use of PF2, the Treasury said that PF2 will only be used in a "handful" of cases over the next three years, but were unclear on the number and cost of future projects.[88] The Treasury told us that it now views PF2 as a "useful tool" in a range of options for financing public infrastructure, but that it will use it in a more focused way. It confirmed that it would not return to the levels of investment seen at the height of PFI, which saw investment peak at £8.6 billion in 2007–08.[89] Some departments have said that their reduced use of PFI and PF2 results from concerns about cost efficiency and value for money.[90] The Treasury and IPA told us that PF2 is being used less because the public sector is now better at managing project risk, thereby reducing the probability that publicly funded projects with be delayed and run over budget.[91]

20. The Treasury told us that the outlook for investment in infrastructure is very ambitious.[92] In 2016, the IPA identified a need to invest in £300 billion of infrastructure by 2020–21, and expects the private sector to finance half.[93] On current projections PF2 looks likely to provide a relatively small role in achieving these aims, and it appears unclear how far PF2, and similarly other private financing, will help the UK meet these financing needs.[94]

21. We asked the Treasury when PF2 investment would be suitable, if the public sector is now much better at managing risk and can borrow more cheaply. The Treasury told us that the transfer of a project's risk from the public sector to the private sector was one of the main benefits of the PFI model. But it accepted that risks should only be transferred to those who are able to manage them better than in the public sector.[95] Some assets are more complex, and therefore risky, to build than others. Around two-thirds of all current PFI contracts involve "accommodation", (for example schools) which is considered to involve relatively low construction risk.[96] The Treasury told us that it considers PF2 to be a specialist tool, appropriate in a relatively narrow set of circumstances, and if the risk transfer is not suitable, then PF2 is not the right structure for investment. As such, large, complex projects such as HS2 and Crossrail are now being funded publicly.[97] The IPA told us that only projects where the private sector is best placed to identify and manage risks should be considered for PF2, and that projects that are large, with too much complexity and technology risk (such as IT projects) are unsuitable for PF2.[98] If PF2 is more targeted than PFI, and the public sector is better at managing projects as well as being able to borrow more cheaply, it becomes more difficult to justify using PF2 because there is a smaller range of projects where the private sector is better placed to manage risk, and the future scope for PF2 to contribute to the UK's infrastructure investment needs looks limited.[99]

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86 Qq 34, 39
87 Correspondence with HM Treasury, 11 April 2018
88 Qq 31–41
89 Qq 23, 30–31
90 C&AG's Report, para 2.3
91 Q41
92 Q 132
93 C&AG's report, para 1.2
94 Qq 41, 123, 130, 132
95 Qq 22, 31, 80
96 C&AG's Report, para 1.7
97 Q 121
98 Q120
99 Qq 41, 121

Formal minutes

Wednesday 13 June 2018

Members present:

Meg Hillier (in the Chair)

Sir Geoffrey Clifton-Brown	Shabana Mahmood
Chris Evans	Layla Moran
Caroline Flint	Anne Marie Morris
Luke Graham	Lee Rowley

Draft Report (*Private Finance Initiatives*) proposed by the Chair, brought up and read.

Ordered, That the draft Report by read a second time, paragraph by paragraph.

Paragraphs 1 to 21 agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report by the Forty-sixth of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report by made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 18 June at 2.30pm

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Wednesday 28 March 2018

Question number

Charles Roxburgh, Second Permanent Secretary, HM Treasury, **Tony Meggs**, Chief Executive, Infrastructure and Projects Authority, and **Matthew Vickerstaff**, Deputy Chief Executive, Infrastructure and Projects Authority — Q1–134

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

PFI numbers are generated by the evidence processing system and so may not be complete.

1 Association of Investment Companies (PFI0005)

2 Elliott Asset Management Ltd (PFI0002)

3 Professor Dexter Whitfield (PFI0001)

4 The Lift Council (PFI0004)

5 UNISON (PFI0003)

Published correspondence

The following correspondence was received and can be viewed on the inquiry publications page of the Committee's website.

1 Correspondence with HM Treasury, dated 11 April

List of Reports from the Committee during the current session

All publications from the Committee are available on the publications page of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2017–19

First Report	Tackling online VAT fraud and error	HC 312 (Cm 9549)
Second Report	Brexit and the future of Customs	HC 401 (Cm 9565)
Third Report	Hinkley Point C	HC 393 (Cm 9565)
Fourth Report	Clinical correspondence handling at NHS Shared Business Services	HC 396 (Cm 9575)
Fifth Report	Managing the costs of clinical negligence in hospital trusts	HC 397 (Cm 9575)
Sixth Report	The growing threat of online fraud	HC 399 (Cm 9575)
Seventh Report	Brexit and the UK border	HC 558 (Cm 9575)
Eighth Report	Mental health in prisons	HC 400 (Cm 9575) (Cm 9596)
Ninth Report	Sheffield to Rotherham tram-trains	HC 453 (Cm 9575)
Tenth Report	High Speed 2 Annual Report and Accounts	HC 454 (Cm 9575)
Eleventh Report	Homeless households	HC 462 (Cm 9575) (Cm 9618)
Twelfth Report	HMRC's Performance in 2016–17	HC 456 (Cm 9596)
Thirteenth Report	NHS continuing healthcare funding	HC 455 (Cm 9596)
Fourteenth Report	Delivering Carrier Strike	HC 394 (Cm 9596)
Fifteenth Report	Offender-monitoring tags	HC 458 (Cm 9596)
Sixteenth Report	Government borrowing and the Whole of Government Accounts	HC 463 (Cm 9596)
Seventeenth Report	Retaining and developing the teaching workforce	HC 460 (Cm 9596)

Eighteenth Report	Exiting the European Union	HC 467 (Cm 9596)
Nineteenth Report	Excess Votes 2016–17	HC 806 (Cm 9596)
Twentieth Report	Update on the Thameslink Programme	HC 466 (Cm 9618)
Twenty-First Report	The Nuclear Decommissioning Authority's Magnox	HC 461 (Cm 9618)
Twenty-Second Report	The monitoring, inspection and funding of Learndirect Ltd.	HC 875 (Cm 9618)
Twenty-Third Report	Alternative Higher Education Providers	HC 736 (Cm 9618)
Twenty-Fourth Report	Care Quality Commission: regulating health and social care	HC 468 (Cm 9618)
Twenty-Fifth Report	The sale of the Green Investment Bank	HC 468 (Cm 9618)
Twenty-Sixth Report	Governance and departmental oversight of the Greater Cambridge Greater Peterborough Local Enterprise Partnership	HC 896 (Cm 9618)
Twenty-Seventh Report	Government contracts for Community Rehabilitation Companies	HC 897 (Cm 9618)
Twenty-Eighth Report	Ministry of Defence: Acquisition and support of defence equipment	HC 724 (Cm 9618)
Twenty-Ninth Report	Sustainability and transformation in the NHS	HC 793 (Cm 9618)
Thirtieth Report	Academy schools' finances	HC 760 (Cm 9618)
Thirty-First Report	The future of the National Lottery	HC 898
Thirty-Second Report	Cyber-attack on the NHS	HC 787
Thirty-Third Report	Research and Development funding across government	HC 668
Thirty-Fourth Report	Exiting the European Union: The Department for Business, Energy and Industrial Strategy	HC 687
Thirty-Fifth Report	Rail franchising in the UK	HC 689
Thirty-Sixth Report	Reducing modern slavery	HC 886
Thirty-Seventh Report	Exiting the European Union: The Department for Environment, Food & Rural Affairs and the Department for International Trade	HC 699
Thirty-Eighth Report	The adult social care workforce in England	HC 690
Thirty-Ninth Report	The Defence Equipment Plan 2017–2027	HC 880

Fortieth Report	Renewable Heat Incentive in Great Britain	HC 696
Forty-First Report	Government risk assessments relating to Carillion	HC 1045
Forty-Second Report	Modernising the Disclosure and Barring Service	HC 695
Forty-Third Report	Clinical correspondence handling in the NHS	HC 929
Forty-Fourth Report	Reducing emergency admissions	HC 795
Forty-Fifth Report	The higher education market	HC 693
First Special Report	Chair of the Public Accounts Committee's Second Annual Report	HC 347