

PFI: Construction Performance



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
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Summary

- 1 The Private Finance Initiative (PFI) is being used to procure many projects involving construction of assets which are needed to deliver public services. Up to December 2002 PFI contracts had been let for 25 major hospital schemes, seven prisons, nine roads and a number of other projects such as departmental office accommodation and training facilities. The Office of Government Commerce (OGC) has central responsibility for promoting good practice in public sector construction projects. It is also responsible for the central development of PFI policy. These two areas overlap in those projects where a service procured under the PFI requires the construction of an asset, such as a road or building.
- 2 This report examines the construction performance achieved in PFI projects so far. It focuses on three key areas of construction: price certainty for departments; timing of construction delivery; and the quality of design and construction. To gather evidence on experience to date we carried out a census of all English PFI construction projects let by central government,¹ which were due to have been completed by Summer 2002. The methodology we adopted for this study is set out in Appendix 1. In summary:
 - we tested the hypothesis that PFI will deliver price certainty for departments and timely delivery of good quality assets;
 - our census of projects generally supported the hypothesis, though it is not possible to judge whether these projects could have achieved these results using a different procurement route.



The hypothesis is that PFI will deliver price certainty for departments and timely delivery of good quality assets

- 3 Under a PFI contract the same private sector party, usually a consortium of companies, is responsible for delivering the required service over the whole life of the contract. In PFI accommodation projects, such as hospitals or prisons, the construction element typically represents around 25 to 30 per cent of the total value of the contract. But other project costs, such as maintenance, will be influenced by the quality of the construction work. In theory, PFI incentivises the consortium to:
 - estimate the full cost of constructing and maintaining built assets when pricing the contract, as the consortium will not be able to recover unforeseen increases later by claiming them back from the department;
 - complete the construction element as soon as possible because the consortium does not begin to receive payments until the asset is ready for use and the service is being delivered;

¹ This includes all completed NHS hospitals for which contracts are let locally by NHS Trusts, but not schools contracts, which are let through local authorities.

- achieve good quality construction as the consortium is obliged to maintain the building to agreed standards throughout the life of the contract, and failure to do so can result in payment deductions or financial damages. This incentive encourages a 'whole life' approach to construction as longer term costs can be reduced by building to higher standards. This differs from traditionally procured assets, where the companies responsible for construction have no interests in the long term performance of the assets.
- 4 We spoke to a number of major PFI contractors, construction industry bodies and academics. They confirmed that these are the incentives which, in theory, are provided by the PFI approach and considered that they are generally working in practice. The incentives were leading to improvements in built assets through the better integration of design, construction and maintenance, leading to the better management of construction cost risks.

The census of projects generally supported the hypothesis

Price certainty

- 5 Our census showed that most PFI projects were delivering price certainty to departments with 29 out of the 37 projects surveyed reporting no construction related price increase after contract award. Where there had been a price increase it had been due to changes led not by the contractor but by the department or other parties. The price changes mainly related to further work, which had not been part of the original specification, on additional or improved facilities or changes to the function of a building. But construction cost increases had been mainly borne by the consortium with no increase to the department's payments. This, together with the fact that there has been publicity of some construction companies incurring losses on certain PFI work, is evidence of risk transfer working. Construction companies say that risk transfer is also working in that it places pressure on them to manage risks more effectively.
- 6 The census results compare well with historical experience of construction contracts in the public sector. In our 2001 report 'Modernising Construction' (HC87, Session 2000-01) we reported that some 73 per cent of departments' and agencies' construction projects had run over budget for the public sector. In our PFI census only 22 per cent of those surveyed had overrun (see Figure 1). These price increases were generally relatively small and not due to the consortia charging more for the work originally specified.

1 Improved project delivery under the PFI

	Previous experience (1999 Government survey)	PFI experience (2002 NAO census)
Construction projects where cost to the public sector exceeds price agreed at contract	73%	22% ¹
Construction projects delivered late to public sector	70%	24% ²

NOTES

- None of the increases in PFI price after contract award were due to changes led by the consortium alone. For example, in some cases the department changed some of the specifications from those for which the consortium had bid, so the price increased to reflect the changes. Some of these specification changes arose due to new factors affecting the department's needs after contract award. These changes would also have led to price increases under traditional procurement.
- In only eight per cent of PFI projects surveyed was the delay more than two months. No comparative data for this statistic are available for traditionally procured projects. Previous studies of traditional projects had referred to the percentage of time overruns rather than the number of months.²

Source: National Audit Office

- Where prices had increased, we found that departments had carried out benchmarking in less than half the cases to satisfy themselves that the price increase was reasonable. This is important as such changes take place without competitive pressure. Further, as PFI building contracts are often for 25 or more years, departments may find they need to change or add to the built asset during the contract period. Where they do so it is important that they have procedures in place to demonstrate that the pricing of the change is value for money.
- This report has focused on the delivery of PFI construction projects to the public sector. As noted above, the private sector experience is that risk transfer is working. But the available information on the level of rewards to construction companies from PFI work is limited and rather mixed. Whilst these issues have not been the focus of this report we hope to return to them in future reports.



² The 2002 Mott MacDonald report found that traditionally procured standard building projects examined had taken between one and four per cent longer to complete than expected at business case stage, before contract award. Standard buildings are those not requiring special design considerations. Non-standard buildings examined had taken between two and 39 per cent longer. Non-standard buildings involve special design considerations and may include specialist hospitals, innovative prisons, high technology facilities, other unique buildings or refurbishment projects. The 1999 report, Benchmarking the Government Client found that construction programmes overrun by an average of 13 per cent compared to the tender stage.

Timing of delivery

- 9** We found that 28 out of the 37 PFI projects surveyed were delivered on time or earlier than specified in the contract. Only two construction projects that were due to be completed were unfinished at the time of our survey (Summer 2002), and the construction of one of those has since been completed. Of the nine that were not delivered on time, six were delayed by two months or less (Figure 1). Where PFI buildings have been delivered late, departments have been able to defer payments, make payment deductions or seek damages.
- 10** This result is also an improvement over previous public sector construction experience. In our 2001 'Modernising Construction' report we found that some 70 per cent of central government's construction projects were delivered late. Some of the improvement under PFI may be because specifications are often worked out in greater detail and cost and time targets are set later in the procurement process than under traditional procurement. This reduces uncertainty in the process.

Quality of design and construction

- 11** Most public sector project managers surveyed were satisfied with the design and construction of their PFI buildings. They were also mostly satisfied with the performance of the building. However, it was more difficult to obtain a view of user satisfaction. Formal user surveys had been undertaken by departments in only four of the projects surveyed, although in around half of the projects the departments had gathered informal feedback from users. Where formal user surveys had been undertaken the feedback from users was generally favourable.



- 12 Interviewees said they felt that procuring departments were putting more emphasis on design quality and aesthetics in more recent PFI projects than had been the case in earlier projects. They felt it was important for departments to make the importance of design quality clear to bidders to emphasise that the department was not simply looking for the lowest cost bid. The OGC has worked with the Commission for Architecture and the Built Environment (CABE) to develop recommendations to ensure design best practice in all large government capital programmes.³

It is not possible to judge whether these projects could have achieved these results using a different procurement route

- 13 There have been a number of changes and initiatives in the construction industry in recent years which aim to improve construction results regardless of the form of procurement. These include encouraging closer working between clients and consortia, and setting targets for improvements in construction performance. There is also the Achieving Excellence Programme, which aims to improve departments' performance as procurers of construction. Finally, there are different procurement routes, other than PFI, such as design and build and prime contracting, which also aim to improve value for money in construction.

- 14 This report, and our census, focused on post-contract construction experience in the PFI projects considered. We did not set out to examine the value for money of the deals. This has been covered by many of our previous PFI reports. Nor did we try to judge how well the construction element would have been performed had the contracts been let using other procurement methods. The positive results of our census do, however, generally compare favourably with the results of other studies which have considered the historical experience of other public sector construction projects. For example, 'Modernising Construction' (HC87, Session 2000-01), Mott MacDonald: 'Review of Large Public Procurement in the UK', July 2002, Agile Construction: 'Benchmarking the Government Client', 1999.



³ *Improving Standards of Design in the Procurement of Public Buildings* (published 2002).

Recommendations

- 15 This report has shown that there is strong evidence that the PFI approach is bringing significant benefits to central government in terms of delivering built assets on time and for the price expected by the public sector. In future projects departments need to weigh the prospect of such benefits in the balance with the other advantages and disadvantages of using the PFI or alternative forms of procurement.
- 16 As a result of this examination we make the following additional recommendations:
- A The OGC should prepare updates of the statistics which have been presented in this report on the extent to which PFI projects are being delivered on time and to the cost expected by the public sector. These are important measures of the private sector's performance in PFI projects. The data are relatively easy to collect and provide a valuable insight into how well projects are being delivered under the PFI.
 - B Departments should assess the extent to which it is possible to use the lessons of the PFI approach to improve the delivery of projects using other forms of procurement. PFI construction companies are incentivised to perform because the consortium they belong to will not be paid until the required service is being delivered, but there are also other positive features of the PFI approach which could be applied to conventional construction projects. These include clearer statements of requirements before setting timescales and budgets.
 - C As part of their ongoing relationship aimed at improving the built environment, the OGC and CABE should publicise good examples of design and construction in PFI projects, in conjunction with departments and the private sector. Making examples of good practice available within both the public and private sectors will help to stimulate further innovation in future PFI projects.
 - D Departments should carry out user surveys as part of their post-contract evaluation of PFI projects. User surveys are a valuable way for a department to gather information about how well a built asset is operating. A user survey may identify problems and issues which the department needs to discuss with the consortium. Users' experiences can also be used to inform the development of future projects involving similar assets. In particular, users can make valuable input to the design stage.