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The performance and management of hospital PFI contracts

Summary

The Private Finance Initiative in the NHS

1 Private Finance Initiative (PFI) hospital contracts are awarded and managed by local Trusts. The contracts use private funding to build and maintain hospital buildings. The contractor often provides support services, typically including cleaning, catering and portering, often referred to as hotel services.

2 The Department of Health (the Department) is responsible for approving new contracts with a capital value of over £35 million or those that are high risk. The Department also supports Trusts in negotiating and managing the contracts. The Department currently supports 76 such operational PFI contracts in England, costing £890 million a year.

3 The Department's accountability for the contracts depends on the type of Trust managing the contract:

- **a** **Thirty-nine per cent of the contracts are managed by Foundation Trusts (Foundations).** Foundations provide NHS services but are independent of the Department. The Department cannot require Foundations to provide information or direct Foundations to take specific action. Each Foundation chief executive is directly accountable to Parliament as an Accounting Officer.
- **b** **Forty-nine per cent of the contracts are managed by NHS Trusts.** These Trusts have not yet achieved Foundation status and remain directly accountable to the Department. The Department aims that all NHS Trusts obtain Foundation status by the end of 2013-14.
- **c** **Twelve per cent of the contracts are managed by Primary Care Trusts (PCTs).** Some PCTs operate hospitals as part of their provider function. PCTs are formally accountable to the Department via Strategic Health Authorities.

We use the word Trust to include all three types of Trust.

Scope of this report

4 This report is about the performance of the maintenance and support services under the PFI contracts, and how they are managed by the Trusts. It focuses on the stage of the contract once the buildings are open for use, by which time the choice of using PFI has already been made. The report does not examine the decision to use PFI as a procurement route, the financing or design and construction issues. The report highlights the challenge for Trusts with operational contracts of making the most of the contract and their relationship with the contractors, and ensuring they get the services expected.

5 The report also focuses on how the Department supports Trusts in their management of the contracts. The Department devolves delivery of health services to Trusts, as part of a framework of devolved delivery, decision-making, financial incentives and accountability. It is attempting to intervene as little as possible in local delivery and to not direct Trusts nor require information from them superfluously. The report highlights the challenge to the Department of how to balance supporting local delivery with allowing Trusts to manage their affairs.

6 In scoping this report we used three value for money criteria:

a **Performance (Part 2).**

Are performance and costs as specified in the contract and meeting the needs and expectations of Trusts?

b **Management (Part 3).**

Are Trusts managing their contracts in line with best practice?

c **Role of the centre (Part 4).**

Is the Department providing Trusts with effective support in managing their contracts?

Key findings

Performance and cost of services

7 **Information collected by the NAO indicates that most contracts are performing satisfactorily or better and meeting the expectations of Trusts.** We base this on each Trust's reported satisfaction, and information from their Performance Management Systems. Sixty-seven per cent of Trusts report satisfaction with their contracts, and the majority of Trusts report consistent or improved performance over time. The level of penalties applied for poor performance is low. Fifty three per cent of Trusts charged no deductions in 2008-09, with the remainder charging deductions which represented a low percentage of their annual payments. Although we have some reservations about data quality, we believe that there is strong enough evidence to say that most contracts are delivering the value for money expected of them.

8 **However, there is scope for improvements.** Thirty-three per cent of Trusts are dissatisfied with at least one of the services they receive under their PFI contracts. None rated all services as excellent. Problems with performance have varied and do not suggest a single set of systematic issues.

9 **Available information shows the cost and performance of PFI hotel services are similar to those services in non-PFI hospitals.** The cost of each service varies significantly in both PFI and non-PFI hospitals, and there is a large amount of overlap in these price ranges between the PFI and non-PFI groups. Most of the variation in costs cannot be explained using the Department's current information. There is also no difference between Trust assessments of performance against objective measures for cleaning and catering services in PFI and non-PFI hospitals. There are no comparisons of the performance of other services. Our analysis shows:

- cleaning, laundry and portering costs are about the same whether delivered through PFI or not;
- catering is on average slightly cheaper in PFI hospitals; and
- hospitals with PFI buildings spend more on maintenance annually, because the contracts require them to be maintained to a specified high standard.

It was not possible to do this analysis for 2008-09 or 2009-10 because the NHS stopped collecting the data.

10 **It is thus not clear whether it is better or worse value for money to include the hotel services within the PFI contract, rather than managing them separately.** The value for money of the whole PFI contract, however, depends upon wider factors outside the scope of this report, such as potential benefits from the construction and design of the buildings, risk transfer during the construction phase or having fixed whole life costs, all set against the higher costs of private finance.

Managing contracts

11 **Managing PFI contracts is a challenging task. We found four main areas where Trusts are trying to defend value for money in their interactions with contractors:**

a Interpreting the scope of the contract to defend the Trust's position in any contractual disputes.

b Managing the change process to ensure changes to the building and services are value for money and timely.

c Fulfilling their obligations to ensure intended risk transfer.

d Ensuring that the expected level of performance is delivered.

12 Most Trusts are managing their contracts well day-to-day but need support with certain complex issues. We assessed the way Trusts manage their contracts against best practice. We found, with a few exceptions, that Trusts are currently well equipped to manage their contracts day-to-day and understand the risks to value for money. However, the risks outlined in paragraph 11 remain. We also found that Trusts rely on their support networks and the Department to keep them up-to-date on what is good practice and how to manage more complex issues and risks.

13 Some Trusts are not, however, devoting sufficient resources to contract management. Many Trusts have recently increased the resources they devote to the management of their PFI contracts. These Trusts realised that managing the contracts was a greater challenge than they had at first thought. However, nine of the 76 PFI contracts (12 per cent) have no one assigned to contract management.

14 Trusts are likely to be expected to make efficiency savings over the next few years, but their ability to make savings from their PFI contracts is limited. PFI commitments represent between 0.4 and 18.3 per cent of each Trusts' operating costs. This commitment is relatively fixed in real terms. The contracts allow the price to be increased annually for certain aspects of price inflation in contractors' costs, but Trusts can benefit from certain specific cost reductions:

- through sharing refinancing gains if they occur; and
- if the market price for hotel services is below the price in the PFI contract at value testing reviews which are normally every five years. The experience to date, however, is that these value testing reviews, which can result in price increases or decreases, have rarely led to price reductions for Trusts.

15 There are several reasons why it is difficult for Trusts to further reduce their PFI spend or get service improvements through sharing in efficiency savings:

a Unlike refinancing gains, the contracts do not require investors or contractors to share gains they can generate through more efficient management or service delivery in individual contracts, or groups of contracts, where these gains are not reflected in prices offered in the value testing reviews.

b We saw little evidence of partnering work between contractors and Trusts aimed at driving down costs and producing mutual benefits.

c Although maintenance services are subject to competitive tension in the tendering process, Trusts have not been able to benefit from any efficiencies in building maintenance which contractors achieve over the contract's life. This is because these services are not value tested and contractors do not share with Trusts information on their maintenance spend.

Whilst some Trusts have sought to make savings by reducing the scope or performance requirements of their PFI services, there is little experience of these negotiations or their outcomes. Trusts need to ensure that any decision to reduce services is informed of the long-term consequences to costs and the impact on patients.

The Department's Role

16 The Department has developed significant expertise in how to support Trusts' management of their contracts within its Private Finance Unit. The Unit was set up to manage the programme of new PFI contracts. It provides valuable support through:

- a quarterly forum for contract managers;
- guidance on good practice; and
- providing advice to Trusts with issues.

17 The Private Finance Unit's ability to further support Trusts to manage their contracts is, however, limited by a lack of performance and cost data. The Department cannot require Foundations to provide them with data on the performance of PFI projects, or to direct them to engage with the support it offers. Whilst it retains more control over other Trusts, it does not require them to provide any data on their PFI schemes. This means that:

- there is a lack of central data on the performance of the PFI portfolio. This restricts the Department's ability to assess value for money and to target its resources towards assisting Trusts most in need of help;
- although the Department spreads good practice amongst Trusts that engage with it, it does not systematically set out to assess, collate and define good practice; and
- the Department does not use its leverage over the market from having 76 contracts in force. With more information on Trusts' projects the Department could use this leverage to update contracts on common issues, or facilitate performance and efficiency improvements.

Conclusion on value for money

18 This report looks at the value for money achieved by hospital PFI contracts once they are operational. We found that most PFI hospital contracts are well managed. And the low level of deductions and high levels of satisfaction indicate they are currently achieving the value for money expected at the point the contracts were signed. However, as the cost and performance of hotel services are similar to those in non-PFI hospitals there is no evidence that including these services in a PFI contract is better or worse value for money than managing them separately.

19 There continues to be risks to the long-term value for money from these contracts. Managing the contracts is complex. The long-term service commitments of PFI contracts and the Trusts' approach to managing the contracts has limited Trusts' ability to make efficiency savings from certain areas of the contract, and to drive continuous service improvement. Investors and contractors will naturally seek to maximise their profit margins, and we have seen examples where this is at the expense of the Trust. Limitations in performance and cost data restrict the Department's support to Trusts and increase the risk of value for money being eroded over time.

Recommendations

20 The management of PFI contracts is challenging and Trusts need to take advantage of available support and help. Trusts are well placed to manage the contracts day-to-day, but require support when issues arise, and need to work together to maximise their chances of retaining the intended value for money. Trusts should:

a **Provide sufficient resources to manage their contracts.** We suggest at least one person works most of their time managing a contract, even on the smallest contracts, and larger teams on larger contracts. Without this investment, Trusts are likely to incur far greater costs and eroded value for money.

b **Engage with available support from the Department.** We do not believe that any Trust can fulfil its obligation to achieve value for money from its contract if it is not accessing good practice from the Department or taking advantage of information collated by the Department and shared from other Trusts managing PFI contracts.

21 The Department's delivery model creates challenges in providing appropriate support to Trusts whilst not interfering with local delivery and accountability. The Department needs to balance its cost of providing central support with the effective management of risk to the value for money achieved by Trusts. Trusts are capable of managing the contracts day-to-day but the Department's Private Finance Unit is best placed to provide them with support on complex issues and coordinate activities between Trusts. The Department should:

a **Market the services available to Trusts as a formal PFI support club.** The Department needs to ensure that it retains its expertise and makes that expertise available to all Trusts. It will need to make the support attractive to Trusts that have not traditionally engaged with its support. It should, however, make membership dependent on following the club rules, including the provision of benchmarking data.

b **Develop better benchmarking information on the PFI portfolio.** All Trusts are required to provide data on the costs and performance of their estates, using a system known as Eric. However, this information does not currently serve the needs of the Unit and Trusts with PFI projects. The Department should require contract and site specific data, and improve its quality of data collection, to ensure it caters to the needs of the PFI portfolio. This would allow the Department to provide more assurance on the current value for money of the portfolio; provide valuable benchmarking data to Trusts; and challenge and explain the variations in costs identified in this report.

c **Target its support at Trusts with poorly performing contracts or poor contract management.** Better performance data would allow the Department to be proactive in offering tailored support to Trusts most in need of it, including supporting Trusts in updating contracts to reflect changing needs.

d **Share information between Trusts on contractor performance and performance issues.** This would build on the current community of interest groups to share information. It would help Trusts use contractors' reputation risk as a lever to improve performance, and to identify common ways of addressing performance issues. The use of this information is to address contract management issues. It should not impede open and fair competition during procurement.

We believe that these recommendations will have a small cost to the centre and prevent far greater costs to Trusts. The initial investment in the information systems should then produce a better use of the Department's existing resources.

22 Trusts need to make efficiency savings from their PFI contracts without harming services to patients or reducing the upkeep of buildings in a way that ultimately increases whole life costs. Driving efficiency savings from PFI contracts would help to contribute to the current reductions in government spending. In order to introduce more effective ways of working that can drive efficiencies:

a **Trusts need transparency and clarity over contractors' costs and activities.** They should seek to obtain and use open book accounting arrangements. And Trusts should use better benchmarking information to understand cost drivers.

b **Trusts and contractors need to work together to seek more efficient ways of working.** Currently there is little incentive for Trusts to help contractors reduce their costs, because such savings are not shared. Trusts should seek gain share mechanisms and adopt partnering behaviours to help contractors deliver more efficient services.

c **The Department should monitor whether Trusts are getting the best possible terms from value testing exercises and support Trusts to use value testing to drive efficiencies.** Trusts should seek competitive pricing through value testing. Market testing introduces a competitive process to value testing. It also allows discussion with alternative providers about ways of making service delivery more efficient. If, however, benchmarking information is used then it should be used to guide discussions on what a competitive current price might be. The Department should monitor the steps taken by Trusts to get the best possible outcomes from value testing.

d **Future maintenance expenditure should be subject to review at intervals to allow Trusts and contractors to identify opportunities for gain sharing.** At present, there is no formal mechanism for assessing whether the initial prices which Trusts agreed to pay for maintenance remain value for money during contract periods which may be over 30 years. Contractors should receive a reasonable return for carrying out maintenance work. However, if contractors' maintenance plans and spend were open for review at least once every five years there may be opportunities for gain sharing if:

- it is now clear that initially prudent provisions for maintenance expenditure can be reduced for future years; or
- new techniques in maintenance provide an opportunity for reducing costs.

However, in making any changes in maintenance expenditure Trusts should ensure that the asset is maintained appropriately and that services are delivered at the contracted level. Short-term reductions in maintenance and refurbishment are unlikely to prove to be value for money over the life of the asset.

e **The Department should work with Treasury, who are responsible for PFI policy, to explore ways in which standard PFI contractual terms can be adapted to best encourage partnering and efficiency savings.** They should consider how to fit such changes into existing contracts as well as new contracts.