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GOV/PGC/SBO(2015)8

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

02-Dec-2015

English - Or. English

**PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE
PUBLIC GOVERNANCE COMMITTEE**

Working Party of Senior Budget Officials

**OECD REVIEW OF PUBLIC GOVERNANCE OF PUBLIC-PRIVATE PARTNERSHIPS IN THE
UNITED KINGDOM**

The data presented in this paper was correct as of April 2015. It does not take into account changes that may have occurred after this date.

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JT03387664

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EXECUTIVE SUMMARY

The *OECD Review of Public Governance of Public-Private Partnerships in the United Kingdom* discusses the UK PFI framework according to the 2012 Principles for Public Governance of PPPs. The purpose of this review was to provide a point of departure for a peer-to-peer discussion on the UKs' PFI experiences at the 8th Annual Meeting of Senior PPP Officials on the 23rd of March 2015, in Paris.

The overall conclusion is that the UK firmly lives up to the Principles and that the Principles allow a comprehensive assessment of a national PPP program.

The OECD would like to thank the UK for agreeing to cooperate in this review process. Jo Fox, Head of PFI Policy and Andy Carty, Member of the Management Board, Infrastructure UK, HMT, were responsible for the extensive UK effort in this endeavour. The OECD would also like to thank the peer reviewer, Francois Bergere, Head of the PPP Task Force, Ministry of Finance, France.

The main mission for this report took place on 30 June-4 July 2014. The mission team consisted of Ian Hawkesworth (lead, OECD), Steven Perkins (ITF) and Ihssane Loudiyi (OECD). Additional assistance was provided by Dejan Makovsek (ITF) and Juan Garin.

This summary is structured in the following way: The new developments with regards to PF2 are introduced followed by the institutional framework, the issue of value for money and the budgetary framework.

New developments – introduction of PF2

The private finance initiative (PFI) in the UK was introduced in the early 1990s to provide an alternative mode of infrastructure financing at a time where traditional government financing was showing its limits both in terms of execution and in terms of finance. Since then, PFIs and the framework surrounding them, have evolved significantly in the UK. They are today part of an integrated framework and are considered a choice, among others, on how to procure infrastructure. As a devolved matter, governments in the UK have updated the PFI model in a number of ways. The Scottish Government replaced PFI with the Non-Profit Distributing (NPD) model of procurement which has been used to deliver a pipeline of projects in recent years. Wales has recently announced a pipeline of projects using a similar model to NPD. This report focuses on the evolution PF2 in England.

The PFI model has been adjusted over time as experiences have been absorbed and rules and norms have been updated. Gradual changes include the treatment and sharing of re-financing gains, the definition of force majeure and the basic risk sharing arrangements to the standard PFI contract.

The PFI model has been adjusted over time as experiences have been absorbed and rules and norms have been updated. A standard contract for PFI was introduced in the late 1990's and has been continually updated as the market developed and matured. A few of these updates were significant (like the introduction of sharing the benefits from refinancing) but most involved the gradual refinement of the risk sharing arrangements.

Private Finance 2 (PF2) was introduced in 2012 as an update of the Private Finance Initiative (PFI) in order to inject more transparency, flexibility, and public oversight into private partnership projects. This update stems from a political need to address criticism expressed by public and private stakeholders to speed up the procurement process, to have more transparency regarding project returns, and to make available more innovative financing, among others. Under PF2, the government will take minority equity positions in the

SPV project company. This is meant to alleviate information asymmetry and will give the government part in the return on investment from the SPV. This increased government involvement is not expected to significantly reduce the price of capital for the project. The government's equity participation potentially comes with increased project risks and potential conflicts of interest – the latter being mitigated by the newly established Infrastructure UK equity unit in HM Treasury.

While public and private stakeholders are largely supportive of PF2, some bank and industry voices would like a stronger PF2 project pipeline. Two PF2 contracts have come to financial close since the launch of the program two years ago, and a few more are currently under way. However, there have been approximately 800 PFI projects transacted in the UK, and 700 that are operational, making the UK still one of the most active PFI markets in the world.

The institutional framework for PFIs in the UK

The first PPP principle emphasises the importance of the political leadership ensuring public awareness of the relative costs, benefits and risks of PFIs and conventional procurement. Transparency on the costs, relative benefits and challenges of PFIs is evident in the UK and indeed in the debate leading to the introduction of PF2. In its Whole of Government Accounts (WGA), HM Treasury discloses commitments and future liabilities of PFI/PF2 contracts. The Office for Budget Responsibility also does a dedicated job in making contingent liabilities transparent in a readable manner. The National Audit Office (NAO) plays a key role in informing the public debate about PFIs in the UK through its regular reports to Parliament.

The second PPP principle focuses on the importance of clear institutional roles and strong capacities across involved institutions. The institutional set up and public sector capabilities for PFIs and capital projects generally are clear and coherent. Public officials understand what their role is, and what the role of their counterpart is. HM Treasury's Infrastructure UK (IUK) is well capacitated and its different units regularly advise procuring authorities, Ministers, and HM Treasury regarding the appropriateness of PFI as a procurement mode for infrastructure. HM Treasury's spending teams review and approve significant investment projects, including PFI projects, at appropriate decision points. They are informed by advice from IUK and other oversight institutions such as the Major Projects Authority. As the Supreme Audit institution, the NAO assesses projects and programmes for value for money and derives lessons for the future in order to further improve the framework for PFI/PF2 projects¹. Local Partnerships have been established to provide dedicated commercial support to local authorities across different stages of the project cycle, including through procurement and delivery. There can still, however, be a capacity gap at the local level.

The third PPP principle calls on countries to ensure that all significant regulation affecting the operation of PFIs is clear, transparent and enforced. The UK follows contract law for PFIs and EU procurement directives. There are no apparent issues with respect to the current regulatory framework. Efforts are ongoing to further strengthen this framework through stronger central oversight over the procurement process, and more standardized processes and documents to speed up projects' financial close. Under PF2 projects the competitive phase of the procurement process is expected to be no longer than 18 months.

Ensuring value for money from PFI

The fourth PPP principle focuses on prioritisation, requiring all investment projects to be prioritised at senior political level. The UK National Infrastructure Plan and its 'Top 40 projects' is a good example of a cabinet sanctioned priority process. The allocation of funds and final affordability test happens as part of the budget process.

¹ Note that devolved administrations and local authorities have separate audit bodies.

The fifth PPP principle emphasises that countries should carefully assess which investment method is likely to yield most value for money. All infrastructure projects are subject to the Green Book business case and appraisal process. This process encompasses five interrelated aspects which are developed from the outline business case to the final business case: the strategic case (is there a robust argument for change?), the economic case (how to optimise value for money), the commercial case, if relevant (is the delivery model commercially viable?), the financial case (is it financially affordable?), and the management case (can it be delivered successfully?).

There has been much debate about the Public Sector Comparator (PSC). The PSC value for money test was never meant to be a 'pass or fail' test, it was meant to be an element in a careful case that the line department should build in order to choose the appropriate procurement strategy. The centrally developed value for money test was initially introduced so that departments did not have to develop tailor made models. However, on balance, HM Treasury has concluded that a more bespoke model feeding into the comprehensive Green Book process is probably the better approach, which is why the quantitative, centrally-issued value for money model was removed in 2010.

The discount rate that was applied for PFI projects has been questioned in the past by the NAO. The NAO argued that instead of the time preference rate, a rate reflecting the government's cost of borrowing could be used instead. HM Treasury holds that the time preference rate is appropriate since a line department must take the government's borrowing limit as given. The OECD team agrees with this approach as it considers the value for money exercise as an extension of the classical investment appraisal process. Government agencies in a number of countries have developed methodologies for establishing value for money, often based on methodologies developed initially by the UK Government. Such exercises tend to over-focus attention on the numerical result of the exercise rather than the full set of considerations as reflected in the full Green Book process. The recent changes in UK assessment guidelines are therefore important beyond its borders. The changes are intended to achieve a better balance in the evidence presented to decision makers which is a positive development.

The sixth PPP principle states that the risks should be transferred to those that manage them best. By doing so, it is hoped to achieve better risk management, leading to enhanced cost efficiency. Standardised contracts in the UK provide a sound basis for the allocation of generic risk in a PFI project. In general, apart from expert opinions, (too) little is known empirically on the impact of risk transfer for the overall value for money of projects. However, as part of the UK's appraisal of the PFI model, evidence was collected from stakeholders identifying certain issues with regards to the allocation of risk to the party best able to manage it. Some respondents suggested changes to the typical risk allocation framework, highlighting that the retention and management of certain risks within the public sector could potentially improve value for money. Greater risk retention by the public sector, such as utility consumption risk, can now be noted under the new PF2 scheme to address these issues.

The seventh PPP principle emphasises that procuring authorities should be prepared for the operational phase of PFI projects. In terms of maintaining and evaluating VfM during the operational phase, the technical/operational performance of PFIs is difficult to assess due to a lack of comparable systematic data collection. Evidence suggests that performance has been good in terms of on-time and on-budget delivery of PFI assets, which also mirrors OECD research². The issue of sufficient monitoring and negotiation skills on the public side has often been raised. Some initiatives have been started to mitigate this, but the effects are unclear at this time.

The eighth PPP principle underlines the importance of maintaining value for money when renegotiating a PFI contract. The NAO (2008) surveyed 171 PFI projects (from all sectors) for the year 2006, in which

² OECD (2013) Government at a Glance. OECD Publishing: Paris.

they found the monetary impact of changes to contracts amounting to a 1.1 % increase in unitary charges for the projects that were renegotiated. The general impression for the UK is that, on average, contract renegotiations do not appear to be an issue, at least not to the extent that would incentivize strategic behaviour as a rule by parties to the contracts.

The ninth PPP principle requires government to ensure sufficient competition in the market and a competitive tender process. The UK's market in term of engineering, construction and financial companies is open and vigorous. With respect to both ordinary PFI and other types of social and economic infrastructure type projects, such as roads, housing, or universities, there is little to indicate that there is insufficient competition in the market. A more mixed message emerges with respect to very complex and unique mega projects where the number of bidders in some cases has been less than what would have been preferable. This is essentially a feature of large complex projects that can also affect PFI. The public sector's task in such a situation will be to ensure that the market remains contestable.

The assessment of value for money in general requires data and although the UK government goes to greater lengths than many other governments to make information on PFI projects available publicly, some of the data that would be required to compare the overall costs of projects financed through alternative mechanisms is not collected. In particular, and somewhat paradoxically, this concerns data on publicly financed projects for use in making comparisons with PFI projects. For PFI projects data is more complete, but with such a wide range of projects it has been difficult to compile data in a sufficiently comparable and accessible format. It is worth repeating the oft-made recommendation that collecting this data is useful and should be undertaken, but this needs to be balanced against what is feasible in terms of collecting and making good use of such data.

A final point with regards to value for money concerns its wider impact on the non-PFI sphere. The perceptions of advantages brought by the involvement of PFI have varied over time and between jurisdictions and agencies. The ability of off-balance sheet finance to advance projects that would otherwise strain accounting limits has been a driver of certain projects in the past. However, the overarching drive for pursuing the PFI procurement mode in the UK is the pursuit of value for money, both for the government and end-users. More than 20 years of experience with the PFI model have brought the UK government important lessons and improvements, both with regards to PFI and in general with respect to infrastructure procurement and life-cycle management. One advantage of delivering a significant share of investment through PFIs has been to spread discipline in cost control to all forms of infrastructure procurement. Minimising alterations to project specification through the planning and construction phases has been the key to achieving a higher rate of on-time, on-budget delivery for routine building projects (for example in the health, education and government sectors) in comparison to past chronic failures with traditional public procurement. Maintenance of assets to design standards throughout their planned lifetime is another strength of private finance and something that is seen in the UK as having been successfully delivered by PFIs.

The budgetary framework for PFIs in the UK

The tenth OECD PFI principle emphasizes that, in line with the government's fiscal policy, the Central Budget Authority should ensure that the project is affordable and that the overall investment envelope is sustainable. Several checks are in place in the UK to ensure affordability of all capital projects within an integrated, comprehensive framework. Spending Reviews set a medium term expenditure framework, with firm spending limits for line Departments, followed by specific approval procedures for major investment decisions such as PFI/PF2 contracts. The iterative business case prepared for each project includes an assessment of its affordability and financial sustainability by the procuring authority within the expenditure limits already set. HM Treasury is responsible for issuing approvals during the appraisal process for all PFI/PF2 projects. With the PF2 scheme, HM Treasury also introduced a new control total of GBP 70

billion for PFI/PF2 projects up to 2020 in addition to caps that are already in place for capital expenditures, such as in Scotland. Complementary analysis by the Office of Budget Responsibility (OBR) also helps the government, and the public, keep track of the fiscal sustainability of its expenditures.

With regards to the budget, PFI projects at the outset were not on-balance sheet in the UK, and could thus be considered a form of off-budget borrowing. Consequently, there may have been an inclination by public authorities to pursue the PFI procurement route because of this. In Scotland, the NPD programme was used to accelerate public sector capital investment over and above the capital budget made available to Scotland. As a measure of sustainability, long term investment commitments on NPD are monitored as part of a centrally set cap on estimated future revenue commitments.

For reasons of accountability and risk management, the transparency of PFIs in the budget process is important, which is emphasized in the eleventh PPP principle. Through individual departmental accounts, the WGA, and the OBR, the government presents regularly updated information on PFI/PF2 contracts to the rest of the public sector and end users. There is a high degree of transparency regarding liabilities, guarantees and long term financial contracts. Despite the WGA, there can still be an accounting incentive to use PFI, but this is now minimal and stems mainly from compliance with Eurostat rules. Practically all PFIs are on balance sheet in the WGA, providing a detailed picture of the UK public sector liabilities.

The OBR in its Fiscal Sustainability Report 2014 estimates the total capital liabilities in WGA arising from Private Finance Initiative contracts to be GBP 37 billion. Only GBP 5 billion of these were on the public sector balance sheet in the National Accounts and therefore included in Public Sector Net Debt (PSND). If all investment undertaken through PFI had been executed through conventional debt finance, the OBR estimates, PSND would be around 2% of GDP higher than currently measured.

The twelfth PPP principle underlines the importance of governments guarding against waste and corruption by ensuring the integrity of the procurement process. This is an ongoing priority in the UK as has also been touched on above. The newly established IUK public equity team helps separate the public sector's equity shareholder and client role of procuring authorities by serving on behalf of line Departments on the PF2 project's board. In addition to simplified, more streamlined procurement procedures, government also focuses on capacity building to strengthen procurement skills of its public officials. Efforts for higher integrity and accountability are also witnessed in the 2014 Anti-Corruption Plan which draws together several reforms pursued by government to reduce bribery and corruption during the procurement process. Corruption, however, is not a challenge with respect to PFI in the UK.

SECTION 1: THE STATE OF PLAY OF PPPs IN THE UK

1. This introductory section aims to provide an overview of the evolution of the Public-Private Partnership (PPP) program in the UK, from the inception of the Private Finance Initiative (PFI) programme in 1992 to its current new variation, Private Finance 2 (PF2). It also touches on other structures in the UK such as the NPD programme in Scotland. The evolution of the institutional setup surrounding PPPs is discussed in greater detail in Section 2 of this report. After analysing the most recent changes and attributes of the PF2 update, this section will provide a quantitative overview of current PPPs in the UK, with a focus on projects led by central Government, Scotland, Wales and Northern Ireland.

Defining PPP in the UK

2. Public-Private Partnerships (PPPs) are a way of delivering and financing public services using a capital asset where project risks are shared between the public and private sector. A PPP is designed as a long-term output specified contract between the government and a private partner whereby the public service delivery objectives of the government are aligned with the profit objectives of the private partner. Investment in economic and social infrastructure in the United Kingdom is financed in a variety of ways, from regulated private investment to pure public procurement. Though a range of PPP models exists, in England projects are most clearly identified as PPPs when they are included in the Private Finance Initiative (PFI) program.

3. The PFI definition applied to this review does not include all the private sector participation in public service infrastructure projects in the UK. PFI is a particular vehicle of financing public infrastructure where the private partner finances, designs, builds, and operates the infrastructure asset. PPPs, on the other hand, may refer to a wider range of public-private collaboration, and include several business structures and partnership arrangements such as joint ventures, concessions, outsourcing, and PFI (UK Parliament, 2008). There is no widely recognised definition of PPPs; there is indeed variation between countries and organizations' definition of what constitutes a PPP. The UK's PFI definition is more closely aligned to the OECD's PPP definition,¹ which involves a long-term contractual agreement between the public and private sectors with financing and risk sharing by the private partner. The main feature of a UK PFI is financing of the partnership by the private sector, usually through a mixture of debt (mostly) and equity. In the UK National Investment Plan, the 'Top 40'² prioritised projects are not PFIs, but many could be classified as PPPs according to a more comprehensive definition.

The evolution of PFI in the UK

4. PFI has evolved since its inception in 1992. This evolution has been in response to the needs for infrastructure investment over time (see Table 1.1), the growing experience with PFI projects, and the political preferences of the sitting government. At the outset, the PFI model was introduced as a means to inject reform in the UK public sector. It was part of modernising the delivery of infrastructure in certain sectors, e.g. for prisons and roads, and was meant to give the government a real choice between public and private delivery options. While this objective could be said to have been achieved, PFI has been criticised throughout its existence for a number of reasons (see below). Furthermore, a much discussed topic has been the fact that PFI projects were at the outset not recorded on balance sheet, and could thus be considered a form of off budget borrowing for investment. This has been confirmed as a motivation in at least some early cases of PFI contracts. The

pipeline of projects has followed the evolution of the PFI scheme, with a consistently elevated volume of signed contracts between 1999 and 2008 prior to the global financial crisis (see Graph 1.1).

Table 1.1. Evolution of procurement and delivery of infrastructure in the UK

| Date | UK Infrastructure | Methodology |
|-----------|--|--|
| 1980s-90s | Water, electricity, gas, coal, telecoms, ports (earlier), airports, British Airways, British steel, British Leyland British Nuclear fuel | Privatisation (sale of nationalised industries/companies). Some regulated (e.g. Water and gas/electricity distribution) rest unregulated |
| 1993-97 | Railways and Rolling Stock | Track and stations sold to Railtrack (then to Network Rail) Rolling Stock to Rolling Stock Leasing Companies, operations to private sector franchisees |
| 1992-2012 | Social infrastructure (school, hospital, public facilities) plus more economic infrastructure (road, waste) | PFI |
| 2013 | School Pathfinder Move from Social to Economic Infrastructure | PF2 National Infrastructure Plan |

Source: IUK (2014), 'Markets for PPPs Growing Use, Implications and Lessons Learnt', Presentation by James Ballingall, 3 June 2014

5. In late 2012, PFI was updated in the form of Private Finance 2 (PF2). The new PF2 model was developed in a systematic way through open consultation with public and private sector representatives. It aimed to address criticisms by the public and Parliament with regards both to particular PFI projects and the PFI model in general. PF2 is largely a response to the following concerns (HMT, 2012):

- The PFI procurement process has often been slow and expensive for both the public and the private sector. This has led to increasing costs and has reduced value for money for the taxpayer.
- PFI contracts have been insufficiently flexible during the operational period, so making alterations to reflect the public sector's service requirements has been difficult.
- There has been insufficient transparency on the future liabilities created by PFI projects to the taxpayer and on the returns made by investors.
- Inappropriate risks have been transferred to the private sector resulting in a higher risk premium being charged to the public sector.
- Off-balance sheet classification of many PFI projects has meant that there have been budgetary incentives for departments to use private finance.

6. An additional concern relates to the fact that equity investors in PFI projects are perceived in some cases to have made windfall gains, leading to questions about the value for money of projects to the taxpayer (these were partially addressed by the PFI gain-sharing mechanism). PF2 aims to address the above criticisms further through a variety of measures. The procurement process has been limited to a maximum of 18 months, which could result in significant cost savings. The set of services bundled under PF2 contracts now excludes 'soft' services, such as catering and cleaning, which were typically accompanied by a risk premium on the part of the private sector. Greater risk retention, such as utility consumption risk and utility tariff risk, by the public sector will also help decrease these high

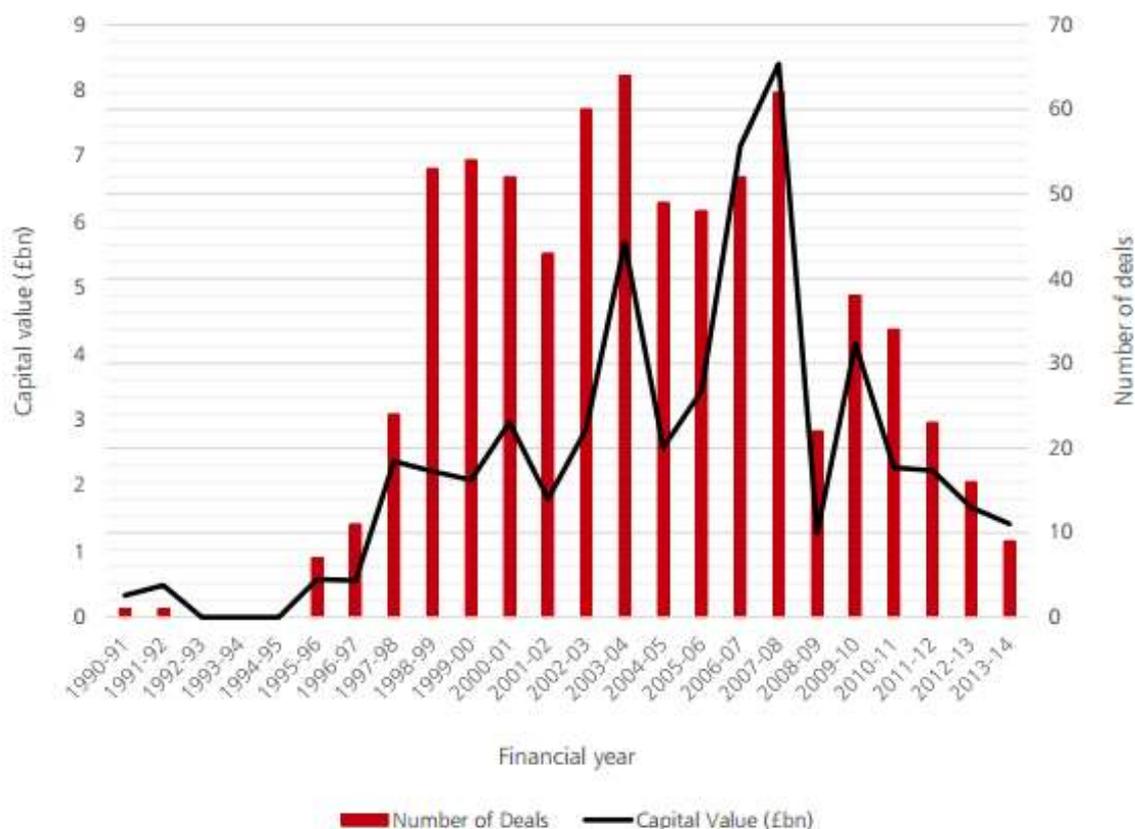
risk premiums. The publication of the Whole of Government Accounts by HM Treasury since 2011 presents a comprehensive overview on centrally-funded PFI commitments and contingent liabilities to the public.

7. PF2 also introduces a government minority equity stake in the project special purpose vehicles (SPVs). This is meant to create a better alignment of priorities between the public and private sectors, and greater transparency and information with regards to the management of the contract. Windfall gains by the private sector are expected to be mitigated through this new hands-on approach, and through the new funding competitions that will introduce long term equity investment earlier into the project cycle. Private sector equity return information is also to be published by Treasury under PF2. This equity stake will be managed by a team within IUK on behalf of the procuring authority (see section 2 on the institutional setup for PPPs). Potential conflicts of interest issues are planned to be addressed by splitting the line Department's grantor role from the IUK Equity team's ownership role.

8. PF2 thus emphasizes transparency and increased robustness of deals through the injection of public equity, cost-optimization and greater flexibility (for the services perimeter) designed to mitigate public criticism. It could be argued that whereas the former government was keen on using PFI for a number of large investment programs in social infrastructure, such as schools and hospitals, the current political focus is more on economic infrastructure where there is a host of alternative project financing options depending on the particularities of the relevant sector. PF2 can be used in many sectors³, but the first sector to which PF2 will be applied is education through the Priority Schools Building Programme. No significant upswing of deal flow is in view at this stage. This is in part due to the focus of the PFI/PF2 programme, which stresses social infrastructure. However, it is clear that PF2 has been successful in terms of public and political engagement in that it appears generally to be perceived as a new, fresh start for PFI. Main differences between the PFI and PF2 models are summarized in Annex 2.

9. During HM Treasury's 12-month review of the private finance initiative in 2012 there was a general slowdown in deals, which has yet to pick up after the recent change of direction (see Graph 1.1). Since its adoption by the government in 2012, only six projects were labelled as PF2, with a cumulative CAPEX of approximately just over GBP 1 billion. However, this should be seen in the context of the National Infrastructure investment Plan (NIP): 20.6% –or GBP 67.5 billion – of planned investment under the 2014 infrastructure pipeline is publically funded, 65.6% –or GBP 214.4 billion–is privately funded, but 13.8% – or GBP 45 billion – will be a mix of public and private investment (HMT, 2014 a). Likewise, under the Top 40 of investment priorities in the UK, 12 appear to be publically funded, 13 are privately financed, and 15 feature a mixture of public and private financing. Included in the Top 40 are programmes that span several to hundreds of projects, some of which could be delivered under PF2. However, most focus on economic infrastructure, which is not expected to be the main area for PF2 projects.

Graph 1.1. Number of PFI/PF2 projects having reached financial close* in the UK, with total capital values (current projects only)



Note: Figures based on departmental and Devolved Administration returns. Current projects only – does not include projects that have expired or terminated.

* Normally calculated at financial close of individual contract

Source: HM Treasury (2014 b), *Private Finance Initiative projects: 2014 summary data*, December 2014

10. PF2 has not significantly altered the financing arrangements that have been used under PFI. The debt-to-equity ratios remain in the vicinity of 90% debt to 10% equity, despite the new focus on injecting an additional layer of public equity. The government is however open to different debt to equity financing structures, if the private sector is able to show that this wouldn't result in higher cost of capital. New schemes like the use of state guarantees have only been used for some infrastructure projects so far, including the Mersey Gateway PPP project.

11. One idea that was incorporated into the PF2 approach was to make PF2s attractive to new categories of equity and debt providers such as institutional investors, e.g. insurance companies, investment funds and pension funds. A more diverse array of investors is expected to increase competitive tension and put downward pressure on the pricing of projects. However, equity funding competitions,³ the use public equity stakes or the use of state guarantees has not as yet attracted a new class of equity and debt investors. The changes in the financing arrangements do not appear at this point to have materially affected the cost of borrowing or the bank spreads. The first test will be the Midland Metropolitan Hospital in Sandwell, which is a GBP 353 million project that will allow the government to pursue this new ambition.

³ HM Treasury (2012), *A New Approach to Public Private Partnerships*, December 2012 [https://www.gov.uk/government/publications/private-finance-2-pf2]

12. In collaboration with its advisor HSBC, the Education Funding Agency (EFA) has tried to identify innovative ways to help attract private sector investment under the Priority School Building Programme (PSBP). The Aggregator Funding Vehicle was created in an attempt to attract both bank debt and capital markets for proposed solutions to fund batches of schools requiring rebuilding or repair. One of the key features of the aggregator is the ability to warehouse loans and thereby aggregate total financing requirements across all the batches.⁴ This was done in recognition that the incorporation of wider financing instruments could significantly increase competition between credit providers. Funding individual schools had proved to be difficult due to the limited size of deals; grouping schools together into one batch brings the project to market-size and reduces financing cost due to competition. To date, there has been a lot of market interest, and deals are coming out with very attractive pricing. Cross-default remains one of the challenges of this scheme, as none of the different market players want their project to be affected negatively by other projects in the same batch. This kind of model however works quite well from an information sharing perspective through public equity and from bonds to senior bondholders. Only five batches totaling 46 schools, with a total CAPEX of around GBP 700 million, will be done through private finance out of the 260 schools under the program – approximately 20% of the programme. EFA signed a funding procurement agreement with the aggregator in November 2014.⁵

Stakeholder Perception of PF2 in the UK

13. As noted elsewhere, PF2 was a response to criticism regarding PFI from a number of stakeholders, including members of Parliament and the National Audit Office (NAO). In line with other stakeholders consulted, the Confederation of British Industry (CBI) is positive with respect to PF2, but notes that it has yet to attract a new class of investors. CBI has emphasized that a key element for private sector investors is deal flow or a viable pipeline of projects, which has yet to materialize in the case of PF2.

14. On the financial and banking sector side, perceptions of the new scheme are positive but also focused on the pipeline of projects. The general observation is that the pipeline in the UK and in Western Europe in general is diminishing compared to a few years ago. There are still some relatively smaller projects in the market of approximately GBP 50-100 million, but the shrinking pipeline has resulted in less investor attention and possibly a winding down of teams. There are currently six PF2 projects announced consisting of five school bundles and the Sandwell Hospital.

15. **Scotland's** Non-Profit Distributing (NPD) model has been in place and evolving for over ten years. This type of PPP agreement differs from the PFI model in that the governing principle is that private sector returns are capped and any excess profit goes back to the public sector (see Section 5 on financing). NPDs also promote enhanced governance and transparency through the appointment of a public interest director to the project company. These key features have resulted in broad public and private acceptance of the NPD model. NPD is thus a major investment program in Scotland that benefits from very strong political support. It has been awarded GBP 2.58 billion from the government in November 2010, and an additional GBP 1 billion in April 2014 to push the program forward (see Table 1.4 below). NPD projects have attracted strong market interest, have overall displayed good value for money and have been delivered below budget. A simplified and standard contract and pragmatic approach has reduced procurement times on NPD projects to an average of 22 months from OJEU to financial close, and in some instances to 17 months. A variant on the NPD model called the hub programme is being used by public bodies to jointly procure community infrastructure such as schools, primary care and community facilities using either an NPD style contract or a traditional design and build contract.

16. In **Wales**, the Government has historically resisted the use of PFI, reflecting its preference for other forms of infrastructure financing. While other parts of the Welsh public sector have undertaken PFI schemes no PFI deals have taken place since early 2008. Recently, however, the Government has announced its intention to finance infrastructure using a “non-dividend investment” model, which would, in practice, mirror the Scottish NPD model. This reflects renewed interest in

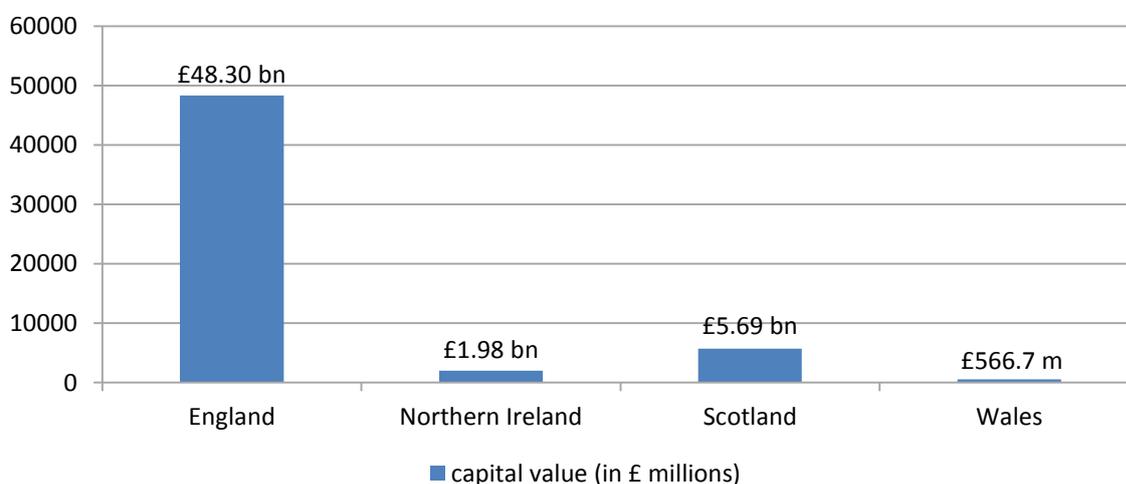
various forms of innovative finance mechanism from the Welsh government in order to meet its infrastructure investment goals. Several NPD projects are in the pipeline. The Government's intention to deploy the NPD model will require a robust approach with firm requirements in place. Included would be a cap on profits, although it is expected that the cap would be 'bid' by private partners.

17. In **Northern Ireland**, the PFI model has been used sparingly since 2009. In part, this is due to concerns over the overall level of exposure to long term commitments which are removing flexibility from (or gradually 'silting up') departmental revenue budgets, particularly since the Northern Ireland Executive already borrows approximately £200 million per year from Treasury through the Reinvestment and Reform Initiative (RRI). This can also be attributed to a lack of confidence that PFIs will consistently deliver good value for money and the NI Audit Office has published several reports on the subject. A Third Party Developer (3PD) model has recently been developed which is being used to deliver investment in primary and community care infrastructure and has the potential to be extended to other accommodation-type projects. The 3PD model is a relatively simple model compared to PFI/PF2 which does not contain the public equity, capping mechanisms or refinancing components found in other models.

Stock and flow of PPPs in the UK

18. The UK remains the most active PPP market in Europe by number of transactions (EPEC, 2014), even if the of number of deals closed peaked in 2003-2004 (see Graph 1.1). It also closed the largest transaction in the European PPP market with the Intercity Express Programme II, at a value of GBP 2.6 billion. The total capital value of current PFI deals was GBP 56.6 billion in March 2014, up from GBP 54.2 billion in March 2013 and GBP 54.7 billion in March 2012 (HMT, 2014 b). As for projects in procurement, there were 11 in March 2014, down from 21 in 2013 and 39 in 2012 (see Annex 1). The graph below shows the distribution of projects, by capital value, among England, Northern Ireland, Scotland, and Wales.

Graph 1.2. Capital value of PFI projects in the UK (as of March 2014)



Source: Authors based on HM Treasury (2014 b), *Private Finance Initiative Projects: 2014 summary data*

19. As part of its annual data collection exercise, HM Treasury collects summary data on PFI projects from central government departments, devolved administrations and local authorities via government departments. As of March 2014, there were 728 PFI projects in the UK, 671 of which are operational. Nine projects with a total capital value of GBP 1.4 billion reached financial close between March 2013 and March 2014 (HMT, 2014 b). Expected unitary charge payments⁴ for 2014-2015 and 2015-2016 are GBP 10,290 and GBP 10,467 million, respectively. Table 1.2 summarizes the net present value (NPV) of remaining unitary charge payments over the lifetime of PFI projects in key

sectors and fields in the UK. As of March 2014, the UK had a NPV of almost GBP 117.5 billion of remaining commitments related to PFI/PF2 projects.

Table 1.2. UK stock of operational PFI projects in key sectors (as of July 2014)

| Sector | # of PFIs | NPV value of PFI contract (in £m) |
|--|-----------|--------------------------------------|
| Courts | 8 | 546.5 |
| Emergency Services | 39 | 1041.7 |
| Energy | 1 | 51.6 |
| Equipment | 2 | 306.9 |
| Hospitals and Acute Health | 144 | 34,131.7 |
| Housing (Housing Revenue Account) | 17 | 1876.5 |
| Housing (Military) | 7 | 233.7 |
| Housing (non-HRA) | 12 | 469.7 |
| IT Infrastructure and Communication | 11 | 377.6 |
| Leisure Facilities | 15 | 540.7 |
| Libraries | 7 | 242.4 |
| Military Facilities | 13 | 2623.4 |
| Offices | 47 | 7099.6 |
| Other | 40 | 15494.3 |
| Prisons | 12 | 3680.5 |
| Roads and Highway Maintenance | 32 | 12484.4 |
| Schools (BSF) | 66 | 5923.6 |
| Schools (Non-BSF) | 149 | 12496.5 |
| Secure Training Centres (YJB) | 4 | 205.8 |
| Social Care | 23 | 816.3 |
| Street Lighting | 32 | 2563.4 |
| Tram/Light Rail | 2 | 603.2 |
| Underground Rail | 1 | 404.6 |
| Waste | 41 | 13276.1 |
| Total: | | 117,490.7 |

Note: NPV values were calculated by summing all unitary charge payments (available in HM Treasury data on a projected nominal basis) across the remaining life of each signed project, discounting using a social time preference rate of 3.5%, and separately adjusting for inflation at 2.5%

Source: OECD Questionnaire to the UK government, May-July 2014

20. The UK's Whole of Government Accounts (WGA) consolidates the audited accounts of around 4,000 organizations across the public sector in order to produce a comprehensive, accounts-based picture of the financial position of the UK public sector.⁶ WGA uses a public sector interpretation of the International Financial Reporting Standards (IFRS) for deciding which PPPs to report on its Statement of Financial Position. WGA's estimates of the PFI/PF2 stock of investment are GBP 37 billion for the net book value of assets funded through PFI, and GBP 36.6 billion of associated future capital repayments (HMT, 2014 c). This represents a cumulative GBP 156 billion in future payments, including service charges, repayment of the capital and interest.⁷ Out of these, WGA estimates that PFI commitments that are not classified under the UK's Public Sector Net Debt (PSND) and therefore do not affect the aggregate fiscal debt amount to GBP 32 billion, or approximately 2% of GDP. The data collection process is still ongoing. The WGA includes a summary of large PFI contracts (in excess of GBP 0.5 billion) that are included in its Statement of Financial Position under IFRS (see Table 1.3).

Table 1.3 PFI contracts with a value above 0.5 £bn in the UK

| Entity | Description of PFI contract | Contract start date | Contract end date |
|------------------------------------|---|---------------------|-------------------|
| Greater Manchester Waste Authority | PFI contract for the construction, maintenance and operation of 43 new waste disposal facilities in the Greater Manchester area. | Apr-2009 | Mar-2034 |
| Department for Transport | Maintain and operate the M25 Orbital route, and widen most of the remaining 3 lane sections to 4 lanes. | Dec-2008 | Nov-2038 |
| Department for Work and Pensions | Maintenance and management of the departmental estate. | Apr-1998 | Mar-2018 |
| Department of Health | Redevelopment, maintenance and operation of the cardiac and cancer facilities at Barts and the London NHS Trust. | Mar-2010 | Apr-2048 |
| | Provision of acute hospital facilities and maintenance and operation of University Hospitals Birmingham NHS Foundation Trust. | Jun-2006 | Aug-2046 |
| | Construction, maintenance and operation of the new Saint Mary's Hospital in Greater Manchester. | May-2009 | Apr-2047 |
| Ministry of Defence | PFI to provide and maintain air-to-air refueling and passenger air transport capabilities. | Mar-2008 | Mar-2035 |
| | Skynet 5: Range of satellite services, including management of existing Skynet 4 satellites. | Oct-2003 | Aug-2022 |
| | Rebuild, refurbishment, management and operation of facilities for Service accommodation at Aldershot, Tidworth, Bulford, Warminster, Larkhill and Perham Down. | Mar-2006 | Apr-2041 |
| | Redevelopment and maintenance of Colchester Garrison to provide accommodation and associated services. | Feb-2004 | Feb 2039 |
| Nottingham City Council | PFI for the construction, maintenance and running of 2 new tram lines. | Dec-2011 | March-2034 |

Source: HM Treasury (2014 c), *Whole of Government Accounts year ended 31 March 2013*, June 2014

21. In Scotland, about GBP 6 billion had been invested through PPPs (encompassing PFI/PPP/NPD projects) as of November 2010 (see Table 1.4). On a per capita basis, this represents slightly more than the average PPP investment per capita for the whole of the UK. The majority of investments took place in the health and education sectors. Since the extension of the NPD scheme, with new funding of GBP 2.58 billion in 2010 and an additional GBP 1 billion in 2014, there were GBP 1.6 billion of projects in construction at the end of February 2014.

Table 1.4. the evolution of NPD investments in Scotland (pre and post November 2010)

| Sector | Capital Value | In construction/ operational (£m) | In procurement/ hub process (£m) |
|------------------------------------|---------------|--------------------------------------|-------------------------------------|
| PFI/PPP/NPD – before November 2010 | | | |
| Local authority* | 3,594 | - | - |
| Health | 1,332 | - | - |
| Central government** | 663 | - | - |
| Waste | 562 | - | - |
| Police | 17 | - | - |
| Further education (FE) | 9 | - | - |
| Other | 3 | - | - |
| Total | 6,180 | - | - |
| PFI/PPP/NPD – since November 2010 | | | |
| Health | 750 | 115 | 573 |
| Education (schools) | 530 | 90 | 352 |
| Education (FE colleges) | 290 | 290 | - |
| Transport (roads) | 780 | 310 | - |
| Total | 2,350 | 805 | 1,400 |

* Majority investment is in schools (GPB 3.4 billion).

** Includes roads (GBP 551 million) and prisons (GBP 112 million).

Source: Scottish Futures Trust (2014), “OECD Review of PPP in the UK”, Presentation, 4 July 2014.

22. There are 30 PPPs that are currently operational in **Wales**, including six that are UK central government PPPs: three by the Home Office, two by the Ministry of Defence, and one by the Ministry of Justice. The level of PFI liabilities in 2013-2014 was GBP 94 million pounds per annum, and will peak in 2022-2023 to a little over GBP 100 million per annum according to publically available information. This represents about 0.6% of the Welsh government’s 2013-14 revenue budget. As of 2013, there were GBP 540 million in capital value of ongoing PFI projects in Wales, which compares to about GBP 2 billion in **Northern Ireland**, almost GBP 6 billion in Scotland, and around GBP 40 billion in England. This is well below PPP/PFI infrastructure investments in neighbouring countries (see Graph 1.2), reflecting the Welsh Government preference for the use of other types of funding instrument.

23. The Welsh government has recently decided to re-explore PPPs as a possible instrument to meet its infrastructure needs. The current PPP pipeline in Wales comprises completing dualling of the A465, a major east-west route that runs across the heads of the Welsh valleys. This route’s upgrade scheme will include two sections that will be completed using the NPD model. This project is at its early stages. Redevelopment of the Velindre cancer centre is also part of the Welsh NPD pipeline. Most recently, ⁸ the Welsh Minister for Finance has announced that the second phase of the government’s 21st Century Schools building programme will be financed in part through the NPD model. This NPD scheme will see an investment of GBP 500 million in priority school projects. These three schemes are reflected in the December 2014 update of the 10-year Infrastructure plan project pipeline.

24. In **Northern Ireland**, there are 39 PFIs in operation representing capital investment of approximately £2 billion. The combined average cost of these repayments will average £245m per year until 2030, peaking in 2017 at £260m – repayments representing less than 3% of the ReSource Budget available to the Northern Ireland Executive. To date, PFI has been used as a means to deliver investment in major road improvements, water and wastewater infrastructure, secondary care, further education colleges and schools. There is a weak pipeline of PPP projects that could be significantly

strengthened subject to a value for money outcome of the two revenue funded primary and community care projects that are currently in procurement using the 3PD model.

Conclusion

25. Private Finance 2 (PF2) was introduced in 2012 as an update of the Private Finance Initiative (PFI) in order to inject more transparency, flexibility, and public oversight into private partnership projects. This update stems from a political need to address criticism expressed by public and private stakeholders to speed up the procurement process, to have more transparency regarding project returns, and to make available more innovative financing, among others. Under PF2, the government will take minority equity positions in the SPV project company. This is meant to alleviate information asymmetry and will give the government a stake in the return on investment from the SPV. This increased government involvement is not expected to significantly reduce the price of capital for the project. The government's equity participation potentially comes with increased project risks and potential conflicts of interest – the latter being mitigated by the newly established Infrastructure UK equity unit in HM Treasury.

26. While public and private stakeholders are largely supportive of PF2, some bank and industry voices would like a stronger PF2 project pipeline. Two PF2 contracts have come to financial close since the launch of the program two years ago, and a few more are currently under way. However, there have been approximately 800 PFI projects transacted in the UK, and 700 that are operational, making the UK still one of the most active PFI markets in the world.

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¹ Public-Private Partnerships (PPPs) are way of delivering and funding public services using a capital asset where project risks are shared between the public and private sector. A PPP can be defined as a long term agreement between the government and a private partner whereby the service delivery objectives of the government are aligned with the profit objectives of the private partner. (OECD 2012)

² As part of the UK’s National Infrastructure Plan, the ‘Top 40’ represents a list of investments (projects and programmes) that are a priority for the UK government. These priority investments fulfil three main criteria: 1) potential contribution to economic growth – investment that enhances productivity and enables innovation; 2) nationally significant investment that delivers substantial new, replacement or enhanced quality, sustainability and capacity of infrastructure; and 3) projects that attract or unlock significant private investment. (HM Treasury, *National Infrastructure Plan 2013*, December 2013)

³ See May 2014 article citing IUK Chief Exec. Geoffrey Spence: <http://www.cnplus.co.uk/news/government-policy/iuk-chief-go-to-the-energy-market-for-projects/8662546.article#.VAmoHfmSweg>

⁴ <https://www.gov.uk/government/publications/psbp-overview/priority-school-building-programme>

⁵ <https://www.gov.uk/government/news/psbp-funding-procurement-agreement-signed-for-aggregator-model>

⁶ <https://www.gov.uk/government/collections/whole-of-government-accounts>

⁷ The WGA uses a discount rate of 2.4%, in line with the real discount rate typically used by Central government schemes. This is different from the social discount rate of 3.5% used for project appraisal under the *Green Book*. The difference in reported NPV liabilities under PFI/PF2 contracts between the WGA and estimates given under the OECD questionnaire are due to the use of different reporting and accounting methodologies, including a different discount rate to calculate the NPV (2.4% for WGA vs. 3.5% for OECD Questionnaire estimates).

⁸ <http://wales.gov.uk/newsroom/finance1/2014/9392379/?lang=en>

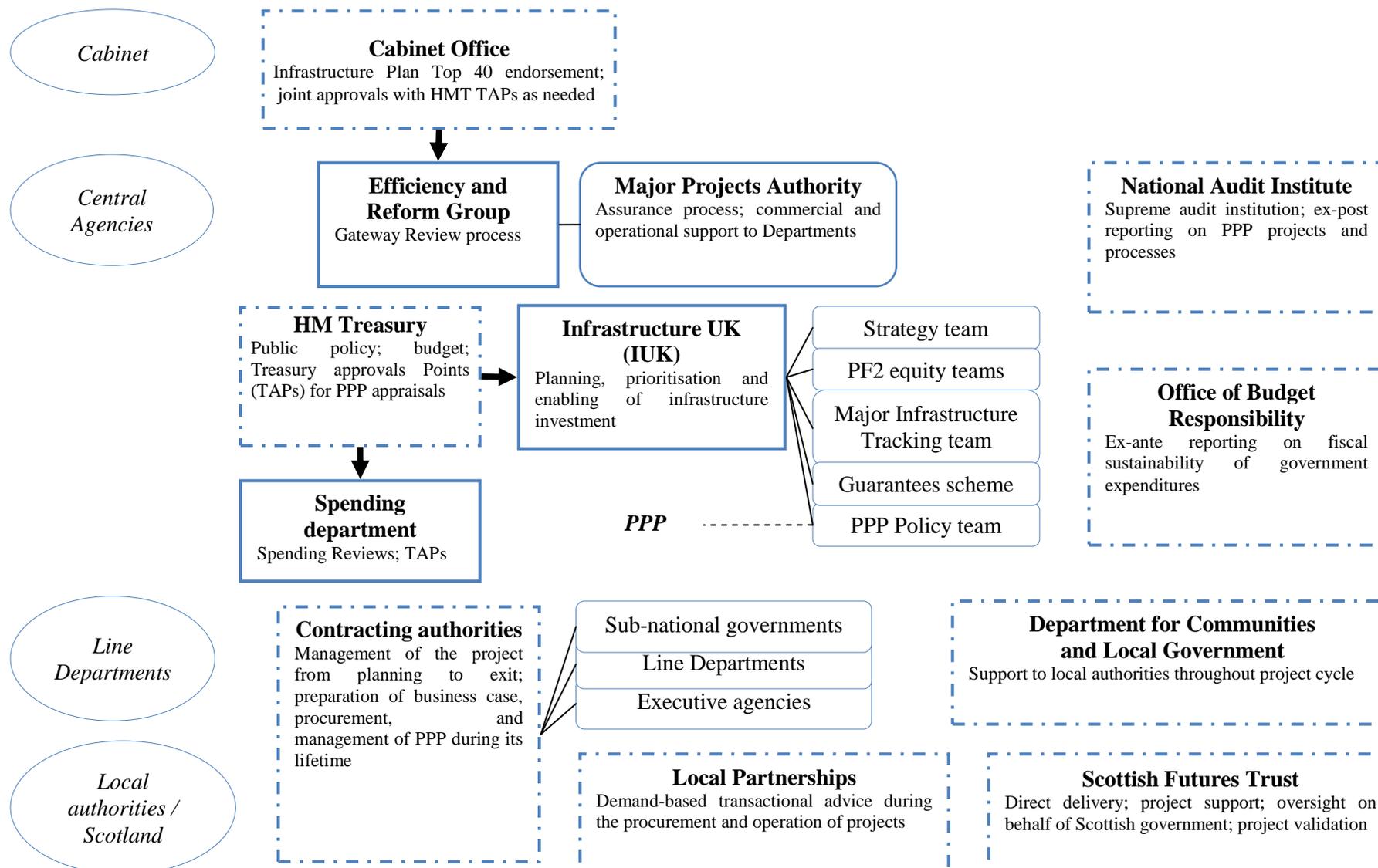
SECTION 2: THE INSTITUTIONAL FRAMEWORK FOR PPPS IN THE UK

27. PPPs in the UK are part of a wider infrastructure framework where all projects are assessed and appraised following a common methodology. This section examines the institutional setup for PPPs in the UK and whether it aligns with the first header of the 2012 *Recommendation of the OECD Council on the Principles for Public Governance of Public-Private Partnerships* (the PPP Principles). Namely, if a clear, predictable, and legitimate institutional framework supported by competent and well-reSourced authorities exists for PFI/PF2 projects in the UK. It starts with an overview of how the central PPP unit has developed in the UK since the introduction of the Private Finance Initiative (PFI) in 1992. HM Treasury's Infrastructure UK and its various units are then presented as the central infrastructure policy and project coordinator in the country. Their roles and in-house capabilities are assessed against the PPP Principles. Other agencies that regulate, advise, and monitor PPPs and other capital projects on the national and sub-national level are also highlighted. This section concludes with an assessment of the adequacy of the legal and regulatory framework for PPP contracts in the UK.

Overview: the evolution of core PPP/PFI institutions in the UK

1. 28. The first heading of the PPP Principles calls for establishing a clear, predictable and legitimate institutional framework that is supported by competent and well-reSourced authorities. With its relatively long history of PPP procurement, authorities in the UK have acquired significant experience in the planning, procurement, and management of PPPs, both at the central and departmental levels. With complementary functions and responsibilities, public authorities in the UK have clear mandates and a firm understanding of their responsibilities surrounding PFI projects and capital investments more broadly, across all stages of the project cycle. Graph 2.1 below shows a mapping of the main institutions responsible for PFI/PPP projects in the United Kingdom.

Graph 2.1. Central Institutional Setup for PPPs in the United Kingdom



29. The main institutional hub for PPPs and infrastructure in the England is HM Treasury's **Infrastructure UK (IUK)**. Not limited to PPP/PFI, its oversight extends over all infrastructure projects that receive central government support, thereby providing an integrated framework for infrastructure investment in the UK. As mentioned in the previous section, the approach to the private financing of public infrastructure has evolved over time in response to the needs and political preferences of the day. Likewise, the institutional framework for PFI/PPP projects in the UK has also evolved since the inception of the program in 1992. Different institutions that were responsible for the PFI program over time are presented below:

- The first institution that was in charge of PFI was the **Private Finance Panel** in 1993, which originally consisted of 15 private sector, public sector, and civil service representatives, as well as seconded staff, and was supported by an executive. The Panel came into existence in order to stimulate innovative thinking around the use of private financing (Yescombe, 2011), and to provide an independent coordination platform between key stakeholders. The Panel's main purpose was to ensure that problems were tackled and projects brought to fruition. Initially, the net effect was limited, which prompted a new requirement in late 1994 for all capital projects to go through a 'universal' or PFI test before being approved by Treasury for public funding. This caused different line departments to gain skills in this contract type, including the department for Transport and the Department for Education. At the same time, Private Finance Units started to be created within line Departments in order to further encourage and spread the private finance initiative. A change of government led to the dissolution of the Panel in 1997. Around 25 large PFI projects were signed by then, totalling more than GBP 8 billion. (Grout, 1997).
- PFI was reinvigorated through a push from the Labour Government and a new entity was created within HM Treasury in 1997, following a speedy review by Malcolm Bates (the Bates I Review), a former member of the Private Finance Panel. The new **Treasury Taskforce** was set up as a 'company' within HM Treasury allowing it more freedom to recruit expertise from the private sector. Between 1997 and 2001, there were almost 450 PFI deals signed with a total capital value of GBP 20 billion (UK Parliament 2001). With hundreds of PPPs taking place post-1997, there was a need to create standardized guidelines and contracts, as well as provide capacity building, for PFI projects. The universal test for capital projects was no longer required and was dropped in 1997. The Taskforce aimed to streamline processes and reduce administrative costs as the government was facing a growing number of PFI contracts. It was also required to approve the commercial viability of significant projects before they went to bid in an attempt to increase the cost-effectiveness of the procurement process (Grout, 1997). The Taskforce was intended to have a two-year limited lifetime, but the importance of having a permanent 'centre of expertise' in place became apparent in those years. (Yescombe, 2011).
- **Partnerships UK (PUK)** was setup in 2000 to absorb some of the roles and responsibilities of the Taskforce, following the Bates II Review. Its key role was to provide technical and project-specific advisory services to Treasury and contracting authorities, through the policy and delivery teams respectively. PUK became a PPP in itself in 2001 (Allan, 2001), with 51% ownership by the private sector. This is important because it meant that it was also able to invest private sector equity into the SPV of some PFI projects, even if that only happened in very few cases.
- The public-sector counterpart of PUK was the **PPP Policy Team** of HM Treasury. The PPP Policy Team set overall policy and was responsible for bringing projects forward to the decision-making level of government. PFI projects reached their peak in the UK in 2003-2004 with more than 60 deals – almost a cumulative 8 billion in capital value – closed in that period alone (see Graph 1.1, Section 1).

Table 2.1. Evolution of central staffing under PFI (1993-2014)

| | Private Finance Panel (1993-1997) | Treasury Taskforce (1997-2000) | Partnerships UK / PPP Policy Team (2000-2010) | Infrastructure UK (2010-) |
|-------------------------------------|--------------------------------------|-----------------------------------|---|------------------------------|
| # of staff | 15 | 8 - 20 | 20 - 60 | 70 (of which 12 on PF2)* |
| * includes part time staff | | | | |
| Main PPP/PFI teams under IUK | | | | |
| Policy | Strategy | PF2 Equity | Major Infrastructure Tracking | ← - - -] |
| TBC | 12 | TBC | 6 | |

Source: Authors

30. The OECD’s research (2010) highlights the functions that are usually held by PPP units. The functions of a dedicated unit may include policy guidance and green lighting of projects, technical support to and capacity building in government organisations, as well as PPP promotion. In England, the PPP Policy team was responsible for all of these activities (with the devolved administrations being responsible for these in the case of Scotland, Wales and Northern Ireland), while Partnerships UK’s role was focused on technical support, capacity building and PPP promotion. Therefore, what in many countries is performed by a single PPP unit was, in England, performed by two entities; the PPP Policy Team and Partnerships UK. As PPPs were receiving a lot more attention than non-PPP projects, some processes from the former started being replicated for the latter, such as having a project review group in place. The line between PPP/PFI and traditional infrastructure procurement (TIP) projects was being blurred, as authorities were moving towards looking at how infrastructure should be approached in general, under one umbrella. PUK was coming to the end of its life as an “arms’ length” organisation and a structure closer to the government was needed. This is where Infrastructure UK (IUK) came into play.

31. This remainder of this section examines the current institutional arrangements surrounding PPPs and PFI projects in the UK, at the heart of which is HM Treasury’s Infrastructure UK. Along with subsequent sections, it will provide an overview of the alignment of the policies of the United Kingdom in the area of public governance of Public-Private Partnerships with the PPP Principles.

Principle 1 of the PPP Recommendation

Principle 1. *Ensure public awareness of the relative costs, benefits and risks of PPPs and TIP as part of an integrated public-sector infrastructure investment and procurement framework. Popular understanding of Public-Private Partnerships requires active consultation and engagement with stakeholders as well as involving end-users in defining the project and subsequently in monitoring service quality*

32. The first OECD PPP Principle states that political leadership should ensure public awareness of the relative costs, benefits and risks of Public-Private Partnerships and conventional procurement. Only if the political level is aware of and accepts the costs and benefits of using PPPs can the issues around PPPs be tackled and balanced appropriately with stability and predictability. The yearly Whole of Government Accounts by HM Treasury and the Fiscal Sustainability report by the Office of Budget Responsibility (OBR) are both prime examples of the UK Government’s commitment to providing clear and understandable data on its PFI/PF2-related liabilities, even when those are not explicitly reflected in the Public Sector Net Debt (PSND). Far-reaching efforts have been made in the UK to keep the public informed about the relative costs and benefits of PFI projects through annual, monthly, and other reports such as those by the National Audit Office (NAO).

33. Popular understanding of Public-Private Partnerships requires active consultation and engagement with stakeholders as well as involving end-users in monitoring service quality. Societal needs and interests must be balanced, especially with regards to end-users, and other affected groups. The same can be said for NGOs and other civil society groups that often have concerns that PPPs may have social and environmental consequences. In order for a project to be viewed as legitimate, involvement in early stages of the planning process is needed. The UK has a process in place for regular infrastructure reviews and consultations, including with the public, as recommended by OECD standards. The recent move in the UK towards a new Private Finance model from PFI to PF2 was adopted by the government in late 2012. The process leading to these new guidelines involved active consultation with several stakeholder groups, including civil society, the private sector, and several government organizations. In order to address main outstanding issues with PFI projects, tools such as questionnaires or one-on-one consultations were used to collect and incorporate feedback from stakeholders in a comprehensive, systematic manner.

34. Independent public oversight of PPP implementation can also promote public sector innovation and better outcomes for the society as a whole through greater accountability and social control. As part of its Parliamentary mandate, the NAO's reports on various PFI projects and tools used have been instrumental in informing public and institutional debate around PFI projects. Two of the NAO's flagship reports on PFI/PF2, the 2011 *Lessons from PFI* and the 2013 report on *Savings from operation PFI contracts*, show important results that have been achieved under the past PFI framework, and provide a forward look on how to continue improving public spending efficiency and effectiveness.

2. 35. The Central Budget Authority – HM Treasury in the UK –, line Departments and executive agencies should ensure that a coherent approach to PPP is rolled out in the public sector and is joined up with other initiatives in adjacent fields. As it stands today, the central structure assessing capital projects in the UK is one that addresses both PFI/PPP projects and conventional procurement in an integrated framework. The main difference between IUK and its predecessor PUK is that the new structure is directly integrated into government and Treasury, allowing it to coordinate different aspects and stakeholders surrounding PF1/PF2 from the heart of government. In addition, common appraisal and evaluation guidelines exist for all centrally-funded projects in the public sector, regardless of their procurement type. The appraisal process refers to the process of assessing policies, programmes, or projects before committing to funding them. It is led by procuring authorities and subject to Treasury approvals. The *Green Book* standard, which is an international reference document, provides five interrelated aspects of appraisal process. The economic case lies at the heart of this process, which is further discussed in Section 3 on value for money. A major effort is currently underway to “refresh” these guidelines, led by HM Treasury's Public Spending Group.

Principle 2 of the PPP Recommendation

Principle 2. *Key institutional roles and responsibilities should be maintained. This requires that procuring authorities, Public-Private Partnerships Units, the Central Budget Authority, the Supreme Audit Institution and sector regulators are entrusted with clear mandates and sufficient reSources to ensure a prudent procurement process and clear lines of accountability.*

36. A number of institutional roles should be competently pursued to secure and maintain value for money: a sound procurement process; implementing the specific PPP; fiscal and budgeting issues; auditing of the PPP; rule monitoring and enforcement. These roles can be maintained in a number of institutional set-ups, but it is important that they are kept separate so as not to confuse the key tasks of each actor and to secure lines of accountability. This section discusses the relevant units and institutions involved in the PPP process in the UK. It sets out their purpose, operations, and the specific roles and inter-relations in the UK PPP framework.

HM Treasury Units

37. Given the complexity of PPPs and their somewhat infrequent use, critical skills to ensure value for money may need to be concentrated in a PPP Unit that provides support to the relevant authorities. The PPP Unit and its complementary units can fill gaps in terms of specific skills, a lack of coordination or high transaction costs. **Infrastructure UK (IUK)** was created in a separate Division as part of the Treasury in 2011. Its responsibilities extend beyond those of a PPP unit as it is the UK's core infrastructure unit. IUK's remit is to provide greater clarity and coordination over the planning, prioritisation and enabling of investment in UK infrastructure, and to improve delivery of UK infrastructure through achieving greater value for money. IUK's main role is to support major, centrally-funded infrastructure projects, including PFI projects, through technical and policy advice to HM Treasury and line Departments. It has a key role in providing support to HM Treasury and the Major Projects Authority (MPA) during the approval process of PPPs. In addition it:

- issues guidance tools and policy notes, such as the new guidance on PF2 projects;
- is responsible for developing the UK's new National Infrastructure Plan and bringing projects under the plan to fruition, with a focus on the Top 40 list;
- acts as a central repository for information about the stock and flow of all infrastructure projects that receive central government funding in the United Kingdom; and
- coordinates efforts among various other public stakeholders that are responsible for PFI projects in England, Northern Ireland, Scotland, and Wales.

38. IUK has around 70 staff members in total to address wider infrastructure issues, and 12 full time equivalent staff focusing on PFI/PF2 issues (EPEC, 2014) (see Table 2.1). About half of the personnel recruited are commercial specialists. According to the new PF2 guidelines, the mandate of IUK will be further strengthened and its commercial expertise boosted to allow for even more efficient project delivery (HMT, 2012). The creation of the PF2 Equity team (see below) is part of this effort to bolster the capacity of IUK.

39. According to the PPP Principles, the Central Budget Authority should scrutinise each PPP in order to secure affordability and project quality. The Central Budget Authority should check and monitor the PPP through each key phase: Planning; Feasibility, Design and Tender Preparation; Bidding and Contract Signing; and Construction and Operation. The Central Budget Authority should also scrutinise the project for value for money, affordability, procedural steps and that the projects remain in line with political agreements. The Central Budget Authority need not possess deep and specific knowledge of the PPP project's technical design. However, it needs sufficient capacity to evaluate the documentation presented to it. The location of IUK within HM Treasury ensures that it would be able to assure the alignment of capital investments with the government's short and medium term macroeconomic stability targets. The coordination of budget and project approvals for PFI/PF2 in the UK is done within HM Treasury through close coordination between the spending teams and IUK's Policy team.

40. HM Treasury's **spending department** aggregates all the departmental budgets. Each line Department has a dedicated spending team that coordinates negotiations over allocated departmental budgets. It sets the spending envelope –both capital and reSource spending– for the Departments as part of the Spending Review process (see Section 4 on budgeting). Having set limits in place for infrastructure expenditures contributes to ensuring the affordability of projects. The spending team also leads the appraisal process for major projects. A Major Project is generally defined as “a central Government funded project or programme that requires HM Treasury approval during its life, as set out in Delegated Authority letters” (Cabinet Office & HMT, 2011). PFI/PF2 projects enter in this definition. IUK's PPP Policy team provides commercial and technical advice to the spending team with regards to the approval of all PPP projects.

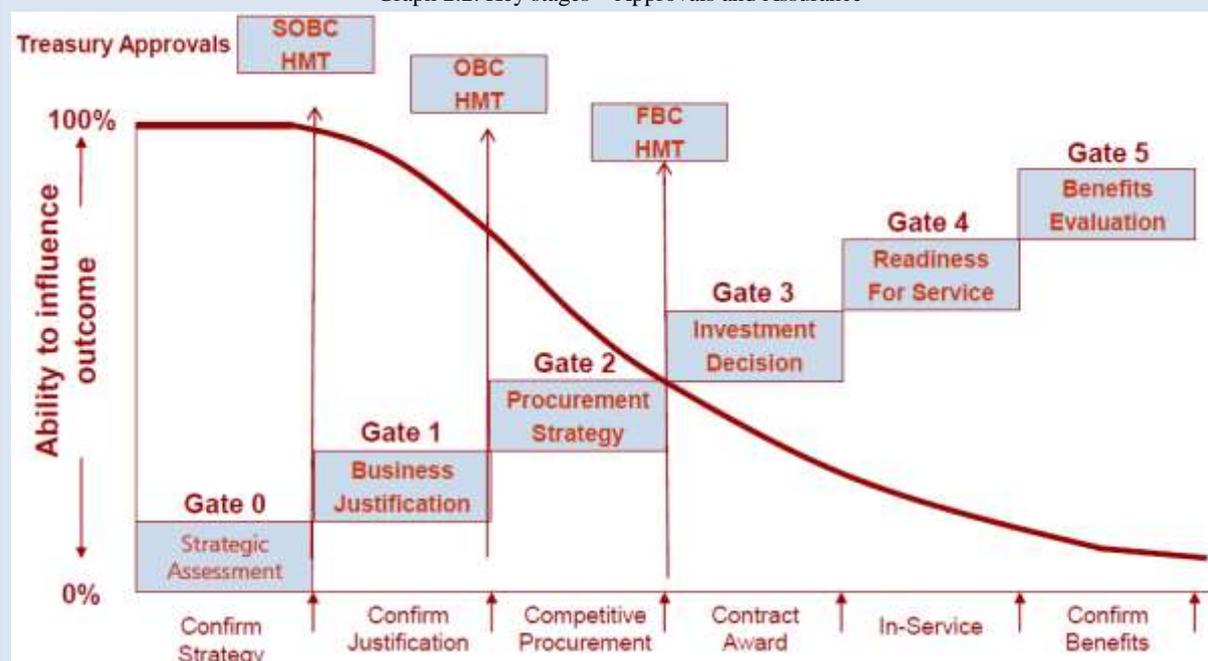
41. Line Departments and other procuring authorities must notify HM Treasury when a major project is seriously under consideration. They are required to go through a set of assurance tools

provided by the Major Projects Authority (MPA), namely the Starting Gate and the Integrated Assurance and Approval Plan (see Table 2.3), before starting the project appraisal process. Based on the line Department's submissions, the spending team agrees the level of detail and scrutiny that it needs to exercise for project approval based on its cost and risk, and the track record of the relevant spending Department (Cabinet Office & HM Treasury, 2011). A business case is then prepared by the procuring authority for the project it chooses to pursue – including a quantitative and qualitative Value for Money assessment– in line with *Green Book* guidance. Treasury Approval Points (TAPs) are required at different stages of the business case process for all PPP projects, and are led by the relevant spending team. A joint TAP / Cabinet Office approval is issued for specific Cabinet Office controls,⁹ including for any new property acquisitions made through a PFI provider. TAPs take the MPA assurance process and the different tools available to it closely into account (see Box 2.1). In addition to HM Treasury, IUK also supports the MPA's assurance process with regards to infrastructure and PPP projects. Line Departments must continue to provide HM Treasury's Policy team and the MPA with details of major projects after the approval of the Full Business Case, and until the project is operational.

Box 2.1. Stages of the Approval and Assurance Processes for project appraisal in the UK

HM Treasury’s spending department is responsible for providing approvals at different stages of the business case appraisal process for all PPP projects through Treasury Approval Points (TAPs). This process runs in parallel to the assurance ‘process led by the Major Projects Authority (MPA). Gateway reviews are one of the essential tools used by the MPA in its assurance process. They are aligned with Treasury TAPs in the following manner:

Graph 2.2. Key stages – Approvals and Assurance



Source: IUK (2014), ‘Transparency, Control and Audit of PPPs: Base Principles and UK Practice’, Presentation by James Ballingall, 4 June 2014

The table below further details elements of the MPA assurance process on which HM Treasury bases itself at each stage of its TAPs.

Table 2.2. Scope and Timing of Treasury Approval Stages

| Treasury Approval Point (TAP) | Scope and timing | How does the TAP relate to MPA approval |
|--|---|---|
| Strategic Outline Business Case (SOBC) - Project initiation stage | <ul style="list-style-type: none"> - All new Major Projects to ensure strategic fit, value for money and deliverability. - Approval required before any public commitment is made. | Preceded by at least one of the following: <ul style="list-style-type: none"> ● Starting Gate ● Gateway Review 1 ● Project Assessment Review (PAR) |
| Outline Business Case (OBC) - Pre-market stage | <ul style="list-style-type: none"> - All Major Projects to assess all options in detail. - Approval required before going to the market/issuing OJEU notice. - All Major Projects pre-spending commitments | Preceded by at least one of the following: <ul style="list-style-type: none"> ● Gateway Review 2 ● PAR |
| Full Business Case (FBC) - Pre-final negotiation stage | <ul style="list-style-type: none"> - Approval required before finalising commercial contracts. - For projects using competitive dialogue as a procurement route, approval required before close of dialogue. | Preceded by at least one of the following: <ul style="list-style-type: none"> ● Gateway Review 3 ● PAR |

Note: Every TAP is preceded by at least one assurance tool (see Table 2.3) led by the MPA

Source: Cabinet Office & HM Treasury (2011), *Major Project approval and assurance guidance*, April 2011

42. A PPP Unit's function can be pursued by a number of complementary units. These units need to have the requisite in-depth financial, legal, economic and project management skills to enable authorities to create, manage and evaluate a PPP efficiently and effectively. IUK counts several teams or units to support its mission.

43. The **PPP Policy team** is still in essence the UK's PPP unit. It oversees the strategic direction of PPP Policy and provides advice to Ministers and others in this context and on specific PFI, PF2, and PPP policy issues (Government, 2014).¹⁰ The PPP Policy team plays a key role in advising HM Treasury on the business case evaluation for PFI/PF2 projects. It supports the main aim behind the TAP (Treasury Approval Point) process, which is to scrutinize the business case to achieve higher quality and better value for money from procured projects. The PPP Policy team can highlight any additional fiscal risks to Treasury's budget department that may arise through each of the three stages of the approval process. It also has a role in reviewing final contract terms if they deviate from standardized documentation, in which case HM Treasury approval is required prior to signature. The PPP Policy team contributes to overarching PPP policy by advising the administration on PPP-related issues, especially in times of changing political strategy by providing a forward-looking perspective on PPPs. It oversees the operational efficiency programme, which seeks to support project managers in identifying and implementing savings measures that would reduce costs while maintaining the quality of public services provided under PPPs already in operation (see Section 3 on value for money). This work is done in conjunction with the Department for Communities and Local Government. The Policy team features a mix of commercial specialists and policy officials whose task it is to ensure that selected projects represent value for money for the government.

44. The **Strategy team**'s aim is to provide tools for different stakeholders to transparently assess projects at different stages in a manner as that is consistent with the overall policy framework. Its main tool is the National Infrastructure Plan (NIP). This document was published for the first time in 2010 to provide more transparency about future infrastructure challenges and opportunities. It has since evolved from an overall strategic document to include specific information on individual capital projects. The NIP is published alongside the most comprehensive, forward-looking infrastructure pipeline to date, which details the size and status of UK infrastructure projects with a detailed regional breakdown.¹¹ The 2014 NIP¹² contains an overall public and private infrastructure pipeline of GBP 466 billion in investments stretching out to 2020 and beyond, up from GBP 375 billion the previous year. The investment pipeline can be considered a list of projects and programs that are under serious consideration rather than a short list of projects that have been decided on, or a commitment to undertake specific projects.

45. The **PF2 Equity team** has been added to IUK as a consequence of PF2. This unit was created to manage the minority equity stake of the SPV under the new PF2 scheme on behalf of the procuring authority. As discussed in section 1, the injection of public equity into PF2 contracts is intended to better align priorities between the public and private sectors, and provide greater transparency in terms of contract management to the government. IUK's PF2 team will represent the procuring authority on the board of the project as an ordinary equity holder, and regularly review the performance of equity holdings in the investment vehicle.¹³ A Memorandum of Understanding will be established between the procuring authority and the Equity team for each PF2 contract. Staff constituting the Equity team have strong financial and commercial expertise, and mostly come from a background in the private sector.

46. The **Major Infrastructure Tracking (MIT) team** was set up within IUK in 2013 to provide more transparency about the delivery process of major projects. The team's role is to track business case approvals for each project in the Top 40 pipeline, thereby making available a high level of detail about their procurement process. The team works closely with line Departments to determine projects' level of progress, and to identify and address any obstacles that may hinder it at the sectoral or central levels. This enables them to do two things: 1) identify recurring issues that are common to several projects; 2) address these issues in the early stages of the project. The team is also responsible for the PFI/PF2 trackers, which is a new way of making data about PFI and PF2 projects more

accessible and comprehensible to the public (see Section 4 on budgeting). The MIT's work to closely monitor projects' procurement process and actively participate in the resolution of problems as they arise is a strong signal of the new hands-on approach taken by the UK government to successfully deliver capital projects, including PFI/PF2 projects.

47. Additionally, IUK acquired an additional mandate with the creation of the **Guarantees Scheme** in mid-2012 as a tool to support infrastructure projects in a time of constrained long-term financing (see Section 5 on financing). This GBP 40 billion scheme will provide different types of state guarantees to infrastructure projects on a commercial basis. It is expected to run until December 2016. An upcoming publication by the NAO will examine the impact of these government guarantees on infrastructure project loans two years after the creation of the Scheme, including the Treasury's efforts to minimize their effects on taxpayers.¹⁴

Other oversight institutions

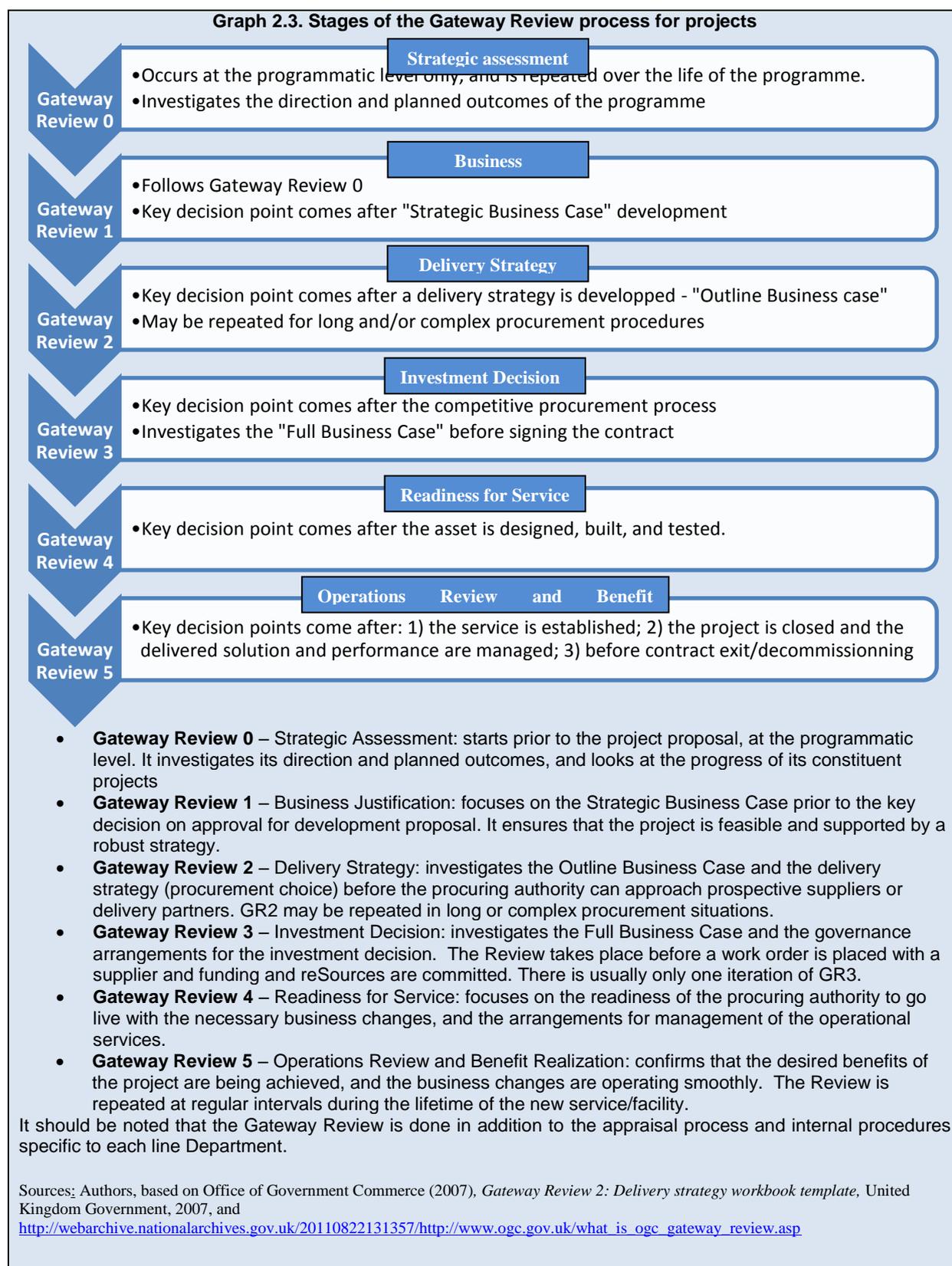
48. In addition to IUK and the units located within HM Treasury, there exists a well-rounded institutional arsenal to regulate, support, and monitor PPPs in the UK. The aim of these organizations is to strengthen the public sector's capacity to plan, procure, and manage major projects such as PFI/PF2. These institutions also provide evaluation tools both *ex ante*, such as in the case of the ERG/MPA and OBR, and *ex post*, such as in the case of the NAO, to secure value for money for planned and future PPPs. Along with IUK, they ensure that procedural steps (gateways) are followed. They also provide oversight on processes and results. The UK's Supreme Audit Institution has a particularly important role in drawing lessons and finding ways to improve future performance.

49. Regulatory and oversight bodies need to operate under an appropriate and clear mandate, with the necessary independence from political influence and regulated subjects. They also need to be appropriately reSourced and equipped, and their decision-making must be fully transparent and accountable. In the UK, a number of utilities and related projects are regulated by dedicated sector regulators; such is the case for projects that fall under the regulatory asset base (RAB) model. PPPs in UK are not regulated by sectoral regulators. There are several bodies responsible for their oversight, along with other large capital projects. The **Efficiency and Reform Group (ERG)** was established as part of the Cabinet Office in 2010 to help line Departments achieve cost reductions through a step change in their efficiency and stronger central oversight of their spending. It reports directly to the Permanent Secretary for the Cabinet Office and to ERG Reform Board, which is chaired jointly by the Minister for the Cabinet Office and the Chief Secretary to the Treasury. The ERG provides support to line Departments to deliver savings and cost-efficiency on behalf of the tax payer in specific areas, including through renegotiating contracts. For major capital projects, including PFI/PF2, its key responsibility is the independent Gateway Review process (see Box 2.2). The Review team comprises of certified practitioners who are independent from the project team. In 2011-2012 alone, the Cabinet Office reported savings of GBP 320 million on External contractors' costs and PFI contracts, one of the areas specifically targeted by ERG (NAO, 2013).

Box 2.2. Overview of the Gateway Review process of capital projects in the UK

As an independent and targeted review process, the Gateway Review is conducted in parallel to the appraisal process, and is mandatory for procurement, IT-enabled, and construction programmes, as well as central government projects. This process was first introduced in 2001 by the Office of Government Commerce (OGC), which was later incorporated into the Efficiency and Reform Group in 2010. This process is used to assess the progress and likelihood of success for a specific project, as well as any risks and critical issues.

The Review examines projects at five critical gateways or stages of their lifecycle to see if they are ready to proceed to the next stage, including Gateways 1 and 2 that are aligned with Green Book guidance (HMT, 2003, 2011). Both gateways are usually cleared before including the project in the budget, and launching the procurement procedure. A description of each gateway and a graphical representation of the timing of their intervention can be found below :



50. The **Major Projects Authority (MPA)** is a collaborative structure between the Cabinet, HM Treasury, and line Departments. It is housed within the ERG. The MPA’s aim is to increase the success rate of major projects across central government. Since its creation in 2011, it has developed a range of interventions to provide assurance over government major projects at all main stages, and to

support HM Treasury approval and funding decisions (NAO, 2014). To this end, it closely oversees and provides assessments on the integrated and iterative appraisal process for major infrastructure projects. The MPA is not responsible for the approval of projects from one appraisal stage to another. Its main function is to provide assurance review reports, including the above-described Gateway Review, in order to inform Treasury approvals during the three stages of the business case proposal. It also approves, together with HM Treasury’s spending teams, the Integrated Assurance and Approval Plan (IAAP) for major projects. This is the expected framework for the “planning, coordination and provision of assurance activities and HMT and departmental approval points throughout the lifecycle of a major project” (Cabinet & HMT, 2011). Departments planning to pursue a major project must submit a draft IAAP, which will be updated throughout the lifetime of the project. Table 2.3 below describes the planned assurance toolkit that is included in the IAAP. All assurance activities are reSourced by the MPA, departments, and public sector specialists elsewhere such as IUK.

51. The MPA also intervenes when difficulties arise from particular projects by providing assurance reviews –through its consequential assurance tools – or commercial and operational support to line Departments. The MPA has an affiliated Major Projects Leadership Academy (MPLA), which is responsible for building capacity within government Departments for program managers. It aims to empower projects leaders while ensuring clear lines of accountability and responsibility (NAO, 2014). Finally, the MPA publishes timely and regular data, and reports on projects for the new Government Major Projects Portfolio (GMPP). It thus provides additional level of oversight and scrutiny on projects with high stakes for the government and public.

Table 2.3. Planned assurance tools

| Tool | Description |
|--------------------------------------|--|
| Risk Potential Assessment (RPA) form | Identifies level and nature of project risk and therefore degree of assurance required |
| Starting Gate Review | Explores deliverability of major new policy and/or business change initiatives prior to public commitment to a project |
| EGC Gateway Review | Series of assurance “gates” before key project milestones |
| Project Assessment Review (PAR) | Flexible assurance review that is tailored to stage of project |

Source: Updated from Cabinet Office & HM Treasury (2011), *Major Project approval and assurance guidance*, April 2011.

52. Another, newly formed oversight entity is the **Office of Budget Responsibility (OBR)**, an independent fiscal oversight entity that was established in 2010, in part to increase independence in the area of economic and fiscal forecasts (OECD, 2014). Previously, the responsibility for producing the official forecasts for the economy and public finances was held by the Central Budget Authority, HM Treasury. The OBR is funded by HM Treasury but reports to Parliament, and is a legally a separate arms-length entity, with its own oversight board. Neither the government nor Parliament have a right to direct OBR analysis, and the OBR takes full responsibility for the content of its publications and other pronouncements. The OBR thus reports independently on the future sustainability of public finances in its annual fiscal sustainability report, drawing on data published in the WGA. Its role is to assess fiscal sustainability across the whole public sector, not to scrutinize policy or enforce spending limits. In doing so, the OBR:

- highlights expected future spending liabilities that are incurred by PFI payments, or commitments of another nature that involve binding commitments by government;
- distinguishes between amounts recorded on and off-balance sheet as they appear on National Accounts. Contingent liabilities, which are separated into quantifiable and non-quantifiable, are taken from the Whole of Government Accounts report (see

Sections 1 on the state of play and Section 4 on budgeting) and individual departmental accounts; and

- uses data collected and published on the Treasury website about signed PFI deals to prepare its reporting on PPPs.

53. The OBR plays an important role in ensuring transparency of public spending in the UK, including PFI/PPP projects. It makes commitments and contingent liabilities transparent in a readable manner, but relies heavily on the rest of the public sector for the quality of the numbers. To safeguard its independence, the OBR makes information on its data contact points in the public administration publically available. It operates with about 20 to 25 staff members.

54. A country's Supreme Audit Institution (SAI) has a key role to play with respect to the PPP program. The **National Audit Office (NAO)** is the Supreme Audit Institution in the UK. It is de facto an independent parliamentary body. The NAO has an important role in examining whether the risks involved in PPPs are managed effectively. Its reports to Parliament can keep the public informed about the services that they receive and also disseminate best practice. The NAO's mission of auditing central government bodies is two-pronged: 1) holding government departments and bodies accountable for the way they use public money, thereby safeguarding the interests of taxpayers, and 2) helping public service managers improve performance and service delivery.¹⁵ The NAO is not responsible for making policy decisions. Its role is to account to Parliament, and the latter decides how to bring about their mandate.

55. A SAI should audit and assess individual PPPs and the PPP program in general ex post with regards to performance, finance and compliance. It should maintain sufficient capacity to give a clear verdict on whether or not the project ultimately represented value for money, suggest possible improvements to the regulatory PPP framework and the procurement processes, and make available overall lessons regarding the use of PPPs and investments. All relevant information should be made available to the NAO in this respect. The NAO contributes significantly to improving the transparency and scrutiny vis-à-vis the public about PFI/PPP projects. It has performed and published close to one hundred reviews of individual PFI projects, and drawn lessons and offered suggestions on how to cut spending and improve efficiency. As part of the operational efficiency programme, the NAO has reviewed 684 operational PFI contracts, out of which 118 reported savings of GBP 1.6 billion. The NAO looks at ways to improve public spending and drive lasting improvement in public services through past public sector experience. In 2011, it released a report on *Lessons from PFI and other projects*, in which it drew lessons from recent project experiences that the public sector needs to address to achieve the best commercial outcomes in the current economic environment of spending constraints (NAO, 2011). The UK's NAO could be said to be a global best practice model for SAI involvement in PPP and infrastructure.

Sectoral and sub-national institutions

56. The authority that is procuring the PPP is the institution ultimately responsible for the project, subject to approval, monitoring and advice from the other actors at various stages. The authority is responsible for preparation, negotiation and administration of the contract, and for monitoring and evaluating contract performance during the construction and operation phases of the project. This is crucial to ensure that the project delivers value for money during the whole life of the contract. This authority is, therefore, ultimately responsible for the PPP contract and its operation. Several departmental and sub-national authorities where a significant amount of PPPs are pursued have their own private finance units and significant experience with PFI contractual arrangements. Some challenges still exist for the management of PPPs by procuring authorities at the UK sub-national level, even if expertise in the UK is more far reaching than other parts of the OECD.

57. **Contracting authorities** are responsible for the procurement, monitoring, and evaluation of the PPPs they have contracted. Contracting authorities may include sub-national governments such as devolved administrations and local authorities, line Departments, and their executive agencies. The

Highways Agency is the executive agency for the Department for Transport, and the Education Funding Agency is a delivery agency for the Department for Education, by way of example. Several line Departments, such as the Department of Health and for Education, have had their own departmental private finance units in place for a number of years. Private finance units also exist at the level of sub-national governments, where they are responsible for coordinating expertise and transacting projects. The Leeds PPP Unit for instance counts around 70 members dedicated to supporting PPPs in the city. Contracting authorities at the local or sectoral level with responsibility for the procurement and selection of the preferred bidder follow EU Directives, supported by interpretive guidance issued by HM Treasury and ERG. Following the necessary Treasury approvals, contract management primarily rests with the procuring authority, including any renegotiation or dispute resolution mechanism. Support is sometimes available for sub-national governments from the relevant Department or Local Partnerships in specific areas.

58. **The Department of Communities and Local Government (DCLG)** plays an important role in the governance of PFI at the local level in key areas. One of its key areas of involvement is with housing associations, which use private financing. Specifically, the Department supports local governments to develop the underlying business case for their project proposals. Both the Treasury and the DCLG need to sign off on the project before the authority can start the procurement process. The DCLG can also make some funding available for specific programs by allocating budgets to local authorities to use as they see fit. In many cases, there is a lack of capacity at the level of local authorities, but also a resistance to standardized projects. Both smaller and larger authorities often want to follow their own procedures instead of following standard processes, which resulted in the past in issues such as draft PFI contracts of prohibitive length.

59. **Local Partnerships (LP)** is a 50-50 partnership between IUK and the Local Government Association. Upon the dissolution of Partnerships UK in 2011, several former PUK staff joined Local Partnerships. It works with nearly two thirds of local public sector bodies in England, and has some involvement in Wales. LP is not responsible for devising policy, performing assurance, or providing approvals. However, LP can provide transaction advisory services during the procurement stage, all the way from the strategic business case stage to the full business case through opinions and recommendations. It is particularly experienced in wastewater, schools and housing, but also works in other areas of infrastructure. It collaborates closely with Treasury on efficiency, or how to drive the best value from existing PPP/PFI contracts. LP was commissioned by the Treasury and the Department of Communities and Local Government in 2011 to look at a number of local authority projects in order to identify savings and gather evidence and learning that could be applied across the wider public sector (HMT, 2011). The role of LP is akin to public authorities “outsourcing” their internal procurement and contract management functions. It’s a flexible model of supporting them to get the most out of their advisors, and to help them to make well-informed decisions. LP has 42 full-time employees, about 70 associates, and includes the vast majority of local governments as members.

Scotland, Wales and Northern Ireland

3. In **Scotland**, the **Scottish Futures Trust (SFT)** was setup in 2008 as a specialist infrastructure team with the responsibility to deliver savings and value for money across public infrastructure investment. It supports Scottish Government Directorates (equivalent to line Departments in England) with the structuring and preparation of their infrastructure contracts, including determining budget and product-type needs and innovative financing structures. It sometimes leads the direct delivery of PPP contracts, such as for the National Housing Trust (Scottish Government, 2011). SFT has a deep understanding of a PPPs’ commercial attributes, putting it in a privileged position to interact with the private sector. SFT also collates data on NPD and hub programmes to provide estimates for revenue support for projects, which feed into Scotland’s Finance Directorate’s model of long-term capital investment commitments. SFT act across all phases of the infrastructure investment cycle, from initial option investigation to asset disposal and supports the public sector through providing a number of roles:

- Deliverer of projects, through managing and leading
- Broker, enabling public authorities to collaborate on projects to deliver greater savings
- Advisor and organiser of funding and financing
- Validator of projects, by carrying out scrutiny and diligence
- Centre of expertise on infrastructure investment

One of its biggest ongoing projects is an initiative on affordable housing, which consists of 26 joint ventures with the private sector, using low cost finance and guarantees. SFT comprises approximately 70 staff, including 15 who are involved in Housing PPPs.

61. In Wales, there is no formal PPP unit and administration of PPP activities is not centralised. No PFI projects have been signed in Wales since 2008, reflecting historical preferences for other types of funding instrument. Nonetheless, the current government is currently rethinking its approach towards infrastructure financing, notably through the Scottish NPD scheme. This would involve strengthening the institutional setup, including project teams, and the hiring of external advisors in the initial stages of the programme.

62. In **Northern Ireland**, The Strategic Investment Board Ltd (SIB) was set up in April 2003 under the terms of the “Strategic Investment and Regeneration of Sites (Northern Ireland) Order 2003”. SIB was established in law and has the lead role as the centre of excellence and expertise in PPPs – the organisation does not have formal policy responsibility or an approval role for PPPs as this is retained by the relevant department. The SIB also assists in operational work on project management and procurement for an agreed group of strategic projects. The company is fully owned by and accountable to the Office of the First Minister and deputy First Minister (OFMDFM).

Principle 3 of the PPP Recommendation

Principle 3. *Ensure that all significant regulation affecting the operation of Public-Private Partnerships is clear, transparent and enforced. Red tape should be minimised and new and existing regulations should be carefully evaluated.*

63. England’s legal regime is based on common law,¹⁶ and there is no dedicated “PPP law”. PPP agreements are governed by contract law, and, as with other EU member states, procurement follows EU procurement directives. The UK has acquired extensive experience with PPP contracting, with clear rules of the game for both the public and the private sector. The principles of competition, fairness, and transparency are upheld as indicated by the UK’s 8th rank in the World Bank’s Doing Business survey.¹⁷ The UK ranks higher than the OECD average on several key indicators, such as the strength of the legal rights index or the time required to enforce contracts.

64. Standardized contracts for the traditional public procurement of goods and services are used in several countries. From a practical point of view, this model works well for “tried and proven” contract models, and allows both the procuring authority and the contractor to significantly reduce the cost of entering into new contractual arrangements. This practice is not as common for large and oftentimes complex projects such as PPPs, but a few countries with significant PPP experience, including the UK, have pursued this approach. SOCP4 (Standardisation of PFI Contracts – Version 4) was the latest standardized version of PFI contracts, released in 2007. New guidance called *Standardization for PF2 contracts* was published at the time of the release of PF2. One of the aspects reflected by this new standard is the greater allocation of risk towards the public sector under PF2 contracts. Having such a document in place helps clarify the wording and requirements that contracts need to exhibit under the new PF2 framework. However, it is not meant to be entirely prescriptive. Procuring authorities have the flexibility to tailor individual contracts according to project needs but require approval by HM Treasury prior to signature of the final contract. Contract changes may for instance occur during the “negotiated procedure” leading up to signature, which will be replaced by the fairly similar “competitive procedure with negotiation”.

65. Private investment will be facilitated if unnecessary red tape is removed and delays to approval processes are reduced. The coordination of approval processes can remove regulatory and procedural obstacles to improve the delivery of PPPs. The UK government has several procedures and guidelines in place to help speed up the process. Most recently, PF2 guidance has limited the maximum procurement timeframe to 18 months. This new measure seeks to address criticism made during the PF2 consultation process that the procurement procedure is too long and cumbersome. The newly-established Major Infrastructure Tracking team has a significant role to play here by identifying and helping address any regulatory or other obstacles that may hinder project procurement. During the approval procedure for project appraisals, Treasury has a maximum of 28 days from the first submission of the business case to communicate its decision in writing to the line Department or procuring authority (Cabinet Office & HMT, 2013). The Merseylink Consortium announced procurement savings of £250m when it reached financial close in March 2014 (HMT, 2014). The government thus continues to explore new ways to cut and streamline processes that will allow for faster procurement and delivery of PFI/PF2 projects.

66. Scotland has its own legal system and also no PPP-specific legislation. The general context for pursuing PPPs is based on transparency and accountability, freedom of information, EU procurement directives, and active stakeholder consultation. The regulatory framework for PPPs in Wales also follows the same structure as England.

Conclusion

67. The **first PPP principle** emphasises the importance of the political leadership ensuring public awareness of the relative costs, benefits and risks of PFIs and conventional procurement. Transparency on the costs, relative benefits and challenges of PFIs is evident in the UK and indeed in the debate leading to the introduction of PF2. In its Whole of Government Accounts (WGA), HM Treasury discloses commitments and future liabilities of PFI/PF2 contracts. The Office for Budget Responsibility makes contingent liabilities transparent in a readable manner. The National Audit Office (NAO) plays a key role in informing the public debate about PFIs in the UK through its regular reports to Parliament.

68. The **second PPP principle** focuses on the importance of clear institutional roles and strong capacities across participating institutions. The institutional set up and public sector capabilities for PFIs and capital projects generally are clear and coherent. Public officials understand their roles, and the roles of their counterparts. HM Treasury's Infrastructure UK (IUK) is well capacitated and its different units regularly advise procuring authorities, Ministers, and HM Treasury regarding the appropriateness of PFI as a procurement mode for infrastructure. HM Treasury's spending teams review and approve significant investment projects, including PFI projects, at appropriate decision points. They are informed by advice from IUK and other oversight institutions such as the Major Projects Authority. As the Supreme Audit institution, the NAO assesses projects and programmes for value for money and derives lessons for the future in order to further improve the framework for PFI/PF2 projects⁴. Local Partnerships have been established to provide dedicated commercial support to local authorities across different stages of the project cycle, including through procurement and delivery. There can still, however, be a capacity gap at the local level.

69. The **third PPP principle** calls on countries to ensure that all significant regulation affecting the operation of PFIs is clear, transparent and enforced. The UK follows contract law for PFIs and EU procurement directives. The current regulatory framework works well. Efforts are still ongoing to enhance this framework through stronger central oversight over the procurement process, and more standardized processes and documents to speed up projects' financial close. Under PF2 projects the competitive phase of the procurement process is expected to be no longer than 18 months.

⁴ Note that devolved administrations and local authorities have separate audit bodies.

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⁹ For Major Projects that meet any of the following Cabinet Office Control criteria, a joint HMT/Cabinet approval process is required: ICT spend over £5million; Marketing and advertising spend over £100,000; for the signing of new leases, renewals of existing leases, the non-exercise of lease break options, any new property acquisitions (including those made through a Public Finance Initiative provider), new build developments, sale and leaseback, and any freehold sales as part of national property controls; Spend on a complex or non-standard commercial model (e.g. joint venture) for a service or Business Process Outsourcing.

¹⁰ OECD Questionnaire to the UK, May-July 2014

¹¹ <https://www.gov.uk/government/publications/national-infrastructure-plan-2014>

¹² December 2014

¹³ <https://www.gov.uk/government/news/new-unit-of-experts-to-manage-government-investment-in-infrastructure>

¹⁴ <http://www.nao.org.uk/work-in-progress/>

¹⁵ <http://www.nao.org.uk/about-us/#>

¹⁶ The body of law developed in England primarily from judicial decisions based on custom and precedent, unwritten in statute or code, and constituting the basis of the English legal system and of the system in all of the United States except Louisiana (Merriam-webster, Encyclopædia Britannica, 2014)

¹⁷ <http://www.doingbusiness.org/data/exploreeconomies/united-kingdom>

SECTION 3: SUBJECTING PPPS TO VALUE FOR MONEY TESTS IN THE SAME WAY AS PUBLICLY PROCURED PROJECTS

70. The UK premise for the PFI program is that it should bring benefits in terms of value for money compared to more traditional procurement modalities. The overriding perceived long term advantage of delivering a significant share of investment through PPPs in the UK has been to spread discipline in cost control to all forms of infrastructure procurement. Minimising alterations to project specifications, through the planning and construction phases, has been the key to achieving a higher rate of on-time, on-budget delivery for routine building projects. Maintenance of assets to design standards throughout their planned lifetime is another benefit that is seen in the UK as having been successfully delivered by PPPs. Perceptions of other potential advantages brought by the involvement of private finance have varied over time and between jurisdictions and agencies (HM Treasury, UK Government Departments, local authorities, Scottish, Welsh and Northern Irish authorities)

71. The potential for PPPs to enable cost savings through innovation in construction techniques is seen as important, particularly with regard to large, one-off economic infrastructure projects. However, such savings are only possible when planning and procurement regulations allow such innovation to be exercised, and where equity from a construction company accounts for a significant share of project finance. The potential for innovation is assessed case by case rather than being assumed to be a generic virtue.

72. The ability of off-balance sheet finance to advance projects that would otherwise strain accounting limits has certainly been an attraction in the past, and remains so in Scotland, as discussed further in the next chapter. There are also cases when the characteristics of the project make the PPP route clearly disadvantageous. Where commissioning deadlines are short, for example with procurement of trains for Crossrail and Thameslink services in 2014, the time that would have been required to establish a special purpose vehicle and attract investors ruled out the use of private finance.

73. In debates about the use of PPPs, the above issues have oftentimes been collapsed into a question of whether PPPs represent greater value for money for the public purse than more traditional infrastructure procurement (TIP). The concept of Value for Money, however, isn't straightforward, and the tools with which such a judgement should be made have been continuously evolving.

74. This section will discuss the concept of value for money followed by a review of the five OECD Principles that relate to the concept (principles four to nine). The fourth principle relates to the issue of prioritisation of projects at senior political level. It will be discussed with reference to the infrastructure planning and budgeting process in the UK. It will be followed by a discussion that links the UK Green book appraisal process to principles five on identifying the procurement effort that is likely to yield the most value for money, principle six on appropriate risk allocation, and principle seven which calls on the procuring authorities to be prepared for the operational phase of the PPP. Finally, the importance of maintaining value for money when renegotiating a PPP contract will be discussed.

What is value for money in relation to PPPs?

75. The basic approach for assessing value for money of a PPP project involves comparing the PPP option with a public sector reference project, the 'public sector comparator' (PSC). A PSC

spreadsheet tool was developed by HM Treasury and has been widely copied throughout the world. A PSC is meant to compare the net present cost of bids for the PPP project against the most efficient form of delivery according to a traditionally procured public-sector reference project. The PSC then serves as a hypothetical risk-adjusted cost of public delivery of the project. Ensuring the robustness of a PSC is difficult, and may be open to manipulation in order to either strengthen or weaken the case for PPPs e.g. depending on the chosen discount rate or the value attributed to a transferred risk.

76. In addition to the quantitative aspects usually included in a ‘hard’ public sector comparator, value for money includes qualitative aspects and usually involves an element of judgement on the part of government. Value for money can therefore be defined as what governments judge to be an optimal combination of quantity, quality, features and price (i.e. cost) expected over the whole of the project’s lifetime. The discussions below will show how the value for money debate has evolved into a more nuanced approach than was the case in earlier years.

77. The term ‘value for money’ is used in the UK guidance materials in relation to several different tests under the strategic, economic, commercial and financial case assessments. It refers to general concepts of delivering a good level of service for the money spent, and sometimes to specific technical comparisons of alternative financing/contractual options. *The guidance on value for money in the UK is constantly under review so it is important to check the HM Treasury website for the latest versions of guidance.*

Principle 4 of the PPP Recommendation

Principle 4. *All investment projects should be prioritised at senior political level. As there are many competing investment priorities, it is the responsibility of government to define and pursue strategic goals. The decision to invest should be based on a whole of government perspective and be separate from how to procure and finance the project. There should be no institutional, procedural or accounting bias either in favour of or against Public-Private Partnerships*

78. As mentioned in the discussion of the organisational framework above, the UK first developed an Infrastructure Plan in 2010 that annually lists the pipeline of potential infrastructure projects. The pipeline amounted to a portfolio of GBP 370 billion in 2014 and covers projects that will rely on public as well as private finance. The purpose of the plan is to:

- Present a global government vision with respect to infrastructure development in the UK.
- Lay out the strategic need for investment in the UK.
- Create transparency about the project pipeline and priority investments in order to assure the business side that there is an ongoing market.
- Ensure delivery progress by measuring and publishing reports on developments.

79. With regards to private finance, the projects represent some public interest and possible use of state guarantees (e.g. the utilities sector). The list covers projects at various stages of development – from budgeted, planned to potential. The investment plan is generated on the basis of departments transmitting their plans and wishes to HM Treasury’s Strategy team, which filters and compiles the list.

80. The actual government prioritisation of projects, however, takes place using two main tools: the “Top 40” list of projects/infrastructure programs and the budget. The Top 40 list of projects has been developed in an iterative process with the line Departments, HM Treasury and the Cabinet office. The projects are chosen based on a number of criteria that essentially focus on political priority and overall value to society. The Top 40 list is finally endorsed by the Cabinet and is subject to consistent review by a Cabinet Committee in order for the projects to move forward.

81. For the project to be implemented, reSources are allocated to it in the annual budget ensuring its fiscal affordability. Possible state guarantees are subject to Treasury approvals and included in the annual budget documentation. The overall affordability of the project portfolio is assured by keeping it within the government's medium term fiscal plan.

Box 3.1. Securing Value for Money

There are criteria that should be considered in the choice between PPP and traditional infrastructure procurement:

- Can risk be defined, identified and measured?
- Can the right type of risk be transferred?
- Is the size of risk large enough to serve as an incentive towards value for money?
- Are private partners willing to accept the risk to be transferred to them?
- How much competition is there for the market?
- How much competition is there in the market?
- How large are the benefits from combining the construction phase and the operating phase of the project in a whole-of-life contract?
- Can the quality and quantity of service output that the private partner must deliver be clearly measured so as to deal with possible cost and quality trade-offs?
- How much innovation is required?
- What is the availability in the public sector of the skills needed to operate the asset?
- How rapidly and significantly does the technology needed for the project change?
- How much flexibility does the government want to change the output specifications of the service to be delivered?

The choice between a pure PPP (depending on the government for its revenue stream) and a concession (depending on user charges levied directly on the beneficiaries of the service) adds further criteria:

- Is demand sufficient to render the levying of user charges a viable Source of income for a concessionaire?
- Does the service create externalities that might give rise to a free-rider problem and hence lead to demand not being revealed by beneficiaries?
- To what extent is there a need for/desire by the government to subsidise all or part of the beneficiaries of a service?

Source: OECD (2012).

Principle 5 of the PPP Recommendation

Principle 5. *Carefully investigate which investment method is likely to yield most value for money. Key risk factors and characteristics of specific projects should be evaluated by conducting a procurement option pre-test. A procurement option pre-test should enable the government to decide on whether it is prudent to investigate a Public-Private Partnerships option further.*

82. This section will discuss the issue of value for money in the appraisal process in the UK. All types of PPP projects, and indeed all projects under contract to government agencies, follow the same appraisal procedure in the United Kingdom. Traditional infrastructure procurement using public finance is currently the UK government's default choice for infrastructure procurement. Private finance is only meant to be mobilised through PPPs when this modality is expected to bring advantages – in other words, when it is expected to achieve more value for money than other options.

The Business Case Appraisal Process

83. All projects funded by public sector bodies are appraised in the same way in the United Kingdom, using a standard methodology. The methodology, developed by the UK Treasury is followed by all Departments of the Government, by local authorities across the country and by investment agencies in Scotland, Wales and Northern Ireland. The appraisal methodology develops a 'business case' for each project or program, designed to summarise the results of all the necessary research and analysis needed to support decision-making in a transparent way. The business case approval process (SOC/OBC/FBC) is applicable to all projects irrespective of their contractual or financing scheme.

84. Business cases are developed for all proposals that require spending on policies programmes and projects using the Treasury "Better Business Cases" methodology which is based on the Treasury's *Green Book* guidance on the appraisal of policies, programmes and projects. This employs the Treasury's "Five Case Model" (see Box 3.2).

85. The business case is a management tool and should be developed over time as a working document as the proposal develops within the line Department. The business case keeps together and summarises the results of all the necessary research and analysis needed to support decision making in a transparent way. In its final form it becomes the key document of record for the proposal, also summarising objectives, the key features of implementation management and arrangements for post implementation evaluation. The analytical resources used depend on the scale and complexity of the project.

86. The business case is structured into five different aspects which are interconnected but distinct (namely, the strategic, economic, financial, commercial and management aspects of the case). The business case should enable HM Treasury and other stakeholders to make sure that the proposal:

- is supported by a robust argument for change – the Strategic Case;
- optimises Value for Money – the Economic Case;
- is commercially viable (where relevant) – the Commercial Case;
- is financially affordable – the Financial Case; and,
- can be delivered successfully – the Management Case.

More detail with regards to each stage and the associated Treasury approvals is found in Box 3.2.

Box 3.2. The steps in the Business Case Appraisal process

The business case is developed in three steps, with more detail being provided at each stage:

Step 1: **Strategic Outline Case (SOC)** – or the scoping stage

- The purpose of the SOC is to confirm the strategic context of the proposal; to make a robust case for change; and to provide stakeholders and customers with an early indication of the proposed way forward (but not yet the preferred option), having identified and undertaken SWOT analysis (Strengths Weaknesses Opportunities Threats) on a wide range of available options, together with indicative costs. With respect to the five aspects this would mean that: the Strategic Case would be mostly completed; the Economic/Value for Money Case would consist of a long-list of alternative options at this stage, but with a tentatively recommended way forward and a shortlist of options to be examined further at the next stage; the Commercial Case would address the fundamentals of any potential procurement; the Financial Case would discuss the likely affordability of the proposed scheme; and the Management Case would outline how the project will be set up and managed.
- **Treasury Approval** would be necessary as part of this stage. HM Treasury would check to ensure strategic fit, value for money and deliverability. The approval would be required before any public commitment is made. This is the phase where HM Treasury has the most opportunity to fundamentally influence the project's direction.

Step 2: **Outline Business Case (OBC)** – or the detailed planning phase

- The purpose of the OBC is to revisit the SOC in more detail and to identify a preferred option which demonstrably optimises Value for Money. It also sets out the likely Deal; demonstrates its affordability; and details the supporting Procurement Strategy, together with the relevant management arrangements for the successful rollout of the Scheme. This phase links to Gateway 2 (Procurement Strategy – see Box 2.2). In the OBC one would expect a brief revision of the Strategic Case; the Economic Case would be completed according to the Green Book guidance; the Commercial Case would outline the envisaged Deal structure and key contractual clauses and payment mechanisms; the Financial Case would contain a detailed analysis of the project's affordability and any funding gaps; the Management Case would be developed in more detail with respect to how the scheme would be delivered.
- **Treasury Approval** would also be required as part of the OBC. The approval would have to be received before the relevant line department can go to the market/issue Official Journal of European Union tender notice.

Step 3: **Full Business Case (FBC)** – or the detailed final phase

- This takes place within the procurement phase of the project, following detailed negotiations with potential service providers prior to the formal signing of contracts. The purpose of the FBC is to revisit the OBC and record the findings of the subsequent procurement activities; together with the recommendation for an affordable solution which continues to optimise value for money, and detailed arrangements for the successful delivery of the project as well as the recommended supplier. This phase maps on Gateway 3 (Investment Decision). In the FBC, one would expect the Strategic Case to be revisited and revised if required; the findings of the procurement process included in the Economic Case and analysed; the Commercial Case would contain the recommended Deal; the affordability and funding issues would be resolved in the Financial Case; the Management Case would contain the detailed plans for delivery and arrangements for the realisation of benefits, management of risk; and ex post evaluation.
- **Treasury Approval** would happen prior to the final negotiation stage where the contracts would be completed. For projects using the competitive dialogue as a procurement route, Treasury approval would be required before the close of the dialogue.
- The Treasury's experience is that projects often go off track after Full Business Case stage. The Treasury will therefore agree with the department a set of milestones in addition to these key stages where approval must be sought for each project or programme and the Treasury reserves the right to add further approval milestones where necessary.

Source: HMT

87. Examination of the **economic case** lies at the heart of appraisal. The Economic dimension employs a Social Cost Benefit analysis approach that considers the Social Welfare of the UK (not just

economic effects) for which it estimates a net present value (NPV). There is an emphasis on comparing alternative options based on the level of Net Present Public Value of public welfare and an analysis of risks and the costs of risk mitigation. Options are qualified for consideration by the generation of a Net Present Social Value (NPV) which includes the cost of risk management.

88. The economic case is concerned with the socio-economic value of a project to the UK population rather than the budgetary impact on specific government agencies or private parties. In establishing the economic case, projects undergo cost benefit assessment following guidelines established in the Green Book on Appraisal and Evaluation in Central Government. This sets out the standard parameters to be used in appraisal, including the discount rate to be applied to establish the net present value of projects (a pure time-preference rate, with no relation to market interest rates). The cost of risk isn't accounted for in the discount rate used. Instead risk management needs to be included as an *additional* cost when modelling the business case.

89. Procuring authorities and line Departments, undertake project appraisals in accordance with the Green Book. Line Departments have developed additional guidance for their sectors; for example the 'WebTag' methodology of the Department for Transport that, amongst other things, establishes standard values of time to be used in transport project appraisals. All the common parameters employed are aligned with the Green Book. Green Book appraisal methodology and parameters are updated periodically with the last overall revision in 2003. Updated guidelines are currently under preparation for publication in 2015/2016.

90. The *commercial* and *financial cases* include an assessment as to whether private finance would bring advantages. This is not designed to be a pass/fail test of whether to proceed with the project, or whether to proceed under public or private finance as such. Rather, it is intended to determine if private finance is suited to the project and would enhance the project. The financial dimension of the case is used to estimate the net impact of each of the proposed options on the budget of the procuring line Department. A benefit-cost ratio for each proposal based upon social NPV divided by the budget impact of the proposal provides an initial ranking of options based on the social benefit per pound generated. The final choice is also informed by consideration of any significant but unquantifiable factors and of the risks involved alongside the NPV and BCR figures. The case discounts future expenditures with the standard Green Book time-preference discount rate to establish the net present cost of a project under alternative financing models. Capital expenditure in the construction phase of a project under traditional public procurement thus records a higher net present value than an equivalent spend spread over the lifetime of a PPP project through unitary charges as discussed further below.

Selection of contracting approach: financial modelling and public sector comparators

91. The choice between PPP or TIP is an integral part of considering alternative options at each stage and is not taken in isolation. It is addressed at the initial strategic stage of the appraisal which considers a long list of options, and is reviewed again when the shortlist of options is considered in a detailed cost benefit analysis. This part of the decision concerns not just financing options, but also risk management and risk transfer considerations. Potential efficiency gains are important as is an examination of complexity which can drive up costs and risks at all levels.

92. Selection of the preferred contracting approach in the UK is made on the basis of project-specific qualitative and quantitative assessment of the options available. The quantitative assessment is integrated with the economic, commercial and financial case assessment outlined above. Previously, PFI guidelines included a specific Value for Money Assessment Quantitative Assessment Tool (a spreadsheet tool also known as the Public Sector Comparator) to model the impacts of alternative contracting approaches. In its guidance for PF2⁵ the Government noted that "in practice the

⁵ A New Approach to Public Private Partnerships <https://www.gov.uk/government/publications/private-finance-2-pf2>

tool encouraged procuring authorities to compare a PFI solution against a conventionally funded – and in some cases undeliverable – alternative, rather than consider alternative contracting approaches. All too often it has continued to be interpreted as a pass/fail test with insufficient weight given to the qualitative judgements.” Furthermore, the former PSC excel template did not fit well with all project cases – e.g. the model was criticised for not having the tools needed to account for the timing of cash flows. The UK Treasury therefore withdrew the tool in December 2012 and will not create a new PSC. Instead, it will provide further advice on the application of Green Book principles to select a contracting approach in the forthcoming revised Green Book. The new guidance on how to interpret the Green Book under PFI/PF2 will essentially place the responsibility for the quantitative assessment with the procuring authority⁶.

93. The objective of the Green Book guidance is to ensure that rather than presenting a single monetary amount for each project option, decision-makers are presented with a more tangible set of indicators on which to weigh the pros and cons of different project options. This mirrors the way in which appraisals for traditionally public funded projects are presented to decision makers. An impact summary table is used, presenting the net present value from a cost/benefit analysis alongside a range of other indicators including monetised values for potential wider economic benefits, environmental costs (some monetised, others in physical units) and quantitative or qualitative indications of other impacts related to current government policy priorities (e.g. equity impacts).

94. Financial modelling to compare the net benefits of projects financed publicly or through PPPs is frequently criticised, in all countries, for the potential to manipulate parameters to achieve a particular outcome. UK guidelines for calculating value for money have been challenged in particular on the choice of discount rates employed. Genuine differences exist between appraisal experts on the appropriate discount rate to employ. More widely, there can be confusion between discount rates to reflect time preference, and market interest rates to reflect costs of borrowing or returns on equity. To minimise the potential for confusion, appraisal methods need to use a consistent set of discount and interest rates, and modelling needs to be kept relatively simple so that comparisons are transparent. PFI appraisal guidelines aimed to provide such transparency but were criticised, notably by the National Audit Office (NAO), and appraisal has been simplified further for PF2 projects.

95. The discount rate that was applied for PFI projects has been questioned in the past by the NAO. The NAO argued that instead of the time preference rate, a rate reflecting the government’s cost of borrowing could be used instead. HM Treasury holds that the time preference rate is appropriate since a line department must take the government’s borrowing limit as given. Regardless of which view is taken as the point of departure, this technical debate tend to focus excessive attention on the numerical result of the exercise, rather than the full set of considerations as reflected in the full Green Book process. The recent changes in UK assessment guidelines are therefore important beyond its borders. The changes are intended to achieve a better balance in the evidence presented to decision makers which is a positive development.

96. The assessment of value for money in general requires data and although the UK government goes to greater lengths than many other governments to make information on PFI projects available publicly, some of the data that would be required to compare the overall costs of projects financed through alternative mechanisms is not collected. In particular, and somewhat paradoxically, this concerns data on publicly financed projects for use in making comparisons with PFI projects. For PFI projects data is more complete, but with such a wide range of projects it has been difficult to compile data in a sufficiently comparable and accessible format. It is worth repeating the oft-made recommendation that collecting this data is useful and should be undertaken, but this needs to be balanced against what is feasible in terms of collecting and making good use of such data.

⁶ In Scotland, value for money assessment does not include a PSC for the NPD programme. For the supplementary VFM guidance that the Scottish Government issued for revenue financed programmes see: http://www.scottishfuturetrust.org.uk/files/publications/Value_for_Money_Supplementary_Guidance_for_Revenue_Funded_Projects_-_October_2011.pdf

97. It needs to be emphasised that the role of the PSC and value for money test should not be overstated, as it is only part of the comprehensive Green Book process. The value for money test was never meant to be a ‘pass or fail’ test, it was meant to be an element in a careful case that the line Department should build in order to choose the appropriate procurement strategy. The centrally developed value for money test was developed so that departments did not have to develop tailor made models that were more costly to create and perhaps more prone to unrealistic assumptions. However, on balance the Treasury has concluded that a more bespoke model feeding into the comprehensive Green Book process is probably the best approach, which is why the value for money model was removed in 2010.

Principle 6 of the PPP Recommendation

Principle 6. *Transfer the risks to those that manage them best. Risk should be defined, identified and measured and carried by the party for whom it costs the least to prevent the risk from realising or for whom realised risk costs the least.*

98. Project risks should be defined, identified and measured and borne by the party for whom it costs the least to prevent the risk from occurring, or for whom a realised risk costs the least. By doing so, it is hoped to achieve better risk management so as to generate overall cost efficiencies and greater certainty of success. It is not sufficient that risks are transferred. For a PPP to work, risks have to be appropriately allocated, and managed appropriately once allocated. This entails that risks in the regulatory framework, which are endogenous to the public side, should be borne by the public sector whereas risks that are associated with the construction and operation of the asset should be borne by the private contractor. The issue of who should bear the demand risk depends on which party is responsible for key issues such as price, marketing, etc. Standardised contracts in the UK have embedded a particular allocation of risk that is considered good practice.

99. However, as part of the UK’s appraisal of the PFI process, evidence was collected from stakeholders that identified issues with regards to the allocation of risk. Many respondents considered that under the PFI model the risk allocation sometimes departed from the principle that each risk should be allocated to the party best able to manage it. Some of these respondents suggested a few small changes to the typical risk allocation under the PFI model, and highlighted that the retention and management of certain risks within the public sector could potentially improve value for money.

100. In response to this the rules under PF2 stipulate changes to the risk allocation standards with a view to improving value for money through a greater retention and management of certain risks by the public sector. The following risks will in future be borne by the public sector: the risk of additional capital expenditure arising from an unforeseeable general change in law; utilities consumption risk; and the risk of the site being contaminated by offsite Sources where the public sector has provided the site. In addition, procuring authorities will be required to undertake adequate investigations into legal title for sites made available to bidders and provide a warranty to the contractor; and where the authority provides the site for the project, the authority will also be required to procure ground condition surveys and make them available to all bidders with the benefit of a warranty. To improve the value for money of insurance the procuring authority will be allowed to take a bigger share and reduce the contractor’s need to build up reserves against market movements.

Principle 7 of the PPP Recommendation

Principle 7. *The procuring authorities should be prepared for the operational phase of the Public-Private Partnerships. Securing value for money requires vigilance and effort of the same intensity as that necessary during the pre-operational phase. Particular care should be taken when switching to the operational phase of the Public-Private Partnerships, as the actors on the public side are liable to change.*

101. Monitoring the performance of the PPP in the construction phase and the operational phase requires skill and dedication, especially as targets may shift and unforeseen, but legitimate, obstacles may arise. Related recommendations were provided in the past by NAO (2008) noting that project managers were responsible for too many projects, and that relevant skills and knowledge, which were accumulated by the team during the inception of the projects, were not retained in the operational phase of the projects (due to the mobility of the team members or other reasons).

102. For non-core services, a market testing procedure is in place, which allows savings to be generated during the operational phase of the project. For core services, however, the same approach is not possible within the framework of the competition for the contract approach.

Principle 8 of the PPP Recommendation

Principle 8. *Value for money should be maintained when renegotiating. Only if conditions change due to discretionary public policy actions should the government consider compensating the private sector. Any re-negotiation should be made transparently and subject to the ordinary procedures of Public-Private Partnership approval. Clear, predictable and transparent rules for dispute resolution should be in place.*

103. In some cases the assumptions underlying the project may turn out to be flawed and in extreme cases this can lead the project towards failure. As the public sector has an interest and sometimes a statutory responsibility in making sure that the asset keeps operating smoothly, a re-negotiation should take place to investigate possible solutions. Principle eight emphasizes the importance of maintaining value for money during any potential contract renegotiation. Clear, predictable and transparent rules for dispute resolution should be in place to resolve disagreements between the public and private parties. The general impression for the UK is that contract renegotiations do not appear to be an issue, at least not to an extent that would incentivize strategic behaviour by parties to the contracts. The NAO (2008) surveyed 171 PFI projects (from all sectors) for the year 2006 in which they found the monetary impact of changes to contracts amounting to a 1.1 % increase in unitary charges for the projects that were renegotiated. A more comprehensive review on the impact of changes over the full life of the projects is not available. The majority (82%) of changes concerned GBP 5,000 or less. Nearly all changes originated with a request from the public sector rather than from the private sector contractor or as a result of a change in law.

104. There are, however, infrequent cases of high impact renegotiations of infrastructure projects with significant fiscal consequences, such as the Channel Tunnel Rail Link. The contract to build the line to London and take over the responsibility for running of the Eurostar international train services was awarded to London & Continental Railways Limited in 1996 with the government providing grants totaling GBP 1.8 billion for the construction of the rail infrastructure and its use by domestic train services. A renegotiation in 1998 and the resale of the failing concession in 2009/10 resulted in net taxpayer support, largely as a result of debt service obligations, rising to a total of £10.2 billion through 2070 in 2010 prices according to National Audit Office estimates (Perkins, 2013). More recent examples include two hospital projects. It should be noted, however, that a recent NAO report (2013) pinpointed that some renegotiations have brought significant savings to projects. A current issue is the extent to which the current low interest rate regime can be utilised to refinance PPPs with potential savings to be shared between the operator and the public side.

Principle 9 of the PPP Recommendation

Principle 9. *Government should ensure there is sufficient competition in the market by a competitive tender process and by possibly structuring the Public-Private Partnerships program so that there is an ongoing functional market. Where market operators are few, governments should ensure a level playing field in the tendering process so that non-incumbent operators can enter the market.*

105. Competition helps ensure the effective transfer of risk, that optimal solutions are developed by the private sector, and that the most competitive bid is tendered. The UK market in terms of engineering, construction and financial companies is open and vigorous. With respect to both ordinary PFI and other types of social and economic infrastructure projects, such as roads, housing, universities, there is little to indicate that there is insufficient competition in the market. Indeed, according to HM Treasury, there are normally at least three bidders that participate in the dialogue phase after pre-qualification screening of the bidders has been conducted. The pipeline of projects has been strong for decades, and a substantial industry has developed expertise and the relevant teams to furnish the public sector with sufficient bids to ensure the basis for a competitive process.

106. A more mixed message emerges with respect to very complex and unique projects where the number of bidders in some cases has been less than what would have been preferable. Sometimes only a single bidder remained at the final phase. Two examples of projects that were unable to retain competition until the very end (though neither of these were PFI/PF2 projects) are the Hinkley Point nuclear power station, a project to construct a 3,200 MW two reactor nuclear power station in Somerset, England; and The Thames Tideway, a GBP 4 billion, proposed 25 km tunnel running mostly under the River Thames through central London, intended to provide storage and conveyance of combined raw sewage and rainwater (NAO, 2014). However, this is not an issue limited to the UK, and nor does it relate solely to PPPs. If projects are highly complex and unique, there may simply only exist a very limited number of private actors with the balance sheet, expertise and appetite for such a task, irrespective of the delivery modality.

Conclusion

107. The **fourth PPP principle** focuses on prioritisation, requiring all investment projects to be prioritised at senior political level. The UK National Infrastructure Plan and its ‘Top 40 projects’ is a good example of a cabinet sanctioned priority process. The allocation of funds and final affordability test happens as part of the budget process.

108. The **fifth PPP principle** emphasises that countries should carefully assess which investment method is likely to yield most value for money. This is the essence of the PFI-debate and requires a nuanced answer that goes beyond the technicalities of the public sector comparator. The PSC is only part of the value for money process which is governed by the comprehensive Green Book. All infrastructure projects are subject to the The Green Book business case process. It encompasses five interrelated aspects which are developed from the outline business case to the final business case: the strategic case (is there a robust argument for change?), the economic case (how to optimise value for money), the commercial case if relevant (is it commercially viable?) the financial case (is it financially affordable?) and the management case (can it be delivered successfully?).

109. The PSC value for money test was never meant to be a ‘pass or fail’ test, it was meant to be an element in a careful case that the line department should build in order to choose the appropriate procurement strategy. The centrally developed value for money test was developed so that departments did not have to develop tailor made models that were more costly to create and perhaps more prone to manipulation. However, on balance the Treasury has concluded that a more bespoke model feeding into the comprehensive Green Book process is probably the best approach, which is why the value for money model was removed in 2010.

110. The **sixth PPP principle** states that the risks should be transferred to those that manage them best. By doing so, it is hoped to achieve better risk management, leading to enhanced cost efficiency. Standardised contracts in the UK provide a sound basis for the allocation of generic risk in a PFI project. In general, apart from expert opinions, little is known empirically on the impact of risk transfer for the overall value for money of projects. However, as part of the UK’s appraisal of the PFI model, evidence was collected from stakeholders identifying certain issues with regards to the allocation of risk to the party best able to manage it. Some respondents suggested changes to the typical risk allocation framework, highlighting that the retention and management of certain risks

within the public sector could potentially improve value for money. Greater risk retention by the public sector, such as utility consumption risk, can now be noted under the new PF2 scheme to address these issues.

111. The **seventh PPP principle** emphasises that procuring authorities should be prepared for the operational phase of PFI projects. In terms of maintaining and evaluating VfM during the operational phase, the technical/operational performance of PFIs is difficult to assess due to a lack of comparable systematic data collection. Evidence suggests that performance has been good in terms of on-time and on-budget delivery of PFI assets, which also mirrors OECD research⁷. The issue of sufficient monitoring and negotiation skills on the public side has often been raised. Some initiatives have been started to mitigate this, but the effects are unclear at this time.

112. The **eighth PPP principle** underlines the importance of maintaining value for money when renegotiating a PFI contract. The NAO (2008) surveyed 171 PFI projects (from all sectors) for the year 2006, in which they found the monetary impact of changes to contracts amounting to a 1.1 % increase in unitary charges for the projects that were renegotiated. The general impression for the UK is that, on average, contract renegotiations do not appear to be an issue, at least not to the extent that would incentivize strategic behaviour as a rule by parties to the contracts.

113. The **ninth PPP principle** requires government to ensure sufficient competition in the market and a competitive tender process. The UK's market in term of engineering, construction and financial companies is open and vigorous. With respect to both ordinary PFI and other types of social and economic infrastructure type projects, such as roads, housing, or universities, there is little to indicate that there is insufficient competition in the market. A more mixed message emerges with respect to very complex and unique mega projects where the number of bidders in some cases has been less than what would have been preferable. This is essentially a feature of large complex projects that can also affect PFI. The public sector's task in such a situation will be to ensure that the market remains contestable.

⁷ OECD (2013) Government at a Glance. OECD Publishing: Paris

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SECTION 4: THE BUDGETARY FRAMEWORK FOR PPPS IN THE UK

114. The annual budget is the primary mechanism with which OECD governments reconcile competing policy interests, allocate reSources and set the medium-term direction for public spending. The central budget authority, typically located within the Ministry of Finance, is the custodian of this budget process. Given the complex and long-term nature of PPP projects, they require particular scrutiny to ensure close linkages with the budget process. This section aims to determine if the budgetary process in the UK is used transparently to minimise fiscal risks and ensure the integrity of the procurement process, in line with the third heading of the PPP Principles. It starts by exploring the planning and budgeting process for capital projects and PPPs in the UK. The checks in place to ensure affordability and sustainability of PPP spending are then examined. In the UK, the bulk of the responsibility for these issues lies within HM Treasury and procuring authorities. The section then examines measures taken in the UK to ensure that the budgetary process is used to transparently disclose and monitor all PFI/PF2 commitments and contingent liabilities. It then considers the accounting treatment of PPPs and its effects on reporting. The section ends with a review of the efforts undertaken by government to minimize waste and corruption in the procurement process for capital projects in general, and PFI/PF2 projects in particular.

Principle 10 of the PPP Recommendation

Principle 10. *In line with the government's fiscal policy, the Central Budget Authority should ensure that the project is affordable and the overall investment envelope is sustainable.*

115. PPPs, as well as conventional long-term government borrowing for investment, are more difficult to integrate with the annual budget process than more ordinary variable expenditures that can be modified from year to year. This makes affordability assessments particularly important when the project is being prepared. An investment project is affordable if the expenditure and contingent liabilities it entails for the government can be accommodated within current levels of government expenditure and revenue, and if it can also be assumed that such levels will be and can be sustained into the future.

116. PPPs limit flexibility as they are long term contractual and financial commitments. The contractual rigidity of PPPs has made it more difficult for some government agencies to respond to budget cuts by reducing their expenditures on capital and maintenance. This future rigidity in fiscal space needs to be considered by procuring authorities when contemplating the PPP route.

117. The investment expenditure budget, including an assessment of contingent liabilities, should be based on medium and long term fiscal projections and regularly updated. As in the majority of OECD countries, the United Kingdom has a well-established medium term expenditure framework with a Spending Review or Round that is performed every three years. Spending reviews allocate multi-year reSources to government Departments in an attempt to focus and prioritize public spending in line with overall fiscal realities and targets. Their main aim is to optimize government spending over the long term, and contribute to reducing the structural deficit. Under these reviews, negotiations between Treasury and Line Departments result in firm spending ceilings, which are then used to prioritize and select projects. The general framework for planning and budgeting for PFI/PF2 projects, and various affordability checks in place to ensure the financial viability of projects, will be discussed next.

Overview of Planning and Budgeting for capital projects

118. Funding decisions in the UK are taken as part of **Spending Reviews** in order to meet the fiscal targets set by government Ministers. Fiscal targets in the UK are determined by the government's 5-year fiscal mandate (see sub-section below on affordability). While the Spending Review normally sets an allocation for three to five years, the 2013 Spending Review set the overall departmental budgets for a limited, one year timeframe covering 2015-2016, in order to align it with the May 2015 elections. This follows the 2010 Spending Review, which covered a four-year period from 2011/2012 to 2014/2015. Under the 2013 round, department capital budgets accounted for almost GBP 100 billion. Spending Reviews present a multi-year investment framework with capital and reSource Departmental Expenditure Limits (Capital DEL and ReSource DEL).¹⁸ The preparation of Spending Reviews takes place via interaction between line Departments and HM Treasury through the Treasury's spending teams. For each line Department, there is a dedicated spending team in HM Treasury that coordinates the Spending Review process. This creates an interface between the Treasury and each Department made of a permanent set of staff interacting with departments on a range of issues, from policy to budget preparation and execution. The spending team also leads the approval process for project business cases when Treasury approval is required, including for all PFI/PF2 projects. The PPP Policy team in IUK assists the spending team in assessing value for money for individual PFI/PF2 projects during the appraisal process. Business cases are approved either through a written Treasury Approval Point (TAP) procedure, or a TAP with a panel meeting where the procuring authority is brought in to discuss any outstanding issues with the business case. TAP panels¹⁹ are usually required for novel or contentious projects.

119. Line Departments are asked to submit their suggested portfolio to their spending team within HM Treasury for each Spending Review, with clear indications on expected cost and public welfare benefits that each capital project will generate. This is part of the appraisal process for capital projects (described in Section 3 on value for money) and results in a prioritized list of projects. In principle, projects that are at the bottom of the ranking are either cut or postponed when the spending limit is reached. Proposed projects are usually in line with the National Infrastructure Plan (NIP) and its Top 40 list of prioritized projects. Given the long-term planning that usually goes into capital projects, it is unlikely for projects not to appear as part of the NIP pipeline before they are submitted by line Departments. Approvals for PFI/PF2 procurement, and for projects where total cost exceeds GBP 50 million, are granted by HM Treasury separately from the Spending Review process on a project by project basis.

120. Among other sponsor Departments in the UK, the Department of Communities and Local Government (DCLG) works closely with local authorities to prepare their project portfolios according to strategic needs and priorities. The Department receives bids for centrally-funded PPP projects from local authorities in the form of strategic outline cases. Visits are sometimes made to local authorities to assess their capacity to deliver PPP/PFI projects before a decision on can be made on which bids should go through at the departmental level. The DCLG's Private Finance unit supports the relevant local authorities in developing the outline business case of the proposed project, with the support of HM Treasury. The DCLG and HM Treasury are both required to approve the project before the procuring local authority can initiate procurement. Central approvals are also required during the selection of the preferred bidder, and the submission of the final business case.

121. In **Scotland**, the planning and budgeting process for capital projects, including NPD projects, is similar to the rest of the UK. The Scottish Futures Trust is responsible for PPPs as discussed in Section 2. Scottish Ministers determine priorities for potential investments, which are then transferred into Infrastructure Investment Plans and Spending Reviews (Scottish Government, 2011). The Cabinet approves the draft Scottish Budget on the basis of the Plan, with commitments for infrastructure extending over the medium term. Spending allocations within the draft are closely examined and approved by the Scottish Parliament. The management of expenditures is led by Scotland's budgeting authority, the Finance Directorate, under its Infrastructure Investment Unit (IIU). In addition to the necessary value for money assessment based on *Green Book* guidance, the

decision to pursue a project looks at other elements: the balance sheets of individual Directorates (equivalent to Departments in England) and existing limits on spending for infrastructure. PPP's in the form of revenue-financed projects using NPDs and the hub programme are examples of creating additional investment over and above traditional budgets. Long-term investment commitments are subject to a centrally set cap. Projects are managed by the relevant Directorates, which are responsible for project monitoring and reporting. IIU also works closely with the Scottish Futures Trust at the programmatic level to support contracting authorities during different stages of the project cycle, including governance, procurement and monitoring. The infrastructure investment board scrutinizes the planning and budgeting process across the board (Scottish Futures Trust, 2014).²⁰

122. In **Wales**, the Welsh Government funds the capital financing element of a limited number of Local Authority PFI projects, whereas, with the exception of current transport PFIs that are centrally managed, other PFIs are budgeted for as part of budget allocations to Local Health Boards.

Ensuring Affordability

123. The government's overall fiscal mandate has a forward-looking five-year horizon, and is set out in the Charter for Budget Responsibility (HMT, 2013 a). The main target is to reach a cyclically-adjusted balanced budget, excluding investment, by 2014-2015. As per the Golden Rule, the Government should then only borrow for investment purposes. A secondary target is for public sector net debt (PSND) to fall as a share of GDP the same year. This decrease requires significant reductions in government spending.

124. The three-year Comprehensive Spending Review is used to determine total annual expenditure limits for the government, expressed as Annual Managed Expenditure (AME) amounts, for a three-year period. AME is allocated to government departments through Departmental Expenditure Limits (DEL), of which a certain proportion will consist of capital spending. Thus, the overall capital budget for the UK will consist of the aggregate of the capital portion of the various DELs. More specifically, the total investment budget is a residual derived from a number of capital related decisions taken in procedures that are separate from the annual budget process. Mega projects (such as High Speed Rail, Trident, the London Olympics) will have gone through particular scrutiny and have been decided on separately. For a number of years these types of project will be part of the base line. Other projects will have been decided in previous year's budget process and be part of the infrastructure/PPP portfolio. The remaining part will be a result of new interactions between the line Department, HM Treasury, and priorities of the government. Overall fiscal sustainability is secured via the Spending Review totals, but the capital part of this varies according to the priorities of the government, and takes place through a combination of top down and bottom up approaches.

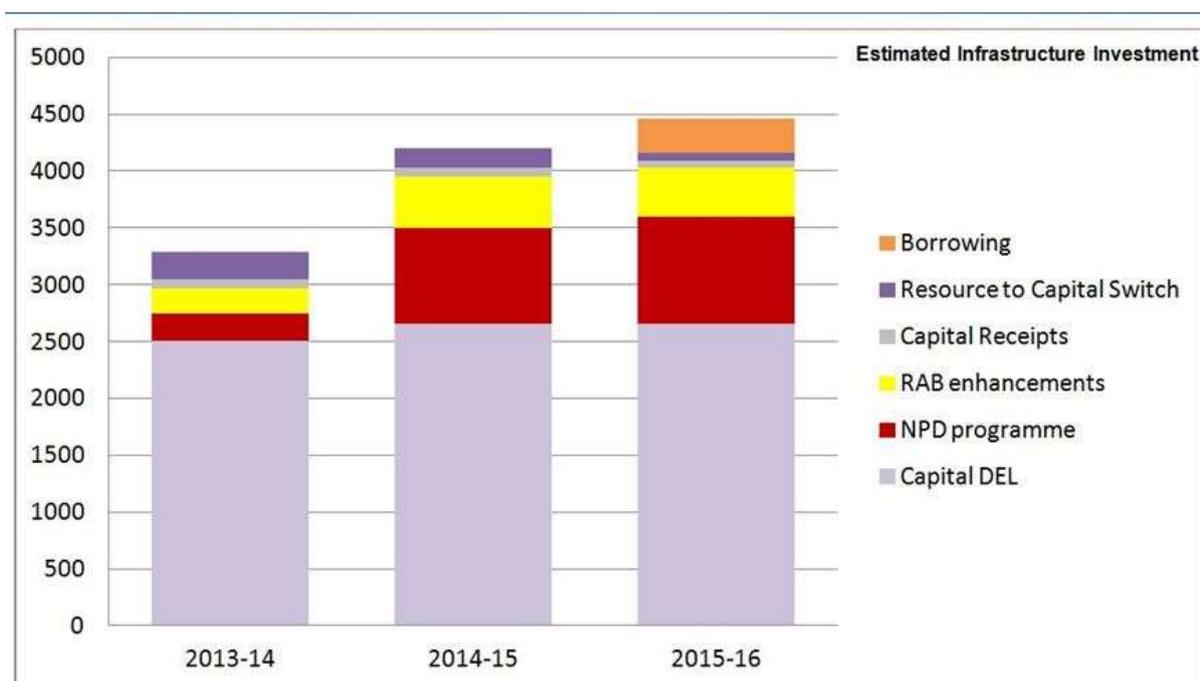
125. With regards to specific projects, affordability is addressed as part of the business case presented by line Departments and procuring authorities for each project. Direct project costs are part of both the economic and financial dimension of the business case prepared for significant spending decisions. The economic case incorporates direct costs in the value for money assessment, whereas the financial case incorporates direct costs in the analysis of annual affordability (Government, 2014). Any contingent liabilities are collated and reported in the OBR's fiscal sustainability report (see below). The independent Gateway Review process, led by the Efficiency and Reform group, also examines the financial viability of the project and the proposed approach to its implementation (OGC, 2007). It looks at the whole-of-life affordability of the project and how it fits with the budget.

126. In order to determine whether they can afford a project, local authorities consider several elements: payments, adjusted with a cost inflation index; sensitivity analyses showcasing different scenarios; an evaluation of value for money, which can sometimes have an optimism bias; and whether a new service is being provided, or, alternatively, if it's a service that is re-provisioned. Unlike at the central level, the decision to pursue PPPs is not influenced by national accounting limit considerations, although there are clear rules regarding how much local governments can borrow. Instead, it is largely based on affordability according to Local Partnerships (LP, 2014).²¹ Local

governments don't have the duty to report non-centrally funded PPPs or use standardized documentation for their contracts, as long the procedures of transparency, evaluation, and appraisal set out by the *Green Book* are respected.

127. Limits on stocks and flows of PPP, while not a substitute for medium-term planning, can help contain fiscal costs and limit overall public sector long-term commitments to levels that are fiscally affordable. With the PF2 scheme, Treasury has introduced a control total that limits PFI/PF2 commitments to GBP 70 billion and that will be set for five years starting from 2015-2016. GBP 50 to 55 billion have been committed so far. It is HM Treasury's task to ensure compliance and performance against the control total, annually, at Budget (HMT, 2013 c). The OBR has a complementary role in assessing whether the government is within its targets by reporting progress of PFI commitments against the control total in its report on fiscal sustainability. The introduction of this limit under PF2 guidance will provide an improved whole-of-life assessment of the cost of PFI/PF2 projects and their affordability. It will also help limit the accumulation of off-balance sheet debt through PPPs, as we discuss further below.

128. Additional checks exist in Scotland in order to ensure the financial sustainability of PPP projects. In 2011, Scotland capped the total revenue amount that it can spend on certain capital investments to 5% of its annual DEL budget, (Scottish Government, 2011). This figure is not considered a target, but a fiscal limit through which the Scottish government aims to provide assurance about the affordability of these financial commitments. Capital expenditure categories that are revenue financed and thus affected by this fiscal rule in Scotland are: payments for completed PFI and NPD projects, debt repayment of future borrowing – both principal and interest, and RAB payments of Scotland's rail network investment (Scottish Parliament, 2013). In the Draft 2014-2015 Budget, these payments were projected to reach 3.5% and 4.5% of total DEL in 2014-2015 and 2017-2018 respectively. A public progress report is sent to the Scottish Parliament every quarter, disclosing progress against the 5% target on all relevant projects. Revenue-financed NPD projects are also individually tracked and reported by the Scottish government.²² The government's website contains the Scottish Infrastructure Investment Plan, information about government commitments with regards to PPP/PFI and NDP projects, and a pipeline of operational projects. From 2015 onward, the Scottish government will be able to borrow up to 10% of its capital budget (CDEL), which could be used for infrastructure investment according to Scottish Futures Trust²³. This will provide increasing options and reSources for capital investment in Scotland as shown by the graph below.

Graph 4.2. Estimated spending on capital investments in Scotland (2013-2016)

Source: The Scottish Government (2013), *Scottish Budget - Draft Budget 2014/15*, Edinburgh, 2013. [<http://www.gov.scot/ReSource/0043/00433802.pdf>]

Principle 11 of the PPP Recommendation

Principle 11. *The project should be treated transparently in the budget process. The budget documentation should disclose all costs and contingent liabilities. Special care should be taken to ensure that budget transparency of Public-Private Partnerships covers the whole public sector*

129. The system of government budgeting and accounting should provide a clear, transparent and true record of all PPP activities in a manner that will ensure that the accounting treatment itself does not create an incentive to take the PPP route. It should also clearly disclose not only costs, but also any PPP guarantees or contingent liabilities at different government levels. The UK's disclosure procedures for centrally-funded projects clearly favor full transparency on a regular basis and on different complementary documents. Significant efforts are made to keep the Central Budget Authority, Parliament, and the public informed of all activities surrounding PPPs. The Whole of Government Accounts (WGA) provide a long-term view of payments and contingencies on projects regardless of their classification in National Accounts terms. WGA, which are based on IFRS accounting standards, report projects when the contracting authority controls or regulates services under the PFI, and controls any significant residual interest in the infrastructure in line with the "control" criterion (HMT, 2014; see Box 4.1). On the other hand, ESA rules, which the UK is obliged to follow, require that PFI/PF2 projects be classified according to "risk and reward" criterion in their treatment in the UK National Accounts (see Table 4.2). This may generate budgetary incentives for the use of PPPs, and creates discrepancies about the reporting of PPPs as we discuss below.

Accounting for PPPs

130. PPPs should only be undertaken if they represent value for money and are affordable. Budgeting and accounting systems sometimes make it possible to avoid some spending controls and use public-private partnerships to circumvent spending ceilings and fiscal rules. There is a view in the UK that the selection of PFI as a procurement method for capital projects may have been driven, in the past, by the appeal of pursuing projects off-budget.

131. In the UK centrally-funded PFI/PF2 projects are reflected in the budget on an annual basis following National Account standards, which fall under the European System of Accounts (ESA 10 2014).²⁴ The recording of PFI transactions in budgets is intended to reflect their fiscal impact (HMT, 2013 a). For this reason, budgeting for PPPs follows National Accounts classification standards instead of International Financial Reporting Standards (IFRS). This often results in a different treatment of PFI transactions under line Departments’ accounts than under their budgets. PFI expenditures are recorded at different times under two spending types in the budget –reSources and capital–, depending on whether the project is considered on or off-balance sheet (see Graph 4.1). For on-balance sheet / on-budget projects, the capital value (i.e. the debt required to undertake the project) is recorded in the first year of operation as capital spending (CDEL), and remaining charges are recorded each subsequent year under reSource spending (RDEL). For off-balance sheet projects, the capital value is not recorded in the first year of operation. Instead, PFI contract payments are spread out over the lifetime of the project and recorded as RDEL together with the remaining components of yearly unitary payments to the private sector. The effect of off-budget treatment is an initial increase in fiscal space, potentially allowing a government to initiate the same amount of investments in one year while recording less expenditure for that same year. However, the net effect of both budgeting and recording methods is roughly equivalent over the lifetime of the asset (see Table 4.1).

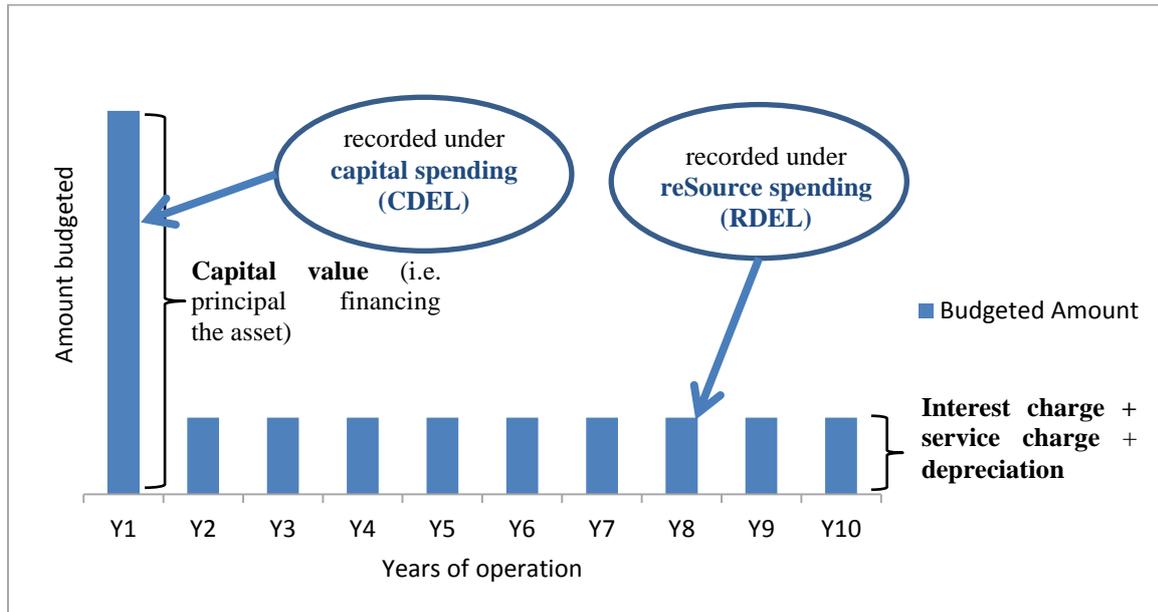
Table 4.1. Differences between on-budget and off-budget treatment of PPPs

| | | Treatment on National Accounts | |
|----------------------------|---|---|---|
| | | On-balance sheet | Off-balance sheet |
| <u>Treatment on Budget</u> | <i>1st year of operation</i> | CAPEX; i.e. funds necessary to finance the asset. | (no recording) |
| | <i>Subsequent years</i> | Interest charge, service charge and depreciation. | Interest charge, service charge and debt/capital repayment. |

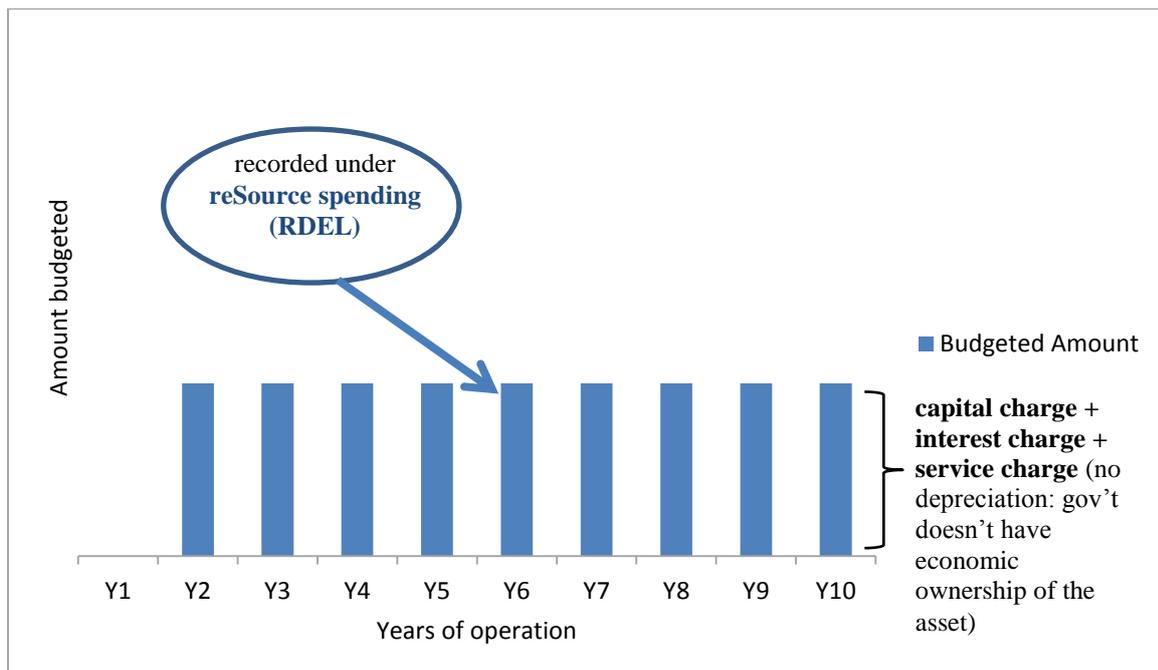
Source: Authors.

Graph 4.1. Accrual budgeting for PFI/PF2 projects in the UK

On-budget PPPs



Off-budget PPPs



Source: Authors, based on HM Treasury (2012), *A new approach to public private partnerships*, December 2012 and HM Treasury (2013), *Consolidated budgeting guidance from 2013-2014*, March 2013.

132. According to the OBR, only GBP 5 billion out of the GBP 37 billion of total capital liabilities arising from PFI contracts were on the public sector balance sheet in the National Accounts, and therefore not included in PSND (OBR, 2014 b). The Office for National Statistics (ONS) is responsible for the preparation of UK National Accounts, and classifies assets on the public sector balance sheet according to the “risk and reward” criterion (see Table 4.2). Under this standard, PPPs may be privileged for budgetary as opposed to value for money reasons leading them to be recorded off-budget, which may create a perceived lack of transparency. Additionally, the previous credit

regime for local authority PFI, withdrawn in 2010, provided a budgetary incentive to pursue PFI instead of public finance. This could undermine a genuine appraisal of projects.

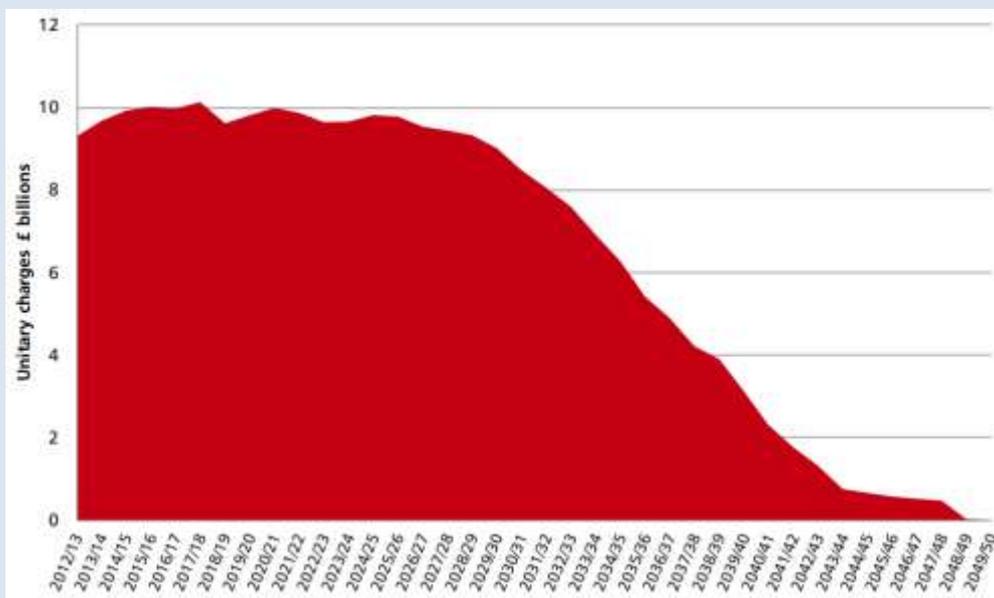
133. However, government officials emphasize that PPP/PFI projects are not usually pursued if they do not demonstrate a valid business case. Uncertainty always exists around the budgeting and accounting treatments of projects, which often doesn't become clear until the final stages of the procurement process – although Departmental guidance stresses that the accounting treatment for projects should be determined at an early stage (NAO, 2009). In one Transport sector case, a clear commercial case was made by one of the smallest authorities in the country, which intended to pursue a GBP 500 million bridge project. Initially, the accounting view was that the project would be off-balance sheet, but it was later recorded on budget due to subsequent changes in the Manual on Government Deficit and Debt (MGDD) related to toll risk. Regardless of its budget classification, the fact that the project still represented value for money took it to financial close. A different case is the M25 motorway, with an on-budget capital price tag of approximately GBP 2 ¼ billion according to the Department for Transport. In this case, the PPP route was again selected based on the assessment that it provided the best value for money. In the Health sector, which has resorted heavily to PFI contracts in the past, an ex-post report by the NAO on PFI hospitals indicates that most are well managed and are achieving the value for money initially intended (NAO, 2010). That same sector was criticized for the existence of past guidance pointing towards the off-balance sheet treatment of PFI projects, which was retracted in 2005 (NAO, 2009).

Box 4.1. The United Kingdom’s assessment of availability payments under WGA

HM Treasury has developed an indicator on aggregated future PFI commitments that the government needs to pay, which reflect the sum of all future disbursements. The Whole of Government Accounts (WGA) is the instrument through which PFI commitments and liabilities are kept track of in the UK. It consolidates the audited accounts of 3,800 organisations across the public sector in order to produce a comprehensive, accounts based picture of the financial position of the UK public sector. WGA is based on International Financial Reporting Standards (IFRS), the system of accounts used internationally by the private sector and provides a complement to the published National Accounts based measures used for managing the public finances. In the 2014 WGA, the present value of obligations for future PFI payments was estimated at GBP 198.8 billion, or 2.4% of GDP.

WGA is a major step forward in accountability and the government places great importance on fiscal transparency and the role it plays in the management of the public finances. Publication of the WGA supports the government agenda to make more public data available. The WGA is independently audited, giving both Parliament and the public greater confidence in the figures, and supports effective scrutiny by Parliament through the Public Accounts Committee.

Graph 4.3. Estimated future unitary charge payments (in nominal terms, undiscounted) under signed PFI projects as of end 2011



Sources: HM Treasury (2012), *A new approach to public private partnerships*, December 2012, HM Treasury (2014), *Whole of Government Accounts year ended 31 March 2013*, June 2014

134. Off-balance sheet private finance is best captured by the Whole of Government Accounts. In order to get a comprehensive view of public finances, the OBR draws on WGA, National Accounts, and signed PFI deals tracked within HM Treasury. It then assesses the NPV of PFI/PF2 of future cash flows by performing an approximate analysis. In 2013, total potential capital liability of on and off-balance sheet PFI contracts (PPP debt) represented an estimated 2.4% of GDP (see Table 4.3), or 3.1% of GDP after accounting for contingent liabilities. Public Sector Net Debt (following the European System of Accounts definitions) would thus increase to 78.2% of GDP in 2012-13 if both on and off-balance sheet PFI liabilities were taken into account. Data from a separate data collection exercise led by the Treasury indicate that PSND would rise by 2% of GDP should all investment under PFI have been carried out under traditional government debt financing (OBR, 2014 b). In the UK, unlike in some other countries, the impact of off-balance sheet PPP debt on total net debt is moderate. Net debt including PFI/PF2 liabilities is projected to reach 85.6% of GDP in 2016, before declining.

Table 4.3. Whole of Government Accounts data for total future costs of PFI deals

| | £ billion | | | |
|---|--------------|--------------|--------------|--------------|
| | 2009-10 | 2010-11 | 2011-12 | 2012-13 |
| WGA data for PFI deals on balance sheet:¹ | | | | |
| Figures from the Statement of Financial Position (balance sheet): | | | | |
| Net book value of PFI assets | 30.9 | 34.9 | 38.7 | 37.0 |
| Liability for future capital payments | 28.1 | 32.0 | 36.1 | 36.6 |
| Present value of obligations for future payments | 164.9 | 183.6 | 191.7 | 198.8 |
| <i>Of which:</i> | | | | |
| Capital payments ² | 34.1 | 35.1 | 38.0 | 39.3 |
| Interest payments | 33.4 | 39.0 | 42.3 | 42.2 |
| Service charges | 97.4 | 109.5 | 111.4 | 117.3 |
| HM Treasury data for percentage of PFI deals on balance sheet (IFRS basis) (per cent) ³ | - | 89% | 97% | 97% |
| OBR calculations of WGA liability for future capital amounts payable, grossed up to total PFI deals, on and off balance sheet (per cent of GDP) | - | 2.4% | 2.4% | 2.4% |

¹ On balance sheet on IFRS basis at end of financial year. Figures for 2009-10 to 2011-12 are as restated in following year's WGA.

² The obligations for future capital payments include additional costs such as contingent rents and lifecycle replacement costs.

³ Calculations based on data that cover all PFI deals funded by central government. This includes many local government PFI projects, but it will exclude any local government or public corporations PFI schemes that are funded by their own sources of finance. The calculations also exclude any data that does not specify whether the PFI deal is on or off balance sheet.

Source: Office for Budget Responsibility, Fiscal Sustainability Report 2014.

Contingent liabilities and other fiscal risks

135. According to the PPP Principles, the Budget documentation should transparently disclose all information possible regarding the costs and contingent liabilities of the PPP portfolio. In the UK, Departments and other relevant public bodies are required to disclose information on fiscal risks as part of their budget documentation. The information should include what and when the government will pay, and full details of guarantees and contingent liabilities. The *Consolidated Budgeting Guidance* gives line Departments detailed instructions about how their budgets should be disclosed (HMT, 2013 a).²⁵ Line Departments include notes on contingent liabilities in their accounts. If they are likely to crystallize, they should be treated as either provisions or creditors – a type of liability. Departments are also required to report their contingent liabilities to Parliament. Guarantee contracts should be treated like contingent liabilities, regardless of whether or not they are recognized in departmental accounts. Departments are encouraged to hold some provision back against their DELs to deal with unforeseen pressures that may emerge during the budgeted year, including their known contingent liabilities. They are required to show that guarantees would be affordable from a budgetary point of view by allowing for sufficient provisions under CDEL.

136. As previously mentioned, the WGA also reports on both quantifiable and non-quantifiable contingent liabilities for PF1/PF2 and other project types. Contingent liabilities are defined in the WGA and by the OBR as risks of future costs that have less than a 50% chance of materializing, otherwise they are considered contractual provisions.

Principle 12 of the PPP Recommendation

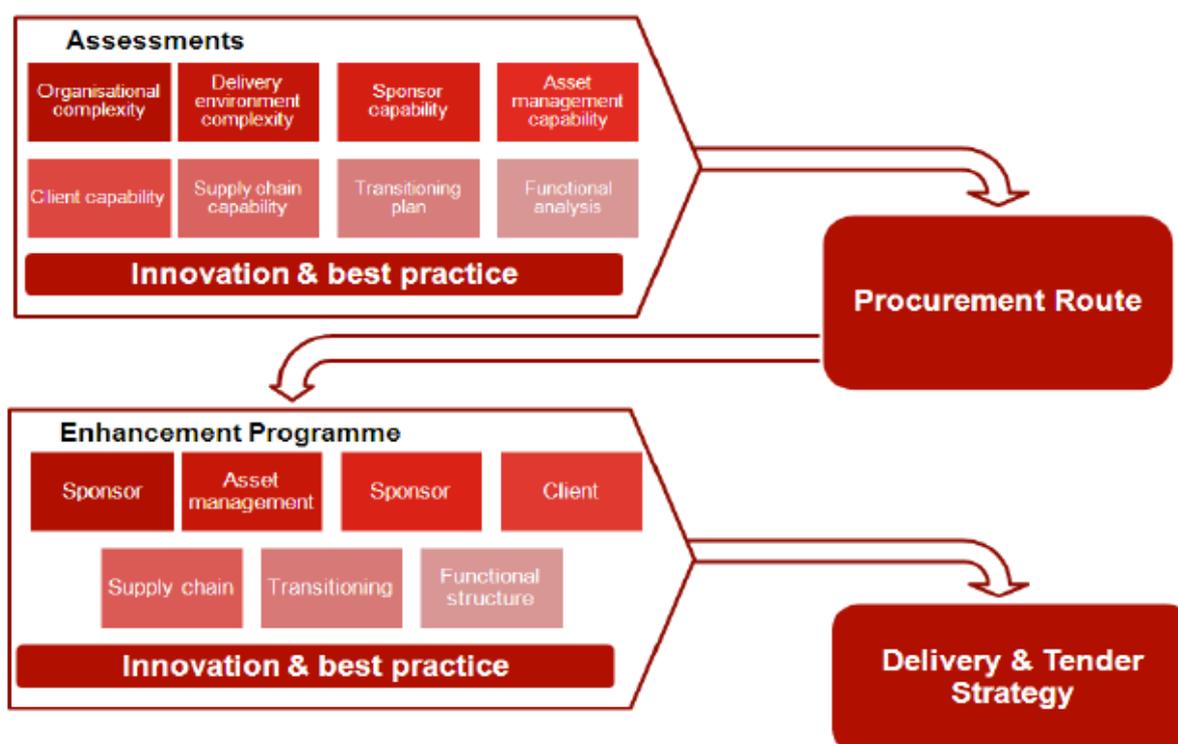
Principle 12. *Government should guard against waste and corruption by ensuring the integrity of the procurement process. The necessary procurement skills and powers should be made available to the relevant authorities.*

137. Enhancing integrity necessitates recognising the risks inherent throughout the entire procurement cycle, developing appropriate management responses to these risks, and monitoring the impact of mitigating actions. This requires a thorough assessment of the project at the development stage, as supported by the comprehensive project appraisal process described in the *Green Book* guidance. Project development and appraisal should also be supported by competent authorities that have the necessary skills to manage the procurement process. PPP procurement should be a strategic profession, informed by an understanding of relevant commercial principles rather than a simple administrative process within a public organisation. This transformation necessitates the development of knowledge and the creation of tools to support improved procurement management decision-making.

138. Although displaying high capabilities and experience with PPPs, it has been recognized that procuring authorities in the UK, especially within local authorities, did not always have sufficient capacity to procure PPPs. This includes effectively planning and engaging with suppliers and the market. Several recent measures in the general procurement framework aim to address this, including the *LEAN Procurement Guidance* issued by government to shorten project delivery timescales, or the upcoming *Standard Operating Procedures for Competitive Dialogue* to strengthen engagement with the private sector (HMT, 2013 b).

139. The government has identified procurement as an area for better performance and has adopted several approaches to strengthen the skills of project managers in this area. New developments in public procurement aim to increase its transparency and strengthen the capacity of public authorities to identify their needs and engage with the private sector. In 2013, the UK government released a new Procurement Routemap after consultation with the public sector, industry, and academics. The Routemap is aimed primarily at organizations that deliver major infrastructure projects and programmes, long term capital investment plans and publicly procured mega-projects – including PFI/PF2 projects (HMT, 2013 b). In the face of often lengthy and expensive procurement procedures, the Routemap aims to create a more optimal environment for project delivery. This is done through identifying and addressing, at an early stage, potential gaps and needs for a project to succeed, and ensuring that these needs are being fulfilled throughout the procurement process (see Graph 4.4).

Graph 4.4. Routemap overview: from Assessment to solution



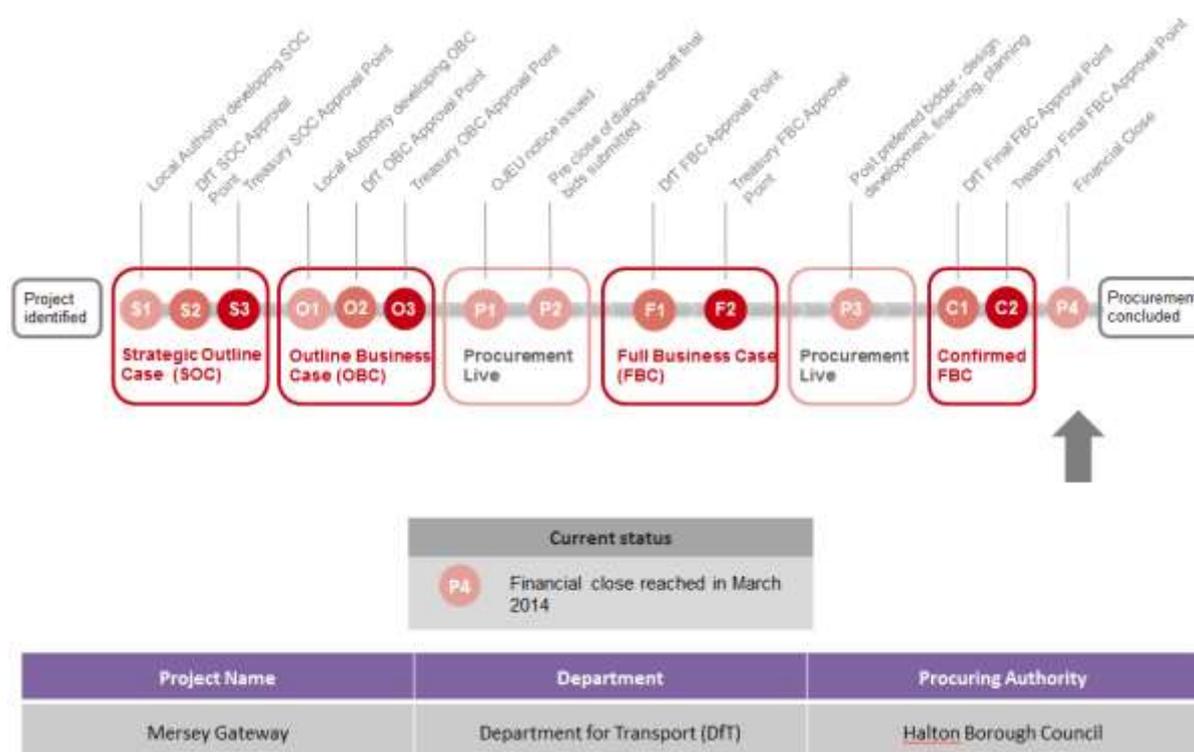
Source: HM Treasury (2013), *Infrastructure procurement routemap: a guide to improving delivery capability*, January 2013

140. First, an assessment is performed in three layers to examine: 1) the organisation and project delivery environment and complexity; 2) the procuring authority’s own capability to support the delivery of the project or programme and to manage the asset; and 3) the client and supply chain’s capability. This assessment serves to direct the choice of the procurement route through the identifications of risks and opportunities facing each delivery mode. Highly complex projects are likely to require a procurement approach following a strategic delivery mode such as PF2. A second stage is to identify the enhancement activity that is needed for effective delivery of the project or programme based on the assessment’s findings. For instance, if the procuring authority’s capacity is assessed to be below project requirements, two options are possible: reducing project complexity, or bolstering the capacity of the authority. *In fine*, the Routemap will allow the procuring authority to select the most effective delivery strategy, one that is both suited to its capabilities and the complexity of the project.

141. Other initiatives led by central government aim to reinforce the procurement framework for PFI/PF2 projects in the UK. In the past, PFI projects have been generally procured and managed by local authorities. Over 75% of PFIs by number in the UK have been done at the local authority level (IUK, 2014). PF2 guidance encourages line Departments to consider setting-up a central procurement unit for their PF2 project pipeline (HMT, 2012). This aims to address a perception of public sector skills shortage during the procurement of projects. Training and capacity development organized to address such shortages are ongoing in the UK, across all modes of infrastructure delivery. The Major Projects Leadership Academy, as discussed under Section 2, equips public officials with the technical and commercial know-how required to manage large projects. The newly created Crown Commercial Services provides training to public officials on lean sourcing. Sustained training and capacity building is important to keep public officials up to date with new developments in regulations and processes, including new UK procurement regulations that were drafted following a new EU Procurement Directive on procurement in February 2014.²⁶

142. Further measures were put in place to increase the integrity and the transparency of the infrastructure procurement process (including PFI/PF2). Under the leadership of the new Major Infrastructure (MIT) team in IUK, the tracking of individual major projects shows the increased focus on delivery and transparency as per the new PF2 guidance. The new infrastructure tracker shows the different stages of the procurement process and tracks the progress of specific projects. In this way, it provides greater accountability and transparency for both the public and the private sector.²⁷ Graph 4.5 below shows the Tracker’s progress for the Mersey Gateway PPP project, which came to a financial close in March 2014. As of September 2014, there were 4 trackers in place for: the Department for Communities and Local Government, the Department for Transport, the Department for Education, and the Department of Health.

Graph 4.5. Tracker for the Department for Transport: Mersey Gateway



Source:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/327689/PF2_tracker_DfT_PFI_Projects_updated_3July_2014.pptx

143. Corruption in the procurement of PF1/PF2 projects has not been raised as an issue in the UK. Alignment with EU directives on public procurement sets in place minimum standards to ensure fairness, non-discrimination, and transparency during the procurement of contracts in the UK. The high scrutiny to which PFI/PF2 contracts are subject to, including by HM Treasury, serves to reinforce these standards. Transparency International’s (TI) Corruption Perceptions Index 2013²⁸ ranks the UK 14th out of 177 countries in the world. This improved rating is partly thanks to the Bribery Act 2010, which came into force in the UK on July 1 2011. The Act was introduced to improve the UK law on bribery and corruption, in line with the 1997 OECD anti-bribery convention. It carries strict penalties for both local and international companies engaging in such activity. The OECD has noted significant progress in raising awareness and combatting foreign bribery since its entry into force (OECD, 2012). The standardized PF2 shareholders’ agreement also includes provisions regarding compliance with the Bribery Act 2010, and any corruption offence warrants a contract default (HMT, 2013 e & f).

144. In December 2014, the government released the *UK Anti-Corruption Plan*, which brings together all the UK's work in this area in one place. It sets out a number of actions that the government will take to improve responses to bribery and corruption on the national and international stages (HM Government, 2014). At the procurement level, the government has clear requirements for transparency and publication of awarded contracts. For instance, line Departments are now required to publish all new central government tenders and contracts over GBP 10,000 on the Contracts Finder website.²⁹ At the local level, the *Local Audit and Accountability Act 2014* and the *Local Government Transparency Cost 2014* require local bodies in England to transparently account for their spending decisions. Together, they enable local citizens to see how their money is being spent by local authorities, and to scrutinize procurement and spending decisions.

Conclusion

145. The **tenth OECD PPP principle** emphasizes that, in line with the government's fiscal policy, the Central Budget Authority should ensure that the project is affordable and that the overall investment envelope is sustainable. Several checks are in place in the UK to ensure affordability of all capital projects within an integrated, comprehensive framework. Spending Reviews set a medium term expenditure framework, with firm spending limits for line Departments, followed by specific approval procedures for major investment decisions such as PFI/PF2 contracts. The iterative business case prepared for each project includes an assessment of its affordability and financial sustainability by the procuring authority within the expenditure limits already set. HM treasury is responsible for issuing approvals during the appraisal process for all PFI/PF2 projects. With the PF2 scheme, HM Treasury also introduced a new control total of GBP 70 billion for PFI/PF2 projects up to 2020 in addition to caps that are already in place for capital expenditures, such as in Scotland. Complementary analysis by the Office of Budget Responsibility (OBR) also helps the government, and the public, keep track of the fiscal sustainability of its expenditures.

146. With regards to the budget, PFI projects at the outset were not on-balance sheet in the UK, and could thus be considered a form of off-budget borrowing. Consequently, there may have been an inclination by public authorities to pursue the PFI procurement route because of this. In Scotland, the NPD programme was used to accelerate public sector capital investment over and above the capital budget made available to Scotland. As a measure of sustainability, long-term investment commitments on NPD are monitored as part of a centrally set cap on estimated future revenue commitments.

147. For reasons of accountability and risk management, the transparency of PFIs in the budget process is important, which is emphasized in the **eleventh PPP principle**. Through individual departmental accounts, the WGA, and the OBR, the government presents regularly updated information on PFI/PF2 contracts to the rest of the public sector and end users. There is a high degree of transparency regarding liabilities, guarantees and long term financial contracts. Despite the WGA, there can still be an accounting incentive to use PFI, but this is now minimal and stems mainly from compliance with Eurostat rules. Practically all PFIs are on balance sheet in the WGA, providing a detailed picture of the UK public sector liabilities.

148. The OBR in its Fiscal Sustainability Report 2014 estimates the total capital liabilities in WGA arising from Private Finance Initiative contracts to be GBP 37 billion. Only GBP 5 billion of these were on the public sector balance sheet in the National Accounts and therefore included in Public Sector Net Debt (PSND). If all investment undertaken through PFI had been executed through conventional debt finance, the OBR estimates, PSND would be around 2% of GDP higher than currently measured.

149. The **twelfth PPP principle** underlines the importance of governments guarding against waste and corruption by ensuring the integrity of the procurement process. This is an ongoing priority in the UK. In addition to simplified, more streamlined procurement procedures, government also focuses on capacity building to strengthen procurement skills of its public officials. Several recent

measures were put in place to streamline and strengthen procurement skills and processes, including the new procurement Routemap, the Major Projects Leadership Academy, and the newly created Crown Services Central. Efforts for higher integrity and accountability are also witnessed in the 2014 *Anti-Corruption Plan* which draws together several reforms pursued by government to reduce bribery and corruption during the procurement process. Corruption, however, is not a challenge with respect to PFI in the UK.

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¹⁸ Money within Departmental Expenditure Limits (DEL) can be split into reSource spending and capital spending. ReSource spending is money that is spent on day to day reSources and administration costs. Capital spending is money that is spent on investment and things that will create growth in the future. [<https://www.gov.uk/government/publications/how-to-understand-public-sector-spending/how-to-understand-public-sector-spending>]

¹⁹ A TAP panel will usually comprise a Treasury Director or Deputy Director (chair); Spending Team representative; MPA representative; IUK representative where appropriate; and General Expenditure Policy Team representative. A maximum of 5 attendees from the project team, including the project SRO and departmental representatives, may attend the TAP meeting. (Cabinet Office & HMT, 2011)

²⁰ OECD interview with and Presentation by Scottish Futures Trust (2014), "OECD Review of PPP in the UK", 4 July 2014

²¹ OECD interview with Local Partnerships, July 2 2014

²² <http://www.scotland.gov.uk/Topics/Government/Finance/18232/12308#>

²³ OECD interview with Scottish Futures Trust, July 4 2014

²⁴ The European System Accounts 2010 (ESA 2010) was introduced in September 2014 and supersedes ESA 95.

²⁵ 2013-2014 edition

²⁶ <http://www.mills-reeve.com/pf2-and-complex-procurements-12-18-2014/>

²⁷ <https://www.gov.uk/government/collections/hmt-pfipf2-business-case-approval-trackers>

²⁸ <http://www.transparency.org.uk/rss/12-blog/805-corruption-perceptions-index-2013>

²⁹ <https://online.contractsfinder.businesslink.gov.uk/>

ANNEX 1 – PFI/PF2 PROJECTS IN PROCUREMENT IN THE UK AS OF 31 MARCH 2014

| Department or executive authority | Project name | Procuring authority | Sector | Estimated date of financial close | Operational contract life (years) | Expected funding requirement |
|--|---|--|----------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| <u>Department for Education</u> (4 projects) | Building Schools for the Future Wave 5 Phase 3 (Deansfield and Heathpark Wolverhampton BSF 2) | Wolverhampton | - Schools (BSF) | 2013-09-30 | 28 | 36.0 |
| | Priority School Building Programme (Hertfordshire, Luton and Reading) | No data | No data | No data | No data | 160.0 |
| | Priority School Building Programme (Northeast) | No data | No data | No data | No data | 125.0 |
| | Priority School Building Programme (Northwest) | No data | No data | No data | No data | 120.0 |
| <u>Department of Health</u> (3 projects) | Papworth Hospital New Cardiothoracic Centre | Papworth Hospital, NHS Foundation Trust | Hospitals and Acute Health | 13-02-2015 | 30 | 140.0 |
| | Replacement of the Hospital's older buildings (Harrow East) | Department of Health (NHS) | Hospitals and Acute Health | 31-07-2013 | No data | 90.0 |
| | Extra Care Housing and Centre of Excellence for People with Dementia | Hull | Social care | 01-10-2013 | 25 | 44.5 |
| <u>Department for Communities and Local Government</u> (2 projects) | Kent Excellent Homes for All | Kent | Housing (Non-HRA) | No data | 27 | 40.0 |
| | Stoke Round 5 Housing | Stoke-on-Trent | Housing (Non-HRA) | 31-01-2014 | 25 | 60.6 |
| <u>Northern Ireland Executive</u> (3 projects) | arc21 Residual Waste Infrastructure Procurement | Arc21 Joint Committee | Waste | 01-03-2013 | No data (29 estimated in 2013) | No data (440.4 estimated in 2013) |
| | North West Region Waste Management Group Waste Infrastructure Procurement | North West Regional Waste Management Group | Waste | 30-06-2012 | No data (27 estimated in 2013) | No data (104.6 estimated in 2013) |

Source: HM Treasury and Infrastructure UK (2013), <https://www.gov.uk/government/statistics/pfi-projects-data-march-2013>, published August 22 2013

ANNEX 2 – KEY DIFFERENCES BETWEEN THE PRIVATE FINANCE INITIATIVE (PFI) AND THE PRIVATE FINANCE 2 (PF2) SCHEMES

| | PF2 | PFI |
|------------------------|---|--|
| Finance: Equity | <ul style="list-style-type: none"> The public sector will be a (minority) equity holder A proportion of equity will be competed for post preferred bidder | <ul style="list-style-type: none"> In nearly all PFI projects the equity holders are from the private sector All equity allocated at the point of appointing the preferred bidder |
| Finance: Debt | <ul style="list-style-type: none"> Must bring forward a debt solution that does not rely on bank debt <ul style="list-style-type: none"> Capital structure likely to have a lower gearing c80/20 | <ul style="list-style-type: none"> Since 2008 virtually all debt has been raised from the banks A PFI accommodation project has a typically c90/10 structure |
| Procurement | <ul style="list-style-type: none"> Tendering phase of projects not allowed to take longer than 18 months (unless an exemption has been agreed by the CST) <ul style="list-style-type: none"> Additional pre-procurement checks before projects go to market | <ul style="list-style-type: none"> No time limit on the tendering phase (worst projects took up to 60 months) |
| Services | <ul style="list-style-type: none"> “Soft services” such as cleaning and catering removed from contracts Standardised output specifications introduced for accommodation projects | <ul style="list-style-type: none"> “Soft services” included in most PFI projects Output specifications generally designed on a project by project basis |
| Transparency | <ul style="list-style-type: none"> Spending control total to be introduced for PF2 projects <ul style="list-style-type: none"> Private sector equity return information to be published by Treasury A business case approval tracker to be introduced | <ul style="list-style-type: none"> Assessment of PFI liabilities published since July 2011 in the form of WGA but no spending control of projects <ul style="list-style-type: none"> Private sector equity return information derived only from published annual accounts No published information on status of business cases |
| Risk allocation | <ul style="list-style-type: none"> Some risks retained by the public sector compared with PFI | <ul style="list-style-type: none"> Risks such as change in law held by the private sector. |

Source: IUK (2014), “Markets for PPPs Growing Use, Implications and Lessons Learnt”, Presentation by James Ballingall, 3 June 2014.