



National Audit Office

# Making Changes in Operational PFI Projects

LONDON: The Stationery Office  
£13.90

Ordered by the  
House of Commons  
to be printed on 14 January 2008



# SUMMARY

**1** Under the Private Finance Initiative (PFI), the public sector enters into a long-term contractual arrangement with private sector companies to design, build, finance and operate an asset such as a hospital or school. There are now over 500 operational projects (nearly 400 of which are in England) with a combined capital value of £44 billion. Future payments across all PFI projects up until 2031-32 amount to £91 billion in today's money.<sup>1</sup> Although public sector requirements are specified in contracts, it is inevitable over the course of 25 to 30 years of operation that changes will be needed to the services and assets provided. It is therefore important that PFI contracts are able to provide the flexibility required at a cost that represents value for money.

## Findings

- 2** An estimated £180 million was paid by public authorities to PFI contractors to undertake changes in 2006. In our examination of these changes we found that:
- a** PFI deals are offering sufficient flexibility to the public sector. Contractors had handled urgent requests in a timely manner and around 90 per cent of contract managers responding to our survey were satisfied or very satisfied with the quality of work done to implement change requests.

- b** The timescales for agreement and completion of larger changes compare well with conventionally outsourced refurbishment or upgrade work in the public sector. Timescales were slower for minor changes than for equivalent conventionally outsourced work. This was an occasional source of frustration for front-line users, although service delivery was not affected.
- c** Taking all projects together, some achieve better value for money than others but several components of the cost of changes were problematic:
  - i** higher value changes were not always competitively tendered, partly because of timing, cost and the difficulties of integrating new work with the existing set of obligations under a long-term contract, though other provisions to validate costs were sometimes in place. Contractual provisions in existing PFI deals do not always give the public sector adequate rights to insist on competitive tendering, although this has now been rectified in the latest guidance issued by the Treasury on standardised terms for future PFI contracts.
  - ii** For minor works, there was little consistency in the methods used by public sector teams to validate costs and in some instances there was no validation. Base costs for the installation of electrical sockets, a common example of a minor change, varied widely between projects and, for the projects we reviewed, were on average higher than benchmark prices published by the Royal Institution of Chartered Surveyors.
  - iii** The cost of replacing an item throughout the life of the contract was usually calculated at the point of requesting the change. This “lifecycle cost” has the advantage of improving transparency of costing but it was applied inconsistently and sometimes added inappropriately.
  - iv** In addition to mark-ups to cover overheads and profit added by service providers, the Special Purpose Vehicle (SPV – a company set up by a consortium of contractors to design, build, finance and operate the asset) often charges a fee, typically 5 to 10 per cent of the cost of the change. In total, an estimated £6 million was paid in such fees in 2006. Usually, this fee was not specified in the contract, although the most recent Treasury guidance requires that this is clear at the outset. Although in principle, the private sector should be able to charge an appropriate fee to cover the overhead cost and profit for work that they have not already contracted to do, we found that this fee often related to work that was carried out by sub-contractors rather than the SPV and was very often not justified.
- d** Overall, we found that if the change process is managed well and there is a good relationship between the parties, changes are more likely to be cost-effective and implemented quickly. Some public sector authorities do not employ a full-time contract manager, risking false economy in the case of contracts that are worth up to £10 million in payments to the private sector each year.

## Conclusion and Recommendations

**3** The Treasury has recently produced guidance for new PFI projects coming to the market which sets out good practice in the management of changes. The value for money of individual changes to existing projects varies but value for money is not generally being obtained. The following recommendations are intended to complement the new guidance published by the Treasury and are aimed at PFI projects that are already operational:

- a** Where there is a relevant contract clause, competitive tendering should be undertaken if Authorities deem this to be value for money and they should insist on at least three competitive tenders being obtained for larger changes. In the absence of a contractual clause requiring competition, Authorities should negotiate such a clause when the opportunity arises. For example, as part of negotiations needed during benchmarking or market testing exercises, which are part of regular reviews of PFI contracts.
- b** For existing deals, Authorities need to put in place consistent and robust means to validate the costs of small changes. Authorities should consider carefully the need to pay lifecycle costs for the replacement of small items and challenge inappropriate costs. They should also consider the advantages of bundling together the processing of small changes, including the negotiation of appropriate lifecycle costs, and agreeing any adjustments to the unitary charge once every six months or yearly.
- c** Public authorities should explore with their private sector partners the feasibility of clarifying earlier contracts to bring them into line with current best practice. For instance, Authorities could seek to re-negotiate SPV fees when discussing major asset changes, as happened at the Blackburn hospital.

- d** Information is not shared across locally managed PFI projects as widely as it needs to be. Authorities should develop forums whereby questions and answers on the handling of changes and their costs can be shared within and across sectors. Authorities should also make more use of central government resources already provided, for instance the training courses, helpline and websites run by Partnerships UK (PUK) and 4ps who are the bodies which provide help and guidance to central and local government PFI projects.
- e** Contract management teams should be properly resourced in order to manage the change process. In general, it should be exceptional for a PFI contract not to be managed by the equivalent of at least one person full-time on the public sector side, and there should be more than this for larger contracts or where a lot of changes are anticipated. Authorities should also consider employing a quantity surveyor on a part-time basis specifically to check the cost of changes, where the number of changes processed is likely to justify it.
- f** Public sector authorities can also improve the value for money of changes by adopting the good practices used in some projects. These include:
  - i** Adopting a strategic approach to changes – for instance, bundling similar changes together to reduce costs or planning a change programme based on anticipated needs.
  - ii** Understanding the contract to be sure that a change request is actually a change and not covered under the existing agreement and pricing structures.
  - iii** Keeping good permanent records of changes and payments made, including whether new assets will need to be replaced at some point during the remainder of the contract and form part of the lifecycle cost element of the unitary charge paid to the SPV. Failure to do so risks paying for something twice at a later point in the contract when, for instance, works are already covered by lifecycle cost payments.
- iv** Providing their private sector partners with proper briefs to make it clear what they want done. This is especially important for larger, more complex changes.
- v** Using effective validation mechanisms to challenge costs when necessary, including the use of industry-wide benchmark prices and the experience of other PFI projects.
- vi** Fostering open lines of communication with front-line users and other stakeholders, as well as the PFI contractor. This is necessary in the operational phase as headteachers, medical and nursing staff and other users have narrower scope to act autonomously in arranging for work to be done in the context of a contractual relationship than they may have had previously.