The case for PFI

a White Paper

May 2003

Managing car parks across the UK

CP Plus Limited 10 Flask Walk, London, NW3 1HE
T: **020 7431 4001** F: **020 7435 3280**
E: **info@cp-plus.co.uk** W: **www.cp-plus.co.uk**

Why PFI?

Private Finance Initiative (PFI) projects – and less formal Public Private Partnership (PPP) projects – bring together the public and private sector in a mutually beneficial symbiosis. Well run, such projects combine the best of both worlds, balancing private sector ideas of innovation and discipline with public sector traditions of service and affordability.

PPPs and PFIs have been with us since the 1990s but the general concept is far from new. Private companies, after all, have always been involved in public sector projects, as contractors providing design, construction, management, operational and other services. With PPP/PFI projects two important additional elements are added: the sharing of risk and increased accountability.

Most PPP/PFI projects involve the transfer of the risk and the investment burden from the public to the private sector, where it can be better managed. Under traditional client/contractor arrangements, overspends could be passed onto the public sector body and limited sanctions were available to protect against poorly performing contractors.

PPP/PFI techniques address some of these problems, while at the same time introducing to the public sector the considerable benefits of efficiency and cost-effectiveness which have developed in the more competitive environment of private sector industries.

Defining terms

What's the difference between PPP and PFI? Both terms cover the management of complex public sector investment and construction programmes using private sector expertise.

Broadly speaking, a PPP project is any alliance between public bodies, local authorities or central government, and private companies to deliver a project. A PFI is one type of PPP.

A PFI is a more specific and formal long-term partnership, covering both the capital asset and the services that form a project. Typically, under a PFI regime, the public sector sets a level of service and the private sector operator provides the services in return for a charge. So the public sector body is able to finance the project over the term of a contract, often 25 or 30 years. Funding, in the form of PFI credits, may be available from central government to support the capital element.

Though they vary tremendously, many PFI/PPP projects have the following features in common:

- long project life, usually at least 5 years, sometimes many more
- A substantial initial capital spend which is recovered over the project's life
- Financed with high levels of borrowed capital
- Income and risk-sharing determined by a long-term contract

PFI and VFM

As the provision of public assets and services involves the expenditure of taxpayers' money, it is more important than ever to ensure that funds are spent wisely, so as to achieve good value for money (VFM).

Projects ranging from schools and hospitals to roads and prisons have been financed through PPP/PFI. Car park provision is one of many public services suitable for this kind of treatment.

Why is it growing in acceptance? One of the main arguments in favour of the PPP/PFI route is its ability to deliver improved value for money.

Over recent years PPP/PFI projects have proved to be an affordable and effective way for the public sector to deliver investment in assets and services. They enable public bodies to provide better quality services, and monitor and control performance standards, delivering real value for money.

They also maximise the value of public investment by ensuring any risks attached to investments and services are dealt with by those best able to manage them -— private sector companies.

For the public sector, the main advantage of financing major projects through PPP/PFI is it removes the necessity for public sector organisations to invest large capital sums allowing them to spread the cost over a longer term.

As such payments are usually performance-related, a high degree of accountability is added to the mix.

Is PFI delivering?

A recent report (PFI: Construction Performance, 5 February 2003) by the independent public spending watchdog, the National Audit Office, presents strong evidence that the PFI approach is bringing significant benefits.

The NAO findings conclude that central government is obtaining a much higher degree of price certainty and timely delivery of good quality built assets through projects funded using these techniques, compared to previous conventional government building projects.

Under PFI, the study says, 22% of PFI projects were over budget, a dramatic improvement on the 73% overspent on traditional public sector projects. And 24% of PFI projects were delivered late, as compared to 70% of projects traditionally procured.

PFI projects are often built and designed to a higher standard, the NAO found, because the company or consortium of companies who own them are responsible for their long-term maintenance. This ‘whole life cost’ approach engendered by PFI encourages good quality design and construction.

Commenting on the dramatic improvement in performance outlines in the findings, the NAO’s auditor general Sir John Bourn said:

"The theory is that PFI should incentivise the private sector to deliver good quality buildings on time and to the price agreed with the public sector. The results of our census show that this is being achieved in central government."

So PFI is actively driving up the standards of our public sector projects and providing better services, as well as delivering built assets for the price expected by the public sector. This is good news for the taxpayer and good news for the delivery of public services.

PFI in practice

The PPP/PFI route is probably most beneficial in the case of a public body, like a local authority or NHS Trust, wishing to embark on a project that is both capital intensive and includes a high level of service provision.

Under PFIs, instead of having to produce the capital to fund a new hospital or other public facility, the project is funded by paying a private firm an annual fee to cover the entire construction, management and operation.

One of the beneficial side effects is that it allows Treasury funding to be stretched further, since the cost is spread over a number of years.

Through competitive tendering, the authority selects a private sector partner company or companies, to design, build, operate and maintain the new facility. In return for this, the local authority pays their private sector partner or partners a fee over the lifetime of the contract, dependent on how well the partner performs according to set criteria.

At the end of the period, which may be up to 30 or more years, the facility reverts to the local authority's ownership.

Project delivery

As the National Audit Office report and countless other examples prove, PPP/PFI delivers:

- value for money and improved efficiency
- transfer of risk from public to private sector
- increased provision of services and infrastructure
- access to private sector innovation and expertise

Value for money and improved efficiency

Incentivisation is built into the fabric of PPP and PFI projects, encouraging the private sector operator or operators to perform well.

So, for example, under PPP/PFI, a private sector participant will have a more pressing need to complete construction on time, as they may only start to receive payment once the facility is open for business. Other payments may be linked to the delivery of maintenance and services, encouraging the PFI private sector participant to deliver to high standards.

And since the same company or group of companies usually design, construct, maintain and operate the facility, there are opportunities to make savings by adopting an integrated approach during the whole life of the project.

Transfer of risk from public to private sector

With PPP/PFI, the private sector accepts a range of risks in relation to the project, including construction cost, completion and operational risk. For many public sector projects, the sad truth is that there is no other source of funds for large schemes.

The private sector partner has the worry of securing capital investment and maintaining and operating the building or other asset, leaving the local authority, NHS trust or other public body to concentrate on their own areas of expertise.

Increased provision of infrastructure and services

PPP/PFI enables public sector bodies like NHS trusts and local authorities to provide new infrastructure and services for minimal initial capital outlay and investment. PPP/PFI also take the longer view, ensuring that facilities are well maintained and developed throughout the project's lifecycle, which for major facilities may extend over 15 to 25 years.

Access to private sector innovations and expertise

Perhaps one of the biggest benefits of PPP/PFI is the introduction of private sector management skills and innovation into public sector projects. Again these can lead to reduced costs, increased efficiencies, and higher standards of designs, construction and operation of assets and services. This, in turn, frees public sector staff to focus on their core activities, whether this is running a hospital or providing local authority services.

How extensive is PFI?

The UK leads the world in this form of project delivery to the public sector, to the extent that other countries look to us when seeking ways of getting the private sector to help in the development of public sector services. Holland, South Africa, Portugal and Finland are all currently looking at the UK model.

The Office of Government Commerce (OGC) was set up in 2000 to work with civil departments to achieve best value for money in their commercial activities. OGC reported in December 2002 that a total of more than 500 PFI projects have been signed to date in the UK. In excess of 80 per cent of new hospitals are now being built using private finance.

Of these, (according to figures from the private sector organisation, PPP Forum, 1 January 2003) more than 150 large projects, each with a capital value of over £15 million, have been completed and are operating, with a total value of more than £11 billion. Many more PFI and PPP projects are in the pipeline.

PPP/PFI and CP Plus

CP Plus is an acknowledged expert in car park management and security, active and successful in both the public and private sectors, operating both multiple and large single sites on behalf of our clients.

We are working with local authorities, NHS trusts and leading architects, developers and construction companies on a number of major public sector projects, including those funded through the PPP/PFI route.

In the private sector, our client portfolio is drawn from a wide variety of industries, including high profile companies in the areas of motorway services, retail and transport.

CP Plus operates at more than 450 UK sites and is:

- the UK's fastest growing parking management and security company
- the leading parking services provider to the NHS
- a major service provider to local authorities and other public sector bodies
- a key service provider in the private sector, including retail, rail and motorway service areas

For more information contact:
Steve Hannington at CPPlus on: 0207 431 4001
or click here to email: steve.hannington@cp-plus.co.uk