National Audit Office

Report
by the Comptroller
and Auditor General

Cabinet Office, HM Treasury

Managing PFI assets and services as contracts end

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Report by the Comptroller and Auditor General

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This report provides information on managing PFI contracts as they come to an end and considers whether government is making appropriate preparations to manage the expiry of PFI contracts. Most PFI contracts expire from 2025 onwards, meaning there has so far only been a limited number of practical examples to learn from.

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Contents

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Key facts

72	£3.9bn	4 out of 9
number of private finance initiative (PFI) contracts ending over the next seven years in England (excluding devolved governments)	estimated capital value of PFI assets that will revert to public sector ownership at contract end over the next seven years in England (excluding devolved governments)	surveyed authorities, which took ownership of the PFI assets at expiry, were not satisfied with the asset's condition

>4 years	number of years between the start of expiry preparations and contract end for 57% of PFI contracts surveyed (survey respondents)
55%	percentage of survey respondents who recognise they need more knowledge on asset condition
60%	percentage of survey respondents who recognise they will need to recruit external consultants to help with contract expiry
328	number of authorities (signatories of the PFI contract) which are responsible for a PFI contract across the UK, with 182 authorities responsible for one contract only
82%	share of PFI contracts local bodies are responsible for (versus central government) out of all 700+ PFI contracts across the UK
18%	percentage of all 700+ PFI contracts across the UK that are the responsibility of the 10 public authorities with the most PFI
>50%	percentage of all 700+ PFI contracts across the UK that are owned by the 10 largest investors in PFI (by number of contracts)
>33%	percentage of survey respondents who consider that disputes near contract end are likely, with 86% of disputes expected to relate to the quantity of rectification work

Summary

Our report

1 Private finance initiative (PFI) contracts are a form of public private partnerships used in the UK since the 1990s. PFI is a way to finance and provide public sector infrastructure and capital equipment projects, such as roads, hospitals and schools. There are currently more than 700 operational PFI contracts in place in the UK with a capital value of £57 billion.[1] This study focuses on the 571 English PFI contracts, excluding those for which devolved governments are responsible.

2 The management of PFI contracts involves different organisations across central government and local bodies. The public authority (the authority) which entered into the original agreement is primarily responsible for managing the contract, including the expiry process. Government departments can be involved as the authority or as a sponsor (sponsor department) for a local body that signed the contract. The Infrastructure and Projects Authority (IPA) provides a support function to departments and authorities as the government's centre of expertise for infrastructure and major projects. It reports to the Cabinet Office and HM Treasury. HM Treasury is responsible for PFI policy and fiscal decisions and co-owns the PFI strategy with the IPA.

3 PFI projects involve a new private finance company – a special purpose vehicle (SPV) – being set up. The SPV finances, builds, maintains and operates the assets over the contract term, usually 25 to 30 years. During this term, the authority makes payments, known as a unitary charge, to the SPV which cover debt repayment, financing costs, maintenance and any other services provided. The SPV is obliged to deliver the contract and because the PFI model is designed to be self-monitoring, the SPV is also responsible for reviewing performance and reporting back to the authority.

4 In October 2018, government announced it would no longer use the PFI model. Existing PFI contracts remain in place and the earliest ones are now starting to expire. These earlier PFI contracts did not always benefit from standardisation which HM Treasury introduced in 1999. Most PFI contracts result in the assets being returned to the authority once the contract ends. One potential benefit of PFI is that the assets should be well maintained throughout the contract life and therefore be in a good condition when returned to the authority. The main risks to value for money is that the assets are not returned in a satisfactory condition and that the continuity of service associated with the assets, if required, is therefore not assured.

1 The £57 billion represents the nominal value.

Scope of our work

5 This report provides information on managing PFI contracts as they come to an end and considers whether government is making appropriate preparations to manage the expiry of PFI contracts. Most PFI contracts expire from 2025 onwards, meaning there has so far only been a limited number of practical examples to learn from. As a result, we surveyed 107 of the 571 English PFI contracts that have or will expire over the next seven years and received 75 responses. Of the 107 contracts surveyed, 89 PFI contracts were still operational at the time the survey was conducted, and 18 had expired. Our fieldwork was conducted before the outbreak of COVID-19, so we do not assess the potential impacts on the expiry of PFI contracts.

6 The purpose of this report is to draw out the challenges and best practice that can most benefit those managing PFI contracts coming to an end. Throughout the report we have identified illustrative examples from specific PFI contracts. Although not representative of the full survey population, they provide helpful prompts to draw the reader's attention to some of the potential risks authorities may face, enabling preventative steps to be considered. This report is not intended to conclude on the value for money of individual contracts.

7 The report structure is as follows:

- Part One sets out the background to PFI, the contracts which are due to expire, and the roles and responsibilities of key stakeholders;
- Part Two examines the skills and capabilities of authorities for the expiry process and aspects of day-to-day management of the contracts relevant for the preparation process;
- Part Three examines the preparation for and delivery of contract expiry; and
- the Appendices set out our methodology, list of the 10 largest PFI contracts expiring in the next 10 years and the National Audit Office's (NAO's) catalogue of past PFI reports. The results of our survey are published separately.

Key findings

8 **The public sector does not take a strategic or consistent approach to managing PFI contracts as they end and risks failing to secure value for money during the expiry negotiations with the private sector.** Across the UK, 328 authorities are responsible for PFI contracts, with 182 authorities responsible for only one contract. These authorities are at various levels across government, with local bodies, such as individual NHS trusts and local authorities, managing 82% of contracts. As such, they receive varying degrees of support from sponsor departments or supporting bodies, such as the IPA. Around 30% of survey respondents have told us that they would welcome more support and want the opportunity to learn from other authorities; government is starting to address this. In contrast, ownership among private investors is far more concentrated. The 10 largest private investors in PFI own more than 50% of the contracts, and the top six management companies are responsible for almost 45% of the contracts. This concentration allows the private sector to take a portfolio approach to expiry negotiations which risks putting the public sector at a disadvantage (paragraphs 1.8 to 1.17 and 2.6, Figure 3 and Figure 8).

9 **There is a risk of increased costs and service disruptions if authorities do not prepare for contract expiry adequately in advance.** At the end of the PFI contract authorities will have to decide whether services, such as maintenance and cleaning, are either provided in-house, by a new contractor or by the current provider. If authorities do not prepare properly there is a risk to service continuity or they may have no choice but to extend the contract. Where assets do not return to the public sector, authorities will still need to decide if they want to continue to use the assets. If so, they will need to negotiate with the PFI company or procure alternative assets. For example, at the end of an accommodation PFI contract the authority had to buy the homes it still needed, running into the tens of millions of pounds. Some PFI school contracts have more unique challenges – as some schools have been reclassified as academies, the future ownership of the assets and the responsibility for administering the PFI contract are not aligned. Authorities may not be incentivised to use their resources to manage the expiry process effectively knowing that they will not retain ownership of the assets. This creates a risk of service disruption and increased maintenance costs after expiry, if assets are returned below the contractually stipulated condition (paragraphs 3.8 to 3.14, Figure 6 and Figure 12).

10 **Some authorities have insufficient knowledge about the assets' condition, which risks them being returned to the public sector in a worse quality than expected.** Around 55% of respondents recognise they need more knowledge of the assets' condition. It is the SPV's responsibility to maintain the assets and report to the authority, but the authority needs to monitor asset condition. Authorities can gain this knowledge by proactively monitoring assets during the life of the contract, but this does not always happen – 30% of survey respondents are not monitoring annual maintenance spending and 50% do not maintain an asset register. Many PFI contracts, particularly those signed before 2000, contain contractual limitations over what data can be requested from the SPV, such as maintenance expenditure and the ongoing assets' condition. Around 35% of respondents stated they had insufficient access rights to monitor the maintenance programme adequately. There is also evidence that PFI investors and sub-contractors are not cooperating with authorities to provide information – 20% of survey respondents who had asked for information considered the contractor had been uncooperative, with data requests being ignored or denied on grounds of not being a contractual obligation. Not continually monitoring the assets' condition increases the risk of assets being returned below the contract's stipulated quality. Four out of nine survey respondents whose contracts have already expired were unsatisfied with the condition of the assets they took ownership of at expiry (paragraphs 2.7 to 2.19, 3.22, 3.23 and Figure 4 and Figure 10).

11 **Many authorities start preparing for contract expiry more than four years in advance but there is a risk this is not enough time.** Most authorities are confident they have started early enough, with 57% of survey respondents preparing more than four years before expiry. Experience from expired contracts, however, suggests that preparation time is often underestimated, and the process should be started as early as possible. Preparation times will vary across contracts depending on the complexity and the treatment of assets on expiry. The IPA's guidance recommends preparations start seven years in advance. Highways England, which is managing the expiry of multiple PFI road contracts, is preparing seven to eight years in advance of expiry (paragraphs 3.15 to 3.21, Figure 13, Figure 14 and Figure 15).

12 **Authorities recognise that contract expiry will be resource intensive and require unique skills, and expect to fill gaps with consultants.** During the life of a PFI contract, the priority for each authority is to ensure the assets are operational and running smoothly. In the final years of the contract, authorities will need to deliver the contract expiry process alongside day-to-day management, creating additional pressure on resources – about 30% of respondents anticipate not having enough staff. The skills required to deliver the expiry process, such as contract negotiations and asset management, differ from those needed to manage the day-to-day running of the contract. About 25% of respondents consider they lack the necessary in-house skills to deliver the expiry process and 60% are planning to hire consultants. The government's piecemeal approach to hiring consultants, such as legal experts, may not represent value for money in the long term. Authorities told us they would appreciate standardised procurement documents and processes to support them when hiring consultants (paragraphs 2.2 to 2.6 and Figure 9).

13 **A misalignment of investor and authority incentives at contract expiry creates a potential for disputes.** Authorities will want to ensure they receive an asset in the best condition possible as this will minimise future maintenance spend. Meanwhile, PFI providers have an incentive to limit expenditure on maintenance and rectification work in the final years of the contract as any savings can be used to pay out higher returns to investors. This will be more likely where the cost of completing rectification work is greater than any performance penalty for not doing this work. For 35% of respondents, the main method to compel SPVs to complete rectification work is by withholding a portion of the monthly unitary charge. If any contractual rectification work remains outstanding at contract expiry, there are limited options for recourse, increasing the need to resolve all disputes before contracts end. More than one-third of respondents expect to have formal disputes – 86% of anticipated disputes relate to the amount of rectification and 75% to the cost of this work. Disputes can be costly for authorities and a positive outcome is not necessarily guaranteed (paragraphs 3.22 to 3.32 and Figure 16).

14 **Early PFI contracts are likely to contain significant ambiguity around the roles and responsibilities of the parties at contract expiry.** Only one-third of respondents stated that contracts are clear about roles and obligations of different parties at expiry. Around one-quarter stated their contract does not contain any information on how and in what condition assets should be returned. Poorly drafted clauses are often open to interpretation, which has resulted in differing views between authorities and PFI providers, particularly around the quality and useful life of assets upon return to the public sector. Where issues do exist, some authorities are making improvements. For example, Highways England proactively engaged with SPVs to jointly interpret and clarify ambiguous clauses, thereby avoiding the potential for disputes and legal proceedings (paragraphs 3.2 to 3.7, 3.18, 3.19 and Figure 11).

Recommendations

15 Only a small number of PFI contracts have expired so far and the public sector's preparedness and understanding of the risks varies greatly between the many authorities responsible for these contracts. Our findings suggest there is a lack of a consistent approach across these authorities, with no strategic central support on managing the end of contracts. Authorities also risk underestimating the time, resourcing and complexity involved in the expiry process. Progress is being made and there is still time remaining to make changes that will benefit the bulk of the contracts expiring from 2025 onwards. Many of these issues may become less prevalent in the longer term as the later PFI contracts benefit from better defined and clearer contractual terms.

16 Early preparations, and a collaborative approach between public and private stakeholders, can help to ensure a successful exit from these contracts. This will require all parties seeking to understand each other's goals, establishing a partnership approach on each PFI project, and sharing experiences on how to manage contract expiry across all levels of government. Our specific recommendations are:

Sponsor departments should:

a Encourage authorities to:

- start preparing for contract expiry on a timely basis;
- ensure the PFI contract is complete and all expiry provisions are well understood;
- develop a contract expiry plan that identifies all the critical tasks and obstacles that may prevent a successful exit; and
- escalate problems which cannot be resolved at a local level to the sponsor department in a timely fashion.

b provide direct financial support to authorities where required, with particular focus on funding dispute resolutions and hiring additional resources.

IPA and sponsor departments should:

c proactively coordinate and develop a programme of support that can be made available to authorities. This should include:

- building internal resource and sector-specific expertise;
- developing a range of different tools that can be deployed depending on the nature of support required, including specialist advice and guidance documents; and
- developing contract expiry training.

d develop an approach to identifying high-risk projects, such as those sitting with authorities that lack appropriate skills and capabilities. The IPA and departments should work with public sector stakeholders to assess how skill shortages can be addressed; and

e assess the costs and benefits of developing an electronic repository of PFI contracts which supports authorities to manage their contracts and helps sponsor departments and IPA to identify high-risk projects and enable a more consistent approach across government.

IPA should:

f assess whether any areas of the contract expiry process would benefit from a more coordinated and centralised approach. This should include:

- assessing the value for money of developing a new centralised pool of internal resources, such as lawyers and surveyors, that authorities can use;
- publishing contract expiry guidance and other useful documents such as terms of reference templates for engaging with external consultants;
- developing a consistent approach to resolving legal disputes including guidance on how an authority should balance the costs and benefits of taking legal action; and
- developing an investor strategy which manages the relationship with private sector PFI stakeholders – equity investors, management service companies, contractors – across all PFI contracts. Such a strategy could also consider working with other government bodies, such as UK Government Investments, who may have interactions with similar private sector companies.

HM Treasury should:

g provide funding to departments which assist financially constrained authorities in formal disputes where it is value for money and practical to do so.

Part One

Background

1.1 This part provides a brief description of the private finance initiative (PFI) model, the contracts which are expiring, the roles and responsibilities of stakeholders and the support provided by the centre of government.

The PFI model

1.2 PFI is an infrastructure delivery model that aims to leverage the skills and resources of the private sector. Over the past 25 years, government used this model to finance, build, maintain and operate assets such as roads, schools and hospitals – there are currently more than 700 operational PFI contracts in place across the UK with a capital value of £57 billion.[2] We have reported on PFI contracts extensively in the past (Appendix Three) and recently described how the PFI model works in our January 2018 report *PFI and PF2*.[3]

1.3 In 2018, government withdrew the PFI model for all new investments while continuing to honour existing operational PFI contracts.[4] Existing PFI contracts remain in place and the public sector continues to pay for these, with ongoing commitments (unitary charges) to pay £168 billion over the next 30 years from 2020-21 onwards – an average of £5.6 billion a year.[5]

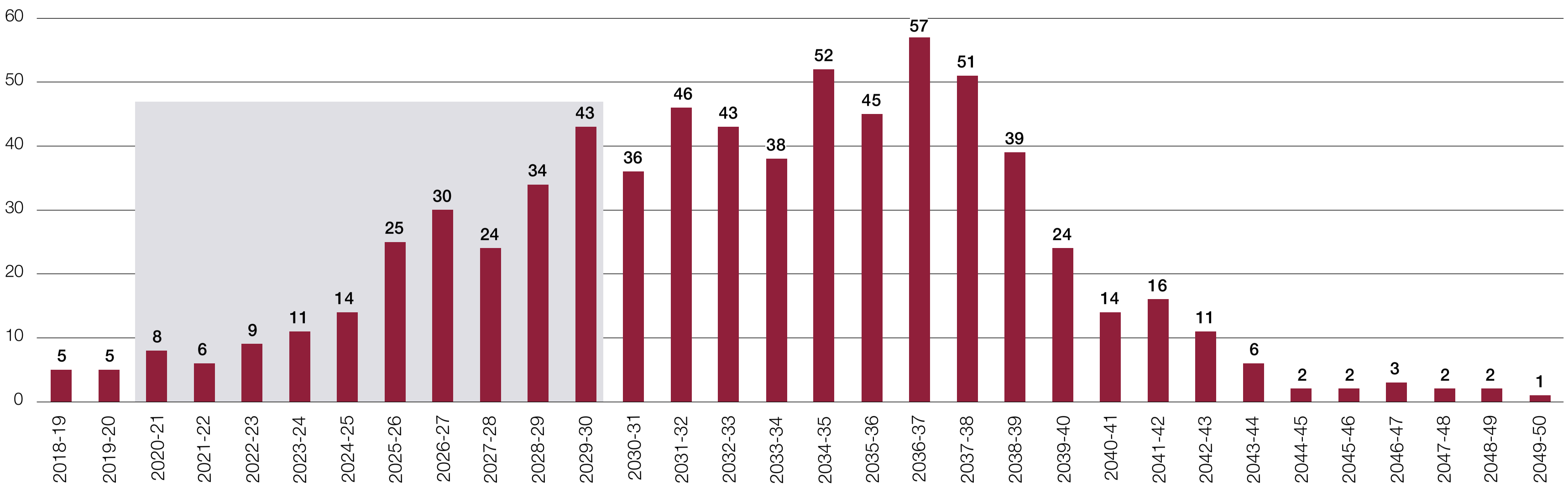
1.4 PFI contracts typically have a 25- to 30-year operational term and only a few have expired so far but this will increase significantly from 2024-25 onwards (**Figure 1**). In the five years to 2024-25 an average of 10 contracts will expiry annually. This increases to an average of 31 contracts in each of the five years between 2025-26 and 2029-30. We estimate that over the next 10 years 204 PFI contracts will expire, covering assets with a capital value £11.7 billion.[6] The 10 largest PFI contracts ending in the next 10 years are listed in Appendix Two.

2 Capital value figure is in nominal terms, representing operational PFI contracts as at 31 March 2018.
3 Comptroller and Auditor General, *PFI and PF2,* Session 2017–2019, HC 718, National Audit Office, January 2018.
4 HM Treasury, *Budget 2018*, HC 1629, October 2018, para 1.51, p.29. In December 2012, following a 12-month consultation process, HM Treasury launched Private Finance 2 (PF2) as the successor to PFI. This was in response to concerns that the PFI model was too costly, inflexible and opaque. Only six PF2 projects reached financial close before HM Treasury withdrew the model in *Budget 2018*. Despite the minor differences between PFI and PF2, we do not separate the two models throughout this report.
5 Figures are in nominal terms.
6 See footnote 5.

Figure 1

Timeline for private finance initiative (PFI) contracts that will expire by 2049-50

Over the next 10 years more than 200 PFI contracts will expire[1]



Notes

1 Data covers all PFI contracts across the UK. The shaded area represents the contracts ending over the next 10 years (204 contracts).

2 The above data are an estimate produced by the National Audit Office based on HM Treasury's 2018 PFI database and the year the final unitary charge payment is made.

Source: National Audit Office analysis of HM Treasury's 2018 PFI database

1.5 We have described the potential benefits of PFI in our report *'PFI and PF2'*. In summary, these are:

- certainty over construction costs;
- improved operational efficiency; and
- higher quality and well-maintained assets.

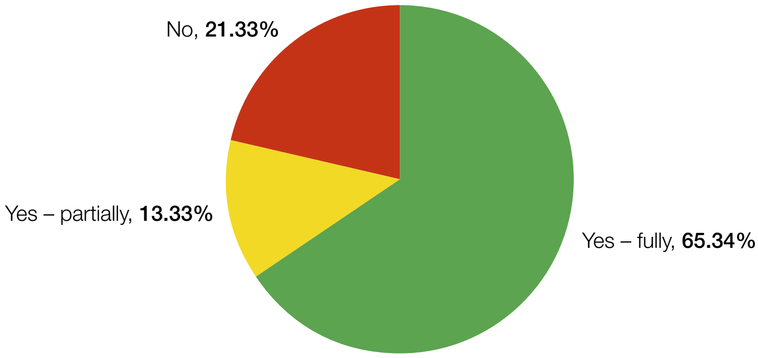
We previously reported there is a lack of data to demonstrate whether these benefits have been realised.[7] However, as PFI contracts expire, it provides an opportunity to examine whether the assets being returned to public sector ownership are higher quality and better maintained than public sector equivalents.

1.6 At the end of a PFI contract, the assets typically return to the public sector. In our survey, 79% of respondents indicated that the assets will either fully or partially return to the public sector upon expiry (**Figure 2**).[8] In the next seven years, reverting assets represent a capital value of £3.9 billion.[9]

Figure 2

Survey results showing the percentage breakdown of asset ownership on expiry of private finance initiative (PFI) contracts

In 79% of contracts surveyed, the assets did or will either fully or partially revert to public sector ownership[1]



Note

1 Survey results relate to question 4: On contract expiry, did or will the asset(s) (school, hospital, road, etc) transfer to the authority? Number of responses: Yes – 49, Partially – 10 and No – 16.

Source: National Audit Office private finance initiative expiry survey

7 See footnote 3.
8 Question 4: On contract expiry, did or will the asset(s) (school, hospital, road, etc) transfer to the authority? Number of responses: Yes – 49, Partially – 10, No – 16, 59/75 = 78.67%.
9 Figure is in nominal terms.

Stakeholders

1.7 There are many stakeholders involved with PFI contracts across both the public and private sectors.

Public sector stakeholders

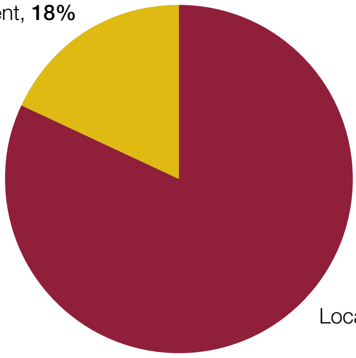
1.8 Public sector stakeholders are spread across different levels of government, from central government departments to local bodies such as local authorities or NHS trusts. The key types of parties involved are:

- **Authority:** This is the public sector organisation which has entered into the original PFI contract. It is responsible for managing the contract throughout the contractual term, including the expiry process. The authority can be a central government department or a local body such as a local authority or NHS trust. We estimate that 82% of all PFI contracts are managed at a local level (**Figure 3** overleaf).
- **Sponsor departments:** When initially set up, each PFI contract had a central government sponsor department which supported the contracting authority. Ongoing engagement by departments with authorities varies depending on the number, type, and complexity of the contracts. In general, departments will provide an advisory role to authorities. Figure 8 on pages 22 to 24 summarises the type of support activities provided by the main departments.
- **Supporting public bodies:** There are multiple public bodies that play a supporting role in managing PFI contracts, the main ones being the Infrastructure and Projects Authority (IPA) and Local Partnerships:
  - The IPA is central government's centre of expertise for infrastructure and major projects, and it reports to the Cabinet Office and HM Treasury. It provides advice and support to departments and local authorities and is responsible for PFI operational matters such as commercial and delivery. The IPA also maintains a publicly available database of all the operational PFI contracts.
  - Local Partnerships is a joint venture between HM Treasury, the Local Government Association and the Welsh Government which provides commercial support and delivery expertise to the public sector. Local Partnerships has a dedicated team of PFI specialists who provide support to contracts across the full range of financial, technical and legal specialisms.
- **HM Treasury:** This is the central government department responsible for PFI policy and fiscal decisions. The strategy on PFI is co-owned alongside the IPA.

Figure 3

Percentage breakdown of private finance initiative (PFI) contracts managed by central government and local bodies

Eighty-two per cent of PFI contracts are managed by local bodies



Notes

1 Local bodies include NHS Trusts, NHS Foundation Trusts and local authorities.

2 Data covers all UK PFI projects as at 31 March 2018.

Source: National Audit Office analysis of HM Treasury's 2018 PFI database

Private sector stakeholders

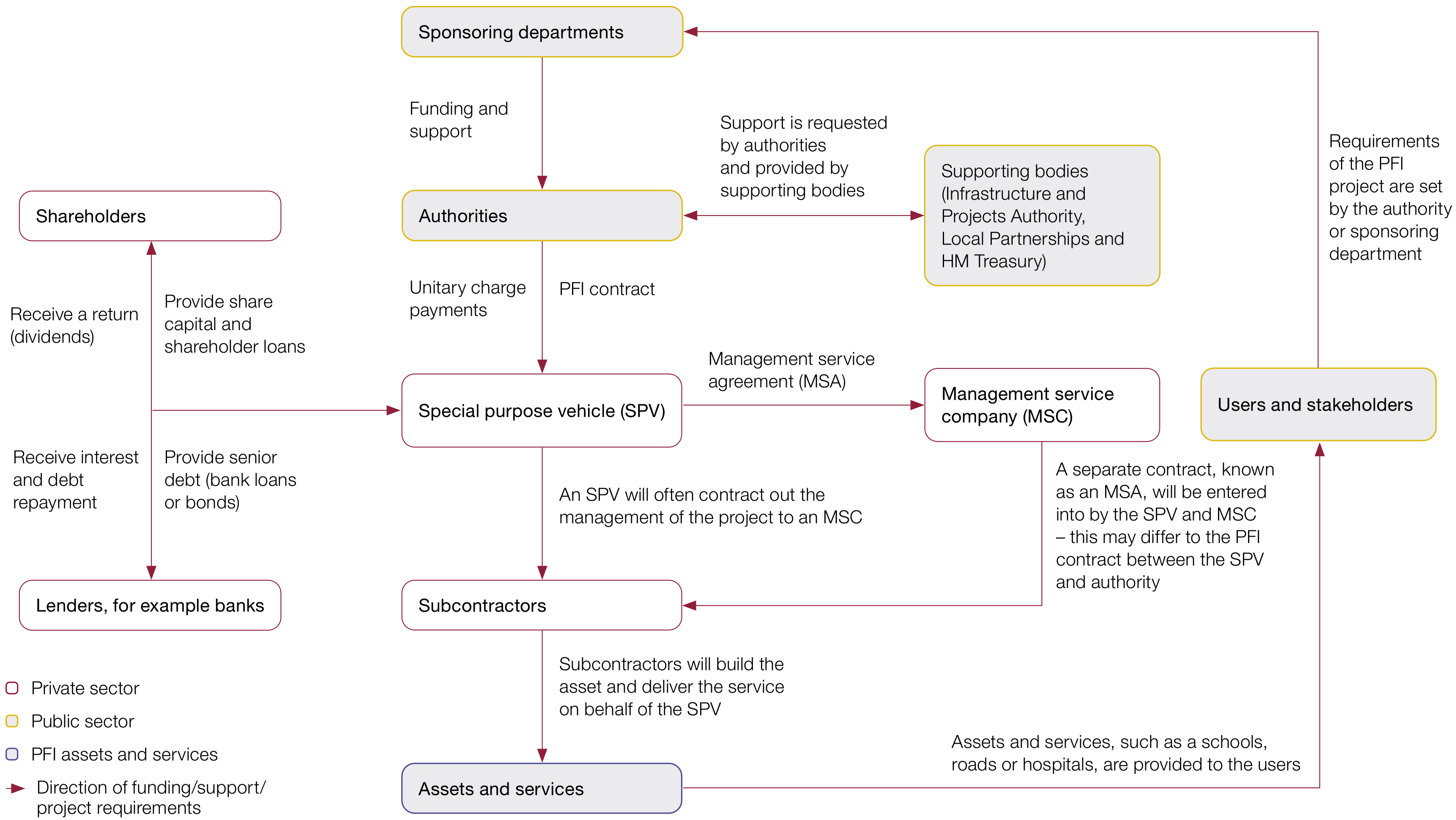
1.9 The key private sector parties involved in PFI contracts (**Figure 4**) are:

- **Special purpose vehicle (SPV):** The authority contracts a private company, sometimes called an SPV, to finance, build and deliver the services and take responsibility for performing systematic monitoring of the assets and reporting back to the authority.
- **Management service company (MSC):** SPVs will often use an MSC to manage the day-to-day activities on its behalf. A separate contract between the SPV and MSC, known as a management service agreement, will be put in place.
- **Shareholders:** Investors in the SPV provide financing in the form of share capital or loans.
- **Lenders:** Banks or bond holders will typically provide the majority of the project financing.
- **Subcontractors:** Contracts for the provision of services such as facilities management (cleaning and catering) can be awarded to smaller, specialised companies.

Figure 4

Illustration of the key stakeholders in a typical private finance initiative (PFI) project

Every PFI contract involves a multitude of public and private parties



Notes

1 See paragraphs 1.8 and 1.9 for definitions of the parties.

2 This illustration is a simplification and the parties involved may vary depending on the contract.

Source: National Audit Office analysis

The landscape of PFI

1.10 Almost all government departments are involved in PFI contracts, either as an authority or as a sponsor department. The departments with the highest number of PFI contracts are the Department for Education (DfE) and the Department of Health & Social Care (DHSC) with 173 and 128 respectively (**Figure 5**). Over the next seven years,[10] we estimate that the following six departments are involved, either as authorities or sponsor departments, in 88% of the 72 PFI contracts that are due to expire: Ministry of Defence (16 contracts), DfE (13), Department for Transport (11), Ministry of Justice (10), Home Office (8) and DHSC (5).[11]

1.11 The PFI model has been used to deliver many different types of assets, ranging from military equipment to roads and street lighting. Over the next 30 years, the majority of PFI contracts that are due to expire can be classified as 'accommodation'-type projects, such as schools, hospitals and office buildings (**Figure 6** on page 20). There are variations between contracts for different asset types and variations within the same asset type – this is because no two PFI projects are the same.

1.12 Since the adoption of the PFI model in the early 1990s, contracts have gradually evolved as government developed a greater understanding of the typical risks. Since 1999, HM Treasury has published guidance known as *Standardisation of PFI Contracts* (SoPC) to address these challenges. It published the first guidance in 1999, and there have been multiple iterations since then. Within the PFI contracts surveyed, around 45% are pre-SoPC (**Figure 7** on page 21) and therefore contain a higher risk of ambiguity in their contracts, potentially leading to disputes (see Part Two).

Central government support

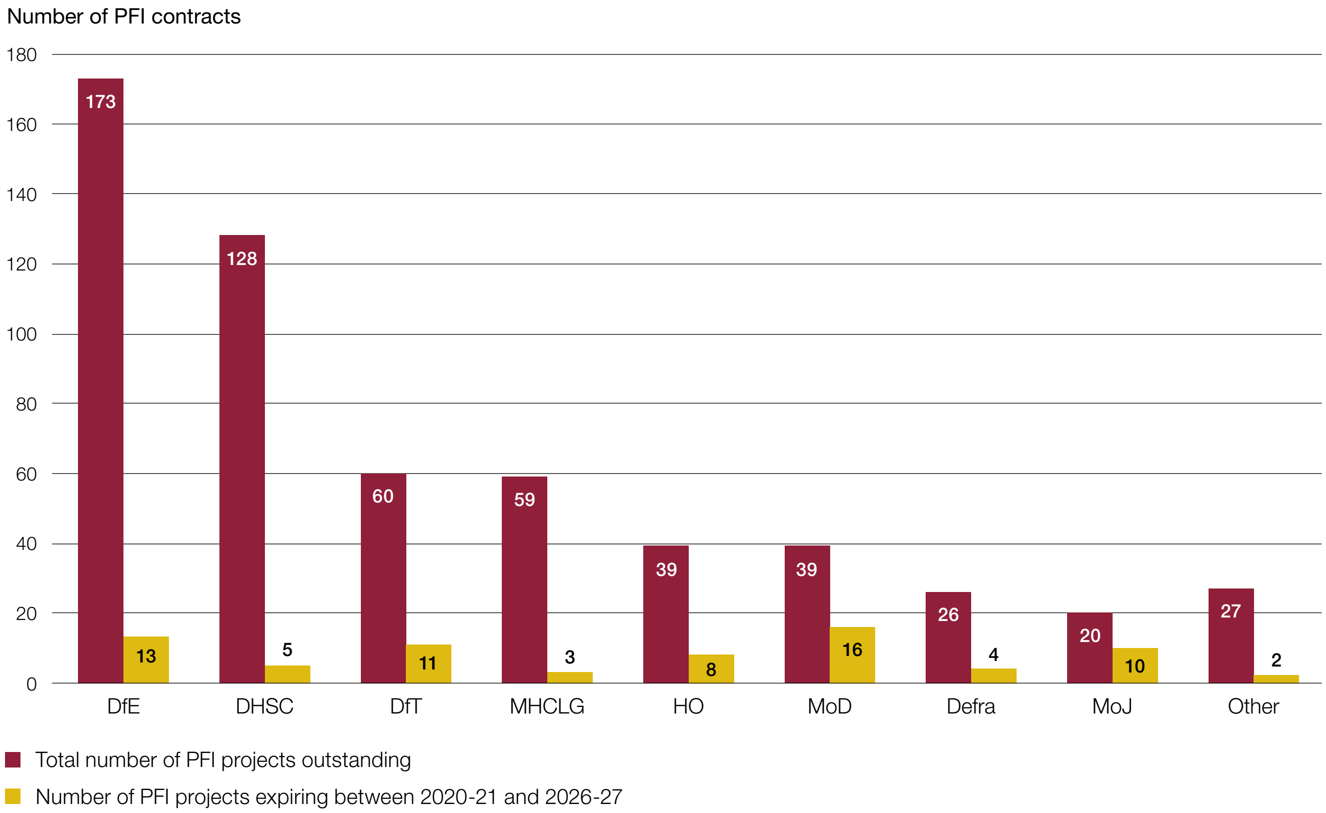
1.13 The high level of devolved responsibility for the projects, the varied nature of projects and high level of pre-standardisation of contracts makes it challenging for government to take a standardised approach to managing the early expiry of PFI contracts. Poor management of contract expiry can lead to assets being returned to the authority in a worse condition than stipulated in the contract. This could lead to additional funding requirements in order to pay for repairs and maintenance that the SPV should have carried out.

10 The total number of PFI contracts expiring in the next seven years covers the period 2020-21 to 2026-27.
11 Data represents the position as at 31 March 2018 in HM Treasury's 2018 PFI database. Between 31 March 2018 and the time of publication, a small number of PFI contracts have been terminated or expired. Data are NAO estimates based on the year of the final unitary charge payment.

Figure 5

Estimate of the total number of private finance initiative (PFI) contracts outstanding by department

The Department for Education and the Department of Health & Social Care sponsor the most PFI contracts across government



Notes

1 Total number of PFI projects excluding contracts in Scotland, Wales and Northern Ireland.

2 Total number of PFI projects is in line with HM Treasury's 2018 PFI database. Between 31 March 2018 and the time of publication, a small number of PFI contracts have expired. The total number of PFI contracts expiring between 2020-21 and 2026-27 differs to the number of contracts in our survey which includes projects expiring in the next seven years, plus those that have already expired.

3 Data covers departments that are responsible for PFI projects either as an authority or sponsor department.

4 Data are NAO estimates based on the year of the final unitary charge payment.

5 DfE = Department for Education; DHSC = Department of Health & Social Care; DfT = Department for Transport; MHCLG = Ministry of Housing, Communities & Local Government; HO = Home Office; MoD = Ministry of Defence; Defra = Department for Environment, Food & Rural Affairs; and MoJ = Ministry of Justice.

6 The 'other' category includes the following departments: Department for Digital, Culture, Media & Sport, HM Revenue & Customs, Department for Work & Pensions, Security and Intelligence Agencies, HM Treasury, Department for Business, Energy & Industrial Strategy, Foreign & Commonwealth Office and the Cabinet Office.

Source: National Audit Office analysis of HM Treasury's 2018 PFI database

Figure 6

Breakdown of all private finance initiative (PFI) projects and those included in our survey sample, by project type

Accommodation-type projects represent the majority of PFI assets across the total population and within our survey sample, with 81% and 65% respectively

Project type	Total number of PFI projects		Number of PFI projects in National Audit Office survey	
		(%)		(%)
Accommodation[1]	463	81	70	65
Waste	31	5	8	8
Defence[2]	16	3	12	11
Roads	23	4	9	8
Other[3]	38	7	8	8
Total	**571**	**100**	**107**	**100**

Notes

1 ‘Accommodation’ includes projects such as hospitals, schools, offices and military facilities, and much of this is generally known as ‘social infrastructure’.

2 Ministry of Defence PFI contracts are split between the ‘defence’, ‘accommodation’ and ‘waste’ categories.

3 ‘Other’ includes projects such as street lighting, rail, vehicles and emergency services.

4 Data excludes PFI contracts entered into by the devolved governments of Scotland, Wales and Northern Ireland.

5 Data represents the position as at 31 March 2018 in HM Treasury’s 2018 PFI database.

6 Some numbers may differ due to rounding.

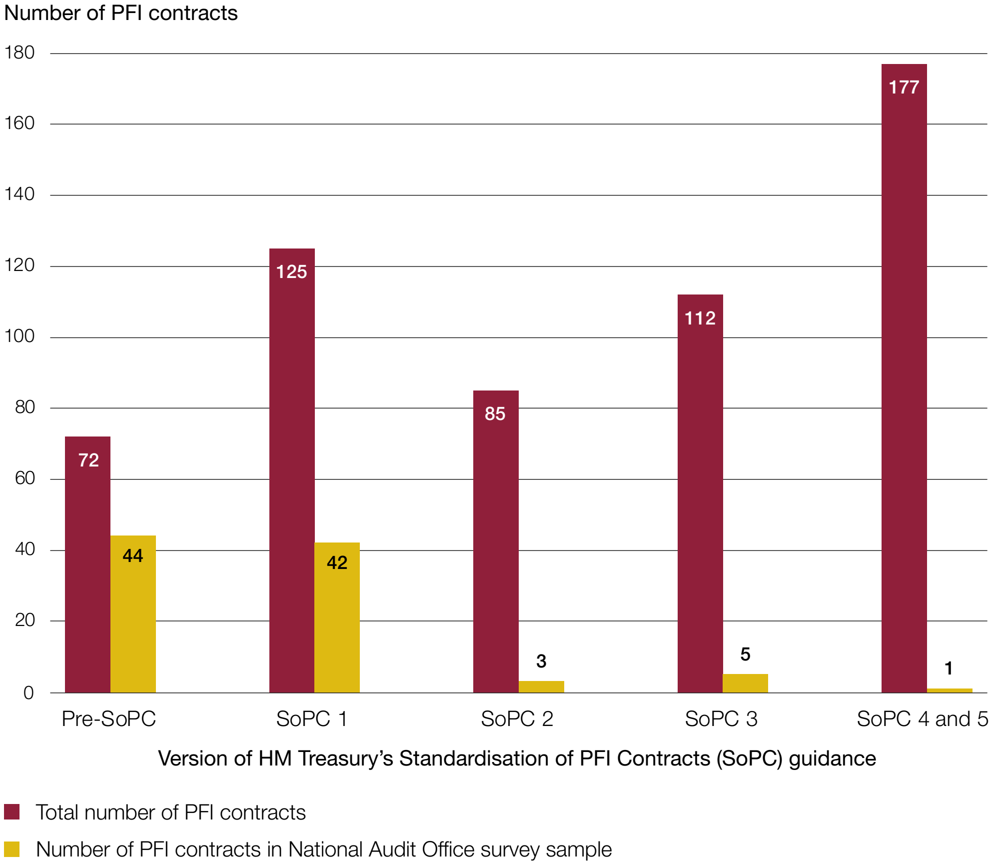
Source: National Audit Office analysis of HM Treasury’s 2018 PFI database

1.14 Those departments with the most contracts, either as authorities or sponsor departments, are starting to prepare for the PFI expiry process but the extent of these preparations varies significantly. These departments tend to be reactive to demands by authorities rather than proactively seeking out those PFI projects or authorities most at risk (**Figure 8** on pages 22 to 24).

Figure 7

Estimated breakdown of private finance initiative (PFI) projects, overall and in the survey sample, by the version of standardised contract guidance used

Around 45% of contracts in our survey were procured before standardised contract guidance was introduced by HM Treasury and therefore contain a higher risk of ambiguity



Notes

1 Data excludes PFI contracts entered into by the devolved governments of Scotland, Wales and Northern Ireland.

2 Authorities procuring a PFI contract would have used guidance known as the Standardisation of PFI Contracts (SoPC). This guidance was first published in 1999. There have been multiple iterations of this document including SoPC 1 (1999), SoPC 2 (2002), SoPC 3 (2004), SoPC 4 (2007) and SoPC 5 (2012). The PFI model was first used in the early 1990s meaning the early PFI contracts were produced without any standardised guidance. SoPC 5 relates to PF2 projects – only six projects were procured under this model. SoPC 3.5 has been combined with SoPC 3.

3 There is no data on the type of SoPC used for each contract. The above data are estimates based on the publication date of each version of the SoPC and the date the PFI contracts were entered into, also known as financial close.

4 Around 45% is based on 44 Pre-SoPC contracts out of 95 PFI contracts in our survey which have not expired at the time of the study (44/95=46.3%). The survey covers 107 PFI contracts; however, HM Treasury's 2018 PFI database contains insufficient data to produce an estimate for 12 expired contracts. These 12 contracts are excluded from the data above.

Source: National Audit Office analysis of HM Treasury's 2018 PFI database

Figure 8

Summary of private finance initiative (PFI) projects and expiry preparations by department

There is significant variation across departments for the PFI expiry process, both in terms of approach and preparedness

Department	Number of operational PFI projects	Capital value of PFI projects (£m)	Total number of PFI projects managed by local bodies[1]	Total number of pre-standardised PFI contracts[2]	Summary of departmental PFI contract expiry preparations
Department for Education (DfE)	173	8,525	168	6	DfE sponsors the largest number of PFI contracts and most are managed at a local level. Most contracts expire in the 2030s. DfE's 'Private Finance' team provides assistance to authorities as part of its wider duties. It is planning to add more PFI specialists to the team to strengthen its skills and capacity. Owing to the number of PFI contracts managed at a local level, DfE aims to provide strategic advice and guidance rather than providing direct support. For a minority of earlier projects, DfE plans to take a more hands-on approach to gain a greater understanding of the challenges, with the intention of transferring knowledge to each authority in the form of guidance materials as the number of expired contracts increases.
Department of Health & Social Care (DHSC)	128	12,886	128	20	DHSC sponsors the second largest number of PFI contracts and all are managed at a local level. The majority of PFI contracts expire after 2030. DHSC sets the policy framework for the use of PFI projects across the health sector, has a Centre of Best Practice on PFI and supports authorities on a thematic basis. The Centre of Best Practice focuses on developing the contract management skills of authorities and will increase its focus on contract expiry as more contracts approach expiry. DHSC take the view that if a PFI contract is managed effectively during the full term, then the NHS trusts will be in a better position to think about and prepare for contract expiry.
Department for Transport (DfT)	60	7,534	42	13	DfT sponsors a large number of PFI contracts, with most managed at a local level. The majority of contracts expire from 2025-26 onwards. DfT's Corporate Finance team provides assistance to authorities as part of its wider duties. PFI expertise is spread out across DfT and can be drawn upon when required. It holds an annual networking event which is open to all authorities with a transport PFI project. DfT coordinates with Highways England, which has a dedicated PFI team, and participates in its six-monthly forums to discuss key projects. DfT has limited oversight of Transport for London PFI projects but holds regular conversations.

Figure 8 *continued*

Summary of private finance initiative (PFI) projects and expiry preparations by department

Department	Number of operational PFI projects	Capital value of PFI projects (£m)	Total number of PFI projects managed by local bodies[1]	Total number of pre-standardised PFI contracts[2]	Summary of departmental PFI contract expiry preparations
Ministry of Housing, Communities & Local Government (MHCLG)	59	2,398	59	2	MHCLG sponsors a large number of PFI contracts, which are all managed at a local level. The majority of PFI contracts expire after 2030. MHCLG's central finance teams, supported by its Housing and Local Government Finance directorate, are responsible for dealing with PFI contracts and work alongside Homes England. MHCLG established a new commercial team, which it expects to support the PFI expiry process in the future. MHCLG provides support on a request basis rather than proactively and participates in regular networking meetings.
Ministry of Defence (MoD)	39	9,242	0	14	MoD is directly responsible for its PFI contracts and these have no local body involvement. Responsibility for PFI contracts is spread out across different parts of MoD such as the Defence Infrastructure Organisation and Defence Equipment & Support. A Defence Finance Unit (DFU) was set up in July 2019 with resource provided by UK Government Investments (UKGI) Defence team. The purpose of the DFU is to act as a centre for best practice for private finance within MoD and PFI expiry is part of its remit. It has undertaken a number of actions to assist in the preparations for PFI expiry, such as: • undertaking a review of all projects due to expire before March 2028 to assess the level of risk; • identifying key lessons learned from current expiry processes; and • developing a database of all contracts and financial models.
Home Office (HO)	39	2,869	37	3	Most of the HO's PFI contracts expire in the next nine years. The HO has established a PFI expiry group to allow for the sharing of knowledge and best practice. It has provided additional funding in the form of capital bidding programmes to authorities to initiate a contract variation in the past and may do so again in the future.

Figure 8 *continued*

Summary of private finance initiative (PFI) projects and expiry preparations by department

Department	Number of operational PFI projects	Capital value of PFI projects (£m)	Total number of PFI projects managed by local bodies[1]	Total number of pre-standardised PFI contracts[2]	Summary of departmental PFI contract expiry preparations
Department for Environment, Food & Rural Affairs (Defra)	26	2,797	25	3	Defra's first PFI contract will end in 2024 with the remainder expiring between 2027 and 2041. Defra provides support to authorities with up to 18 days per year of assistance from Local Partnerships' PFI professionals.[3] This is funded by a grant agreement with Local Partnerships.
Ministry of Justice (MoJ)	20	863	5	8	MoJ is directly responsible for most of its expiring PFI contracts, the majority of which are due to expire before 2030-31. Responsibility for PFI contracts is spread across different parts of MoJ such as Her Majesty's Prison and Probation Service (HMPPS), Her Majesty's Courts and Tribunals Service (HMCTS) and MoJ's commercial team. A dedicated MoJ project team is in place to manage the expiry of the first three PFI prison contracts. HMCTS does not have a dedicated PFI team but is in the process of setting up a court PFI exit team. MoJ's commercial team works closely with both HMCTS and HMPPS to provide oversight, monitor PFI contracts and support with contract variations and disputes.

Notes

1 Local bodies may own more than one PFI contract.

2 HM Treasury first introduced standardised PFI contract guidance in 1999. There have been four iterations of this guidance.

3 Local Partnerships is a joint venture between HM Treasury, the Local Government Association, and the Welsh Government which provides commercial support and delivery expertise to the public sector. Local Partnerships has a dedicated team of PFI/PPP specialists who provide support to contracts across the full range of financial, technical and legal specialisms.

4 Only departments with 20 or more PFI contracts, for which they are responsible as either an authority or sponsor department, are included in this analysis.

5 Data on contract number or value represents the position as at 31 March 2018 in HM Treasury's 2018 PFI database. Between 31 March 2018 and the time of publication, a small number of PFI contracts have expired.

Source: National Audit Office analysis of HM Treasury's 2018 PFI database and interviews with departments

1.15 In summer 2019, the IPA began to develop a programme to "support the delivery of value for money as PFI contracts end". Funding for this programme was secured through the Budget 2020. The IPA has told us that the programme will look at: improving the performance, efficiency and management of a sample of PFI contracts; and focus on building contract management capability through guidance, tools and training, knowledge sharing and networking. It told us that it will work closely with the government functions,[12] sponsor departments and authorities. The IPA also intends to continue its market engagement with private sector stakeholders involved in PFI contracts. The IPA is at the beginning of this programme and it is too early to assess its success.

1.16 Currently, government is not taking a strategic approach to managing the expiry of PFI contracts on a holistic basis. The responsibility for managing these contracts is fragmented across various levels of government with no central oversight. There are 328 different authorities responsible for the 700+ outstanding PFI contracts across the UK, with 182 authorities responsible for only one contract. The 10 authorities with the most PFI contracts represent 18% of the total number of projects. In contrast, the 10 largest private investors in PFI own more than 50% of the PFI contracts, and the top six management companies are responsible for almost 45% of all contracts.[13]

1.17 These investors are also involved in PFI contracts across multiple sectors. For example, the largest investor is involved in PFI contracts across seven sectors, ranging from hospitals to waste management facilities. By not taking a strategic approach there is a risk that the public sector is not achieving consistent outcomes to expiry negotiations involving the same investors. For example, if PFI contracts for a school and a hospital involve the same investor, and they are both expiring over a similar timeframe, holding expiry discussions in isolation may weaken the public sector's overall negotiation position.

12 These are areas of expertise that provide professional support and services to departments, for example commercial, legal, or project delivery.

13 The IPA's analysis of private investors and management companies.

Part Two

Skills, capability and business as usual

2.1 This part examines what public authorities (authorities) need to have in place to manage the expiry of the contract, such as skills and capabilities, as well as the importance of maintaining business as usual.

Skills and capabilities

2.2 As private finance initiative (PFI) projects come to an end, authorities will need to manage the contract expiry process alongside its daily operations, which can put pressure on resources – 30% of respondents in our survey anticipate not having enough staff to manage the expiry process.[14] The priority for each authority is to ensure that public assets such as roads and hospitals are fully operational and available for day-to-day use. When resources are scarce, there is a risk that less priority is given to expiry preparations, with this being a greater risk for smaller authorities than for those departments which are directly managing a PFI contract. For example, HM Revenue & Customs directly manages four PFI contracts and established a dedicated expiry team, together with an operational management team. In contrast, we have identified examples at a local authority level where multiple PFI contracts are being managed by only one individual with limited additional support.

2.3 In 2018, the Department for Work & Pensions (DWP) exited a 20-year PFI contract known as PRIME (Private Sector Resource Initiative for Management of the Estate). Under this contract, DWP outsourced the management of its entire estate – more than 1,000 properties – to a private sector provider. Owing to the complexity of this contract, DWP had to significantly increase its expertise and capability. The team responsible for delivering the exit increased to 135 civil servants and contractors. This took time, and only after recruiting personnel with the required skillset was DWP able to properly assess its approach to the expiry negotiations.

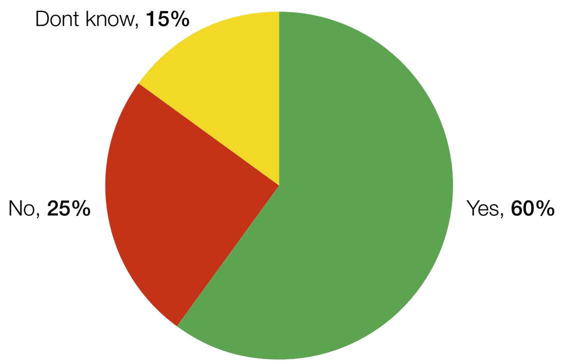
14 Question 18: Did or does the authority expect to have enough staff to manage contract expiry and, if applicable, the transition to new arrangements? Number of responses: Yes – 53, No – 22, 22/75 = 29.34%.

2.4 The long-term nature of a PFI contract means it is likely that the people responsible for the contract within the authority will change over time. It is therefore important that authorities have robust records management procedures and staff handover processes to ensure knowledge of the contract is not lost. The PFI expiry process also requires a different set of skills, such as contract negotiations and asset management, compared to managing day-to-day operations. About 25% of respondents consider they lack the necessary in-house skills to deliver the expiry process and 60% of respondents are planning to hire consultants (**Figure 9**).[15,16] Our survey highlights that external consultants are required primarily to address three skill shortages: legal expertise to draft new or amend existing contracts, technical skills to assess asset conditions and validate dilapidation surveys, and financial expertise.

Figure 9

Percentage breakdown of survey respondents that require external consultants to deliver the expiry process

Sixty per cent of respondents have hired or expect to hire external consultants to fill internal skill gaps



Note

1 The survey results to question 21: did the authority use or expect to use, external advisers (for example, project management consultants) to help deliver contract expiry and the transition to new arrangements? Yes – 45, No – 19, Don't know – 11.

Source: National Audit Office private finance initiative expiry survey

15 Question 19: Did or does the authority have staff with the appropriate skills to deliver contract expiry and the transition to new arrangements? Number of responses: Yes – 47, No – 18, Don't know – 10, 18/75 = 24%.

16 Question 21: Did the authority use or expect to use, external advisers (for example. project management consultants) to help deliver contract expiry and the transition to new arrangements? Number of responses: Yes – 45, No – 19, Don't know – 11, 45/75 = 60%.

2.5 Addressing the lack of in-house skills, either through external consultants or by building up internal expertise, represents an additional cost to authorities. Authorities need to make a judgement about the costs and benefits of building internal expertise versus hiring consultants. There are currently no standard terms of reference to help authorities hire consultants. In addition, there is only a limited pool of technical experts, such as commercial specialists or lawyers, across central government that could support those authorities experiencing skill shortages. It is unlikely that the current piecemeal approach, whereby experts are hired directly by authorities on a case-by-case basis, will represent value for money as the volume of expiring contracts increases.

2.6 The level of central support being provided, and the amount that is considered appropriate, varies across authorities. Around 50% of respondents indicated that no support is being provided from the centre of government,[17] with around 30% stating that more support would be helpful.[18] Respondents identified contract expiry guidance and support with procuring consultants as helpful resources. Some departments, such as the Department for Education, told us they plan to develop sector-specific guidance. Many respondents also expressed a desire for contract expiry training as well as greater sharing of lessons learned supported by case study examples of previously expired contracts.

Maintaining business as usual

2.7 One of the underlying principles of the PFI model is that it is designed to be self-monitoring, whereby the special purpose vehicle (SPV) is responsible for reviewing performance and reporting back to the authority. However, this does not preclude authorities from monitoring PFI projects to ensure the SPV is meeting the contractual obligations. Effective management of the contract throughout the term can reduce the risk of problems arising during the expiry process. We have identified four areas essential to managing the PFI contract – monitoring of maintenance and lifecycle funds; transparency and access rights; involving wider stakeholders; and effective contract management. These are discussed below.

Monitoring maintenance and lifecycle funds

2.8 Under the PFI model, maintenance risk is fully transferred to the private sector with the SPV being responsible for repairing and replacing the assets.[19] Authorities pay for this maintenance via the unitary charge and therefore have a duty to monitor ongoing maintenance work throughout the life of the contract. For example, this can be achieved by monitoring the planned maintenance programmes, auditing forecast and actual expenditure or conducting asset condition surveys in the lead–up to expiry.

17 Question 23: What support was or is being provided from the centre of government (for example, from HM Treasury, the Infrastructure and Projects Authority (IPA)) to help in your contract expiry preparations? Number of responses: None – 38, 38/75 = 50.67%.

18 Question 23a: Was or is the level of support sufficient? Number of responses: Yes – 52, No – 23, 23/75 = 30.67%.

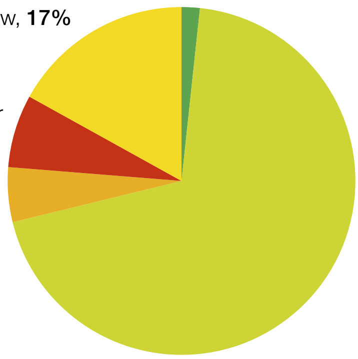
19 The SPV can subsequently pass on maintenance risk to sub-contractors.

2.9 Failure to monitor asset conditions increases the risk that the public sector receives lower-quality assets and around 55% of respondents recognise they need more knowledge of the assets' condition.[20] Just over 70% of respondents expect to receive the assets in the condition stipulated in the contract or higher (**Figure 10**).[21] However, the experience is different for the nine PFI contracts that have already returned to the public sector following expiry – four out of the nine survey respondents were unsatisfied with the condition of the assets they took ownership of.[22]

2.10 Maintenance carried out by the SPV falls into two categories: reactive maintenance, which is ongoing throughout the contract to ensure the service remains continuously available; or proactive maintenance whereby planned preventative maintenance such as replacing boilers, is carried out at regular intervals. The latter ensures the assets remain fully functional and also that handover conditions are met when the contract ends.

Figure 10
Survey results showing the percentage breakdown of expected asset conditions at contract expiry

Seventy-one per cent of respondents expect to receive the assets in the condition stipulated in the contract or better



Note

1 Survey results to question 8: Did or do you expect to receive the asset(s) in the condition stipulated by the Project Agreement? Yes – Quality higher than stipulated – 1, Yes – Quality as stipulated – 41, No – Quality slightly lower than stipulated – 3, No – Quality much lower than stipulated – 4, Do not know – 10. Seventy-one per cent is the share of all 'Yes' responses (42/59=71.19%).

Source: National Audit Office private finance initiative expiry survey

20 Question 32b: From your experiences of end of contract management so far, please indicate whether you would have welcomed more or less time, knowledge, capability, resources or guidance in relation to the preparation and negotiation of the contract expiry in regard to knowledge of the condition of asset(s): Number of responses: More – 41, About right – 25, Less – 0, Don't know – 9, 41/75 = 54.67%.

21 Question 8: Did or do you expect to receive the asset(s) in the condition stipulated by the Project Agreement? Number of responses: Yes – Quality higher than stipulated – 1, Yes – Quality as stipulated – 41, No – Quality slightly lower than stipulated – 3, No – quality much lower than stipulated – 4, Don't know – 10, 42/59 = 71.19% from a survey response of 59 (as 16 do not return to the authority).

22 We surveyed 18 expired PFI contracts and received 15 responses. Of those 15 responses, only nine involved assets which transferred to public sector ownership at expiry.

2.11 The SPV will usually build up a dedicated fund, known as a sinking or lifecycle fund, to ensure there is sufficient money to fund the planned maintenance – this was true for more than 55% of the respondents in our survey.[23] Every time an authority makes a unitary charge payment, a proportion is set aside specifically to fund future preventative maintenance. The SPV bears the risk of the lifecycle fund being insufficient to meet the replacement obligations, but equally, any surpluses are typically retained by the SPV and paid out to investors.

2.12 This creates an incentive for SPVs to manage the assets efficiently. If assets are well maintained, fewer unplanned replacements are required, leaving a larger surplus in the lifecycle fund at expiry. Equally, there is a perverse incentive to underinvest in assets – some authorities raised concerns that SPVs are 'sweating' the assets and making them last longer than originally planned.

Transparency and access rights

2.13 Most PFI contracts should permit an authority access to any information reasonably required to monitor the performance of the SPV.[24] In some PFI contracts, there are restrictions over the type of information that can be shared with the authority. From our survey, 35% of those who monitor the maintenance programme stated they had insufficient access rights to monitor the SPV's maintenance programme.[25] Similarly, of those contracts in our survey with a lifecycle fund, around 25% do not have access rights over the size and fluctuations of the fund.[26]

2.14 Typically, an authority will have access to a financial model outlining all the forecast maintenance expenditure across the life of the contract. In addition, an SPV will usually provide the authority with an annual maintenance plan, which is the case in 70% of the contracts in our survey.[27] These maintenance plans are not always supported with detailed actual expenditure data. Instead, authorities must rely on information contained in the financial statements of the SPV, which do not provide sufficiently detailed information on maintenance expenditure.

23 Question 13: Did or does the Project Agreement include a provision for a lifecycle fund, sinking fund or other measures to cover maintenance over the life of the contract? Yes – 33, No – 21, Don't know – 5, 33/59 = 55.93%, from a survey response of 59 (as 16 do not return to the authority).

24 HM Treasury, *Standardisation of PFI Contracts Version 4*, March 2007, para 26.2.1, p.220.

25 Question 30b: Did or does the authority have sufficient access rights to monitor the maintenance programme adequately? Number of responses: Yes – 15, No – 8, 8/23 = 34.78%, from a survey response of 23 (as not all monitor the maintenance programme).

26 Question 13a: Did or does the authority have access rights to information on this fund, such as size, fluctuations, in order to understand how the fund is being used? Number of responses: Yes – 19, No – 8, Don't know – 6, 8/33 = 24.24%, from a survey response of 33 (as not all have lifecycle or sinking funds).

27 Question 30: Did or does the authority monitor the annual maintenance programme under the contract? Yes – 52, No – 23, 52/75 = 69.33%.

2.15 In one PFI hospital, the authority has identified a large gap between what is being paid into the lifecycle fund compared with actual maintenance expenditure. A gap could either indicate the SPV is not carrying out maintenance work as planned or less maintenance is needed owing to efficiencies in building design and management by the SPV. The authority is unable to robustly challenge this variance as it has limited access rights to the lifecycle information. We identified similar experiences in PFI school contracts where asset surveys conducted by the SPV are not shared with the authority or data on lifecycle funds are not provided.

2.16 The cooperation between the authority and SPV depends on the strength of the relationship. For example, we identified one contract where an SPV shares information on a voluntary, rather than contractual, basis. The SPV responsible for providing office space for Transport for London (TfL) shares information on retrospective maintenance expenditure, despite this not being a contractual obligation. Furthermore, the SPV performs regular audits of the subcontractor to assess whether the facilities management services are provided in line with the contract. These audit reports are also voluntarily shared with TfL.

Involving wider stakeholders

2.17 The day-to-day management of a PFI contract will typically take place between an authority and either the SPV or the management service company (MSC) (see Figure 4 on page 17). If there are problems with the contract, involving a wider range of stakeholders may help to accelerate the resolution of these issues. For example, lenders such as banks, can play a role in how incentivised SPVs are to maintain assets appropriately. Lenders will typically put in place restrictions over how the PFI contract is managed to ensure that the authority continues to pay the unitary charge, and any debt and interest owed to the banks are repaid before payments are made to shareholders. In the early years of the contract, these restrictions help to ensure lifecycle maintenance is carried out and reported on. As debt levels reduce over time these restrictions either fall away or are easier to meet and lenders become less incentivised to hold the SPV to account. The senior debt repayment profile is typically shorter than the length of the PFI contract, meaning lenders are repaid around one to two years before expiry, making it more important to raise contractual problems with the SPV while the lenders are still involved.

Contract management

2.18 Effective contract management by the public sector can ensure the SPV is being properly held to account and maintenance work is being completed in line with the contract. While 70% of respondents stated that the annual maintenance programmes provided by the SPV are regularly monitored, just under 25% of respondents were unable to confirm whether this planned work had been completed.[28, 29] Our survey results also highlighted that just over 50% of respondents do not maintain an asset register, meaning authorities are not keeping an accurate record of the number, size, type and value of assets being managed under the PFI contract.[30]

2.19 Carrying out lifecycle maintenance often requires part or all of the service to be temporarily stopped so the work can be completed. This can be challenging when there are no natural breaks in services, such as with hospitals, whereas school contracts can complete works during holiday periods. A contract manager for a PFI hospital told us they have established monthly meetings with the relevant parties to plan maintenance across the year and ensure access can be granted at the appropriate times. If the lifecycle maintenance fund is left unspent, this money will eventually be paid out to investors, and the authority may face higher future maintenance costs after the contract expires. This will put further pressure on already stretched budgets. For example, one authority is experiencing backlogged maintenance of around £90 million for its existing portfolio of non-PFI schools. Taking over former PFI schools might add to this backlog.

28 Question 30: Did or does the authority monitor the annual maintenance programme under the contract? Number of responses: Yes – 52, No – 23, 52/75 = 69.33%.

29 Question 30a: Was or has the scheduled work been completed so far? Number of responses: Yes – 39, No – 1, Don't know – 12, 12/52 = 23.08%, from a survey response of 52 (as not all monitor the maintenance programme).

30 Question 27: Did or does the authority maintain an asset register? Number of responses: Yes – 35, No – 40, 40/75 = 53.33%.

Part Three

Preparing for and delivering contract expiry

3.1 A successful exit from a private finance initiative (PFI) contract requires both careful preparation and delivery of the contractual obligations. This part examines some of the components of this, such as understanding the contract, assessing future service requirements and relationship management.

Preparing for expiry

3.2 Preparation can be split into two phases: understanding how the expiry process works contractually and assessing what assets and services will be required after the contract ends. These two phases need to be considered simultaneously as the contract outlines whether or not assets are due to be returned, which in turn affects the decisions around the future service arrangements after expiry.

Understanding the contract

3.3 The PFI contract is central to preparing for and managing the expiry process. These contracts are long, complex documents and in most cases, the parties to the PFI contract will have made amendments over time to change service requirements or achieve specific savings. We have identified a small number of examples where the public authority (the authority) no longer holds part or all of the original contract. The authority then needs to request a copy of the contract from the special purpose vehicle (SPV) or other parties such as lawyers. Depending on the number of variations, it can take a considerable amount of time to gather together the PFI contract. For example, Highways England (HE), which has started to prepare for expiry early, did this sequentially for all its contracts over a period spanning a year. HE was aware of this potential difficulty ahead of time and therefore started this preparation process early.

3.4 The sponsor department will sometimes hold copies, but there is no central electronic repository of PFI contracts to systematically assess which authorities are exposed to risks such as poorly drafted handover provisions. The Infrastructure and Projects Authority (IPA) does, however, maintain a PFI database which includes information on each of the 700+ contracts, such as the capital value of the project, annual unitary charge, date the contract was signed and contract length. This information is updated annually, with the IPA making enhancements to the database. For example, the next annual update will, for the first time, include expiry dates for each contract. This new data will be central to the IPA's expiry programme (see paragraph 1.15). Furthermore, the IPA has recently improved its knowledge of the key private stakeholders in PFI projects, which has been shared with some departments.[31] However, there is little evidence that this data is being used proactively, either by the IPA or the sponsor departments, to improve the negotiating position of authorities with the same private stakeholders.

Handover provisions

3.5 A PFI contract should include handover provisions which set out several rights and obligations for the SPV and the authority. HM Treasury's standardisation of PFI contracts provides guidance on what the handover provision should contain and include, for example:

- an asset register and condition of these assets at the end of the contract;
- procedures for identifying the amount, cost and responsibility for paying for any rectification work;
- requirements for asset condition surveys and other inspections prior to handover, including procedures for appointing and paying for a surveyor;
- the creation of a retention fund for rectification work identified in the asset condition survey;
- the transfer of all relevant documentation to the authority, such as data on service users (pupils, patients or prisoners), maintenance history, manuals, compliance reports and manufacturers' warranties;
- procedures outlining how knowledge and skills are to be transferred at expiry and the treatment of employees;
- the treatment of confidential data; and
- details about the exit process and dispute procedures.[32]

31 Key private stakeholders include equity shareholders and management service companies.
32 HM Treasury, *Standardisation of PFI Contracts Version 4*, March 2007, p.135.

3.6 An absence of any of the above provisions represents a potential handover risk for authorities and should be discussed with the SPV as early as possible. Within the PFI contracts surveyed around 45% were entered into before HM Treasury published guidance known as *Standardisation of PFI Contracts* (SoPC) (paragraph 1.12) and therefore may not contain detailed handover provisions. Two-thirds of respondents identified some form of gap in their handover provisions, ranging from a lack of detail on the disputes process to treatment of intellectual property rights.[33] Around one–quarter of respondents stated their PFI contract does not contain any reference to the condition of assets upon expiry.[34]

3.7 Where handover provisions are included they often contain insufficient detail and are open to interpretation.[35] For example, only one–third of respondents stated that the roles and obligations of different parties at expiry are clearly defined (**Figure 11** overleaf).[36]

Asset ownership options and future service requirements

3.8 The ownership of assets at expiry will be dictated by the contract. Assets will either fully or partially transfer to the public sector or remain with the private sector. If the assets return to the public sector, authorities have four options: sell the asset if the service is no longer required, tender out the service element to a new private sector provider, operate the service in-house, or do nothing.[37] Situations which require continuity of service, with the assets reverting to public sector ownership, represent the greatest risk to government. Our survey highlights that this group represents the largest share of the outstanding contracts (**Figure 12** on page 37).

3.9 In some instances, the future ownership of assets and responsibility for administering the PFI contract are not aligned. Schools which have converted to academy status are outside of the remit of the authority and are run by independent academy trusts. These trusts are funded directly by the Department for Education (DfE). The responsibility for administering the PFI contract, however, remains with the authority until it ends. The authority may not be incentivised to use its resources to manage the expiry process effectively knowing that they will not retain ownership of the assets. According to DfE, around 300+ schools with PFI contracts have been converted to academy status.

33 Question 7: Did or the do the contractual hand back provisions include details on the following (please tick all that apply): a. condition of the asset(s) upon expiry, b. surveys, c. rectification work, d. details of any inspection prior to handover, e. disputes resolutions processes, f. details on the treatment of transferring employees, g. details on the treatment of intellectual property rights, h. secure disposal of confidential assets or systems, i. other. Number of responses: 50/75 = 66.67% of respondents stated their hand back provisions excluded some or all of the above categories.

34 Question 7: See above. Number of responses: 20/75 = 26.67% of respondents stated their hand back provisions did not include information on category a (see footnote 33).

35 This is more likely in cases where contracts were entered into before HM Treasury introduced the standardised contract guidance.

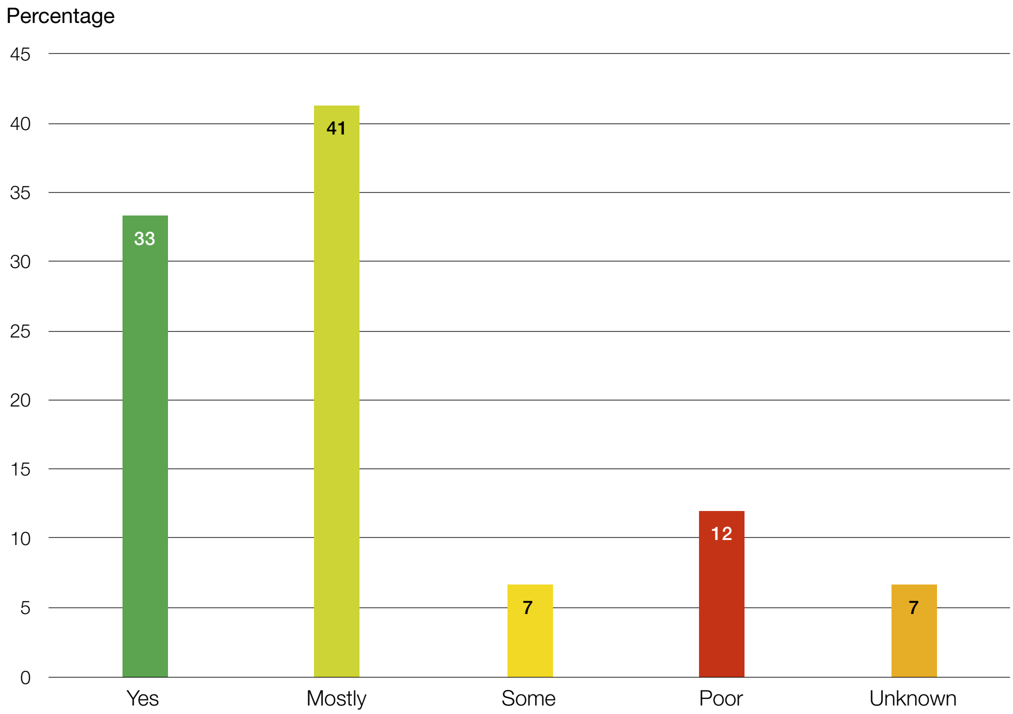
36 Question 10: Were or are the role and duties of the parties at contract expiry defined clearly enough in the Project Agreement so that there is no misunderstanding by the parties involved? Number of responses: Yes – the Project Agreement clearly defines all parties roles and obligations at contract expiry – 25, Mostly – most roles and obligations are well defined – 31, Some – some roles and obligations are well defined, but others are not – 5, Poor – the roles and obligations of parties are poorly defined – 9, We have not reviewed the Project Agreement in sufficient detail to be able to respond to this question – 5, 25/75 = 33.33%.

37 The 'do nothing' approach could involve the asset being moth-balled or re-provisioned elsewhere within an authority's existing operations.

Figure 11

Percentage breakdown of survey respondents' views on whether private finance initiative (PFI) contracts clearly define the roles and responsibilities at expiry

Only one-third of respondents stated that the roles and obligations of different parties at expiry are clearly defined



Note

1 Survey results to question 10: Were or are the role and duties of the parties at contract expiry defined clearly enough in the Project Agreement so that there is no misunderstanding by the parties involved? Yes – the Project Agreement clearly defines all parties roles and obligations at contract expiry – 25, Mostly – most roles and obligations are well defined – 31, Some – some roles and obligations are well defined, but others are not – 5, Poor – the roles and obligations of parties are poorly defined – 9, We have not reviewed the Project Agreement in sufficient detail to be able to respond to this question – 5.

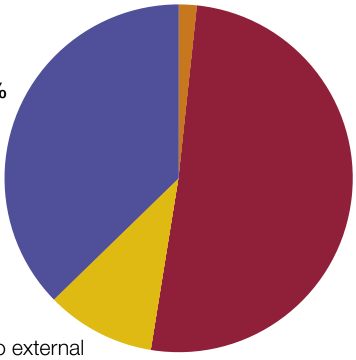
Source: National Audit Office private finance initiative expiry survey

3.10 The authority will need to assess whether the service provided under the PFI contract, such as operating a waste disposal plant, will be required once it has expired. The requirement for the service depends on many different factors, such as changes in demand, technology or wider government policy. For example, in one accommodation-type PFI contract, the authority decided not to enter into a new lease post-expiry. Existing publicly owned offices were to be used instead, following the authority's estate rationalisation programme.

Figure 12

Survey results showing the percentage breakdown of expected treatment of assets and services post-private finance initiative (PFI) contract expiry

More than 50% of respondents stated that at expiry the assets will be kept by the authority with the service being tendered out to a private sector provider



Note

1 Survey results to question 5: What happened or does the authority currently expect to happen to the transferred asset(s) and the related services after the contract expiry? Sell asset as no longer required – 1, Keep assets and tender service element – 30, Keep assets with no external tendering of the service element – 6, Options not yet assessed – 22.

Source: National Audit Office private finance initiative expiry survey

3.11 Once the nature of the future service is established, the authority will need to decide how this will be delivered post-expiry. Options include running the service in-house using existing public sector resources, procuring a service delivery contract with a new private sector provider or extending the existing PFI contract. The breadth of options may depend on the resources and skills available to the authority. A government department or large authority may be able to absorb expiring PFI contracts into existing operations, but this may not be a viable option for smaller authorities.

3.12 The PFI contract itself may restrict how the service could be delivered in the future. We identified an example whereby the PFI contract stipulates that a payment of £1 million be made to the SPV should the authority decide to enter into a service delivery contract with a new provider upon expiry. This reduces the competitiveness of a tender process and may result in the authority having to extend the contract or enter into a new agreement with the existing SPV. In another example, Transport for London (TfL) started to engage with the SPV two years prior to expiry following the timeframe set out in the contract. Owing to the complex nature of the project, however, it required at least three years to fully assess and implement the future service delivery option. As a result, TfL negotiated a short-term contract with the incumbent delivery partner.

3.13 The authority will need to consider the resource requirements of maintaining assets after they take over management at the end of the contract. This is particularly important for authorities that have been receiving PFI grants, as this additional source of funding will expire when the contracts end.[38] Where PFI assets are not returned in the stipulated condition and subsequently require more than expected maintenance work, the authority's maintenance backlogs across its entire estate will increase. We have previously reported that less funding is available to address maintenance backlogs – in 2015-16 and 2016-17, HM Treasury allowed the NHS to move more than £1 billion of funding allocated for capital investment to pay for day-to-day spending.[39]

3.14 In just over 20% of the contracts in our survey responses, the public sector will not take over ownership of the assets at expiry.[40] In these cases, the authority will still need to assess its need for the assets post-expiry. If so, it may need to purchase or find alternative assets either through procuring, leasing or building new ones. This can represent a considerable cost and may take years to resolve. For example, in one accommodation-type PFI contract, the homes did not transfer to the authority on expiry. Owing to the location and lack of alternative housing, the authority had to purchase the homes at market value, running into tens of millions of pounds.

Timing of preparation

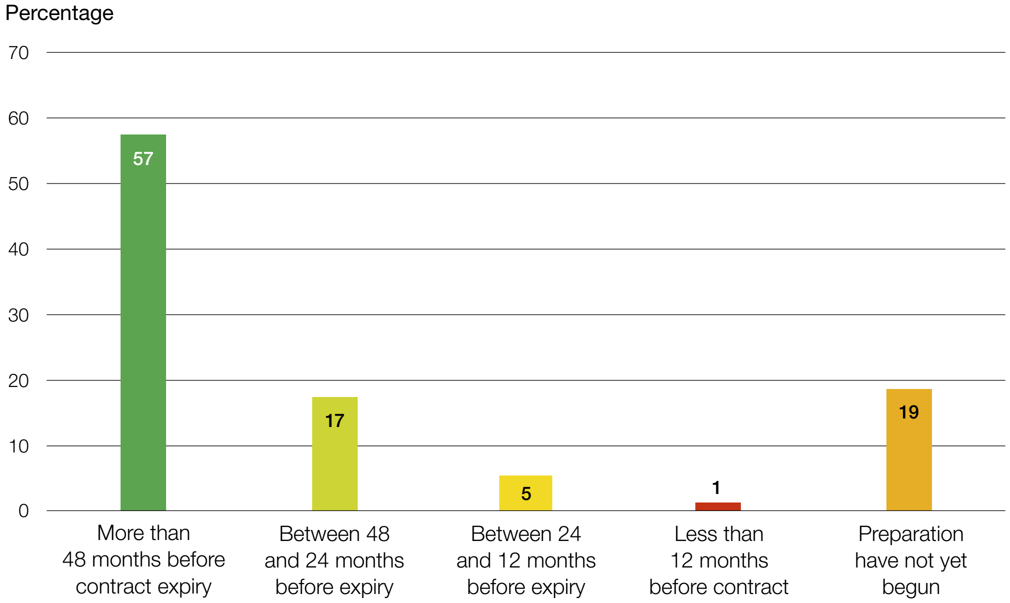
3.15 Our survey results highlight that there is significant variation in preparation times from contract to contract. Around 57% of respondents have started or are planning to start preparing four or more years before expiry (**Figure 13**).[41] Around 57% believe they are starting sufficiently early.[42] The timing depends on many factors, such as the complexity of the contract, number of assets, handover provisions, resourcing and how the assets are treated on expiry. Preparations should start before it is contractually required, and the IPA's guidance recommends starting seven years in advance.[43] Evidence from HE and the Department for Environment, Food & Rural Affairs suggests starting preparations more than seven years in advance to enable a full assessment of the assets and options.

38 PFI grants provided central government funding to local authorities to deliver PFI projects.
39 Comptroller and Auditor General, HM Treasury, *PFI and PF2*, Session 2017–2019, HC 718, National Audit Office, January 2018, para 1.12, p.10.
40 Question 4: On contract expiry, did or will the asset(s) (school, hospital, road, etc) transfer to the authority? Number of responses: Yes – 49, Partially – 10, No – 16, 16/75 = 21.33%.
41 Question 16: When did or has the authority started the process of preparing for contract expiry? Number of responses: Yes, more than 48 months before the contract expiry date – 43, Yes, between 48 months and 24 months before the contract expiry date – 13, Yes, between 24 and 12 months before the contract expiry date – 4, Less than 12 months before the contract expiry date – 1, No, we have not started preparation yet – 14, 43/75 = 57.33%.
42 Question 32a: From your experiences of end of contract management so far, please indicate whether you would have welcomed more or less time, knowledge, capability, resources or guidance in relation to the preparation and negotiation of the contract expiry in regard to time to prepare for the end of the contract: Number of responses: More – 18, Don't know – 8, About right – 34, 34/60 = 56.67%, from a survey response of 60 (as 15 have expired and are referred to separately in the report).
43 Based on a draft of the PFI expiry guidance document the IPA intends to publish in the future.

Figure 13

Percentage breakdown of the number of months before contract end that survey respondents started private finance initiative (PFI) expiry preparations

Fifty-seven per cent of respondents started preparing for expiry more than four years before contract end



Notes

1 Survey results to question 16: When did or has the authority started the process of preparing for contract expiry? Yes, more than 48 months before the contract expiry date – 43, Yes, between 48 months and 24 months before the contract expiry date – 13, Yes, between 24 and 12 months before the contract expiry date – 4, Less than 12 months before the contract expiry date – 1, No, we have not started preparation yet – 14.

2 Data does not sum to 100% due to rounding.

Source: National Audit Office private finance initiative expiry survey

3.16 Experience from expired PFI contracts suggests there is a risk that authorities underestimate the preparation time. Out of the 15 expired contracts included in our survey, three stated that in hindsight they would have started preparing earlier.[44,45] In each case, unforeseen events such as disputes caused additional challenges which impacted the expiry timelines. Evidence from a lessons learnt exercise conducted by the Department for Work & Pensions on the PRIME (Private Sector Resource Initiative for Management of the Estate) PFI contract concluded that expiry preparations should have started earlier.

44 Question 32a: From your experiences of end of contract management so far, please indicate whether you would have welcomed more or less time, knowledge, capability, resources or guidance in relation to the preparation and negotiation of the contract expiry in regard to time to prepare for the end of the contract: Number of responses: More – 3, About right – 12, from a survey response of 15 (as 60 are operational and are referred to separately in the report).

45 Our survey sample included 18 PFI contracts that have already expired, and we received 15 responses.

Delivering the contract expiry

3.17 After the planning stage, the authority needs to ensure the SPV meets all the contractual obligations for expiry to ensure a smooth transition to the post–expiry arrangements. An authority needs to be aware of the contractual tools available to ensure the SPV adheres to its expiry obligations and it knows how to resolve disputes.

Asset condition surveys

3.18 PFI contracts should include a provision allowing for the completion of an asset condition survey prior to expiry – this is the case for more than 75% of respondents in our survey.[46] The survey should identify the amount and cost of any rectification work needed so that the assets can be returned to the authority in the condition stipulated in the contract.

3.19 The contract should stipulate how many years before expiry the survey should be carried out. Just under half the respondents expect to complete the last survey between 24 and 12 months before expiry (**Figure 14**).[47] There is a risk that carrying out the final asset condition survey too close to expiry leaves limited time to complete the identified rectification work and resolve any disputes. This could be a potential issue for one-third of the contracts in our survey, which expect the final survey to be conducted less than 12 months before expiry.[48]

3.20 Some PFI contracts allow the authority to conduct surveys throughout the life of the contract, not just in the lead–up to expiry. This allows an authority to better monitor whether the SPV is meeting its maintenance obligations, which is important in cases where the authority has limited access to performance data. About 50% of respondents stated that multiple asset condition surveys will be carried out before expiry, with 17% of respondents saying that five or more will be completed in the seven years before expiry (**Figure 15** on page 42).[49,50]

46 Question 7: Did or do the contractual hand back provisions include details on the following (please tick all that apply): a. condition of the asset(s) upon expiry, b. surveys, c. rectification work, d. details of any inspection prior to handover, e. disputes resolutions processes, f. details on the treatment of transferring employees, g. details on the treatment of intellectual property rights, h. secure disposal of confidential assets or systems, i. other. Number of responses: 57/75 = 76% of respondents stated their hand back provisions included surveys (category b).

47 Question 25: When was the last asset condition survey or how many months before contract expiry does the authority expect to conduct the last asset condition survey? Number of responses: Greater than 24 months before contract expiry – 6, Between 24 and 12 months before contract expiry – 36, Less than 12 months before contract expiry – 24, Don’t expect to conduct an asset survey – 3, Unknown – 6, 36/75 = 48%.

48 Question 25 as in footnote 47: Less than 12 months before contract expiry – 24, 24/75 = 32%.

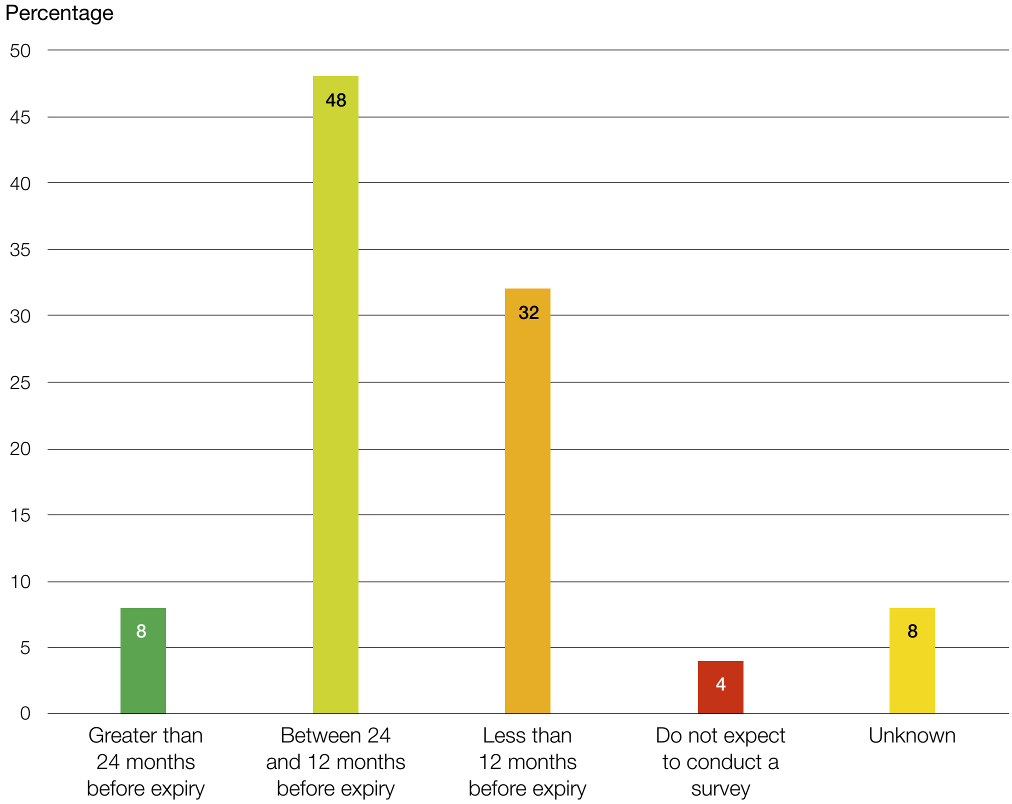
49 Question 24: How many asset condition survey reports were received or do you expect the authority to receive in the 7 years before contract expiry? Number of responses: 5 or more – 13, 3 to 4 – 10, 2 – 15, 1 – 17, None – 4, Other/unknown please explain – 16, 38/75 = 50.67%.

50 Question 24 as in footnote 49: 5 or more – 13, 13/75 = 17.33%.

Figure 14

Percentage breakdown of when respondents expect the final asset condition survey to be completed

Nearly one-third of respondents expect the final asset condition survey to be completed in the final 12 months of the contract



Note

1 Survey results to question 25: When was the last asset condition survey or how many months before contract expiry does the authority expect to conduct the last asset condition survey? Number of responses: Greater than 24 months before contract expiry – 6, Between 24 and 12 months before contract expiry – 36, Less than 12 months before contract expiry – 24, Don't expect to conduct an asset survey – 3, Unknown – 6.

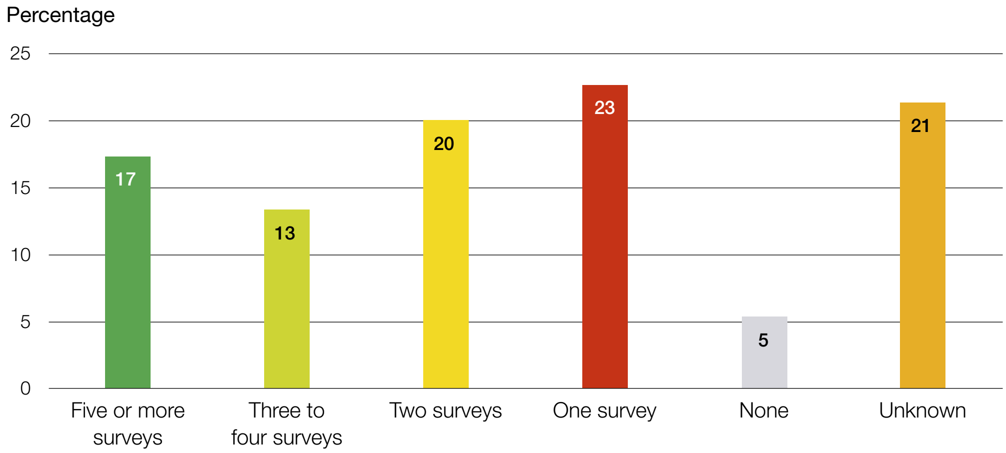
Source: National Audit Office private finance initiative expiry survey

3.21 Measuring the condition of an asset can be a subjective process, which means appointing an independent surveyor, agreed by both the authority and SPV, is important. The contract should include arrangements for appointing a surveyor. The terms may vary in regard to who appoints the surveyor (SPV, authority or jointly) and who pays for it. A number of authorities highlighted the importance of ensuring the surveyor is independent, thereby eliminating the risk of surveys being biased. In one example an authority appointed its own surveyor, which was allowed under the contract, but the SPV disputed the findings. With hindsight, the authority felt that the risk of a dispute may have been reduced if an independent surveyor was appointed jointly. If there is disagreement, the contract may outline a procedure whereby an independent expert acts as an arbitrator.

Figure 15

Survey results showing the number of asset condition surveys expected to be completed before expiry

Fifty per cent of respondents expect more than one survey to be completed in the seven years prior to contract expiry



Notes

1 Survey results to question 24: How many asset condition survey reports were received or do you expect the authority to receive in the 7 years before contract expiry? 5 or more – 13, 3 to 4 – 10, 2 – 15, 1 – 17, None – 4, Other/unknown please explain – 16.

2 Fifty per cent is the sum of the following three responses 'Five or more surveys (17%)', 'Three to four surveys (13%)', and 'Two surveys (20%)'.

3 Data does not sum to 100% due to rounding.

Source: National Audit Office private finance initiative expiry survey

Engagement with the SPV

3.22 Around 20% of respondents noted a lack of cooperation from SPVs in providing information on the assets' condition.[51] In one school PFI contract, the authority attempted to carry out an independent survey to confirm whether maintenance work was being completed as planned, but the SPV denied access to key areas of the school as it did not perceive it as being part of the contract. In one prison PFI contract the authority had the right to receive cost information relating to the performance of the service, but the SPV did not provide it.

51 Question 14: Did or does the Contractor cooperate with the authority in providing information in relation to retention, lifecycle, other funds, or information about related maintenance/rectification work? Number of responses: Yes – 33, No – 12, Don't know – 2, We have not requested any such information – 12, 12/59 = 20.34%, from a survey response of 59 (as 16 do not revert back to the authority).

3.23 Ambiguity in a PFI contract or lack of cooperation can be resolved in one of two ways: early engagement with the SPV to negotiate an agreed position or by going through a formal dispute resolutions procedure. Resolving any issues requires a balanced approach from both public and private sector parties. Relationships will come under greater strain as earlier PFI contracts start to expire, as these are exposed to greater ambiguity. A lack of compromise in the short term may damage relationships and hinder future expiry negotiations.

Addressing ambiguity

3.24 We have identified several examples whereby government departments and authorities are improving existing handover provisions. In one example, the Ministry of Justice (MoJ) formally changed the contract to simplify the language and add more detail on transferring employees at expiry. MoJ incurred a cost for this amendment but achieved a higher level of handover certainty in a cooperative way.

3.25 In another example which involved eight road PFI contracts, the handover provisions did not specify how the residual life of some assets should be calculated at contract expiry. Rather than making a change to the contract, HE instead developed a methodology which provides clarity to the SPVs on how they should demonstrate that the residual life requirements have been met. HE subsequently produced a Memorandum of Understanding for the SPVs to sign agreeing HE's approach. Despite developing this methodology at its own expense, HE believes that it will provide efficiency savings at expiry as the risk of disputes is reduced.

Disputes

3.26 If any contractual ambiguity cannot be resolved via negotiations with the SPV, the remaining option is to go through the formal disputes process. Each PFI contract will set out a formal procedure for handling disputes, called the Dispute Resolution Procedure (DRP). More than one–third of respondents expect to have formal disputes with the SPV regarding the handover of assets.[52] Around 86% of anticipated disputes relate to the amount of rectification work needed, while 75% relate to the cost of any rectification work (**Figure 16** overleaf).[53,54] Of the 15 expired contracts in our survey, two went through DRP. One dispute related to the cost of purchasing assets at expiry, while the second related to the quality of the maintenance being carried out by the SPV. A survey carried out by the authority found that the maintenance work was carried out by unqualified people. One dispute remains in the courts awaiting appeal while the other was resolved by extending the contract on terms which required remedial action by the SPV.

52 Question 15: Has there been or does the authority expect there to be, any formal disputes between the authority and the contractors regarding the handover of assets? Number of responses: Yes – 28, No – 47, 28/75 = 37.33%.

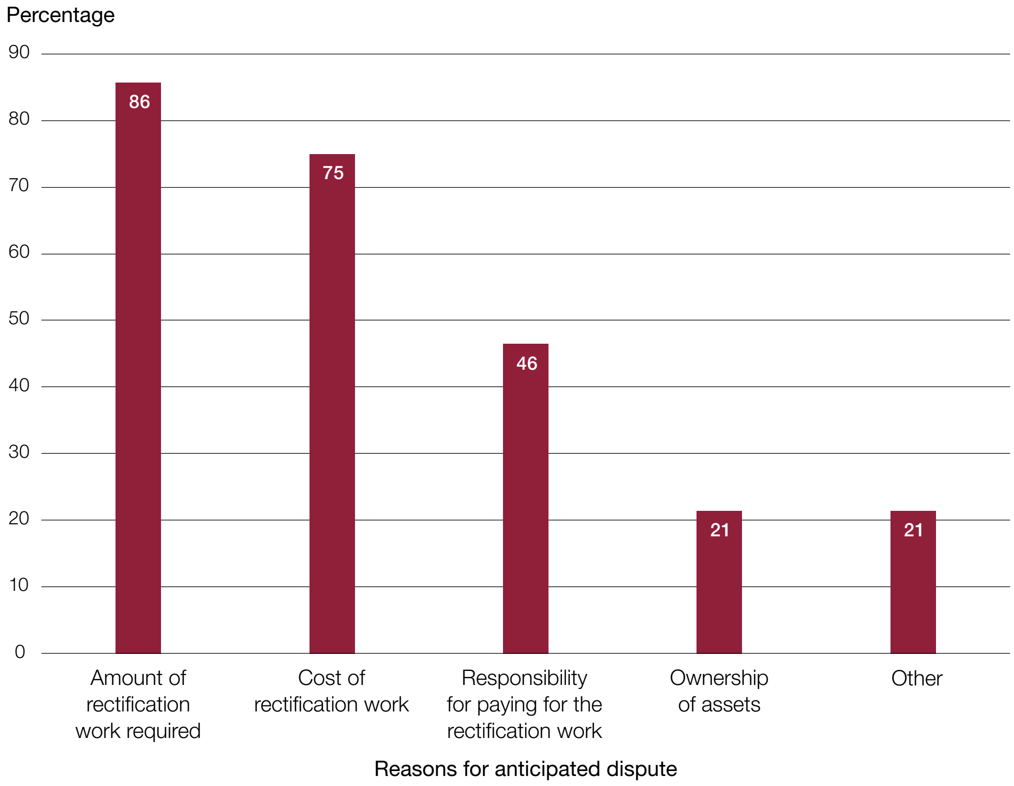
53 Question 15a: What did or do you expect the disputes to relate to? Please tick all that apply: i. amount of rectification work required, ii. cost of rectification work, iii. responsibility for paying for the rectification work, iv. Ownership of assets, v. other. Number of responses: 24/28 = 85.71% mentioned the amount of rectification work as a source of dispute. From a survey response of 28 (as only 28 replied yes to Question 15 – see footnote 52 above).

54 Question 15a as footnote 53: 21/28 = 75% mentioned the cost of any rectification work as a source of dispute.

Figure 16

Survey responses on reasons for anticipated private finance initiative (PFI) contract expiry disputes

The amount and cost of rectification work required are stated as the most common reasons for disputes



Notes

1 Survey results to question 15a: What did or do you expect the disputes to relate to? Please tick all that apply: Amount of rectification work required – 24, Cost of rectification work – 21, Responsibility for paying for the rectification work – 13, Ownership of assets – 6, Other – 6. Only those who responded to question 15 (Has there been or does the authority expect there to be, any formal disputes between the authority and the contractors regarding the handover of assets?) with 'Yes', of which there were 28, were asked this question.

2 The 'other' category includes potential issues such as the performance of the assets, sinking fund arrangements, termination payments and intellectual property rights.

3 Data does not sum to 100% as the survey question contained multiple choice responses.

Source: National Audit Office private finance initiative expiry survey

3.27 DRPs can be lengthy despite aiming to be more efficient and cost-effective than going to arbitration or through the courts. In one contract we reviewed, the DRP could take a minimum of 10 months to complete. Some contract managers have also raised concerns that the DRP is expensive, which may prohibit authorities from pursuing this option, especially given that a positive outcome is not guaranteed. In the case of an unsuccessful DRP, resolving disputes via arbitration and the courts can increase costs even further. Authorities need to balance the benefits and costs of such an approach, including whether additional financial support is available.

3.28 HE has developed an informal issue resolution procedure designed to settle disagreements before they are escalated to a formal dispute. This represents a quicker and more cost-efficient process should issues be resolved without a DRP. The procedure involves both HE and the SPV nominating individuals who have the authority to engage in discussions and reach an agreement. Stage one takes place at the operational level in order to discuss the technical issues of the dispute. If an agreement is not reached, the issue is escalated up the management chain, with stage two review being carried out at a project manager level. Failure to reach an agreement after stage two results in the contractual DRP being the next option.

Recourse

3.29 The PFI model is designed so that the unitary charge should cover all project costs. This means shareholders and lenders face limited financial exposure beyond the money already invested in the project. Once a contract has expired, any surplus cash will be paid out to investors and the SPV company will be closed. This means it may be difficult for the public sector to recover any payments from the SPV post-expiry, making it more important for authorities to resolve any disputes or recover any monies owed before the contract ends.

Withholding unitary charge payments

3.30 All PFI contracts have the option of withholding a proportion of the unitary charge in the event of sub-standard performance, with deductions reflecting the severity of the failure. The scenarios whereby deductions can be made will differ between contracts. For 35% of respondents there are no provisions to fund rectification work and the main method to compel SPVs to complete required work is by withholding a portion of the unitary charge.[55] However, this can be difficult – one contract manager told us that there is no contractual right to withhold the unitary charge on the grounds of incomplete rectification work. Deductions can only be made on the grounds of non-performance and unavailability, meaning that if the school building is not being maintained, but remains operational, the authority cannot withhold any payment.

55 Question 12: Did or does the Project Agreement contain a provision for a retention fund to cover any rectification work? Number of responses: Yes – 28, No – 21, Don't know – 10, 21/59 = 35.59%, from a survey response of 59 (as 16 do not revert back to the authority).

Retention funds

3.31 Some PFI contracts may have the option to set up a retention fund in the final years of the contract. This fund allows the authority to segregate a portion of the unitary charge for rectification work identified in the asset condition survey. The authority can use this fund if rectification work is not completed according to the contract. Any remaining balance will be paid out to the SPV. This can create an incentive for the SPV to limit expenditure on maintenance and rectification work so that higher returns can be paid out to shareholders. This incentive is increased if the cost of completing any rectification work is greater than any performance penalty for not doing this work. If the retention fund is not large enough to cover the rectification work, the authority will need to recover the balance from the SPV as a debt. Of the 28 contracts in our survey that contain a retention fund, 10 respondents do not expect it to be large enough.[56]

Performance bonds

3.32 Some contracts may also contain the option to procure a performance bond as an alternative to setting up a retention fund. A performance bond is a way of protecting the authority against the risk the SPV fails to complete the rectification work. In the event the SPV does not complete the work, the bond provides compensation to the authority. We only identified one instance where a performance bond was being used. In this contract the bond lasts for five years after contract expiry. If any defects in the assets are identified and attributable to the former SPV, the bond can be used to finance the work. The size of the bond is driven by an asset condition survey carried out two years before expiry. We have been told that in this example, the cost of the performance bond was borne entirely by the SPV. This may not be the case in other contracts as it is likely the cost is passed on to the authority via a higher unitary charge.

56 Question 12b: Was or does the authority expect the size of the retention fund to be large enough to cover expected rectification work? Number of responses: Yes – 11, No – 10, Don't know – 7, from a survey response of 28 (as only 28 replied yes to Question 12 – footnote 55).

Appendix One

Our evidence base

1 Our independent conclusion on whether government is making appropriate preparations to secure value for money from private finance initiative (PFI) contracts nearing the end of their term was reached following our analysis of evidence collected primarily between November 2019 and April 2020. Our main methods are outlined below:

Survey

2 We undertook a survey of 107 PFI contracts covering projects across central government and local bodies including the NHS. We achieved a 70% response rate. The survey results can be found in our online publication 'PFI contract expiry – survey results'.[57]

3 We identified 107 PFI contracts that have or will expire in the seven years from 2020-21. Of these, 89 were still operational at the time the survey was conducted, and 18 had already expired.

4 We used the following sources to determine our survey population:

- HM Treasury's PFI database was the main information source;
- contract expiry dates are not included in the PFI database, so we used the year of the final unitary charge payment as a proxy;
- we produced a list of expired projects by comparing historic PFI databases; and
- we included in our sample contracts expiring in the seven years from 2020-21 as this achieved a balance between having a sufficiently large pool of potential respondents (about 20% English PFI contracts as of March 2018) with enough representation of accommodation-type projects, such as schools and hospitals, which represent the majority of the contracts in both the sample and the overall population. This approach also minimised the number of instances where authorities may not have started preparations yet.

57 Available at: www.nao.org.uk/other/nao-interactive-data-visualisation-on-pfi-contracts/

5 A number of exclusions were made to the sample population:

- PFI contracts entered into by the devolved governments of Scotland, Wales and Northern Ireland were excluded. This is because these projects are outside the remit of HM Treasury and the Infrastructure and Projects Authority (IPA), hence any findings and recommendations in this report are not directly applicable to the devolved governments;
- projects that were terminated early were excluded; and
- a number of 'non-typical' PFI projects were excluded from the sample population. These exclusions largely relate to older, expired PFI contracts such as small Information and Communications Technology projects, which do not represent future projects in the expiry pipeline.

6 Since our survey population was based on estimated contract expiry dates, a small number of contracts were included despite having expiry dates outside of our seven year sample period.

7 The survey questions were developed using HM Treasury's *Standardisation of PFI Contracts* (SoPC) guidance (version 4) together with the National Audit Office's (NAO's) existing knowledge based on previous reports. The questions were tested with the IPA and Local Partnerships. The survey consisted of the following nine themes: asset use, the PFI contract and handover provisions, retention funds, disputes, preparation for expiry, staffing, governance, information requests, and monitoring.

8 Each survey response was reviewed, and in some cases, additional contact was made to either clarify responses to ensure the results were being correctly interpreted or to request additional information. Where possible we have attempted to corroborate evidence from the survey respondents through interviews. We have not attempted to audit the individual PFI contracts included in the survey.

Quantitative analysis

9 We analysed data from HM Treasury's 2018 PFI database, which includes information on all operational PFI projects across the UK as at 31 March 2018. This was the most up-to-date database at the time of publication. We performed analysis of the survey results by aggregating responses to determine and present the overarching themes.

Document review

10 We reviewed key documents including:

- HM Treasury's *Standardisation of PFI Contracts*;
- IPA analysis and documents;
- evidence submissions by departments and private sector investors; and
- selected historic NAO reports on private finance (see Appendix Three).

Interviews

11 We undertook audit interviews with a range of PFI stakeholders:

- officials from central government departments including HM Treasury, Department for Education, Department of Health & Social Care, Ministry of Defence, Department for Transport, Department for Work & Pensions, HM Revenue & Customs, Home Office and the Department for Environment, Food & Rural Affairs;
- officials from wider government bodies including the IPA, Highways England, Local Partnerships and the Local Government Association;
- individual PFI contract managers across central government and local bodies including the NHS; and
- representatives from private sector investors, consultants, and management service companies in PFI projects.

Other methods

12 We made a 'call for evidence' which invited 16 supranational institutions and Supreme Audit Institutions to submit evidence on the following areas: the risks associated with the expiry of PFI contracts, how international governments are preparing and any research or guidance published on this topic.

Appendix Two

Top 10 largest private finance initiative (PFI) contracts by capital value

Figure 17

Top 10 largest private finance initiative (PFI) contracts by capital value ending in the next 10 years[1]

Project name	Capital value (£m)[2]	Sponsor department	Procuring authority	Sector[3]	Estimated year of contract end
Airwave	1,470	Home Office	Home Office	Other	2022-23
Skynet 5	1,360	Ministry of Defence	Ministry of Defence	IT infrastructure and communications	2022-23
STEPS – Mapeley PLC	370	HM Revenue & Customs	HM Revenue & Customs	Offices	2020-21
DLR Lewisham	264	Department for Transport	Transport for London	Tram/light rail	2020-21
Attack Helicopters Training – Apache Simulator Training	234	Ministry of Defence	Ministry of Defence	Military facility	2023-24
Newcastle Estate Development[4]	218	HM Revenue & Customs	HM Revenue & Customs	Offices	2029-30
M1–A1 Lofthouse to Bramham Link	214	Department for Transport	Highways England	Roads and highway maintenance	2025-26
Herefordshire & Worcestershire Waste Management Service Contract	198	Department for Environment, Food & Rural Affairs	Herefordshire	Waste	2023-24
Ministry of Defence-wide Water and Wastewater (Project Aquatrine) – Package C	194	Ministry of Defence	Ministry of Defence	Other	2029-30
Strategic Sealift Service	175	Ministry of Defence	Ministry of Defence	Other	2024-25

Notes

1 PFI contracts up to 31 March 2030.

2 Figures are in nominal terms.

3 'Other' includes projects such as street lighting, rail, vehicles and emergency services.

4 Newcastle Estate Development is also known as the Newcastle Estates Partnership.

Source: National Audit Office analysis of HM Treasury's 2018 PFI database

Appendix Three

Past private finance initiative (PFI) reports

1 See **Figure 18** on pages 52 to 57.

Figure 18

Past National Audit Office (NAO) private finance initiative (PFI) reports

High-level summary of past NAO PFI reports

Ref	Title of the report	Short summary
1	Investigation into the rescue of Carillion's PFI hospital contracts	This report is about what happened to Carillion's two major public sector construction contracts after it collapsed and how the PFI operates in these circumstances. The investigation focuses on the role of central government and the Trusts in relation to the two hospital projects before, during and after Carillion's failure in January 2018.
2	PFI and PF2	This briefing presents information on: the rationale, costs and benefits of PFI and PF2. This reports presents information on the programme as a whole and do not seek to form a view on the model or individual projects.
3	The choice of finance for capital investment	This briefing paper describes several factors affecting central government capital investment decisions, including budgeting, project appraisal, procurement, finance and accounting treatment. Based on these factors the report makes a number of observations about the relative flexibility, transparency and other attributes of different financing choices, including cost.
4	Oversight of three PFI waste projects	This report presents information on the principal roles of the Department for Environment, Food & Rural Affairs (Defra), local authorities, and other central government departments in relation to three contracts. The report examines those contracts, and Defra's influence or involvement. The report is not a value for money (VfM) report of these three contracts.
5	Review of the VfM assessment process for PFI	This briefing paper is a response to the Treasury Committee's request to examine the VfM assessment process and model for the PFI. The VfM assessment process combines a quantitative and qualitative approach to VfM appraisal and includes a set of questions for the authority to consider at each level of the three-stage process, around the viability, desirability and achievability of the project.
6	Equity investment in privately financed projects	This report examines whether authorities' use of private sector equity in recent standard form PFI contracts is VfM. The report examines whether: investors positively contribute to delivering the specified public services and encourage beneficial service improvements; investors bear, and actively manage, project risk; and the returns for investors are transparent and reasonable, derived from contracts priced in line with market principles.
7	Lessons from PFI and other projects	This report draws out lessons from recent project experience that the public sector needs to address to achieve the best commercial outcomes in an economic environment of spending constraints. The report draws on five previous reports.
8	Procurement of the M25 private finance contract	This report focuses on the Highways Agency's (now known as Highways England) decision-making to assess whether it has procured a VfM solution to congestion and poor journey time reliability on the M25 motorway.
9	Financing PFI projects in the credit crisis and the Treasury's response	This report examines the effects of the 2008-09 credit crisis on privately financed government infrastructure projects and HM Treasury's response.
10	PFI in Housing	This report reviews the PFI in the housing market with focus on the Department for Communities & Local Government and the Homes and Communities Agency.
11	The performance and management of hospital PFI contracts	This report is about the performance of the maintenance and support services under the PFI contracts and how they are managed by the NHS trusts.

Theme	Date	Session number	Link
Hospitals	January 2020	Session 2019-20 HC 23	www.nao.org.uk/wp-content/uploads/2020/01/Investigation-into-the-rescue-of-Carillions-PFI-hospital-contracts.pdf
Programme assessment	January 2018	Session 2017–2019 HC 718	www.nao.org.uk/wp-content/uploads/2018/01/PFI-and-PF2.pdf
Finance	March 2015	N/A	www.nao.org.uk/wp-content/uploads/2015/03/The-choice-of-finance-for-capital-investment.pdf
Waste	June 2014	Session 2014-15 HC 264	www.nao.org.uk/wp-content/uploads/2014/06/Oversight-of-three-PFI-waste-projects.pdf
Procurement, Programme assessment	October 2013	N/A	www.nao.org.uk/wp-content/uploads/2014/01/Review-of-VFM-assessment-process-for-PFI1.pdf
Finance, Programme management	February 2012	Session 2010–2012 HC 1792	www.nao.org.uk/wp-content/uploads/2012/02/10121792.pdf
Lessons learnt	April 2011	Session 2010–2012 HC 920	www.nao.org.uk/wp-content/uploads/2011/04/1012920.pdf
Procurement, Lessons learnt	November 2010	Session 2010-11 HC 566	www.nao.org.uk/wp-content/uploads/2010/11/1011566.pdf
Finance	July 2010	Session 2010-11 HC 287	www.nao.org.uk/wp-content/uploads/2010/07/1011287es.pdf
Housing	June 2010	Session 2010-11 HC 71	www.nao.org.uk/wp-content/uploads/2010/06/101171.pdf
Hospitals, Programme management	June 2010	Session 2010-11 HC 68	www.nao.org.uk/wp-content/uploads/2010/06/101168.pdf

Figure 18 *continued*

Past National Audit Office (NAO) private finance initiative (PFI) reports

Ref	Title of the report	Short summary
12	Managing complex capital investment programmes utilising private finance	This report provides a best-practice model for departments produced jointly by HM Treasury and the NAO. The report explores common themes in managing PFI programmes based on the experience of 10 departments.
13	Department for Environment, Food and Rural Affairs: Managing the waste PFI programme	This report focuses on PFI projects for which Defra has responsibility through granting PFI credits to local authorities. Many of the issues set out in the report will also be relevant to local authorities taking forward other forms of waste infrastructure procurement.
14	Allocation and management of risk in Ministry of Defence PFI projects	This study examines whether there has been effective allocation and management of risk in the Department's PFI projects. The findings are based on a detailed examination of eight PFI case study projects. This analysis is supported by a census of all the Department's PFI contracts let in 2007 and consultation with the Department's staff, contractors and advisers.
15	Making Changes in Operational PFI Projects	This study examines changes to PFI contracts and their effectiveness based on a survey of 170 projects and interviews with stakeholders. The report also includes small case studies.
16	Benchmarking and market testing the ongoing services component of PFI projects	This report examines whether, based on early experiences, benchmarking/market testing is likely to contribute to the value for money of PFI projects. The study is based on a sample of 34 PFI contracts and considers the mechanics for effective benchmarking, the applicability and any lessons learnt so far from existing projects.
17	Improving the PFI tendering process	This study focuses on 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.
18	The Termination of the PFI Contract for the National Physical Laboratory	This report examines the Department for Business, Innovation & Skills' (formerly the Department of Trade and Industry) handling of the first contract termination and draws lessons that might apply to other PFI projects. The report examines the problems that led to the termination, why these problems arose, how the Department managed them and the VfM consequences of the termination.
19	Update on PFI debt refinancing and the PFI equity market	This report examines: how the level of debt refinancing gains which government has secured compares with the Office of Government Commerce's expectations in 2002; how well the new arrangements to share debt refinancing gains have been working; whether there are any risks for authorities from debt refinancing; and how the maturing PFI market is affecting the use of equity capital in PFI projects.
20	The Refinancing of the Norfolk and Norwich PFI Hospital: how the deal can be viewed in the light of the refinancing	This report examines the terms of the original bank finance with the new terms, comparison between early PFI hospital deals, and other factors which may affect the overall comparison of the trust's deal with current PFI deals.
21	Transfer of property to the private sector under the expansion of the PRIME (Private Sector Resource Initiative for Management of the Estate) Contract	This report examines VfM issues of this high-profile transaction which did not involve any direct competition. The questions asked were: Were the project objectives clear? Did the Department apply the proper processes? Did the Department select the best available deal put forward? Is the contract robust?
22	PFI: The STEPS Deal	The report focuses on the VfM of a property and services outsourcing deal by the Inland Revenue, HM Customs & Excise and the Valuation Office Agency.

Theme	Date	Session number	Link
Programme management, Lessons learnt	March 2010	N/A	www.nao.org.uk/wp-content/uploads/2010/06/Managing_Complex_PFI_projects.pdf
Waste, Programme management	January 2009	Session 2008-09 HC 66	www.nao.org.uk/wp-content/uploads/2009/01/080966.pdf
Defence, Programme management	October 2008	Session 2007-08 HC 343	www.nao.org.uk/wp-content/uploads/2008/10/0708343.pdf
Programme management	January 2008	Session 2007-08 HC 205	www.nao.org.uk/wp-content/uploads/2008/01/0708205.pdf
Benchmarking, PFI programme management	June 2007	Session 2006-07 HC 453	www.nao.org.uk/wp-content/uploads/2007/06/0607453.pdf
Procurement, schools, hospitals	March 2007	Session 2006-07 HC 149	www.nao.org.uk/wp-content/uploads/2007/03/0607149.pdf
Termination of PFI contract, Lessons learned	May 2006	Session 2005-06 HC 1044	www.nao.org.uk/wp-content/uploads/2006/05/05061044.pdf
Finance	April 2006	Session 2005-06 HC 1040	www.nao.org.uk/wp-content/uploads/2006/04/05061040.pdf
Finance	June 2005	Session 2005-06 HC 78	www.nao.org.uk/wp-content/uploads/2005/06/050678.pdf
PRIME	January 2005	Session 2004-05 HC 181	www.nao.org.uk/wp-content/uploads/2005/01/0405181.pdf
STEPS	May 2004	Session 2003-04 HC 530	www.nao.org.uk/wp-content/uploads/2004/05/0304530.pdf

Figure 18 *continued*

Past National Audit Office (NAO) private finance initiative (PFI) reports

Ref	Title of the report	Short summary
23	PFI: The New Headquarters for the Home Office	The report reviews the PFI contract of the Home Office deal for its new headquarters. The study focuses on the following questions: the Home Office's objectives; its procurement processes; the options assessment; and its ongoing management arrangements.
24	The Operational Performance of PFI Prisons	The report considers the operational performance of PFI prisons against the contract. It identifies how the private sector has brought benefits to the Prison Service and whether there is incorporation of innovation from the sector.
25	PFI: The Laganside Courts	The report considers whether this PFI deal is likely to deliver VfM. It applies the methodology of an earlier report, Examining the value for money of deals under the Private Finance Initiative (HC 739, 1998-99).
26	PFI: Construction Performance	This report examines the construction performance achieved in PFI projects. It focuses on three key areas of construction: price certainty for departments; timing of construction delivery; and the quality of design and construction.
27	The PFI Contract for the redevelopment of West Middlesex University Hospital	The report examines the extent to which this PFI contract is likely to deliver VfM and whether lessons had been absorbed from the earlier reports by the NAO and the Committee of Public Accounts.
28	Managing the relationship to secure a successful partnership in PFI projects	This report highlights key issues which authorities need to keep in mind when developing and managing relationships with private sector PFI contractors. The study in this report has been based on surveys of authorities and contractors responsible for managing 121 PFI projects where contracts had been let prior to 2000.
29	Innovation in PFI Financing: The Treasury Building Project	The report examines the funding competition held for the award of HM Treasury's PFI deal to refurbish its office space.
30	The Re-negotiation of the PFI-type deal for the Royal Armouries Museum in Leeds	This report examines the original PFI deal, the subsequent events which led to financial problems at the authority, and the renegotiation of the deal in 1999.
31	The Private Finance Initiative: The Contract for the Defence Fixed Telecommunications System	This report examines the extent to which the Department secured VfM and achieved their objectives for the Defence Fixed Telecommunications System project.
32	Examining the value for money of deals under the Private Finance Initiative	This report gives details of how the NAO has examined the VfM of deals reached under PFI. It focuses on objective setting, programme planning, option selection and procurement. It provides an overview to the analytical framework used by the NAO and risk allocation.

Source: Past National Audit Office reports, which are available at: www.nao.org.uk/search/PFI/

Theme	Date	Session number	Link
Programme assessment	July 2003	Session 2002-03 HC 954	www.nao.org.uk/wp-content/ uploads/2003/07/0203954.pdf
Prisons, Programme management	June 2003	Session 2002-03 HC 700	www.nao.org.uk/wp-content/ uploads/2003/06/0203700.pdf
Payment mechanism	June 2003	Session 2002-03 HC 649	www.nao.org.uk/wp-content/ uploads/2003/06/0203649.pdf
Construction	February 2003	Session 2002-03 HC 371	www.nao.org.uk/wp-content/ uploads/2003/02/0203371.pdf
Hospital, Programme assessment	November 2002	Session 2002-03 HC 49	www.nao.org.uk/wp-content/ uploads/2002/11/020349.pdf
Programme management	November 2001	Session 2001-02 HC 375	www.nao.org.uk/wp-content/ uploads/2001/11/0102375.pdf
Finance, Procurement	November 2001	Session 2001-02 HC 328	www.nao.org.uk/wp-content/ uploads/2001/11/0102328.pdf
Finance, Programme management	January 2001	Session 2000-01 HC 103	www.nao.org.uk/wp-content/ uploads/2001/01/0001103.pdf
Programme management	March 2000	Session 1999-2000 HC 328	www.nao.org.uk/wp-content/ uploads/2000/03/9900328.pdf
PFI Analytical Framework	August 1999	Session 1998-99 HC 739	www.nao.org.uk/wp-content/ uploads/1999/08/9899739.pdf

Appendix Four

Survey responses

1 Online appendix found here: www.nao.org.uk/other/nao-interactive-data-visualisation-on-pfi-contracts/

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