National Audit Office

# Improving the PFI tendering process

Ordered by the
House of Commons
to be printed on 5 March 2007

LONDON: The Stationery Office
£13.50

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 149 Session 2006-2007 | 8 March 2007

# SUMMARY

1 Before new PFI assets are constructed and services delivered, there is a process by which procuring authorities invite tenders and select a winning bidder for the contract **(Figure 1)**. In order for value for money to be achieved in PFI deals, all stages of the deal have to be managed effectively, including this tendering stage.

2 This study has arisen out of concerns expressed by the Committee of Public Accounts in 2003 that the tendering of PFI projects did not follow good practice and was not handled with sufficient skill on the part of the public sector, incurring high costs and risking value for money. New European Union procurement rules reinforce the need for best practice in the future.

3 We examined the tendering process for all central Government Department PFI projects in England that closed between April 2004 and June 2006, including PFI schools and hospital projects.[1] The effectiveness of this process impacts directly on the value for money of PFI deals, though it is outside the scope of this report to provide an evaluation of the value for money of each single deal that closed over the period.[2]

1 We surveyed 49 projects with a combined capital value of just under £8 billion. We excluded a small number of local authority projects (combined capital value of £750 million) and projects with individual capital values of under £20 million that would now not be considered for PFI under Treasury guidelines.
2 See Appendices 1 and 2 for details of the methodology and projects covered in this study.

**4** We found that key elements of the tendering process had not improved and in some respects had worsened:

**a** There are signs that the private sector is becoming more selective in developing detailed bids[3] for PFI projects, in part due to the cumulative impact of lengthy tendering periods and high bid costs. One in three projects that closed between 2004 and 2006 had two detailed bids competing for the business, compared with one in six authorities prior to 2004.

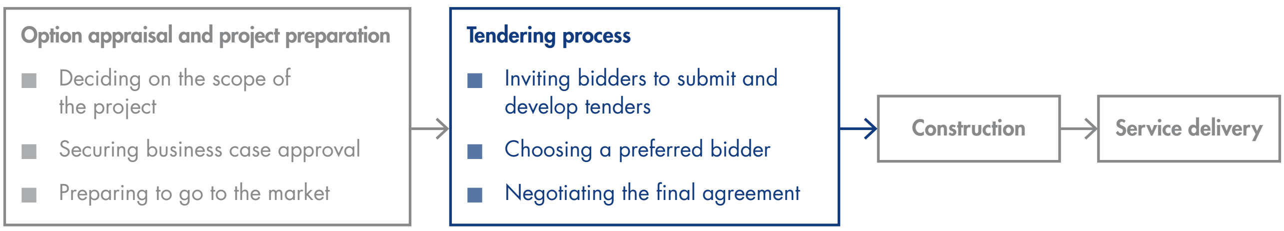
**b** Though with differences between sectors, tendering periods overall lasted an average of 34 months (25 months average for PFI schools, 38 months for PFI hospitals and 47 months for other PFI projects) - no better than the average for projects that closed between 2000 and 2003.[4] Shorter tendering periods are not desirable if they are achieved at the expense of the overall value for money of the projects. However, we found that many of the reasons for long tendering periods (some of which may relate equally to conventionally procured projects) could have been avoided or mitigated by the public sector, without risking overall value for money. Within the overall tendering period, negotiations to finalise deals with a single preferred bidder have increased, lasting on average over a year and in some cases as long as five years.

**c** Material changes (both upwards and downwards) were frequently made by public sector project teams and contractors to the prices of deals during preferred bidder negotiations, when the discipline of competitive tension had been removed. In one-third of projects we examined, there were major scope and specification changes (both upwards and downwards) during the preferred bidder period worth just over 17 per cent of the projects' present values or an average of £4 million a year for each project.

**d** Project teams have continued to plan less well than they should for the amount of professional advice needed for a PFI deal. Where budgets were set, spending was on average 75 per cent more than anticipated, or £0.9 million extra per project. The average cost of external advice for all projects was just over £3 million per project or approximately 2.6 per cent of the capital value of the projects. In the health sector, for which data are available over time, the amounts spent on advisers as a proportion of the value of deals has gone down marginally since 1997-2000.

**e** Although many project teams told us that they passed on lessons learned to others, systematic ways to ensure that useful lessons are shared were not always exploited. Some issues common to PFI deals were resolved by project teams acting in isolation. However, the issuance of guidance on standard PFI contract terms was one way in which lessons were captured and the Treasury believes that the further development and application of standard terms will yield further benefits in relation to both contractual terms and improved procurement times.

**1** The position of the tendering process within a PFI project




*Source: National Audit Office*

3 Detailed bids for this purpose are defined as bids submitted at the Invitation to Negotiate Stage.
4 The overall average for deals that closed 2000-03 was 33 months. In no sector was there significant improvement compared with the period 2000 to 2003. Our figures for tendering times differ slightly from the figures quoted in *Strengthening Long-Term Partnerships* (HM Treasury, 2006). This is due to a different project selection: further details can be found in Appendix 1.

**5** Public authorities are now expected to use a new procurement procedure known as Competitive Dialogue.[5] Under this procedure, more of a PFI deal has to be agreed with all bidders before a preferred bidder is selected than has been the case in the past, so maintaining competitive tension for longer and reducing the scope to make significant changes to the deal once the competition has been closed, as happened in the past. Some sector-specific guidance has now been issued to procuring authorities, however, the practical effects of Competitive Dialogue are uncertain at this early stage. The enhanced competitive element within the new procedure will in principle bring benefits, but any risk of increased tendering costs for the private sector will need to be managed so that bidder interest does not weaken.

## Recommendations

**6** In its March 2006 publication, *Strengthening Long-Term Partnerships*, the Treasury put forward several proposals to improve public sector skills and procurement support and to reduce procurement timescales and costs for both the public and private sectors. These included a greater emphasis on preparation of projects before they go to the market, increased monitoring and scrutiny of projects, including a new stage of scrutiny before selection of preferred bidder, and measures to address shortages of skills in the public sector. Other measures which had already been taken to address issues of lesson learning, co-ordination and skill shortages included the creation of sector-specific programmes such as Building Schools for the Future. This programme brings together all future PFI school projects with the aim of introducing centralised programme management. Our recommendations are intended to supplement and to complement these proposals and measures, and will remain relevant in the light of the Competitive Dialogue process.

### Addressing the risk of PFI deals not receiving enough developed bids for a viable competition

**a** The level of public sector experience is a factor that can influence bidders' interest in projects. Authorities should always ensure that they can draw on staff with experience of complex capital procurement and Departments, including where relevant their Private Finance Units (PFUs), should also have sufficient specialist knowledge on which to draw. As part of the reform of the Government Procurement Service[6], the Office of Government Commerce (OGC) is considering how to facilitate the effective recycling of existing skills in complex procurement across the public sector and to promote an attractive career path in complex procurement, such as PFI, backed by a structured training and development programme.

**b** Public sector procurement teams have in the past aimed to receive detailed bids from at least three bidders. Under Competitive Dialogue, there may be circumstances in which, after eliminating weaker bidders, it makes sense to undertake the later stages of the dialogue with the two strongest bidders. However, where only two viable bids for a project are received early on, or if bidders pull out of the competition, leaving the procuring authority with only two bids to choose from[7], there should be a review by the relevant sponsor Department. The review should consider whether:

- there are any defects in the scoping or management of the project that may explain the low level of market interest and could be remedied in time for a re-run of the competition; and whether
- the bids on the table offer a good competition and are likely to lead to a value for money solution.

**c** The OGC should ensure that there are consistent principles and comprehensive guidance for practitioners across the public sector in applying the Competitive Dialogue procedure to PFI procurement. The OGC should also carry out a review after the first 18 months of the operation of Competitive Dialogue to identify any lessons, in particular to ensure that private sector bidder interest is maintained.

**d** For the first time there is now a database maintained by the OGC containing information about planned construction projects across the public sector. Departments should use this database to assess the impact of their planned projects on the market. In addition, the OGC should use the database to provide the market with information on when projects are expected to proceed to tendering and to monitor whether projected demand from the public sector is likely to exceed market capacity. Departments and, where relevant, the Treasury should also continue to assess whether project teams have tested likely market interest as part of the Outline Business Case approvals process.

5 This stemmed from an EU Directive, implemented into UK law from January 2006, which added the option of Competitive Dialogue to the existing range of public procurement procedures.
6 *Transforming government procurement* (HM Treasury, January 2007).
7 In cases where only one bid has been received, the Treasury has published specific value for money guidance.

## Reducing the length and cost of tendering

**e** We have found examples of well managed and properly resourced projects that have taken 18 months to tender, including preferred bidder negotiations lasting less than six months. This suggests that a target of between 18 to 24 months would not be unreasonable for many projects, although it may be unrealistic for particularly complex, one-off PFI deals. Departments should agree with the Treasury what would constitute an appropriate target time for their sector, and individual procurement teams should be bound to this unless they can satisfy the Department that the target would be unrealistic in their case, even with more up-front preparation.

**f** To achieve much tighter timescales while maintaining good value for money, Authorities should:

- obtain commitment to the project from all key stakeholders at an early stage;
- develop better output specifications, including greater dialogue with potential bidders about the design of assets, before approaching the market;
- establish the affordability of the project before it is brought to the market and again before a preferred bidder is selected. In establishing affordability, authorities should calculate available resources against a range of scenarios; and
- agree the commercial basis of a deal as well as key aspects of the detailed design prior to selecting a preferred bidder – now a requirement under the Competitive Dialogue procedure.

**g** As part of good project and programme management using appropriate methodologies, the monitoring of projects as they progress through procurement should be ongoing and highlight where target times are likely to be missed. In these cases, the likelihood of missing the target time should serve as an alarm signal and trigger an action plan from the procuring authority.

**h** Partnerships UK maintains a database of information on PFI projects, parts of which are available on its website. The Treasury should consider whether information on the length of time taken to procure individual deals should be published, possibly in the form of an annual league table, to help motivate project teams to achieve shorter tendering times.

**i** The same issues arise repeatedly across projects, lengthening procurement periods and increasing costs unnecessarily. Departments should identify lessons from recently closed PFI projects of relevance to subsequent projects, revising sector-specific guidance and standard specifications where new issues recur across projects in a particular sector. Where appropriate, a programme approach to PFI projects such as that under Building Schools for the Future can facilitate the transfer of experience from earlier to later deals.

**j** There should also be a more structured process of learning and sharing lessons across sectors and public authorities, which includes:

- Departments ensuring that post-project evaluations are completed as a matter of course and any lessons shared with other public sector procurement teams;
- a more co-ordinated and targeted approach to sharing good practice by central advisory bodies such as the OGC, PUK, 4ps and the Project Review Group within the Treasury; and
- a forum through which procuring Authorities can share their experiences and raise queries, to complement the existing PUK helpline.