HOUSE OF COMMONS

Public Accounts Committee

Oral evidence: Private Finance Initiatives, HC 894

Wednesday 28 March 2018

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Watch the meeting

Members present: Meg Hillier (Chair); Bim Afolami; Sir Geoffrey Clifton-Brown; Chris Evans; Gillian Keegan; Shabana Mahmood; Layla Moran; Anne Marie Morris; Lee Rowley; and Gareth Snell.

Questions 1-134

Witnesses

I: Charles Roxburgh, Second Permanent Secretary, HM Treasury; Tony Meggs, Chief Executive, Infrastructure and Projects Authority; and Matthew Vickerstaff, Deputy Chief Executive, Infrastructure and Projects Authority.

Sir Amyas Morse, Comptroller and Auditor General; Adrian Jenner, Director of Parliamentary Relations, National Audit Office; Simon Reason, Director, NAO; and Richard Brown, Treasury Officer of Accounts, HM Treasury, were in attendance.

Examination of witnesses

Witnesses: Charles Roxburgh, Tony Meggs and Matthew Vickerstaff.

Q1 **Chair:** Good afternoon everyone and welcome to the Public Accounts Committee on Wednesday 28 March 2018. In our first session, we will look at the private finance initiative—both at how the first private finance initiative worked and at PF2, which was the Treasury's revamp a few years ago.

There are 700 ongoing PFI and PF2 deals valued at around £60 billion. PFIs have a benefit to Government in that they take expenditure off the balance sheet but, as much publicity has shown, they give the public bodies that are landed with them a long and ongoing bill in their annual expenditure—so it takes it out of capital but puts it on to revenue.

We will look at the value for money of PFI and what the PF2 revamp did or did not achieve, and we will be testing the Treasury in particular on its thinking about how well PFI works in terms of short and long-term benefits, and potentially disbenefits.

Before we do that, I will introduce our witnesses and then I will ask Mr Charles Roxburgh from the Treasury about the LIBOR fund, following a letter from the Permanent Secretary. From my left to right, our witnesses are Matthew Vickerstaff, the deputy chief executive of the Infrastructure and Projects Authority. Welcome, Mr Vickerstaff. I think it is your first time in front of us.

Matthew Vickerstaff: It is.

Q2 **Chair:** Welcome to you. Tony Meggs is the chief executive of the Infrastructure and Projects Authority, and a relatively regular visitor to the Committee. Charles Roxburgh is the Second Permanent Secretary at HM Treasury. First of all, Mr Roxburgh, the Government's review of the LIBOR fund, which was supposed to be out in December 2017, is now expected, according to Tom Scholar's letter to me of 23 March, in the summer of 2018. Can I just check—that is obviously correct?

Charles Roxburgh: Yes.

Chair: What is the reason for the delay?

Charles Roxburgh: It has just taken a while to get it all completely finalised, to make sure we have got all the completely accurate data, and we will publish it in the summer. It's to make sure we have got completely accurate data on all the projects—all the charities—that have been supported.

Q3 **Chair:** So it was just a bit optimistic to say December 2017—it has just taken a bit longer to get the data together.

Charles Roxburgh: Yes.

Q4 **Chair:** However, by the time you report, in the summer of 2018, according to the NAO's estimate from its Report last autumn, 80% of LIBOR funds will have been spent. So, is it not a bit late to get that information out? You won't be able to correct anything, if anything's gone wrong.

Charles Roxburgh: We have been making sure that the funds are spent appropriately. There has been a very rigorous process and the NAO Report recognises that that process is now in good shape. It is consistent with the best practices for making sure the funds are delivered well. So, the grants have been made, but then obviously it takes time for the disbursement of the funds. However, we think we have got a rigorous process in place for—

Q5 **Chair:** Have you found any evidence so far of individual grants that have not been spent as they were intended?

Charles Roxburgh: Let me explain. The approach of the fund, as it was put in the letter, is that it can only be used for purposes for which Government Departments or services have a legal obligation to use it. If they have a legal obligation to fund something, we cannot use the top-up funds for that.

The funds have been distributed as follows. The LIBOR fines were around £689 million, and the Prime Minister made a manifesto commitment to use £200 million of that for the apprentices. That was a political commitment by the then Prime Minister. Subsequent to that, the then Chancellor made a top-up contribution to the fund with another fine on the financial services sector; it was a fine relating to foreign exchange.

If you take the £689 million, less the £200 million that was spent on the apprentices, and add the £284 million that was a forex fine, actually the LIBOR fund was a bit bigger than it would otherwise have been. That gives a total of £773 million, and we are confident that all those funds have been deployed against appropriate causes, in line with the intent that this fund was set up to support.

Q6 **Chair:** I was very interested in Tom Scholar's letter stressing the point that money couldn't be given for services that Departments had a legal responsibility to deliver, and yet we had already covered with Jonathan Slater, the Permanent Secretary at the Department for Education, this issue around their funding for apprenticeships. In your view, is the apprenticeship funding by the Department something that they are legally required to do, or is there a clever definitional issue, which skirts over the fact that they spent the money on apprentices that they would probably have delivered anyway?

Charles Roxburgh: That was a political commitment by the then Prime Minister to spend the LIBOR money on apprentices—

Q7 **Chair:** So that trumped the previous—

Charles Roxburgh: No. That was a decision that the then Prime Minister took, and it was a manifesto commitment. The fund was then topped up with another financial fine of £284 million, and then those funds—the £773 million—have been deployed in line with the intent that I set out.

Q8 **Chair:** In terms of definition, though, the delivery of apprenticeships under the definition of what a Department is legally required to do—is delivering apprenticeships something that the Department for Education is legally required to do, or does that not quite fit the definition? I'm just not quite clear.

Charles Roxburgh: The Department for Education has a mandate to deliver; I wouldn't quite know whether there is a legal obligation on it, but it is Government policy that they implement the Government's commitment to deliver 3 million apprentices, and that funding was committed to that cause by the Prime Minister.

Q9 **Chair:** When you are doing your review, you are looking at the issue around the delivery of apprenticeships by the Department for Education, as well as the—

Charles Roxburgh: No. Our focus is on the funds that were given. We have put the apprenticeship money to one side and concentrated on what is remaining of the £689 million, plus the £284 million, with the additional fund topping it up—those are the funds.

Q10 **Chair:** Just to be clear, you are not examining whether the Department for Education spent that money on what it was intended for, which was the then Prime Minister's announcement that he wanted to fund an additional 50,000 apprentices.

Charles Roxburgh: No. We were focusing on the LIBOR grants to the armed services and related—

Q11 **Chair:** But that was LIBOR money. So, it wasn't a grant directly; it was LIBOR money given to the Department for Education. It was effectively a grant; it just went to Government, rather than to a charity.

Charles Roxburgh: Yes, but as I say, that was a commitment by the Prime Minister at the time. It was subsequently topped up with additional funds—actually, a bigger fund—and that's the money we have been deploying.

Q12 **Chair:** I have to say that this just fuels my desire to have a hearing on Prime Ministerial initiatives that have emerged from nowhere. Who will be examining whether the Department for Education achieved what the then Prime Minister and, you tell me, the manifesto of the Government party expected to be delivered with that LIBOR funding injection?

Charles Roxburgh: That would be a question for the Department for Education as to how the implementation of the apprentices policy is going.

Q13 **Chair:** We have had a rather weak answer—unusually perhaps—from Jonathan Slater that he did not know the actual number yet. Our view as a Committee was that the money basically got washed into the general apprenticeship fund and was not separated out for these additional ones. As the representative of the Treasury here today, do you think that is a good way for a Department to manage this extra injection of cash?

Charles Roxburgh: The Department has to work out how best to deliver the Government policy it is required to deliver. Having lots of small pots of hypothecated money for different parts of a target for 3 million apprentices—it would make it much more difficult for the Department to deliver 2.95 million apprentices in one way and 50,000 in another. I can quite understand why the Department would want to implement it in a way that delivers the 3 million target.

Q14 **Chair:** From what you have said, when a Prime Minister—whoever it may be; they have all done it, I'm sure—makes an announcement about a pot of money at that point, somehow the Treasury says, "We are not following how it is spent and the Department for Education can do as it wishes with it."

Charles Roxburgh: No. Through our normal spending control process, we would have a lot of discussion, whether that is with the DFE on the implementation of the overall apprentices policy, which is a subject that my colleagues on the DFE spending team work very closely with the Department for Education on—

Q15 **Chair:** That is quite an important point. Was this money included in the Treasury's overview of the overall apprenticeship delivery? If you suddenly have an injection of an extra £200 million, you can have a lot of looseness around the management of the rest of your budget if you know you have that buffer zone. Or was that £200 million part of the Treasury's normal approach to watching how they are managing public money?

Charles Roxburgh: We have been looking at all of their money to ensure that they are managing it appropriately.

Q16 **Chair:** Including that £200 million.

Charles Roxburgh: Yes, we would not have a separate pot and separate processes for that as part of the process. They would be looking at the overall implementation of the policy.

Chair: I won't pick on others at this point, but I think it is worth highlighting that we have concerns about that, which we have raised with Jonathan Slater. We will continue to pursue it with him, and we may come back to the Treasury at a later point, unless any other Members have other issues that they want to raise about that. In that case, I will move on to Bim Afolami, who has a couple of questions on matters arising from the spring statement.

Q17 **Bim Afolami:** Mr Roxburgh, in the spring statement, the Chancellor talked about looking further at how we tax digital companies and technology companies. The Chancellor said there was a need to consider measures such as taxing revenues, rather than profits. Could you just give us a bit of colour as to how far that investigation has gone, or what discussion there has been in the Treasury on that issue?

Charles Roxburgh: As part of the spring statement, the Chancellor made that comment. We are consulting on those issues and the Chancellor will be reporting back in the autumn Budget if he makes decisions to go further. It was one of the areas that he set out in the spring statement. The new fiscal event structure is to have one fiscal event in the autumn, but to have a spring statement to start to raise issues that merit further debate and consultation.

Q18 **Bim Afolami:** So it is still at an open debate stage?

Charles Roxburgh: It is in the policy development process.

Q19 **Bim Afolami:** Just on that point, how easy is it to isolate what you call a "technology company" or a "digital company" from others? In particular, taxing revenues rather than profits would be quite a major change to how companies are taxed, would it not?

Charles Roxburgh: Yes. That is why it is a subject that one would want to air, debate and have these sorts of reflections on, rather than move quickly. As the Chancellor made clear, the system of taxing profits reflects a physical world where profits arise much more clearly in one location. In a much more digital world, it is worth this debate: what is the best tax base in a digital world? That is what the Chancellor is beginning the debate on.

Q20 **Bim Afolami:** As you know, this is an area of real interest to the Committee. To what extent have you or other senior civil servants in the Treasury spoken to your counterparts in other countries on this point about taxing revenues?

Charles Roxburgh: That would be a matter for my colleagues who lead on tax policy. This whole issue of a new way of taxing in terms of the international agreements—those are live discussions. We are not the only country in the world that is thinking about how the tax system should evolve for a digital world, but those are issues that my colleagues who lead on business tax are better placed than me to talk you through.

Q21 **Chair:** Just to pick up on what Mr Afolami was saying, could the UK go it alone, or is it something that needs to be integrated with other tax systems around the world?

Charles Roxburgh: There is a balance of arguments on that, and those are exactly the questions that the Chancellor will be reflecting on.

Chair: We as a Committee are liaising with our fellow Committees around the world—so we are looking at the global picture, and hopefully the Treasury will pick that up too.

We will move on to our main session on the private finance initiative. I will ask Sir Geoffrey Clifton-Brown to kick off.

Q22 **Sir Geoffrey Clifton-Brown:** Good afternoon, Mr Roxburgh. After 25 years, can you briefly tell us what the main benefits to the Government of PFI have been?

Charles Roxburgh: The main benefits to the Government? More than 700 projects have been delivered, and that has brought more schools, more hospitals and more public infrastructure. Those are good things. There has obviously been a spread of outcomes on those projects, as with any projects, but as a result we have more hospitals, schools and public infrastructure.

The question then is, is it done better through private finance than public finance? Then you get to the debate about what the merits are of publicly funding these projects versus the merits of privately financing the projects.

The vast stock of that portfolio—the vast majority—are PFI projects that predate 2010—86% of them. As you know, we have changed to PF2, but in principle the benefits of involving private finance in these projects are around the transfer of risks to the private sector. These sorts of projects are inherently risky. We have seen lots of publicly financed projects with overruns and delays, and in a properly structured privately financed project, those risks are transferred to the private sector.

Another benefit is that the private suppliers, the SPVs—special purpose vehicles—that run these projects are required to maintain them, so all of these schools and hospitals are being maintained to a high standard. At the end of their lives, when they are returned to the Government, they will be in good working order. We know, just from experience, that publicly financed projects often build up maintenance backlogs, and there is quite a high cost to catch up on the maintenance. These privately financed projects have a requirement to maintain them and return them in good working order.

The benefits are that we have more schools, more hospitals and more public infrastructure, and that they are being well maintained. Those are the benefits. We will no doubt talk about some of the costs, but we tried to address the problems of those older projects—the PFI projects dating from that period—when we changed the approach with PF2, which I am happy to talk about as well.

Q23 **Sir Geoffrey Clifton-Brown:** Now we have that on the record, let us dissect some of it. When we did our Report into this matter in 2011, we said that these PFIs had not demonstrated value for money. We asked you to publish the evidence. Our sister Committee, the Treasury Committee, asked again in 2012, and you were going to publish it in 2013. You were going to publish new evidence in 2014. You have still not published that evidence. Why is that?

Charles Roxburgh: The evidence for the benefits—

Sir Geoffrey Clifton-Brown: Yes. The value for money of PFIs.

Charles Roxburgh: The NAO has looked at it extensively. Our focus looking forward has been on the new way, to make sure that we can do these jobs properly going forwards. Ministers have just not decided to do the work required to look at that historical legacy, on which we accept there has been a mixed record, but looking forwards we are focusing on how to get the new processes in place—the PF2 contracts that we use in a much more focused way. The focus has been more on going forwards, rather than on looking back at the whole stock of projects in the past.

Q24 **Sir Geoffrey Clifton-Brown:** Okay, so you are looking prospectively rather than retrospectively. But paragraph 1.33 on page 22 states that the Department for Education got so fed up waiting for this advice that it decided to do its own. Will your Department be publishing any form of value for money on PF2?

Charles Roxburgh: The Department for Education is part of the PF2 schools process, looking at value for money. The DFE has decided—we have agreed with them—that it is a good thing to look at the value for money of those privately financed schools on PF2 contracts versus publicly financed ones—a good comparator. They will be doing that. We are very supportive of that. In fact, it is a condition of the next stage of the investment that we get that evidence to make sure that the benefits—things like the maintenance of the schools—are actually being delivered. So, yes, we will want to see that evidence, and DFE will be doing that work.

Q25 **Sir Geoffrey Clifton-Brown:** In line with not having the value for money evidence published, the second of our Report's conclusions was that there was a lack of transparency and information. That was way back in 2011, and I think the same criticisms are there today on that as well.

Charles Roxburgh: On transparency, one of the difficulties that the PFI contracts had is that we didn't have the detailed insight into the workings of each individual SPV. For the PF2 contracts, we have addressed that. We are an equity investor in those SPVs. We have full insight into the economics, so we get much more information. There is much more transparency on those PF2 contracts.

Q26 **Sir Geoffrey Clifton-Brown:** Another of our criticisms that still seems to apply today was that there were circular arrangements and tax avoidance mechanisms going on, particularly in the secondary market for sales of the equity in these PFIs. That is still going on, but that recommendation was from 2011.

Charles Roxburgh: The vast majority of the SPVs are UK tax domiciled. They are paying corporation tax. If you have evidence that they are not, HMRC would obviously wish to know that.

Q27 **Sir Geoffrey Clifton-Brown:** There have been certain well-publicised cases where the equity element of some PFI contracts or groups of PFI contracts have been sold to offshore arrangements that are paying virtually no UK corporation tax. That is well known. It is in the public domain. This was drawn to your attention in 2011 and it is still going on. Why have you allowed this to continue?

Charles Roxburgh: Your word was "avoidance". If it is not consistent with the tax regulations, HMRC would obviously take action. We cannot have a rule in the PFI contracts that they have to be tax domiciled in the

UK. That is not consistent with public procurement rules. We cannot discriminate against foreign domiciled companies in those, nor can we discriminate against tax-domiciled people elsewhere under our treaty obligations.

So long as it is legal and consistent with the tax laws enforced at the time, we cannot take action against where the end investors sell their participations to. If you think there is evidence of inappropriate tax evasion, we would obviously wish to know and to take action on it.

Q28 **Sir Geoffrey Clifton-Brown:** I might be treading on other people's toes, but one of your considerations in the PF2 considerations was to somehow limit the amount of secondary sales that could be done. By doing that, you would, ipso facto, limit the amount that could be sold to offshore vehicles. I am not at all suggesting that the offshore vehicle is illegal, but I am suggesting that these organisations are profiting at the taxpayer's expense.

Charles Roxburgh: The special purpose vehicles are paying corporation tax on their profits in this country. That is the arrangement.

Q29 **Sir Geoffrey Clifton-Brown:** You are still circling around the question, if I may say so, Mr Roxburgh; we all know what we are talking about. What is actually happening out there in the market is that the equity part of these PFI contracts, which can have excessively high rates of profit—the report says over 30% in one case—are being sold to offshore operations; that specific one may not be, but others are. There is a very high rate of profit on the equity element, and when they are sold off to offshore vehicles, virtually no corporation tax is paid. That is surely gainsaying the system in a way that was never designed to happen.

Charles Roxburgh: Under the system as it works now with PF2 contracts, the equity returns are transparent. They are not at that level. We have introduced equity competitions to get competitive pressure to get the equity returns down, so we can avoid those situations where there were those excessive returns. We have taken action on your concern about there being excessive profits.

The ownership of that equity may be held by a UK pension fund that isn't paying tax. On whether we can therefore actually intervene in who owns these things, depending on whether they are tax exempt, as a UK pension fund is, or tax-domiciled overseas, and discriminate in that way, that is not something that we are doing. We have tackled the problem at source to get more competition for the PF2s that we do, so that the equity returns are competitively set and reasonable.

Matthew Vickerstaff: Can I just make some observations as well? I think that what you are saying is slightly out of date with the market at the moment. It is the case that primary investors sold their equity to secondary market investors, but now, essentially, a tertiary market has been created with many UK pension funds, local authorities and life insurance companies, UK-domiciled, being the end investors in these assets. There are publicly quoted companies as well, and the returns that they seek are nowhere near the levels that were achieved in the past. That is partly because the cost of capital has come down and partly because new contracts have not offered the same returns that the early deals, which were more risky, did. Unfortunately they did create that risk profile, and that reward profile as well.

So I think what you are characterising is a little bit rear-view mirror. The reality now is that, as I say, the likes of the British Coal pension fund, the university superannuation scheme—

Q30 **Sir Geoffrey Clifton-Brown:** I am going to move on, because we have an awful lot more to cover. I am simply looking at 700 PFI contracts under PFI1. You have only had 12 under PFI2, so the reality is that I do not know how we can say what the reality is now, because we do not have enough evidence. Let us see. The point I am trying to make is that we should not be gainsaying the taxpayer in this way.

I want to move on, Mr Roxburgh. Most of the 700 PFI contracts, as you have already alluded to, were done before 2010 when interest rates were very high. As we all know, with the compounding effect, a small difference in interest rate can make a huge difference in the end result and the amount that is paid. I think the graph in figure 7 makes that very clear; it almost doubles the cost. If you were doing them when interest rates were high, when the cost to the taxpayer over a 25 or 30-year period was very considerable because of the high rates of interest, why have you stopped doing them or reduced the number drastically now that interest rates are low? When interest rates are low, that is surely when you would get the maximum benefit from these PFIs.

Charles Roxburgh: We are using PF2 in a much more focused way than was the case for PFI. In the peak years PFI was doing more than 60 projects a year, with over £8 billion of value. PF2s, over the three or four years since they were introduced, have accounted for 0.4% of total public sector investment, so this is a very small specialist approach to financing public investment. We are not driven by trying to call the interest rate cycle. That is not what we think about when we use these forms of financing.

With PF2 we are looking to see whether this type of contract is a better way of getting value for money from the specific project being proposed, and that will come primarily from the transfer of risks. That would be the situation in which we would use PF2, when the value for money is better by using PF2 than by using public finance in a public sector comparator. We have to do that comparison as part of the evaluation. The public sector comparator may well have lower financing costs, which is what you would expect, but the PF2 version of it will have benefits from the risk transfer because we will not be exposed to overruns and delays.

It is only if the PF2 contract gives us better value for money that we would use it. That is a pretty high bar, particularly when there is an awful lot of other public investment going into infrastructure, and the Government have increased that. We are now increasing public investment in infrastructure.

So I would not think the change is anything to do with the interest rate environment. There is a different approach, a much more rigorous approach, to when it is appropriate. It is a very high bar to beat the public sector comparator. I have been the accounting officer for nearly two years and I have not done one of these contracts yet. I am hoping that we will get some good contracts to review in future.

Q31 **Sir Geoffrey Clifton-Brown:** That is the next question. You have said yourself that the Government intend to spend a greater proportion of GDP on infrastructure. That will need funding in one way or another, so what can we expect in terms of the use of PFI going forward and the need to fund that infrastructure?

Charles Roxburgh: It will be a useful tool to have in the range of options for financing public infrastructure. We think it is appropriate in certain circumstances. May I invite my colleagues from the IPA to talk about some of the specific types of projects? Value for money is a critical point; if we are transferring the risks, we have to be confident that we are transferring them to partners who are able to manage them better than we can in the public sector.

Q32 **Sir Geoffrey Clifton-Brown:** That was not the question. The question was this: of the new infrastructure projects going forward, what sort of percentage of our total infrastructure spend each year would you expect to go on PFI2?

Charles Roxburgh: I would expect there to be a few projects, but it will be a small percentage. We have not done a new PF2 project since April 2016, which was the last of the schools programmes. We think there are some promising projects on the horizon—some good roads projects—but we are talking of a handful rather than going back to the days of the 2000s, when it was up to one a week and £8 billion a year at the peak.

Q33 **Sir Geoffrey Clifton-Brown:** A handful. I am trying to get a handle on this. What does that actually mean, either as a percentage of the spend on infrastructure or the total number of projects and their value?

Charles Roxburgh: We are not setting a budget for that, because we're driven by the projects—

Sir Geoffrey Clifton-Brown: You must have an idea how you're going to finance—

Q34 **Chair:** It takes it off balance sheet. You have a lot of projects, with the Government's firm commitment to deliver on big infrastructure. If it's not off balance sheet, it's on balance sheet; you must have a limit there. And then the PFI would presumably absorb the rest, in very simple terms—I mean, it's obviously not as simple as that. Perhaps you could have another stab at answering Sir Geoffrey's question.

Sir Geoffrey Clifton-Brown: Either you or Mr Meggs or Mr Vickerstaff—I don’t mind.

Tony Meggs: Let me just say—I probably won’t help much more—that we have got a small handful of projects, maybe half a dozen, that we are currently looking at. Two in particular are referenced in the NAO Report. One is around the lower Thames crossing; a portion of that project. And the other is the A303.

Q35 **Chair:** Mr Meggs, do you advise about whether PF2 is a good option as a funding vehicle? You aren’t getting a new role, so does your remit extend to that?

Tony Meggs: Our remit extends to ensuring that when people look at this as an option they follow the right standards, and that the assessment they’ve done—we do this with the Treasury, but we have real expertise in the valuation of this, as people have been working on it for many years—ensures that they’ve applied the methodology appropriately, and in particular the transfer of risk, which needs to be carefully calculated. If these are appropriate projects, then we will opine on whether or not their analysis of this approach versus public sector financing has been properly done.

Q36 **Chair:** Do you look at the long-term costs to the institution—the hospital, the school or whatever—as part of your analysis?

Tony Meggs: We do not look at the total budget of the national health service 25 years from now, for example, but we do insist that people take a look at the long-term affordability when they enter into these kinds of contracts. That is part of the Green Book methodology. It requires Departments, or whoever is doing this, to make an assessment of long-term affordability. So if there was a situation where a party wanted to enter into one of these contracts and we could see that it would take up a substantial proportion of their future budget, we would advise against that.

Q37 **Sir Geoffrey Clifton-Brown:** So I see I’m not getting the answer. Could I ask you, Mr Roxburgh, to let us have a letter as to how many PFI projects there are and what value you expect them to be over the next year? I don’t think that’s an unreasonable question. I just want to get a feel of how much we’re going to use this vehicle. As the Chair says, an off balance sheet vehicle would be quite useful to know.

Charles Roxburgh: Happily. For the next year? Is that the time horizon?

Q38 **Sir Geoffrey Clifton-Brown:** If you can give us a forecast beyond the next year, so much the better, but even the next year would—I mean, I haven’t got from you this afternoon any sort of feel as to how much of my infrastructure is going to be funded through this mechanism, and considering that this is a hearing on PFI2 I’m somewhat surprised—

Charles Roxburgh: We have given you two specific projects.

Q39 **Sir Geoffrey Clifton-Brown:** I think Stonehenge will also be—

Charles Roxburgh: That is the A303.

Chair: Given that Sir Geoffrey is the deputy chair of this Committee and represents that area—*[Interruption.]*

Charles Roxburgh: I will come back to you, but the ones that are currently in the public domain as debated are those two. There may be others, but we are talking about a very small proportion of the current level of public expenditure, which is £50 billion a year on investments, and the overall infrastructure pipeline across this whole set of purely private investment—

Q40 **Sir Geoffrey Clifton-Brown:** We will rely on a letter, but I would just quite like to have known, out of that £50 billion, whether you are thinking about £1 billion, £2 billion, £5 billion, £10 billion, or what it is.

Tony Meggs: Two.

Sir Geoffrey Clifton-Brown: Around £2 billion—so five questions and we get there.

Chair: It is around 4% of the total expenditure.

Tony Meggs: If you look at the projects that we are discussing right now, which will occur over the next three years, that is around £2 billion to £2.5 billion, I think; it is the amount that we are considering.

Q41 **Sir Geoffrey Clifton-Brown:** Is that the total you are considering for this coming year?

Tony Meggs: That is the only things that we have got real focus on.

Chair: Of course that is in the Infrastructure and Projects Authority's overview, which is the larger end of things.

Tony Meggs: Within our own—

Chair: That might not be the total, this number.

Tony Meggs: Could I just make another point?

Sir Geoffrey Clifton-Brown: Yes.

Tony Meggs: We are using it less, and I think one of the things to say is that it is about risk transfer. A point I just want to land is that I think we are very stringent in the way that we assess it, but also I think the public sector's ability to design and construct projects on time and on budget—is improved. Therefore the risk transfer, i.e. the probability of a publicly funded project running over budget, is lower, I believe, than it was when PFIs began, because we have learned a lot along the way. Therefore the test becomes a much higher hurdle, to prove that you are going to do much better than the public sector.

Q42 **Sir Geoffrey Clifton-Brown:** Thank you.

Mr Roxburgh, one or two individual health trusts, one or two local education authorities, principally because of the timing of when they did their big infrastructure project—building their hospital or new school or whatever—are saddled with disproportionate costs as a total of their budget. Is there anything that the Treasury is proposing to smooth that problem from them? After all, it probably was not their fault. It was just that they needed a hospital or a school at that time, when interest rates were very high. They are saddled with this for the next 25 or 30 years. What is the Treasury looking at to help with this?

Charles Roxburgh: In the first instance, the trusts should talk to the Department of Health. There may be opportunities to reduce the cost within the existing contract, so that would be the first port of call. The second port of call would be the IPA. The expert team there can and do help, and have helped, with some of the renegotiations, if that is appropriate, or with some of the ways to get better value out of the existing contracts. I cannot make a commitment about future policy, but in the past there have been some areas where direct financial support has been made available to a small number of trusts where it was demonstrated that that was necessary to ensure their future financial stability. That has happened in the past; I cannot make any commitment about future policy. In the first instance the trust should talk to the Department of Health.

Q43 **Shabana Mahmood:** Mr Roxburgh, can I just take you back to your very first answer, when we were talking about the benefits of PFI? You spent a bit of time talking about transfer of risk and certainty around construction costs. That does not mean, of course, that construction costs will be lower; so often a higher price is baked into those construction costs to give you the certainty that you are looking for. That is correct, isn't it?

Charles Roxburgh: There may be some element of that; you get certainty, but also, in a competitive process, you would want to make sure that the proceeds were not excessively high.

Q44 **Shabana Mahmood:** The Treasury Committee, as noted in the NAO Report, found that some PFI projects charge higher prices for construction, to cover unforeseen costs. I am just establishing the point that the great benefit around certainty of costs probably has come at bigger cost anyway.

Charles Roxburgh: In evaluating the project—let us say we are looking at the parallel, as was the case with schools—if you are saying, "Look, this is a PF2 contract on schools, and typically a school costs x to build; well, we are now getting a certainty of building the same type of school for 3x", then obviously that would not be good value for money, and you would challenge that, and that would not get approved. There are processes to check that.

Q45 **Shabana Mahmood:** But the difficulty is around the quantifying of the benefits, isn't it? That is what we have tried to push you and the Department on previously—the difficulty of getting some adequate data so we can measure what these benefits really mean. That takes us right back to the opening of this hearing. What are those benefits, and how do you quantify them?

Charles Roxburgh: What we do with project evaluation now is exactly that rigorous process of quantifying the potential benefits. What we have not done is gone back and done that for the entire stock of projects, retrospectively against credible counterfactuals at the time, because that would be a huge amount of work. What we do when we are evaluating these PF2 projects is exactly that process of trying to make sure that the bids are reasonable—that there is not an unreasonable level of excess profit built in—and, where we quantify, what the benefits are for this risk transfer. That is a process that the teams have to justify and quantify. We use that and test that as part of the VFM contract.

Shabana Mahmood: I think Mr Meggs wants to come in.

Tony Meggs: I want to add a couple of things, if I may. I have to agree that the lack of historical analysis is not something that I am happy with. That applies more widely than PFI.

Q46 **Chair:** You say you are not happy; none of us is happy with it, but are you saying that it hampers you and the Treasury in your ability to judge—

Tony Meggs: No. Sorry, what I was going to say is that we have now recruited somebody for the sole purpose of going back and gathering better evidence about the effectiveness or otherwise of these approaches. Because of the fact that you either do it this way or do it that way, the counterfactual—as the Treasury says—is always difficult to come by. But we have taken somebody on board to do quite a bit more work in this area, to really better understand and answer some of the questions that you have asked.

Q47 **Chair:** Is that understanding current bits?

Tony Meggs: No, we want to look more widely at it.

Q48 **Shabana Mahmood:** You say you want to look more widely; when did you hire this person, Mr Meggs? What is their exact remit? Can you give us some specifics, please?

Tony Meggs: I don't know, he works for Matthew.

Shabana Mahmood: It all sounds good, but it sounds broad and not very detailed.

Matthew Vickerstaff: It is a back-testing. The other area that we will be focusing on is where assets are coming off their PFI contracts. With those contracts, we should be able to look at the underlying assets—the hospitals and the schools—and see how well maintained they are, and compare that with assets of similar maturity, so schools that have been in the public sector, where we are constantly told that there is backlog maintenance. That is the factual evidence. We can test if the model is working, from a whole-life maintenance and discipline perspective. That is one of the huge advantages of these contracts.

Q49 **Shabana Mahmood:** But on the exact point that Mr Meggs made, you said you were not happy about the lack of historical understanding. We are not just unhappy about it; we consider it to be a pretty big gap. You have somebody who will fill in some of those gaps. Will they fill them in just in relation to long-term maintenance, or is it a broader project?

Matthew Vickerstaff: The frustration that we are surfacing is that it takes a lot of time to populate a database: people go out and get the data, and it costs money to get the Departments—now devolved authorities—to spend time reviewing assets. It is extremely expensive to do a survey of 700-odd projects on that basis. I know that is frustrating; we have the same frustrations, but that is one of the big barriers to making this data available.

Q50 **Shabana Mahmood:** Forgive me, Mr Vickerstaff, it is a bit more than a frustration, isn't it? We have 25 years-worth of data sitting around all over the system. It is quite important to understand some of those gaps. We have already moved on, as Mr Roxburgh said in his second answer to Sir Geoffrey. It is all about going forward. But you need to know where you are going forward to. You have to have some idea of the gaps you are trying to fill before you can say confidently before this Committee that you know that you have fixed some of those problems. How have you come to that conclusion without having done the kind of data analysis that the Committee has been pushing for for a number of years?

Matthew Vickerstaff: The data doesn't exist—that is the problem. We have to go out and collect the data.

Q51 **Shabana Mahmood:** It doesn't exist with you, but it exists in the system—that is correct, isn't it?

Matthew Vickerstaff: No, it doesn't.

Tony Meggs: It doesn't always, because if a project's cost overruns under a PFI construct, and the cost to the Government does not change, we do not necessarily get that information, historically. It is not readily available; it is private data. I would hate to raise hopes too high here. We will do what we can with the data that we can find, but it is not readily available in any register or anything.

Matthew Vickerstaff: We absolutely agree—we would love to have an asset register for each Department and each devolved authority, where they track the costs, benefits and status, just as you might have in the private sector. However, it would be an expensive exercise.

Shabana Mahmood: I have to say, your answers have further shattered confidence in the certainty of PFI projects, rather than improving it.

Q52 **Chair:** May I just ask how many PFI deals that have finished will the person doing this work be looking at?

Matthew Vickerstaff: They will be surveying the whole portfolio, so far as data exists. As I am saying, the data does not necessarily exist.

Q53 **Chair:** So all 700 PFI deals will be looked at?

Matthew Vickerstaff: We will be attempting to find the data on all of those, yes.

Q54 **Chair:** Are you focusing on any in particular in short order—say, a school where you have a clear counterfactual, with one school being maintained in the traditional way and one under PFI next door, for example, or in the same town? Are you looking at some examples like that to get a quick win, and a quick bit of data?

Matthew Vickerstaff: The priority schools building programme, as we have said, is a survey that will be extremely valuable, and that is in train. We will then also focus on projects that are coming off contracts. There are many projects to evaluate and look at, as you know.

Q55 **Bim Afolami:** We have spoken a lot about the lack of data at the centre—I appreciate that. Is that not almost the central problem? You have the Treasury, which sort of came up with this idea, and you have the Departments, which use this idea in order to fund certain things. There is nobody at the centre looking at this from a holistic perspective. Was that not one of the key problems with this?

Tony Meggs: If I may, there are two things. I think we are looking at it from the centre from a holistic perspective, and we are constantly looking for ways to learn from the lessons of the past. Although we may not have been great at collecting a lot of data, I think we have been quite good at learning lessons centrally. We have PF2, and over the years we have consistently revised the standard contract. We have another revision of the standard contract. Those things are incorporating the things that we have learned as time has passed. Yes, there is an issue with data. By the way, I would say that the issue with data applies to public sector projects as well, which is to say that the Government historically—

Q56 **Bim Afolami:** On balance sheet as well.

Tony Meggs: Yes. This is not something that the Government historically have done very well, and we are trying to improve that in the project's arena. I do not think that it is necessarily a PFI-specific thing. We do have a central view of what works and where the issues have been. We have consistently worked over time, and not just with PF2, to deal with some of the issues that have been observed.

Charles Roxburgh: On the question of looking at the whole Government balance sheet, the Chancellor announced in the autumn Budget that we are taking much more of a whole-balance-sheet view. We do the whole of the Government accounts, which I think is something that the Committee has taken an interest in and approves of. We are also taking a much more detailed look at the specific assets on that balance sheet and all the liabilities to see how we can manage those better by taking more of a top-down view across the totality of the £1.7 trillion of assets and the £3.7 trillion of liabilities that we have on the national balance sheet.

We are taking that top-down view. Within that, PFI contracts are on that balance sheet. It is a bit of a misnomer to say that PFI is off balance sheet. It does not count for one fiscal metric, but it is on our Government balance sheet for the whole of Government accounts. As part of that we look at all these assets. Against the £1.7 trillion, the £59 billion of PFI contracts is a relatively small part of the total Government balance sheet, but we are going to look at it all top-down.

Q57 **Bim Afolami:** Okay. If we look back and imagine that the debt to GDP ratio was now 10%—it is obviously a lot higher than that—do you think that we would even be considering PFI at all?

Charles Roxburgh: In the context of where we are today, we have very high debt—86.5%, which the Chancellor said is too high—and PF2 contracts account for 0.4% of the total public investment in infrastructure. The Chancellor has committed to increase public investment in infrastructure. It is going to be rising through the course of this Parliament, and is going to be at its highest level for 40 years. The answer to your question is that we will do these projects if they provide value for money, whether debt is 86.5% or 10%. If it is a better way to spend money, we should get better value for the users of those public services by using it, regardless of the level of debt.

Q58 **Bim Afolami:** This is interesting. What you are saying is that, in terms of the assessment, the level of debt to GDP should not be relevant, in terms of deciding whether to do a PFI project or not.

Charles Roxburgh: Correct. It should be the value for money.

Q59 **Bim Afolami:** Depending on which project it is and when it was entered into, the NAO said that doing a PFI project is between 2% and 3.75% higher, in terms of cost, than Government borrowing on gilts. We have talked about data, so let us not go back on that. Do you think the benefits of that spread have come through? Do you think it has been worth it to pay between 2% and 3.75% more to deliver these projects than we would have paid if we had just borrowed the money using normal gilts?

Charles Roxburgh: That is an impossible question to answer on the stock, because we simply don't have the facts. We have better data on the more recent public schools building programme. That was exactly the analysis. I can talk you through that analysis in a second. Because the DFE is doing a post-audit to see how it is turning out, we will get a better read about whether the benefits are not being realised in line with our expectations. The analysis behind the public schools building programme was to look at building those schools, versus the public-sector comparator. Yes, there is a higher financing cost, but there are two benefits. First, the profile of the cash flow is different—this is in figure 4 of the Report. That shows undiscounted cash flows. When we evaluate long-term cash flows, we discount them. We use the Government process—the approved policy—for that, which is the Green Book policy. We discount those cash flows.

Q60 **Bim Afolami:** That discount rate hasn't changed since when? 2003?

Charles Roxburgh: Correct. It is the social time preference rate. It is not linked to the rate of gilts—

Q61 **Bim Afolami:** No, I know how it works. The only flexible metric within that is inflation—RPI. Am I right?

Charles Roxburgh: Yes. Well, the social time preference rate of 3.5% is a real rate, so that doesn't include inflation.

Bim Afolami: No, but then it is plus—

Charles Roxburgh: And then if you are discounting nominal cash flows, you would use a nominal rate. Technically, in the Green Book, you should discount constant cash flows at the real rate, but that is a minor point.

Q62 **Bim Afolami:** The real rate, rather than the nominal rate.

Charles Roxburgh: As long as you are discounting nominal cash flows at a nominal rate, rather than mixing them up, it is fine.

Q63 **Bim Afolami:** So what you are saying is that it is impossible to know now, going on the vast stock of pre-2010 PFIs, whether entering into those projects was worth it, in comparison with a public sector comparator. You are saying that you do not have the data and it is an impossible question.

Charles Roxburgh: We cannot recreate those analyses.

Q64 **Bim Afolami:** What is your feeling on this, and the feeling within the Treasury and the IPA? I appreciate that you don't have the data, but what is your sense?

Charles Roxburgh: We are using PF2 much more sparingly now and in a much more focused way—if we thought that in today's conditions, for today's supply projects, with today's capability in Government, we would get better value for money by doing £60 billion of projects a year, we would do that. Demonstrably, we do not feel that. We think it is a much more focused technique, which is appropriate in some circumstances. For the vast majority of public infrastructure now, the Chancellor's decision has been to increase public investment to support building public infrastructure. In parallel, there is huge investment in infrastructure by the private sector, including airports. Digital, energy and water infrastructure is privately invested. So the totality of investment in the nation's infrastructure is a mix of public investment, private sector investment and then this—at the moment, very small—sliver of public-private partnership projects, which is appropriate in certain very narrow conditions.

Q65 **Bim Afolami:** On that point, one of the difficulties we have around private investment is that we talk about infrastructure as if it is one thing. It is not one thing, because there are all sorts of different types of infrastructure. Some is easier for private investment than others. Bearing in mind—I think it is fair to say—the decreased enthusiasm for PFI that there is now compared with 15 years ago, what areas do you feel will find it difficult to attract private investment in the future?

Charles Roxburgh: This is one of the questions that the National Infrastructure Commission will look at when they think about a 30-year strategy for the nation's infrastructure. They are taking a broad view. They have a fiscal remit that is set at 1% to 1.2% GDP, which guides the scale of publicly funded infrastructure. Obviously, when we get private investment on top of that, that is not constrained by a public measure. I will ask Tony and Matthew to come in on this. The challenge is that it is not actually the availability of finance for a lot of these projects; it is much more how you create a funding model.

Q66 **Bim Afolami:** An investment model. Yes, I understand.

Charles Roxburgh: In other countries, people finance roads with tolls. This country has decided not to do that, and therefore roads are almost entirely publicly funded, but other countries have made a different choice. That is a political choice as to whether you have a revenue model that can attract private finance. For roads, we have not made that choice, but other countries have made a different choice. Matthew and Tony, do you want to add anything on the issue of funding?

Matthew Vickerstaff: Certainly. You will absolutely be aware that there is a huge appetite for infrastructure financing in the private sector, both through a regulated asset base model and actually, I think, even through private finance, so PF2 as well. There are dynamics around that. Long-term pension funds and life assurance companies want investment-grade assets. Projects that go through their construction phase are sub-investment grade, so that does need support from investors to get them to investment grade. Similarly, in the regulated asset base model there is a huge appetite where you have a stable regulatory environment with a return target provided by Ofwat, Ofgem, CAA for airports, water and so on, which does bring in competitive, attractive, value-for-money financing from the private sector. I think the skill is to present investable opportunities to the market.

Just picking up on your point, which is covered in the NAO Report, about the weighted average cost of capital. The blend of debt and equity costing is 4.2% averaged across the schools projects that were done. The long-term gilt rate is 2% at the moment. That is around a 2% differential. In the NAO Report it is compared with 2015 and 2016. In reality, those returns will flow only once the projects are complete, so they are not happening in 2015 or 2016. They may happen in the future.

Again, if the projects are delivered on time and on budget, the risks are transferred and the schools are open and available for use. It comes back to that risk transfer issue—is that a premium worth paying? Once we have done the value-for-money analysis, and we are certain that it is value for money, then it is worth paying. Now should be a very good time to do it, because of the appetite, the finance and the competitive market that there is.

Q67 **Bim Afolami:** Mr Meggs, do you have anything to add? No? You are happy. Mr Roxburgh, you talked about other countries. I know you talked about concessions, and road tolls as a very obvious example. What other countries copied our PFI model? If not, does it surprise you that they didn't?

Charles Roxburgh: Mr Vickerstaff has some comments on that.

Matthew Vickerstaff: Australia and Canada did. The US has many similar features. Most European countries have borrowed our standard form contracts. South Africa, Chile and Colombia have very similar contractual arrangements.

Q68 **Bim Afolami:** Are they continuing to do it more than we are?

Matthew Vickerstaff: Canada has a very strong infrastructure push at the moment; the Prime Minister there is pushing that hard. Australia is also selling regulated utilities and using money at the federal level to give to states to invest in social infrastructure and some transportation. They have very big infrastructure programmes at the moment—Europe less so.

Q69 **Bim Afolami:** What you are implying is that, in terms of this funding model, Britain was a leader?

Matthew Vickerstaff: Definitely, but also, because we were an early adopter, mistakes were made that have been improved.

Q70 **Bim Afolami:** Which other people are now not repeating?

Matthew Vickerstaff: Not necessarily. They have also taken advantage of the improvements we have made along the way, which would include PF2.

Q71 **Bim Afolami:** Do any other countries do things such as, for example, limiting equity returns for investors, or anything like that?

Matthew Vickerstaff: Different countries have different approaches.

Q72 **Bim Afolami:** But some do? It is possible to do?

Matthew Vickerstaff: Some do, but some are more relaxed about the idea that if you take the risk then you should receive a fair reward for taking that risk.

Q73 **Bim Afolami:** On this particular point of limiting equity returns, have some countries done that? Has anybody done that?

Matthew Vickerstaff: There have been some. For example, in concessions, you can have highway usage fees so that—

Q74 **Bim Afolami:** If the fees don't go up to a certain level, then you get the—

Matthew Vickerstaff: Yes, you have profit sharing above a certain level.

Q75 **Bim Afolami:** Right. But on limiting equity returns?

Matthew Vickerstaff: Generally not, because otherwise you would not attract the equity.

Q76 **Bim Afolami:** That is presumably why we have not done it?

Charles Roxburgh: We have done equity competition. That is our response on that.

Q77 **Chair:** And that is under PF2?

Charles Roxburgh: Under PF2, yes.

Q78 **Chair:** Would you say it is successful so far? It is such a small sample.

Charles Roxburgh: It is early days yet and they are small samples.

Q79 **Bim Afolami:** I have one more question. What surprises me, and I think it will surprise others if they read this transcript—as I am sure millions will—is the extent to which you have all been pretty adamant that the percentage of how much debt the country has was not a relevant consideration in whether to do PFI.

Charles Roxburgh: I am saying that is how we would approach it now. We would approach it now with the rigorous Green Book assessment. The Government debt level is not a criterion in the Green Book.

Q80 **Bim Afolami:** It may not be a criterion in the Green Book, but a lot of people will find that surprising.

Charles Roxburgh: How we would approach it now, in evaluating projects going forward, would be to focus on the value for money considerations and particularly the risk transfer. If you compare it to a public sector comparator, it is a high bar to beat, so you have to be confident that the benefits and the risk transfer are there. In that equation, the level of debt is not a factor.

Q81 **Shabana Mahmood:** Can I take you—Mr Vickerstaff and Mr Meggs in particular—back to our discussion about your very helpful revelation of the additional analysis that will be carried out?

Tony Meggs: I thought that would be really good news, but apparently it is not.

Chair: It feels like a daunting task.

Q82 **Shabana Mahmood:** It could be good news. Did I hear you right when you said that all 700 PFIs would be looked at?

Tony Meggs: I should be clear and get expectations in the right place. We have hired somebody with some background and experience in the area to come in specifically with the task of looking at all the available data, including some of the things Mr Vickerstaff mentioned, because it is not just about cost, but about the total life of the asset and so on. They will be looking at that and seeing what we can glean from the data that we can find. It would be wrong for me to say, “We’re going to go out and look at every one of 720 projects, and find out exactly what each one cost and which overran, etc.” That is the first point. We will do what we can, but the specific task of this individual is to study for us the historical data—

Q83 **Chair:** Just to be clear, is that across all 700?

Tony Meggs: Across all that we have. We intend not only to look forward in this work, but to try to address some of the issues. The second thing I want to make clear is that this is not a straightforward analysis. You are doing several things when you do PF2 or PFI, including transferring risk and better quality of assets at the end. The transferring of risk talks about getting price certainty, so in some sense you are paying insurance for something that may or may not happen. You have to take quite a statistical approach to this. It is not as straightforward as saying, "If we did it this way, or this way." I am not making myself very clear here.

Shabana Mahmood: I understand the point.

Tony Meggs: I just wanted to demonstrate that data is scarce and analysis is complex, but we are going to do the best we can.

Shabana Mahmood: But you are brave and you are doing it anyway.

Matthew Vickerstaff: We are going to try to find what data there is and to try to unearth data on every project. I have concerns on some projects, because we found that the data isn't out there. We will attempt to analyse all data that we find, but it might not have 711 line items.

Q84 **Shabana Mahmood:** The Department for Education is, as we know, already collecting some comparative data on the costs of privately and publicly financed projects. Have you had a discussion with them? How will their work cross over with what you are doing?

Matthew Vickerstaff: We are very much involved in discussing its report, which is, as I say, well under way.

Q85 **Chair:** So are they ahead of the game, compared with you and the Treasury?

Matthew Vickerstaff: Obviously, because of the changes that we made to PF2, the priority schools building programme was easier. We were specifically targeting transparency and analysis of data, so that is something that is being actively prepared.

Q86 **Shabana Mahmood:** What are the timescales for this piece of work? Do you have something in mind?

Charles Roxburgh: Over the summer.

Tony Meggs: I think it will be ongoing work.

Charles Roxburgh: I am sorry; was your question about the IPA's backward-looking review or the DFE review?

Shabana Mahmood: Both, in fact. I was going to come on to the DFE review.

Tony Meggs: I don't want to characterise it as a review. I am sorry; I may have been misleading. We have hired somebody to come and work on this, pretty much on a full-time basis, to see if we can build our knowledge. We will not necessarily produce a report on a certain date. That isn't how we have structured it.

Q87 **Shabana Mahmood:** Can you understand why it is a bit strange that you are doing that with, it sounds like, one person on a part-time basis? It is not happening centrally, through the Treasury.

Tony Meggs: We are the Treasury in this context.

Q88 **Shabana Mahmood:** Okay, fair enough. So you can't give us a timescale, but the DFE is saying over the summer?

Charles Roxburgh: Over the summer, yes.

Shabana Mahmood: Okay, so when we are back from recess we will have some new information to play with.

Q89 **Chair:** In all of that, you are looking at the correlative cost, but we know that there are other real-word factors, which may not be financial. For example, *Schools Week* had a recent story on 9 March about United Learning, which is a large academy chain that has refused to take on any PFI schools because they say it is just not worth the hassle. That is an education provider that says it won't touch them. There are real-world aspects to PFIs. Are you factoring any of that into the work that you are doing, or into a separate piece of work about the practical impacts?

Tony Meggs: I think we recognise that PFI—as it was, in particular—comes with advantages and with costs. One of those has historically been the rigidity and inflexibility of long-term costs. These are things that we have tried to address going forward. I don't think we can go and fix history, other than by our team that works with Departments and with individual projects to try to reduce operating costs and those ongoing PF2 costs. However, it is the nature of PFI contracts, particularly the older ones, that you get something early and you pay for it over the long term.

I am not sure that there is much we can do. I don't want to sound heartless here. There have been cases where problems have been solved, such as where things have been bought out. Again, I don't want to sound as though we don't recognise the issue, but I should point out that, for example, in Health or in Education, while they might be large in the local context, they represent only 2% of the total budgets—I say "only". I just want to get it in the right context here.

Q90 **Shabana Mahmood:** Yes, but at a local level, what it means for local budgets is a big deal. I don't think it is not possible to downplay that.

Tony Meggs: I am not downplaying it.

Q91 **Shabana Mahmood:** You can understand that as constituency MPs we take a different perspective. Stories of the sort the Chair pointed out have a big impact locally just on confidence in the local health economy, for example, and on providers. You would accept that, wouldn't you?

Tony Meggs: I think I did accept it, and I do accept it.

Q92 **Chair:** Take Liverpool City Council paying around £4 million a year for Parklands High School, which has been empty since 2010, because it is tied into this contract. That is one of your biggest failures, and there is no way out of there, is there, under the current system?

Matthew Vickerstaff: That is a very unfortunate situation. It is, unfortunately, a little bit like taking out a mortgage. There the analogy is with PFI—

Q93 **Chair:** My point is that the Treasury oversaw this policy and should have been assuring itself about the approach. Obviously there are sometimes very local circumstances, but it is still Liverpool City Council and the taxpayers there who are hit with the £4 million bill for an empty school building. As Ms Mahmood was saying, at local level the pain can be immense, whereas for the Treasury it is fine, because it is off your books; there is no extra cost to the Treasury.

Charles Roxburgh: I would not say it is fine; it is a very distressing situation. In the PF2 contracts that Mr Vickerstaff explained, we have been trying to build in more flexibility. So there are more flexible approaches to that in the contracts going forward, but contracts entered into many years ago—I expect Parklands dates from the 2000s—are fixed, unless there is a way out of the contract by mutual agreement or a voluntary termination, but voluntary terminations are often not good value for money. It may just be a very difficult situation that there is not a solution to, because it is a fixed long-term contract. That is why, for the contracts going forward, maybe Mr Vickerstaff might like to add how we have built in more flexibility.

Matthew Vickerstaff: I was going to add that under the PF2 contract there is the potential to have partial terminations—mothballing—for circumstances such as those with Parklands, where there are empty classrooms and so on.

Q94 **Chair:** What is the benefit for the equity investor? If you are putting money in and looking for a return—

Matthew Vickerstaff: You are pre-liquidating a scenario that they can price at the outset. You should do that when the contract is let, because then you have the competitive tension between competitors for that project actually pricing that risk in at the outset, and therefore you really do feel that you get value for money, even though—you are right—for equity, if they built the whole school, they have made the whole investment. But if they accept that there may be scenarios in which either a portion of the school or classrooms are mothballed as not required, they can price that at the outset.

Clearly, it is very regrettable that a school has been built that is not needed. I should say that is always the case in a public sector or private sector scenario where there is some kind of optimism bias that a school is needed that ultimately is not required.

Q95 **Chair:** They are all big words for someone in Liverpool seeing an empty school building that is not suitable for another use, where their taxes are contributing £4 million a year to that. Given the state of Liverpool schools generally because of what happened in the past with investment programmes, they are in desperate need of that money. Where was the problem? Who did not assure themselves? Is the blame with Liverpool, or should the Treasury have done more to ensure that the assumptions about school places were not going to lead to this problem?

Charles Roxburgh: Without knowing the circumstances of that specific project back—was it 10 or 15 years ago?

Chair: It has been empty since 2010.

Charles Roxburgh: So I assume it was 15 years ago. Without knowing the specifics of the evaluation done at that time, I cannot speculate. Now, it would be a responsibility for a combination of us in the Treasury and our colleagues in the IPA and the PF2 team—and, in that case, the Department for Education—to ensure that there were reliable demand forecasts, that they did think about the affordability, that they had adjusted for optimism bias, which is a very important part of the evaluation process in the Green Book, and that there would be challenge on those things.

Those assumptions would be true whether it was a public sector comparator or PF2, but we would want to ensure, whether it was a school, bridge or whatever, that it was being built on a good understanding of the demand for it. In publicly funded infrastructure in other countries there have been cases of bridges built to nowhere and bridges without a demand. Understanding the demand for infrastructure is a critical part of the early stages of the evaluation. If that was coming to us to evaluate, it would be a job for colleagues in the PF2 and me as accounting officer to say, "Where is the rigorous support for the demand that says we need to build this school or bridge?"

Q96 **Chair:** Then the rub is whether the Treasury would have funded it with capital funding if it was not under PFI. That is the test of whether a new approach to PF2 works, isn't it?

Charles Roxburgh: Projects are often commissioned locally. The DFE's schools programme is being commissioned centrally, but local government has done a lot of these and we would not be—

Chair: That is the rub, really.

Matthew Vickerstaff: I should say that analysis happens on both public or private finance.

Q97 **Shabana Mahmood:** Mr Meggs, apologies for continually returning to it, but I want to go back to this—well, it is not a review; I guess it sounds rather more like a one-man project—that is kicking off. What is the point of it if we do not have a committed outcome that we are trying to get to or a timescale? What is the point? Is it not too little, too late?

Tony Meggs: It is certainly not too late. It is possibly late, but it is not too late. This is still a financing method that we think has utility, and we want to be able to continue to use it in the future. I am sure that the questions about history will continue to be asked, so we are going to do the work. We will define it more carefully and precisely when we have done enough initial work to understand the scale of what we can find out and what we cannot find out. I am sorry that it is not as comprehensive or clear as you would like it to be, but this is literally somebody that we recruited—

Q98 **Shabana Mahmood:** As this Committee has been asking for this kind of work to be done for at least seven years, you might want to write to us with significantly more detail, Mr Meggs, if we are to be convinced that it is neither too little nor too late and will have a proper outcome at the end.

Can I push you on something else that you said in the early part of your evidence? When Sir Geoffrey asked you about the slowdown in the use of PFIs, you suggested that it was because the public sector has got better at delivering projects on budget and on time. Is that because this method of financing was so eye-wateringly expensive and necessity is the mother of invention? Have we got better because we were forced to because it was so expensive?

Tony Meggs: No. If I may clarify, I think I said that it could be a contributing factor. There are lots of other things: the rise in interest rates, the financial collapse and the increase in the amount of capital available from the Treasury, for example. There are lots of factors at work here. What I suggested is that one possibility is that we have more confidence now, or are better at public sector run and funded—

Q99 **Shabana Mahmood:** What is the reason for that improvement?

Tony Meggs: I think we have done an enormous amount of work over a long period of time to build capacity and capability in the public sector. This Committee has heard before about some of the things that the IPA has done—but it is across Government—to train project leaders; to develop project leadership and delivery as a profession across Government; to appoint senior responsible owners, who have clear accountability, with accountability to this Committee for the very largest projects; and to have the Government's major projects portfolio. A lot of things have been going on over a long period of time that have given us more confidence and more capability. I would not suggest for a moment that that extends right throughout the wider public sector—what I am talking about has a lot to do with central Departments—but it is a factor.

Sir Geoffrey Clifton-Brown: Can I come back to this whole business of some of the PFI contracts that are disproportionately large in the budgets of, for example, the local education authority or the health trust or whatever? I point you to *The Daily Telegraph*'s article in 2015 in relation to the rebuilding of the Royal London, Whitechapel and St Bartholomew's hospitals, which says, "The rebuild cost £1.1 billion but, under the terms of the PFI, the final cost will be more than £7 billion with the…Trust making payments until 2049." The trust is "paying £143.6 million this year" when it "runs a…deficit of £90 million." Mr Roxburgh, you referred to going back to the Department of Health to see what they can do, but we had evidence from Professor Whitfield that you have provided a £1.5 billion fund for that sort of buy-out. He says that that will be exhausted by 2027 and you will need another £1.5 billion to bail out some of the rest of the NHS projects. What work have you done on that?

Charles Roxburgh: On the specific—

Sir Geoffrey Clifton-Brown: On the cost of buying out specific health projects. In your earlier answer to me, you said that where there is a bad example, they should go to the Department of Health.

Charles Roxburgh: And I mentioned that historically, there have been some instances—I said I could not commit to policy going forward. I do not want to commit to policy going forward on the hoof, but that would be a matter for the Department of Health, and they should pick it up with DH.

Q100 **Sir Geoffrey Clifton-Brown:** Professor Whitfield says you will need another £1.5 billion when the existing £1.5 billion fund that you have allocated for buying out those health contracts runs out in 2027. Presumably, you must be thinking about those buy-outs, how many you will need to buy out and how much it is going to cost.

Charles Roxburgh: As part of the spending review, Departments will be looking forwards as to what their obligations are. The unitary charges are elements of the Departments' costs, and they need to factor them into their future plans.

Q101 **Chair:** Sorry, Mr Roxburgh, I have said this before, but the Treasury had oversight. Even the Department of Health could not just agree a PFI deal in the past without having some Treasury oversight. The Barts and The London deal has been notorious for a long time. It is now—Sir Geoffrey has laid out the figures—causing a real dent in the budget of a trust that is in difficulty. We have recently looked at hospital trusts. We know that a lot of them are in a spiral of financial difficulty that will never get resolved—the Department of Health is not going to bung them a load of money, because it hasn't got it. Does the Treasury not have some responsibility and, if so, what are you going to do about it?

Charles Roxburgh: Within the overall spending framework set by the Chancellor, our responsibility is to work with the relevant Departments—this will be a major focus of the spending review—to work out the affordable level of spending in the Department of Health or the Ministry of Defence, whatever spending Department it is—all Departments. That will be part of the spending review. Those Departments need to think through what is the best use of the resources that are available to them.

Q102 **Chair:** The Department of Health has notoriously, as we have highlighted over the last few years, raided its capital budgets to fund revenue. Over time, it has been tempting to take things off the balance sheet and do that to solve the problem in the short term, but it is causing a long-term revenue problem. Barts and The London is the biggest example, because it is one of the biggest trusts, if not the biggest. They have mothballed wards and huge problems with staffing and so on because they just do not have the day-to-day cash, because part of it is going on paying back this PFI.

In the end, it is the patients and the people in the hospital who suffer. I have a particular issue with this, because the east London health economy has really been hit hard by it. But everyone seems to say, "Well, it's not really our responsibility." You are saying it is the Department of Health. They are under pressure to balance their budget and did some crazy things, we think, in terms of capital and revenue.

Charles Roxburgh: We work very closely with the Department of Health. Our spending team works very closely with them.

Q103 **Chair:** Who was looking at the Barts deal then, from the Treasury?

Charles Roxburgh: Within the Treasury, we were not looking specifically at the Barts deal.

Q104 **Chair:** But with a big one like that—was it not £7 billion?—was it not something that you should have looked at? Mr Vickerstaff, you were not around then, I guess, when the Barts deal was done.

Matthew Vickerstaff: No, I was not, but I am aware of it. It is extremely difficult. We are absolutely sympathetic to the argument when it comes down to the local level and patients. With Barts, I just thought I would point out that its income is £1.4 billion. The unitary charge is 10%. They are a huge—the biggest—trust, with massive pressures, because they are in London. We all know trusts are under pressure, but if I compare it with a private sector entity of that size, 10% is not actually a very large amount of your budget. There are trusts with more than 10%, undoubtedly, which is very regrettable, but we should not forget that there are many, many pressures on trusts of that size. When I compare them with other organisations of a similar size in terms of their capital assets—

Q105 **Chair:** But my point is that this is a £7 billion PFI deal, so it is a big one, right?

Matthew Vickerstaff: Absolutely. It is across multiple trusts.

Q106 **Chair:** So surely that needed more than local oversight—more than just the Department. At what point does it trigger more expert involvement from—well, it is now the IPA, but was it the PFI unit at the time?

Matthew Vickerstaff: PPP.

Chair: PPP, yes, or the Treasury. What threshold is there? We probably all remember examples. I remember being in one council where the No. 2 in the education department was leading through a major PFI deal on a school. It was the first time they had ever done it, and they had no real expertise in this area. I think in the end they actually did a reasonably good job, although I have not followed it through since, but they were having to learn as they went. Where was the guidance and support for people making huge long-term decisions that would rumble on and affect those institutions long after they had gone?

Matthew Vickerstaff: We within the IPA absolutely do work with our colleagues in—

Q107 **Chair:** Now?

Matthew Vickerstaff: No, we have done that for quite some time.

Chair: Well, you have only been in existence a couple of years.

Matthew Vickerstaff: Before us, there was a predecessor: IUK—the same PPP team. We work with Departments and the private finance units within those Departments, certainly in Health. Again, I was not downplaying it at all. I was just pointing out that the numbers are very large because it is London and it is Barts—it is the biggest trust—but on a relative basis it is not such a large amount. It is of more concern when it reaches up to 20%.

Q108 **Chair:** But it is about the lack of flexibility, isn't it? They cannot negotiate it down. That is one of the points. I am going to bring Sir Amyas in.

Sir Amyas Morse: I just want to make the point that for the Treasury to be watching Departments not carrying out their capital programmes and to be with them when they decide to appropriate capital to revenue—that has happened a lot in Health but also in plenty of other Departments that I look at—has serious implications for unbalancing planned programmes, and it drives people into other sources of funding. I would submit that that is not a good thing. It may be a way of fixing a short-term problem, but I think you need to give it a bit more consideration.

Charles Roxburgh: These issues of healthcare spending and the balance of capital and resource spending are obviously very live. I am not in a position to speculate on how policy will unfold, but you have raised important issues. As I said, the fact that, in the public sector, maintenance has not been maintained, whether it is in hospitals or schools, can end up being a very false economy because it costs a lot more to repair a school after 20 years of it not being maintained than it does to repair a school through constant maintenance. But unfortunately, that is what has happened in some cases.

Chair: It has happened quite a lot in the Department of Health in the last couple of years.

Sir Amyas Morse: But this has been going on in real time in current periods. I am sorry, but it is not a historical phenomenon we are talking about. We are talking about people doing this in current periods. It is something that needs to be considered a bit more fully.

Q109 **Sir Geoffrey Clifton-Brown:** Can I stick with the health service a minute, Mr Meggs, and talk about buy-outs of PFI deals? I refer you specifically to paragraph 2.20 in the NAO Report, which states that in 2014 Northumbria Healthcare NHS Foundation Trust bought out a PFI, and that there were questions about the value for money of buying out that PFI. When any PFI is bought out, are you, as the IPA, always involved in advising on whether it is value for money?

Tony Meggs: That is certainly meant to be the case. I cannot guarantee that it always occurs. Any transaction involving public finance comes to the Treasury for approval, and we are engaged in that work and analysis.

Matthew Vickerstaff: If you are referring to the Hexham in Northumberland, we were not involved in that.

Chair: Sorry, you were not?

Matthew Vickerstaff: Were not.

Q110 **Sir Geoffrey Clifton-Brown:** Mr Roxburgh, you can guess what the next question is. If the Treasury is asked for advice on this matter—clearly, the Treasury has a lot more financial expertise than the Department of Health, the Department for Education or any other Department—why does it not always involve the Infrastructure and Projects Authority, who, after all, know about these things, to give advice on whether it is a good idea to buy these contracts out?

Charles Roxburgh: Well, I think we would. I simply do not know the circumstances around 2014 as to why the IPA wasn't involved.

Q111 **Sir Geoffrey Clifton-Brown:** Forget the specifics of that one. As a generality, why are the IPA not always involved?

Charles Roxburgh: I think we would aim to get them involved on any of these. Yes, we would.

Matthew Vickerstaff: Generally, we are involved. That is an anomaly. Because they are novel and contentious, that is why they come into the Treasury, and we work on them with the spending teams.

Q112 **Sir Geoffrey Clifton-Brown:** If that's the case, then given all 700 infrastructure PFI projects, has any work been done on each one as to what it would cost to buy it out? London Transport have done some buy-outs that offer quite good value for money. It may be that the individual Department is not sufficiently focused on each one of its PFIs to know whether it would be a good idea to buy it out now or whether we should continue to pay the costs for the next 20 years or however long it has to run. Is anybody doing this work?

Charles Roxburgh: We are not doing a review of all those projects—going back and doing that testing. That is not the current policy. For individual Departments, local authorities or trusts, almost all contracts, as I understand it, have voluntary termination clauses. As the Report says, these will often not be good value for money, but if they are, that can be done. Mr Vickerstaff was involved in some. Manchester waste, I believe, was one.

Q113 **Sir Geoffrey Clifton-Brown:** So would it not be a good idea just to run the ruler over all 700 and see where there might be an opportunity to break, if there is a break clause, and even if there isn't, to work out whether it would be good value for public money to buy them out?

Matthew Vickerstaff: The level of work involved would be huge. In principle, it is possible to terminate, but let me just explain how that works.

Q114 **Chair:** We know there is a cost to doing it.

Matthew Vickerstaff: Again, it's like breaking your contract with your cell phone provider, or your mortgage. There is a cost.

Q115 **Chair:** We know that. I'm sure Sir Geoffrey can pick this up, but the point is that if they break the contract and renegotiate it over a longer period of time, some of those hospital trusts or other bodies can, as Sir Geoffrey is saying, smooth out the payments so that they are just a bit less every year and their revenue budget—RDEL—is more manageable when they have other pressures coming with the age of austerity: cuts to staffing budgets and so on.

Matthew Vickerstaff: The difference, though, is that they will have taken back the risk, so they will be managing—

Chair: But they will also have taken back control.

Matthew Vickerstaff: The argument might be that they have taken back control. That is why it will be very interesting to see the comparative analysis.

Q116 **Chair:** Well, you can buy out or renegotiate. I'll let Sir Geoffrey continue, but there are two options, aren't there? They are both expensive, potentially, but there are options.

Matthew Vickerstaff: Can I just outline the process? With a voluntary termination, you have to terminate any hedging arrangements. If there is a bond, there will normally be a make-whole on the bond investors. You will have to pay the equity out. They invested in good faith in a long-term contract. There will be breakage costs on facilities management, soft services—not on PF2, because those are shorter term, but the longer-term PFI contracts will have, I would suggest, very expensive breakage costs. If one did that analysis, it would be very expensive.

There may be individual situations—we do see them from time to time—where because there has been a change in the underlying service, there has been a change in the underlying market. Waste is a particular sector where that could make sense. Or there is just very poor performance. It's perhaps not truly voluntary, but there is a negotiated settlement, which is what I think you are alluding to.

Q117 **Sir Geoffrey Clifton-Brown:** Well, if London Transport have managed to buy themselves out of some of these contracts profitably, might it not make sense to look at all the contracts to see whether the same thing applies, particularly where there are built-in break clauses? We all know you can negotiate your way out, and you simply pay a capital sum for the buy-out, the swap or whatever it happens to be. But might it not make sense at least to look at those contracts where there is a built-in break clause and you have a legal ability to get out of them, to see whether it would offer value for money to buy them out?

Matthew Vickerstaff: I would offer that there are plenty of people looking at that. We are presented with opportunities. Some can. I'm thinking of Manchester waste. Certainly for the local authorities that formed that waste authority, it did mean value for money. However, that is not always the case.

Tony Meggs: I think this is really important, just to be clear. We do not monitor or interact with every single PFI on a regular basis.

Sir Geoffrey Clifton-Brown: I understand that.

Tony Meggs: Matthew's point is good—a lot of people are looking for opportunities here.

Q118 **Chair:** What escalates it though? Is it the Department? Is it the individual? If PFI were problematic locally, when would they escalate it to you for—

Tony Meggs: If there was a proposal to buy it out, or to renegotiate in some way that was novel and contentious, as Matthew said, then we would expect to get sight of that.

Matthew Vickerstaff: Local authorities would come back to the DFE, trusts would come back to the private finance unit within DH. So we all have to go through the Departments, in terms of a value for money assessment, and then a recommendation would be made by the Department through to Treasury, copied to us, which we will evaluate.

Q119 **Sir Geoffrey Clifton-Brown:** Given that these are very long-term arrangements—typically, 25 to 30 years—will all PF2 arrangements have a break clause at some point? A mid-point break clause maybe?

Matthew Vickerstaff: Absolutely. The change in operating services—so the soft services such as cleaning, catering—is that those are not now committed long-term. We have already outlined that flexibility for schools—the ability to look at a partial termination. If you were to have a voluntary termination by just saying, "Okay, I need a school, but in 10 years' time I would like to have the ability to terminate", I would recommend just not building the school in the first place, because it doesn't make sense. These are economic assets that have 25 to 30 years if maintained properly. So you take out the optimism bias, make sure that the population will be there for the use of that school, and ask at the outset, "When do we choose?" and "How do we choose?" A key question is, is there an economic case for that asset? We really test that very carefully because, frankly, if there is not, it should not be financed publicly either, but you really need to be comfortable if you are entering into a private finance transaction that there is an economic requirement for that asset in the long term.

Q120 **Chair:** It seems that there is a pattern to the ones that are terminated. Take the Metronet Transport for London contracts—there was a new directly elected Mayor, a powerful Transport for London Commissioner, who had a very strong view on this from his previous experience. Look at Manchester, for instance—again, there is historically strong political leadership across that city. It seems that political will makes a big difference, because they make that judgment themselves about the money for taxpayers. They go through the other processes—is that a pattern?

Matthew Vickerstaff: If I may say so, Chair, politics is always an element. In fact, both those service contracts were in incredibly complex environments: for Metronet-Tube Lines, there was being on live tube lines, trying to upgrade stations, signalling upgrades and so on, and for Manchester waste there was technology for the processing of waste, so the change that happened in waste production meant increased recycling, but there was a lack of new green technology. Those two deals have a lot of similarities—too much complexity, technology risk and size—so I think politics is actually a small part of the fundamentals. Perhaps, in retrospect, those were challenging deals to have done. The judicial reviews that Ken Livingstone had done at the time meant that it was in a very febrile environment, which doesn't help, I accept.

Sir Geoffrey Clifton-Brown: Mr Vickerstaff, you just said something contrary to what I had always assumed. I have always assumed that the more complex projects were better suited to PFI, because of the transfer of a greater amount of risk. You have just told us that, given past mistakes, you shouldn't be using PFI for complex projects. If you're not using it for complex projects, given that the public sector can always borrow cheaper than the private sector, why are you using PFI at all?

Matthew Vickerstaff: Well, truly complex projects don't do them. If you were going to put them in buckets, one example is IT projects where you have software, hardware scaling risks and so on, so Post Office Counters was originally a project that was done in the private sector. They are too technically complex and difficult to deliver. However, large complex construction projects where the private sector can assess the risk, price it, and arguably get their best by managing that risk are the types of projects that should be taken, or certainly considered for private finance. I am saying the same thing but slightly differently. Where the risks are truly complex and there are demand risks or technology risks that are unproven, it is very difficult for the private sector to price, but where there are priceable, difficult risks, the private sector can take those contracts.

Q121 **Sir Geoffrey Clifton-Brown:** I come back to what I just said: the public sector can always borrow more cheaply than the private sector, and the Debt Management Office has the ability to smooth these projects, whereas with PFI, as we have already established, there is no smoothing ability. Presumably that is why so few PF2 projects have actually been built. The number of cases where it is applicable is probably still remarkably small.

Charles Roxburgh: Going back to my earlier point, I said that it is a specialist tool, appropriate in a relatively narrow set of circumstances. We should keep it in our toolkit, but demonstrably we are doing far fewer now than was the case in the past. When we evaluate them we have 10 criteria. Criterion No. 2 is all about risk allocation—is the optimal risk allocation to transfer it to the private sector? I would not want to have a simplistic yes or no, but there are different types of risks that the private sector is better suited to managing than the public sector, and vice versa.

Absolutely, your point is true that we have to think about whether the risk transfer is appropriate. If it is not, PF2 would not be the right structure for it. We are doing a huge number of very large, very complex projects—think of HS2 and Crossrail. They are large, complex projects being done in the public sector, so yes, it does depend on the nature of the risks.

Q122 **Bim Afolami:** One more from me, on the difference between PFI as originally constituted and PF2. Could you very quickly sum up what were perceived to be the problems of PFI, and to what extent those problems were solved with the introduction of PF2? The point here is within the private finance envelope. I am not talking about the wider point about whether this makes sense or not, or whether we should finance it on the public sector balance sheet, and so on. Within the private finance envelope, can you just explain what problems have been solved by PF2?

Matthew Vickerstaff: Can I summarise, and give you the three key changes in the PF2 contract? First, we invest equity—a minority equity investment.

Q123 **Bim Afolami:** No, I mean in terms of the problems with PFI. To what extent did PF2 cover those problems—100%, 75%, 50%, or what?

Chair: I think Mr Afolami's point is that PF2 is not radically different. We know about, for instance, the difference in that you have transparency. That has already been said, and is in the Report.

Tony Meggs: One of the big issues is transparency. I think we have really addressed the transparency issue head on. We have not 100% fixed the issue of long-term inflexibility, because actually you can't, but we have reduced the amount of long-term inflexibility, particularly by making sure that the soft services and so on are no longer part of the contract, and by having break clauses or other forms of ability to renegotiate where that is possible.

Matthew Vickerstaff: We have also put in a maximum 18-month procurement time, so we are bringing the procurement time down and making it quicker. The NAO, and the Committee, commented on the long procurement times and expenses, so we have improved that. It is something that we are actively looking to improve further as well.

Tony Meggs: On the fundamental nature of PFI/PF2, I think the Report is right to say that it is not fundamentally different, because it is effectively taking out a mortgage. I do not think that the shape of that is fundamentally different, but it is better. It is definitely better.

Charles Roxburgh: There have been important improvements in the contract, but I think the big difference is the selectivity with which we now use it. We are really concentrating on making sure that we would use it only when we meet the 10 criteria set out in the Green Book, and that we use it in the appropriate circumstances. We think it's a valuable tool and we want to continue to use it, but only when it delivers value for money because it is being used for the right projects with the right types of risks, and where we can transfer the risks and get value from it, but that will be a small subset, as we've talked about.

Q124 **Sir Geoffrey Clifton-Brown:** Can I ask about ESA 2010—the European System of National and Regional Accounts—and on and off balance sheet? You originally started with your PF2, as I understand it, wanting to have a 50% profit share, but you've had to reduce that to 33%. Is that correct?

Tony Meggs: That is correct.

Q125 **Sir Geoffrey Clifton-Brown:** If that is correct, how can you be sure that PF2 will offer value for money, if you have had to limit yourselves in the amount of profit share that you can get?

Charles Roxburgh: The test of that will be when we look at the individual project, because that can change. There may be some projects—hypothetically—that would have been value for money on one criterion but are not value for money now. They now have to meet the value for money criteria on the contract as it is. We wouldn't do the project if it didn't pass the value for money test with the contract as it is today.

Q126 **Sir Geoffrey Clifton-Brown:** These are European rules. Will this change once we've left the European Union? Can we set our own rules?

Charles Roxburgh: A lot of these accounting rules and Eurostat rules will be for negotiation, but we are working on the basis, at least if we think about contracts, that we will comply with those rules, but the status of that will be for the final negotiation.

Q127 **Sir Geoffrey Clifton-Brown:** Some of these contracts, in particular PF2 contracts, are predicated on the basis of cheaper money from the European Investment Bank, which again, presumably, we will not have access to after we leave the European Union. Will that make PF2 even less attractive?

Charles Roxburgh: The European Investment Bank has indeed been an investor in—well, a lender to—the six PF2 projects, I believe, and our relationship with that once we leave the EU is still subject to final negotiation. However, there is a scenario in which it will not be as active, or it will not be active in the UK, in which case we will need to find ways to replicate those of its activities that are valuable.

There is the European Investment Fund; I know it's different. The new Chancellor has made a statement that we will step up. We have stepped up some of the activities of the British Business Bank on supporting venture capital and patient capital, as we call it.

Through the IPA, we also have the UK guarantees scheme available, and we can use that. But the long-term relationship with the EIB is still subject to the final negotiation. And for now we are still a member of the EU, with all the rights and obligations. We would hope that would continue until we leave, and we need to negotiate the final relationship.

Q128 **Sir Geoffrey Clifton-Brown:** Thank you, Mr Roxburgh. That's a very helpful answer. Final question—in that profit share, have you built more flexibility into PF2 on unexpected gains in things like insurance? In some of the PFI contracts, there have been considerable gains because they have been able to reduce the insurance premiums. Is that built into PF2, so that the taxpayer actually shares in some of these unexpected gains?

Charles Roxburgh: I will ask Mr Vickerstaff to speak on the contract issue.

Matthew Vickerstaff: We are currently doing a review; it's public knowledge. That is a specific area that we will be looking at—actually, we are looking at—very closely: insurance gains and what insurance risk is taken. That is because we are doing a review of the standard contract.

Q129 **Chair:** Would that mean that you would look at changing the contract for future deals, but you won't get it back from the ones that have already been let?

Matthew Vickerstaff: Yes.

Q130 **Chair:** I remember, when this first Report came out, looking at what the difference was between PF2 and PFI. Actually, rather than you saying, "Oh, we've given up on PFI", you keep saying it's a valuable tool in the toolkit, but with only 12 let, will you really continue to use PF2, or has PFI/PF2 had its day?

Charles Roxburgh: PFI we don't do, so the question is—

Chair: Okay. Private finance initiative 2, then—has private finance really effectively had its day, given that you've only got 12 under PF2? That's a much slower rate.

Charles Roxburgh: To say it has had its day would be saying we are not committed to using it when it delivers value for money—

Chair: Which is not very often.

Charles Roxburgh: As I said, we have 12 deals; we haven't done any in the last 18 or so months. We know that there are two interesting opportunities and perhaps more. I will write to Sir Geoffrey and the Committee with more details of our best estimate of the outlook, but as we have said, it is a handful.

If you are asking whether we expect to go back to the days of the late 2000s, doing 60 deals a year, with up to five, six, seven or eight billion pounds in value a year—no, we do not expect to be at that level of activity. Do we expect to use it in certain circumstances where it delivers value for money for the taxpayer? It would be strange to say that we wouldn't, because if we can structure the deals to deliver better value for the taxpayer by using PF2 than we would by using public finance, that must be the responsible thing to do, so we will use it in those circumstances. But for the reasons we have discussed, particularly about what risks are appropriate to transfer and where you get enough value to justify the higher finance—that is, where you focus other projects—where it is appropriate, we will use it.

Q131 **Chair:** How much is it that the Treasury is just keen to get things off the balance sheet? Surely that was a driver of PFI—to get it off the balance sheet and get infrastructure developed without it appearing.

Charles Roxburgh: As I said to Mr Afolami, the balance sheet factors when we look at the criteria—

Chair: The new criteria.

Charles Roxburgh: The new criteria—are we getting value for money, good risk transfer and the benefits—

Q132 **Chair:** Which means that, in effect, you have watered down that opportunity for the Treasury to get it off the balance sheets so much that there are only a handful that you are now looking at, with nothing in the last 18 months, as you say. Two were identified in the Report, and there are a handful of others. Predicting is not a major way forward for the Treasury to fund infrastructure.

Charles Roxburgh: It is set against the scale of the commitments on public infrastructure financing. The Chancellor set out ambitious plans to increase the level of commitment of public capital to support economic infrastructure—there was an increase in that. Also, remember all the purely private investment that we are keen to see happening.

We have also taken new measures such as the digital infrastructure investment fund— the £400 million fund that we are using to catalyse "alt nets" as they are called, which are private companies investing in fibre to the home. We are using public money to catalyse private money.

The outlook for investment in infrastructure is very ambitious—it is a combination of greater public investment, more purely private investment and the use of public funds through innovative structures such as the digital infrastructure investment fund to catalyse private investment. Within this toolkit, there is a continuing role for PF2—as I said, it is a specialist role, but part of a very ambitious plan overall on infrastructure.

Q133 **Sir Geoffrey Clifton-Brown:** The last question, Mr Roxburgh: many times during this hearing, you have rightly said that one of the main functions of PFI is to transfer risk. We have also heard that specialists have become much cleverer at costing the types of projects that you would consider for PFI. Given that you are more able to cost more accurately these types of projects, does it not make PFI even less attractive if you cannot transfer as much risk?

Charles Roxburgh: It may, but we still have quite a lot of interest. My colleagues from the IPA can talk about the degree of investor interest. We are quite confident that if we can find the right projects that meet the criteria, investor interest in those projects is still quite high. Perhaps Mr Vickerstaff and Mr Meggs would like to add something on investor interest in these sorts of projects.

Matthew Vickerstaff: Certainly, on investor interest, debt investors are attracted to long-term infrastructure assets that produce long-term cash flows that can match their liabilities if they have pensions or insurance contracts. The more worrying area for us at the moment is the appetite for construction risk.

Q134 **Sir Geoffrey Clifton-Brown:** But are there other ways? We have seen at Hinkley C other ways of doing exactly what you have just said, but not in a public-private finance arrangement.

Tony Meggs: I think there are lots of ways—that is what Mr Roxburgh was trying to say. We use a variety of methods that are appropriate to the project. On your point, as the public sector gets better at doing things itself—although still using contractors, obviously—it becomes a higher hurdle to use a PF2 construct. There is no doubt about that. I think it is absolutely vital that we keep this opportunity available, and that the industry around it, and the investors around it, know that there are opportunities to come, because we run a mixed economy around infrastructure investment, and we don't want parts of that mixed economy to die away, really.

Chair: Thank you very much indeed for coming. My last point is that you promised to write to us after Sir Geoffrey's questions about what is in the pipeline. It would also be helpful if you could include in that letter the number of times that the Treasury was involved in the buy-out of any of the PFIs that have been bought out, and what the extent of that involvement was—and the same goes for the Infrastructure and Projects Authority. I think you gather that we are keen to understand where, in the hierarchy of decisions, it kicks in at Treasury level—so not just in the Department. We talk to Departments about this all the time.

Thank you very much indeed for your time. I am sure this is something we will keep an eye on. The transcript of course will, as ever, be up on the website in the next couple of days—so probably after the Easter weekend, now, uncorrected; and our Report will be out at some point in the next month or six weeks or so. So thank you very much indeed.