Lessons from PFI and other projects

Summary of the five PFI reports

APRIL 2011

Summary of the five PFI reports

Procurement of the M25 private finance contract

November 2010
www.nao.org.uk/publications/1011/m25_widening.aspx

Value for Money Conclusion

The Agency's aim was to relieve congestion and improve reliability through securing a private sector partner to widen the M25. It ran a generally effective and competitive procurement in pursuit of that aim and worked with Connect Plus to obtain financing at market rates during the difficult financing conditions in early 2009. Throughout, the Agency assessed the value for money of the project based on the available information relevant to its specified objective of widening the M25. We note, however, that delays in preparing and finalising the project exposed the project to risk for 18 months longer than expected with the result that it incurred higher financing costs in the credit crisis. This increased the net present cost of the deal by £660 million (24 per cent) to £3.4 billion.

In considering the Agency's approach, we looked at whether the Agency could reasonably have been expected to achieve a better outcome, in terms of the use of public funds, to secure increased capacity on the M25 at times of peak congestion. We believe that the Agency could have achieved a materially better value for money outcome by a more agile approach to procurement, recognising the potential cost saving implications of hard shoulder running and keeping the contracting approach open to allow its use. In addition, by driving the whole procurement process forward more promptly, we consider the Agency could, and would, have avoided the cost effects of the financial crisis.

The Department acknowledges that the procurement process did extend beyond its 2008 target for signature, which reflected time spent on finalising complex tender documents, on a limited rebid, and on the finance competition during the credit crisis. However, the Department does not accept that hard shoulder running is simply a lower cost solution, but is one that offers materially lower benefits for the reduced cost. Ministers deliberately chose to provide higher benefits and pay the higher costs given the M25's strategic importance.

Capital value of contracts at the time of our report

£1.1 billion

Financing PFI projects in the credit crisis and the Treasury's response

July 2010
www.nao.org.uk/publications/1011/pfi_in_the_credit_crisis.aspx

Value for Money Conclusion

We have assessed how the Treasury managed the risks to value for money, rather than examining individual projects. Departments' ability to finance the existing programme was in doubt until the Treasury set up The Infrastructure Finance Unit and reactivated the lending market. Our value for money conclusion relates to projects actually financed in 2009. However, we accompany that conclusion with a warning on value for money for subsequent projects.

On projects financed in 2009: It is our opinion that in the circumstances the extra finance costs of projects financed during 2009 were value for money. We take this view because the overarching policy priority to provide economic stimulus severely limited the scope for the Treasury to do more than they did to protect public value while ensuring that the programme of PFI projects was moved forward. In reaching this view we considered the fact that the financing margin being paid had widened significantly, and that banks renegotiated lending terms which resulted in an increased cost of risk for the public sector. We regard this as having been offset to some extent, and as far as was reasonably achievable in all the circumstances, by the increased refinancing gain share terms obtained by the Treasury.

We also considered whether the PFI deals could have been required to submit individual revised business cases, which might have led to some of the least advantageous projects being postponed or discontinued with the effect of improving overall value for money. We concluded that this requirement would have imposed further delay that might have put the policy objectives at risk, and would not therefore be a reasonable yardstick to assess the protection of value for money in the programme. However, having concluded thus positively on projects financed at the height of the crisis, we would expect more exacting criteria to be applied subsequently.

On projects which have yet to be fully developed: There should be no presumption, based on earlier business case analysis, that continuing the use of private finance at current rates will be value for money. We now expect a thorough project by project review of the forward programme to apply more exacting and narrower criteria than applied to projects financed at the height of the crisis. PFI is less likely to be value for money unless there are substantial and credible savings to offset higher financing costs. The Treasury's formation of Infrastructure UK gives a platform for wider consideration of risks, other funding options and alternative procurement models.

Capital value of contracts at the time of our report

£4.9 billion[1]

PFI in Housing

June 2010
www.nao.org.uk/publications/1011/pfi_in_housing.aspx

Value for Money Conclusion

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.

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.

Capital value of contracts at the time of our report

£4.3 billion[2]

The performance and management of hospital PFI contracts

June 2010
www.nao.org.uk/publications/1011/pfi_hospital_contracts.aspx

Value for Money Conclusion

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.

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.

Capital value of contracts at the time of our report

£6 billion[3]

Delivering multi-role tanker aircraft capability

March 2010
www.nao.org.uk/publications/0910/tanker_aircraft.aspx

Value for Money Conclusion

The Department managed the later stages of the procurement of FSTA[4] well, including making effective use of advisers and skilled Departmental staff in the latter stages of the negotiation, and transferring the risk to AirTanker for the introduction of the service. The Department did well to close the deal in difficult market conditions, particularly given the increasingly urgent operational need for the aircraft, and has done well to meet key operational tasks using the existing ageing aircraft.

In conducting the procurement, the Department followed Treasury rules but the test of value for money is not whether actions were taken within the rules but whether the outcome is the best use of public resources which could reasonably be expected. Against this benchmark we cannot conclude that the Department has achieved value for money from the procurement phase of FSTA. The Department's ability to get the best deal it could was undermined by the following:

- the selection of a PFI solution was made without a sound evaluation of alternative procurement routes to justify why the PFI route offered the best value for money;
- timescales more than doubled. After a five-year competition the Department was unable to close a deal and subsequently it took four years of non-competitive negotiation to agree an acceptable deal with AirTanker. Over this period the Department incurred additional costs both in conducting the procurement and running on the existing aircraft fleets;
- during the procurement the discount factor for assessing the Public Sector Comparator changed but the Treasury granted FSTA an exemption. If the revised rate had been applied the PFI solution would not have represented value for money against a Comparator using an A330 aircraft; and
- the lack of a mature fallback plan and the fact that any alternative would have required difficult decisions to find additional capital funding left decision-makers with limited alternatives to going ahead with the deal even when problems arose.

Looking ahead, if the Department is to maximise the value of the deal it has struck with AirTanker, it must develop, implement and maintain the management skills and working practices necessary to operate more commercially.

Capital value of contracts at the time of our report

£2.6 billion

Notes

1 Includes the M25 private finance contract.

2 Sum total of central government credits awarded by the Department over six rounds between 1998 and June 2010.

3 As at April 2009.

4 Future Strategic Tanker Aircraft.

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