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PFI in Housing

Summary

Figure 1
Background on PFI housing

What is a PFI project?

Private Finance Initiative (PFI) projects in the housing sector are long-term contracts between local authorities and private consortia to deliver and maintain housing to a specified standard. The costs are paid by the local authorities to the private consortia through annual payments. Central government allocates funds to cover capital and finance costs whilst local authorities pay ongoing service costs from their own revenues. Local authorities can also contribute towards the capital costs of some projects and do so to varying degrees.

Types of PFI project in housing

There are two types of PFI housing project with different characteristics:

- The majority of funding has been allocated to projects which refurbish existing council housing or, since 2003, build new council housing.
- PFI also funds new non-council social rented housing which will ultimately be owned by housing associations (the most usual form of registered provider).

Key players

- The Treasury is responsible for overall PFI policy.
- The Department for Communities and Local Government is responsible for housing policy, governance and for allocating funding to projects.
- The Homes and Communities Agency is responsible for managing the PFI housing programme delivery.
- Local authorities are responsible for the procurement of PFI projects, contracting with the private sector, and for the local delivery of projects.
- Tenants are the main users of housing services and have a right to be consulted about some decisions about their homes.

Main alternatives to PFI

The Decent Homes Programme requires local authorities to ensure social housing reaches a defined standard. Where local authorities are unable to self-fund improvements there are three options available. Not all routes will be applicable to the particular circumstances of individual local authorities. The three investment options are:

- Transferring stock for a payment equivalent to the value of the stock to a housing association who funds refurbishment through private borrowing and its own resources. Where the stock has a negative value, this has only been possible where there has been gap-funding.
- Establishing an Arms Length Management Organisation to manage and improve stock using additional central funding. This has not been available where significant investment and estate remodelling is needed.
- Using PFI where central government funding is available covering extensive refurbishment and remodelling of existing stock. The PFI route allows for improvements beyond Decent Homes standards.

The main alternative to PFI for local authorities to building PFI non-council social rented housing is through the existing grant regime funded by the National Affordable Housing Programme.

The programme to date

Since 1998, the Department has allocated £4.3 billion to local authority PFI projects through six rounds in which local authorities bid for funding. There are 50 approved projects of which 25 are signed deals.

By April 2009, the programme had refurbished 12,343 homes through the Decent Homes Programme and purchased or built 991 further homes. The Department estimates that the first five rounds of the programme will deliver 28,000 homes, allowing it to tackle large-scale problems and areas of high investment need and provide high quality management and maintenance of homes.

Source: The Department for Communities and Local Government and the National Audit Office

1 The Private Finance Initiative (PFI) was introduced into housing in 1998 and has been a small but significant part of total investment in social housing. The Department for Communities and Local Government (the Department) was responsible for both housing policy and delivery for most of the period examined in this report, but as at December 2008, responsibility for delivery of the programme largely transferred to the new Homes and Communities Agency (the Agency).

Key findings

PFI has been a flexible and useful funding route that has delivered housing improvement

2 Housing delivery has been a government priority, and local authorities have used PFI as an alternative funding route when other options for either improving existing housing or building new stock were not practical or available. PFI has typically been used to regenerate areas with a high social housing need but where stock condition was particularly poor. These projects then benefit from the long-term maintenance which PFI delivers. We found that tenant satisfaction for housing management of a PFI project is similar to comparable housing and slightly higher for repairs and maintenance.

Evaluation of the value for money provided by PFI in housing at a programme level compared to other investment options has been limited

3 There are a number of routes available for local authorities to refurbish or build new housing, including PFI. Not all of these options will be available or appropriate to the particular circumstances of a local authority. Evaluating which route delivers better value for money is difficult as different funding options are designed for particular circumstances and needs. Owing to these difficulties and because the Department has only recently begun to ensure that relevant and appropriate data are collected in a consistent manner, the data-set is patchy. The Department has not routinely undertaken evaluation of its housing investment routes to help assess whether it is realising value for money and did not collect the data which would have allowed it to do so. Programme evaluation undertaken by the Department to date has been limited and largely qualitative in nature.

4 The Department should have done more comparative assessment of the value for money and risks to value for money of housing investment options at a programme level. Although not straightforward, it has not attempted to compare the value for money of the PFI option compared to other investment routes for refurbishing council housing, for example, stock transfers and Arms Length Management Organisations. For new build PFI it has conducted a useful exercise to benchmark the capital cost of projects, but this does not cover the totality of evaluation needed in terms of assessing the full costs, procurement times and benefits achieved for a project. The Department will examine in the 2010 Comprehensive Spending Review the value for money framework for PFI housing in addressing housing investment needs.

5 The Department has evaluated value for money at a project level, following Treasury guidelines and focusing attention where higher costs and funding issues are apparent. Initially, the Department relies on work done locally to assess investment options. The business case and value for money of a PFI project is then reviewed by the Department and the Treasury, with any material changes to value for money during procurement being scrutinised before the contract is signed. Local authorities have an ongoing role in ensuring competitive procurement of projects and their value for money. Individual projects also evaluate value for money using the Public Sector Comparator. This is a common approach in other sectors where PFI is the predominant form of investment, but should have been supported in the housing sector by looking at actual comparator projects where possible. The Department told us it is now undertaking this work.

6 The use and broad aims of PFI in the housing sector have evolved over time based on experience and judgement, largely using feedback from local authorities and providers about what worked well and what further developments are required. This has not, however, translated into clearly defined and prioritised objectives against which to measure success at programme level. There was also only limited formal evaluation of the different types of projects within the programme.

7 The initial decision to pursue PFI to deliver housing is taken locally reflecting the Department's view that within central investment criteria, local authorities should be able to determine their own funding and delivery approach. Local authorities told us that their investment need and the Department's funding structures, rather than a pure focus on value for money often drove their choice of PFI as an investment and procurement route. The Government's funding regime has prevented most local authorities from undertaking direct house-building until recently, except through PFI. Some local authorities reported that PFI was the only available route through which they could secure the funding needed for particular levels of investment and type of development.

Most projects have suffered significant cost increases and delays

8 The Department has funded PFI in a series of bidding rounds (**Figure 1** on page 4). During rounds one and two, PFI procurement was new to the housing sector and a particular complexity for local authorities, their advisers, the market, and the Department was achieving a robust cost for projects at the outset. It took some time for those involved to develop their understanding of stock condition issues, risks and risk pricing for PFI. This resulted in significant central funding increases between endorsement of business cases and finalisation of contracts, although there were no funding increases after contracts had been signed. Early projects were therefore not realistic in terms of expected costs and timetables. Twenty one of the 25 projects which have been signed to date have experienced cost increases above estimates in the business case, 12 of which were over 100 per cent. All signed projects, for which we have data, were delayed and were signed later than was expected when the business case was agreed. The delays range between five months, and five years and one month, the average being two years and six months. The Department took steps to check funding increases were valid, but we consider that across the programme these problems and delays put achievement of value for money at risk.

9 The limited evidence available allowing us to compare PFI to alternative forms of procurement means the Department cannot demonstrate that the programme has achieved value for money. While performance and costs vary between projects there was broad agreement from local authorities, providers and advisers, that PFI procurement can be excessively costly and generally takes too long relative to other routes. The Department's analysis of new build projects shows that the capital cost of PFI projects is similar to housing association developments. This analysis, however, does not take account of all project costs, for example, finance costs. While a straight comparison of the investment options for Decent Homes is difficult, the procurement times for PFI council housing of 34-75 months seen to date compare with an average period of 31 months to complete a stock transfer and 21 months to establish an Arms Length Management Organisation. Long procurement times can also increase procurement and tender costs for local authorities and bidders.

Early programme management was weak although improvements are now in place

10 The Department told us it had learnt lessons from early projects, developed guidance to improve cost estimates and procurement times, and set target procurement timescales for the latest round of projects. The evidence to say whether this is leading to faster procurement is mixed. The time taken to develop business cases has increased, reflecting the Department's aim to make business cases more robust before local authorities are allowed to undertake procurement.

11 The difficulties in the early funding rounds meant the PFI housing programme was slow to develop. Housing is one of the more complex PFI sectors as the challenges and risks posed by the range of building styles and involvement of tenants are different from those found in other PFI sectors. The Department, however, was slow to respond effectively to these challenges and the programme has not subsequently picked up procurement pace.

12 At the time of our audit, local authorities and private sector contractors expressed concerns about the Department's and the Agency's capacity and the level of expertise amongst programme administrative staff and about the transparency of the central management structures. The Agency has subsequently taken steps to increase its capacity and access to appropriate skills. This includes increasing the number of 'transactors' who are individuals with commercial expertise who help some projects through the development and procurement process. While there has also now been time for new management structures to embed, we note that there may be opportunities for the Department and the Agency to streamline working processes, for example, in assessing bids where review by both parties has been sequential rather than in parallel.

13 The programme could have developed more quickly if the Department had attached higher priority to effective management of the programme including timely updating of guidance and adequate resourcing. The Department has now introduced broader, updated guidance and standard documentation to support local authorities. More rigorous performance monitoring and a local authority support and intervention strategy have been introduced. The provision of effective support to local authorities by the Department, however, was put in place slower than it could have been.

Conclusion on value for money

14 The PFI model itself is not inherently poor value for money and success depends on the circumstances in which it is used and how it is applied. The Department has used PFI as a flexible and useful funding route to improve existing housing and build new stock. It has secured housing improvements and some wider benefits for communities. The Department, however, has not managed the risks to value for money effectively in terms of:

- **Delivery to time and budget.** A majority of projects have been affected by significant cost increases compared to business case estimates prior to contract signature and all have experienced delays compared to project targets.

- **Evaluation of whether PFI is the best value option.** Local authorities reported that their initial choice of PFI at a project level was influenced by the Department's funding structures and policy constraints rather than a focus on value for money. The Department has undertaken limited evaluation of whether PFI housing delivers value for money compared to alternative investment routes at a programme level.
- **Putting in place adequate programme management.** For early projects the Department's programme management was weak and under-resourced. This has been a contributory factor in the lengthy procurement timescales of projects seen to date and the slow pace of the programme.

15 The Department has introduced a series of improvements to the programme which it plans to build on. It is currently too early to tell whether these improvements will have an impact on delivery outcomes leading to better value for money in the future.

Recommendations

16 We make the following recommendations:

a The data-set for the programme is patchy. The Department should develop a framework for collecting and using data which will aid evaluation of the programme and help local authorities benchmark their projects. It should use the full range of data already available in the Departmental group and consider the value of collecting additional data. As a priority the Department should consider what additional data it needs to assess whether operational projects are realising intended wider benefits, for example, in terms of regeneration, beyond the delivery of contract specifications.

b The Department has done limited evaluation of PFI housing at a programme level. The Department should evaluate the programme to date, including a quantitative as well as a qualitative assessment of performance. As part of planned assessment of PFI housing through the 2010 Comprehensive Spending Review and in view of a period of restraint and efficiencies in public sector spending, the Department should consider PFI in the context of its other housing investment programmes, assess the different types of project used and ensure that value for money is a primary focus in terms of the selection of PFI as an investment option.

c Evidence to show that cost estimating and procurement times are improving is not yet conclusive. Building on the measures they have put in place to improve cost estimation and procurement times, the Department and the Agency should review, for projects after round three, whether these are proving effective and should consider whether there are further steps they can take to improve performance.

d The Department to date has largely focused its monitoring of value for money prior to contract signature. The Department should build upon existing project monitoring to ensure that formal arrangements are in place with the Agency and all other parties involved, with responsibilities clearly defined, for review of value for money including achievement of wider outcomes over the life of the contract.

e Central management structures are not always transparent to projects. The Department and Agency should establish a communication strategy for their interaction with projects to address any issues which local authorities find confusing. The centre, working together with projects, should develop a timetable for when key actions and decisions are needed on both sides and should keep this under review during procurement. The Department should also review management and reporting structures and its relationship with the Agency to ensure there are clear lines of authority and that the pace of the programme moves more quickly.

f There are benefits to the Department's lean resourcing model, but it has posed risks to effective delivery. Within the context of the efficiencies that need to be achieved in the public sector in the coming years, the Department and the Agency should continue to review the level and quality of resources needed to manage the programme effectively and establish adequate cover arrangements and succession planning. The Department should consider how it can manage its resources and workflow to maintain operational efficiency.