The PFI Contract for the redevelopment of West Middlesex University Hospital

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
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Key Facts of the West Middlesex PFI Deal

	PFI deal as contracted	Conventional procurement alternative
Final deal cost at 2001 prices (discounted over 35 years to April 2001 and excluding clinical costs)	£125 million 35 years £130 million 60 years (Based on annual unitary payment of some £10 million)	£130 million 35 years £140 million 60 years (Risk adjusted)
Cost profiles	Annual unitary charge of some £10 million plus refurbishment costs of £12 million under separate arrangements.	Full capital construction and refurbishment costs of some £62 million (cash estimate) over first four years, followed by ongoing maintenance and ancillary services.
Risk allocation		
■ Remaining with public sector	■ Clinical service provision; ■ Change in Trust requirements; ■ NHS specific regulatory/legislative changes.	Most risks retained by the public sector.
■ Passed on to private sector	■ Construction Design (except changes due to external NHS requirements); ■ Meeting specified performance standards and operating cost risk; ■ Non-NHS specific regulatory/ legislative changes.	
Cost of advisers used in procurement (actual prices)	£2.3 million	The Department has suggested a range of between 2 to 4% of capital value for schemes over £20 million. This would give between £1.2 million and 2.4 million in this case.
Original estimate of deal cost (based on 30 year contract):		
■ Invitation to negotiate (1998/99 prices)	£91 million	£93 million
■ Selection of preferred bidder (February 2000 prices)	£95 million	£98 million
Trust's assessment of additional benefits of its chosen procurement over conventional procurement	Greater price certainty.	Cost overruns passed to public body.
	Incentivises contractor to complete development on time as full payment only starts once the building is ready for use and occupied.	
	Payment linked to delivery of service which incentivises the PFI contractor to deliver the quality of service which is specified over the contract period.	Only recourse for poor performance is to terminate the contract which can also lead to payments from the Trust.
	Same contractor designs, maintains and operates building under one contract and is therefore incentivised to adopt whole-life costing.	Design, maintenance and operation of building is dealt with under separate contracts.

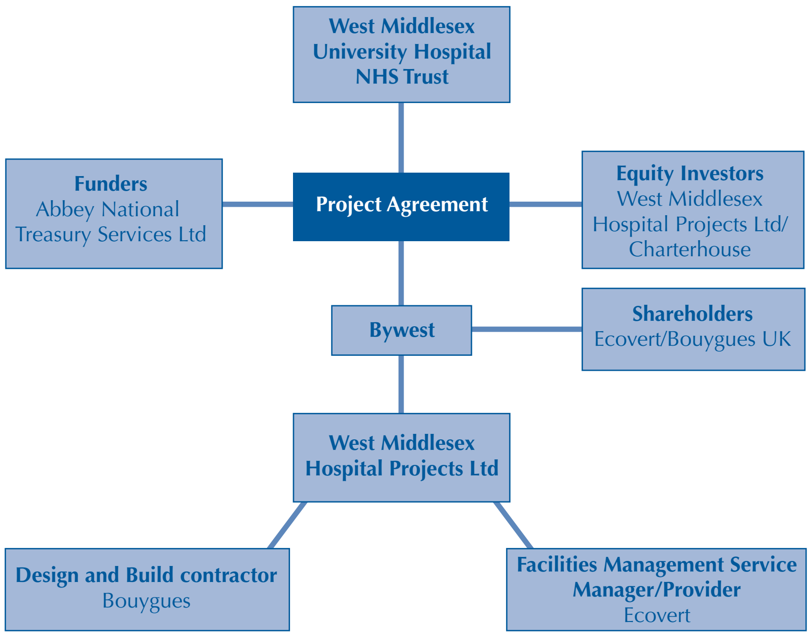
executive summary

" PFI has a central role to play in modernising the infrastructure of the NHS - but as an addition, not an alternative to, the public sector capital programme."
- The Prime Minister, September 2002.

1 It is government policy that some hospitals are going to be built and managed as PFI contracts, as additions to the conventionally procured hospital programme. This report examines one such PFI project to see the extent to which it has absorbed the lessons of previous reports by the Committee of Public Accounts which have been accepted by the government, and how value for money was established in this case.

2 In January 2001, the West Middlesex University Hospital NHS Trust (the Trust) let a PFI contract to a private sector consortium called Bywest **(Figure 1)**. The contract is for 35 years and has an estimated net present value (NPV) of unitary payments of some £125 million. There is also the possibility of extending the contract term to 60 years. The contract requires Bywest to redevelop the Trust's site at Isleworth, West London and then to provide ongoing maintenance and facilities services.

1 **The Trust and members of the Bywest consortium and its main contractors**



3 We examined the extent to which this PFI contract is likely to deliver value for money and whether lessons had been absorbed from the earlier reports by the NAO and the Committee of Public Accounts on the contract for the Dartford and Gravesham PFI hospital[1]. The methodology we adopted for this study is set out in Appendix 1. In summary we found that:

- This 35-year deal meets expected local needs, with some flexibility to address inherent uncertainties in wider long-term NHS plans;
- In getting the best available PFI deal the Trust applied common sense and learnt from experience;
- The Trust considered that the unquantifiable benefits of doing this as a PFI deal outweighed the disbenefits.

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4 As many of the buildings were over 100 years old and dilapidated, the Trust, the local Health Authorities and the NHS London Regional Office (LRO) all considered that a redevelopment of the West Middlesex hospital site was essential to meet local needs for modern, high quality healthcare[2]. In accordance with procedures introduced since the planning of the earlier Dartford and Gravesham PFI project they agreed a strategic outline case for this redevelopment.

5 Long-term planning is difficult in the health service because healthcare is changing over time and the local demography may also change. This may affect the optimum type and location of facilities that are required. This exposes the Trust to the risk that it may become locked into a long-term contract for buildings and services that are no longer needed. This issue is not limited to PFI hospitals, but the long-term service contract of a PFI deal makes termination likely to be more expensive. In the West Middlesex deal there is some flexibility to accommodate these uncertainties. Up to six additional wards can be provided or alternatively bed numbers could be decreased. The Trust believes the contract provides sufficient flexibility to address future uncertainties in long-term healthcare.

In getting the best available PFI deal the Trust applied common sense and learnt from experience

6 In developing this PFI deal the Trust learnt lessons from the early hospital PFI procurements which included its own experience in developing, but not completing, an earlier version of this project. It ran an effective procurement placing particular emphasis on strong senior management involvement, input from clinicians and other stakeholders, and experienced advisers. It was also able to make use of new guidance including a new standard NHS PFI contract.

7 The Trust ran an effective bidding competition. This included a faster bidding process which eliminated an extra round of bidding, reducing the time and costs of both the Trust and the bidders. It selected Bywest as preferred bidder. Bywest's bid offered a slightly lower price than the other bidders, and the Trust judged that the bid offered the best value for money with particular strengths in design, proposed timetable and personnel issues.

1 *The PFI Contract for the new Dartford and Gravesham Hospital: NAO Report HC 423 1998/99; The PFI Contract for the New Dartford and Gravesham Hospital: PAC Report HC 131 1999/00.*

2 *The local health authorities were Ealing, Hammersmith and Hounslow (EHH) Health Authority and Kingston and Richmond (K&R) Health Authority.*

8 It took the Trust a year to close the deal (against its expectation of eight months) due to contractual and design issues, including a late proposal for the use of one of the site buildings. The Trust controlled deal drift up to financial close. Bywest's annual price increased by just under 10 per cent, mainly due to inflation and the decision to use land sale proceeds to fund other work. The Trust asked Bywest to confirm in writing at selection of preferred bidder that, assuming the specification remained unchanged, it would hold its proposed price. The Department believes that this innovation had some impact on limiting price increases during the closing stages[3].

The Trust saw benefits from this PFI deal that outweighed the disbenefits

9 There are generic benefits from PFI deals such as incentivising the contractor to introduce the required service quickly and to maintain the service delivery to a satisfactory standard. These benefits have to be weighed against possible disbenefits, which include being tied into a long-term contract during which the public sector's requirements may change. There may also be further specific benefits and disbenefits from a PFI approach to a particular project.

10 In this project the Trust considered the benefits of the PFI approach outweighed the disbenefits. The Trust placed particular emphasis on the fact that the contract would incentivise Bywest to complete the redevelopment quickly and with price certainty, to maintain the buildings well and to deliver the required standard of service during the 35-year contract period. The Trust has sought to manage the risks of a PFI contract by building into the contract some flexibility and arrangements to test that any contract variations are value for money.

11 The Department told us that it would not necessarily withhold approval for a PFI project that appeared slightly more expensive than conventional procurement if there were convincing value for money reasons for proceeding with the deal. In this case the Trust's initial financial comparison did show the PFI price slightly higher than the cost of conventional procurement. Both the Trust and its advisers KPMG considered the PFI option would deliver value for money taking all benefits and disbenefits into account. But they had concerns about the accuracy of the initial financial comparison and whether its results might prevent the project being approved by the Department.

12 As part of the iterative process of developing the risk analysis which forms part of the financial comparison, the Trust and KPMG re-appraised the figures to ensure the risks inherent in traditional procurement were properly reflected in the public sector comparator (PSC). The final calculations showed a risk-adjusted saving from using the PFI of £5.5 million compared with a PSC, including project risks and clinical costs, of £989 million over 35 years (net present values)[4]. As with all long-term cost estimates there are inherent uncertainties in this comparison, and particularly regarding the size of the adjustment for risk. The total value for risk was, however, consistent with previous experience with conventional hospital projects and was in the middle of the range indicated by a recent wider study. The re-assessed cost comparison therefore reinforced the value for money case for the PFI deal.

13 In this project the financial comparison was not clear-cut. The attention given by the Trust to the figures shown by the financial comparison may have masked evidence of important wider benefits that the PFI approach was expected to secure.

3 The Department of Health and the National Health Service Executive merged in spring 2001. Both are therefore referred throughout the report as 'the Department'.

4 £129.3 million net present value excluding clinical costs.

Recommendations

14 Those engaged in taking forward PFI projects, both within the Department and in other departments, should continue to have regard to the recommendations set out in our earlier report on the Dartford and Gravesham PFI hospital. As a result of this current further examination of PFI in the NHS we make the following additional recommendations:

A The strategic outline case for a PFI project should include a clear analysis of the risks of being locked into a long-term contract. It should also explain how these risks would be addressed if the PFI procurement goes ahead and whether, on balance, the benefits of a PFI procurement are likely to outweigh any disbenefits. In making this assessment a department, and all other key stakeholders in the project, should consider the extent to which there are long-term plans and the uncertainties attached to these plans. The outline case should indicate how the proposed project contributes to a department's strategy both in the short-term and into the proposed contract period.

B As the Trust demonstrated in this procurement, PFI procurements will benefit greatly from the involvement of senior management, input from key stakeholders and the use of experienced advisers. Trusts may benefit from key stakeholders sharing their experience, particularly how clinical considerations should affect the design of the project.

C The Trust moved directly from three bidders to a preferred bidder without an intermediary stage. This may reduce the time and costs of both departments and bidders, and is now part of the Department of Health's guidance. Other departments should consider whether this approach is appropriate. Certain safeguards are needed with this approach (see paragraph 2.21). These include making sure the three final bidders know that there will not be another opportunity to improve their bids and resolving outstanding contractual issues before the selection of the preferred bidder to keep the final negotiations to a minimum.

D Other departments should consider whether it will be helpful to PFI procurements if greater use is made of the type of preferred bidder letter obtained by the Department in this project. This sought confirmation from the preferred bidder that, assuming the specification remained unchanged, it would commit itself, for a defined period, to the price it bid prior to its selection as preferred bidder. This confirmation,now reflected in Office of Government Commerce guidance[5], may help departments to close deals effectively knowing that the contractor has agreed that price changes will only be allowed in exceptional circumstances.

E The departmental approval processes for PFI projects should not, explicitly or implicitly, place undue emphasis on the need for projects to demonstrate savings, however small, against a PSC in order to gain approval. The emphasis should be on demonstrating value for money taking all benefits and disbenefits of the PFI approach into account. There is a risk that project teams may devote too much time refining their financial comparison calculations, at the expense of a more rounded and valuable assessment. Financial and wider non-financial should be considered in deciding whether to go ahead with a PFI procurement.

5 *Standardisation of PFI contract terms, OGC July 2002*