

# Developments in PFI

As the Private Finance Initiative (PFI) continues to be utilised as a means of delivering public services it is being shaped by experience and regulatory factors.

**First introduced in 1992 Private Finance Initiative (PFI) is now firmly established as a procurement vehicle for delivering public services. Since its birth PFI has never been far away from the headlines, attracting controversy over the level of benefit to the public sector of refinancing deals, union opposition, the cost implications of changing requirements and the extended tender process which averages 34 months. (source: National Audit Office)**

**This Knowledge Byte takes a look at some of the current issues for PFI and how the future of PFI may look.**

## **PFI goes International**

PFI has its roots in the UK but is increasingly seen as an attractive way of delivering public services around the world with over 40 nations engaged in PFI activity including Canada, Australia and South Africa.

But what may that expansion mean for the UK and other early adopters of PFI?

- UK is seen as a source of PFI expertise giving new market opportunities for advisers and contractors
- As PFI goes international there is a probability of many countries major project pipelines being unblocked and raising the demand for PFI investors and construction contractors. The impact of this could be:
  - that demand outstrips supply for periods of time or at least supply becomes very tight
  - public sector bodies will need to ensure that their PFI projects are attractive to the market through having efficient tender processes that are not too long and costly and behaving as an intelligent client.

## **PFI is not suitable for all major projects.**

From being seen in some quarters as a panacea to the problem of how to get public sector schemes underway in the face of restricted access to funding there has been a period of reflection. The highly publicised failings of a number of PFI and PPP contracts such as the Metronet scheme for the upgrading of significant parts of the London Underground network may have dented confidence and has certainly led to an increased awareness that PFI may not be appropriate for all large scale projects, especially the more complex. Greater emphasis is now being put on the “up front” work to evaluate whether PFI is the most appropriate means of delivering the project.

## **Preferred Bidder Debt Funding Competitions.**

HM Treasury has drafted guidance that above an interim threshold of £50m senior PFI debt finance will be subject to a preferred bidder debt funding competition (PBDFC). The PBDFC will be run by the preferred bidder and overseen by the public authority with the aim to:

- make the terms of debt finance and the process of securing debt finance transparent and open to authority scrutiny;
- avoid unnecessary duplication of effort by the finance community for those projects that do not require early lender support in order to quantify the terms under which debt finance may be made available;
- capture best value in the terms of finance - whilst recognising that lowest cost is not the sole determinant of value and that the profit element in senior debt finance is a small component of the overall cost of the service; and

- ensure that lenders to PFI projects are selected using open competition with appropriate selection criteria and also that the principles of good practice are shared between projects through Authority oversight and guidance.

Source: HM Treasury

For further information on PBDFC refer to HM Treasury draft guide available at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk).

## **PFI accounting**

The UK government's adoption of International Financial Reporting Standards (IFRS) from April 2008 may have implications for the future use of PFI. It is sometimes stated, incorrectly, that PFI debt is not accounted for on the public sector balance sheet. The fact is that some is and some is not, the rules around this being rather complicated

## **Capital Value of PFI projects in July 2007**

	Prisons	Roads	Hospitals	Schools
On the books	£423m	£1.42bn	£243m	nil
Off the books	nil	£485m	£8.05bn	£4.39bn

Source: HM Treasury

However the amount on the balance sheet is increasing and with the adoption of IFRS it may increase significantly. IFRS says that most PFI projects should be off balance sheet for the private sector and the logical consequence of this is that it should sit on the public sectors books. What might the impact of more PFI debt being on the public sector balance sheet be?

- Some supporters of PFI being fully on the balance sheet say that it will allow PFI to be judged on its true merits as a means of delivering projects. There is currently a suspicion in the minds of many that PFI is primarily used because it is a means of disguising public sector debt
- A squeeze on capital spending could result as bringing PFI debt onto the balance sheet may cause the government to breach its sustainable investment rule limiting public sector net debt to 40% of GDP
- It could move some public bodies such as NHS trusts into loss making entities resulting in the need for expenditure cuts to be made to balance the books

## **PFI models will evolve**

Over time PFI and other forms of Public Private Partnerships (PPP) will evolve and the model will be refined. For example some public sector bodies are exploring the use of best practice procurement tools that have become embedded in PFI, such as whole life costing of assets, and applying them in PPP models in which the Public Sector raises the finance at the more competitive rates that it can attract compared with the private sector. Alternatively the public sector may decide to pay more of the capital costs of a project upfront and in staged payments at key stages of a projects successful construction.

Another emerging trend aimed at providing overall better value for money is the bundling of a number of smaller schemes into a single large project.

## **Summary**

PFI and other forms of PPP will adapt to market and regulatory changes and remain an important procurement vehicle for delivering public services. In the UK it is estimated that PFI will account for 10-15% of gross public investment over the next few years. The current UK PFI pipeline is £22bn up to 2011 with waste, estate rationalisation and regeneration being growth areas (source Partnerships UK). The market will become increasingly international.

*Written by Mike Brookes, CIPS Professional Practice Team.*