House of Commons

Public Accounts Committee

Managing the expiry of PFI contracts

Fifty-First Report of Session 2019–21

Report, together with formal minutes relating to the report

Ordered by the House of Commons to be printed 15 March 2021

HC 1114
Published on 19 March 2021
by authority of the House of Commons

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Contents

Summary

Vital public services such as schools and hospitals face serious disruptions should government fail to prepare for the expiry of its 700 PFI contracts. These PFI projects represent public infrastructure assets worth around £60 billion, and future costs of around £170 billion. The very earliest contracts have expired, and some 200 will expire in the next 10 years, accelerating from 2025 onwards. Any mismanagement of the expiry process could result in large sums of taxpayer's money being wasted. A lack of attention from the public authorities running these contracts could also leave the public sector footing large bills for rectification work which the PFI company has already been paid to do.

The Infrastructure and Projects Authority (the IPA) estimates it takes seven years to adequately prepare for expiry. The IPA plans to review 55 PFI contracts by 31 March 2021 using its new health-check tool. But many challenges remain, and it is unclear how these will be addressed, and at what level of government. Smaller local bodies, especially those with a single PFI contract, are exposed to greater risk as they often have limited resources to effectively manage expiry. Local bodies will need support to manage the expiry risks. While discussions are progressing around who is responsible for providing this support, no decisions have yet been made. What is certain is that action needs to be taken now to avoid this becoming a huge payday for consultants.

By minimising expenditure on maintenance in the final years of the contract, PFI investors can pay out higher dividends and walk away with limited threat of recourse. The IPA is aware of 'difficult' investors who are not sharing important information that authorities need to successfully manage the expiry process. The IPA plans to engage with investors but has not yet set out what this will entail, or how this will help authorities when disputes arise. The high concentration of PFI ownership among private investors allows the private sector to take a portfolio approach to managing the expiry process, which risks putting the public sector at a disadvantage. A lack of contractual tools to hold non-cooperative investors to account further disadvantages authorities in securing value for money from the expiry process.

Introduction

Since the early 1990s the public sector used the Private Finance Initiative (PFI) to build more than 700 public infrastructure assets such as roads, schools and hospitals. PFI deals involve the public sector entering a long-term contract with a private sector company, which has been specifically created to finance the project, through a combination of debt and equity investors, and design and build the asset. When construction is finished the PFI company operates and maintains the assets together with running any associated services over the life of the contract, typically 25–30 years. In exchange, the public sector will make annual payments to the PFI company which cover debt and interest repayments, shareholder dividends, asset maintenance, and in some cases other services like cleaning.

These contracts are now expiring and over the next 10 years, an estimated 200 PFI projects will finish, representing £10 billion of assets. In most cases, when a PFI contract expires, the assets will transfer to the public sector. The process is complex and requires the public body (the authority) that entered into the original contract to take several actions in advance of expiry. First, the authority has a duty to ensure the private company has completed any scheduled or reactive maintenance, including any rectification work required to bring the asset up to the condition stipulated in the contract. Second, the authority needs to decide if the assets and services are required after expiry and, if so, how the asset will be maintained, and the services provided.

It is ultimately the responsibly of the authority to manage its PFI contract, including the expiry process. Each authority will be supported by a sponsor department. Government departments can act as either an authority, if it directly owns a PFI contract, or as a sponsor department if it is supporting a local body such as an NHS trust or local authority with their contract. The IPA is the government's centre of expertise for infrastructure and major projects. It provides advice and support to departments and authorities. Local Partnerships, a joint venture between the Treasury, the Local Government Association and the Welsh Government, provides training and assistance to authorities on any aspect of their PFI contracts. The Treasury is responsible for PFI policy, and indirectly funds all contracts via the budgets it allocates to departments.

Conclusions and recommendations

1. **Government has started to deal with the expiry of PFI contracts, but there remains a lack of urgency and overall plan.** Over the next 10 years, more than 200 PFI projects, representing assets worth over £10 billion, are set to expire. The IPA estimates it takes seven years to adequately prepare for expiry, meaning that work should have already started on those that will be expiring soon. Transferring the responsibility for maintaining the assets and running the service to the public sector after contracts expire represents a significant risk to government as a failure to prepare sufficiently far in advance could leave the public sector exposed to major disruptions to vital public services. The government has acknowledged the seriousness of this challenge and has taken some action to address the risk posed. The Treasury gave the IPA an additional £2 million in the 2020 budget which it has used to develop a PFI contract management programme. This includes a health check tool designed to evaluate the expiry risk of all individual contracts ending in the next seven years. The IPA aims to review 55 contracts by 31 March 2021 using this tool. The IPA has also been developing PFI expiry guidance since 2019, which remains unpublished. The Treasury and IPA are discussing what additional support is to be provided, and by what level of government, but no decisions have yet been made.

   Recommendation: ***Within 3 months, the IPA should publish a plan for how it will support all public bodies with expiring PFI contracts, beyond those expiring in the immediate short-term, including what they will deliver and by when. It should also proactively publish guidance for authorities. HM Treasury should write to key departments encouraging them to develop sector specific PFI expiry guidance.***

2. **The IPA does not yet have the data it needs to fully understand the challenges of managing the expiry of PFI contracts.** The PFI contract is central to understanding the potential expiry risks an authority may face. However, these are long, complex documents which have been subject to multiple revisions over time, as many as 75 variations in one example. An authority may not hold a complete version of the contract, with either part or all of it lost. The contracts are not always easily accessible, sometimes being held on older technology such as CD-ROMs. A lack of standardisation in the early PFI contracts means that the clarity of each contract's expiry clauses can vary, exposing authorities to different challenges depending on the contract's age. The IPA does not hold a central registry of all PFI contracts as it does not consider creating this to be value for money. It has held discussions with key departments about introducing registries, but these are not yet widely in place. Instead, the IPA collects and publishes limited information on each of the 700 contracts, covering the capital value of the project, annual payments, the date the contract was signed and contract length. This does not include the date the contracts will expire. The IPA has started to collect contracts via its health check tool, but this is on a small scale.

   Recommendation: ***The IPA should write to the Committee within 3 months with an update on the thematic PFI expiry challenges that it has identified following its***

review of 55 contracts and how it proposes to address them. In addition to this, the IPA should compile a central list of all PFI expiry dates to help authorities prepare for their conclusion.

3. **Many authorities currently lack the skills, expertise and capabilities to successfully deliver PFI contract expiry, with locally managed contracts most at risk.** The IPA recognises that there is a huge demand for skills, expertise and capabilities in contract management—all of which are currently in short supply. Contracts owned by local bodies, which represent over 80% of the total portfolio, are the most concerning because expertise has dwindled as resources are prioritised elsewhere. Local Partnerships consider the best prepared authorities to be those with multiple contracts, as they will more likely have maintained a PFI team throughout the life of the contract. However, 182 authorities own just one contract. The IPA accepts that filling the skills gap with consultants could be expensive and not the best value for money option. Part of its PFI contract management programme is therefore focused on building capability and recruiting additional staff to develop a central pool of resources. This so far consists of just 17 people, although more people are expected. This is not enough resource to support all 700 contracts. Local Partnerships also has a small team of experts working on PFI and provide training on a reactive basis if an authority requests support.

Recommendation: ***The Treasury and the IPA should write to Committee within 3 months outlining how they plan to fill the current skill shortages, focusing particularly on those authorities with limited funds to recruit or buy-in external support.***

4. **The IPA is not clear what support will be provided to authorities with expiring PFI contracts, and who will provide that support.** Each individual authority is responsible for managing the expiry of its PFI contract. When an authority needs help, support is often lacking, or it is not always clear how to access it, with varying degrees of support available from multiple sources across central government. The IPA is building capacity and plans to provide support and advice via its contract management programme. Local Partnerships provide training courses and lessons-learned examples when requested, while the sponsoring department is responsible for drawing on the expertise at the IPA. Some smaller authorities with multiple PFI contracts are being managed by a single person and could benefit more from additional capacity rather than training courses or specialist advice. The IPA asserts that it is working on proposals on how to provide additional resources, on top of those already available at the centre, and whether this is done by departments or regionally. Decisions about this are still outstanding, exacerbating the lack of support for those local authorities most at risk.

Recommendation: ***The Treasury and the IPA should set out, within 3 months, their plan for providing support to all PFI contracts, especially those owned outside of central government. This should cover:***

1. ***What support will be made available, including how additional funding will be provided to authorities with limited resources or those with the most challenging contracts.***

2. ***Who is responsible, between the Treasury, the IPA, departments, and local government, for providing support.***

3. ***The circumstances under which authorities can access different types of support and the process they need to go through to obtain it.***

5. **We are concerned that the approach to managing the expiry of PFI contracts risks authorities working in silos rather than collectively securing value for the taxpayer.** In the education sector, there are examples where the ownership of the PFI assets and the responsibility for managing the contract are not aligned. When a school is converted to an academy, it is no longer the responsibility of the authority, but is instead run by an independent academy trust and receives funding directly from the Department of Education. The authority, however, remains responsible for administering the PFI contract until it ends, despite not inheriting the assets. This can create perverse incentives to protect budgets and limit expenditure on managing the contract, especially during the expiry phase, potentially putting taxpayer interests at risk. The academy trust acquiring the assets may inherit a 'liability'—the cost of bringing the assets back up to usable condition. The potential risk to the Department for Education is significant with around 300 PFI schools already converted to academy status. This is a very complex issue and further clarification is needed.

Recommendation: ***Within 3 months, the Treasury should outline how it is ensuring taxpayer interests are being protected when the expiry of PFI contracts creates a change of asset ownership between public bodies.***

6. **The IPA has not set out a clear escalation process to avoid disputes between the public and private sector going through the courts.** At expiry, all parties will want to maximise value from the PFI contract. Authorities will want to ensure the assets are returned to the public sector in the condition stipulated in the contract, with all maintenance and rectification work completed before expiry. The PFI company will want to reduce expenditure in order to maximise payments to shareholders. These misaligned incentives can create disputes. The formal process for resolving disputes is outlined in the PFI contract and will usually require an expert panel to make a judgement. If this does not lead to an agreement a resolution is sought through arbitration or the courts. This process can be long, taking a minimum of 10 months in some cases, and prohibitively expensive for some authorities. This can lead to a situation with a small, under-resourced authority dealing with a large, well-resourced PFI company. There are some examples of good practice, such as Highways England agreeing an informal disputes resolution procedure with the PFI company, which is quicker and cheaper.

Recommendation: ***The IPA should publish a disputes protocol, outlining how disputes can be escalated by authorities, and the steps that can be taken to ensure disputes only need to be resolved by the courts as a last resort. Where disputes do materialise, the IPA should conduct a review to determine whether it is a one-off disagreement or a wider problem that may impact other contracts.***

7. **The IPA has not outlined clearly how it plans to engage with investors to ensure that authorities have access to all information needed to manage the expiry**

process. Authorities need to monitor the performance of the PFI company to ensure it is delivering the services that taxpayers are paying for. Transparency can be a problem and the IPA recognises that there are some difficult investors which adopt an approach of 'asymmetric information' where the PFI company holds much more information on the performance of the contract compared to the authority. The IPA plans to engage directly with investors to hold them to account, ensuring that information critical to managing PFI expiry is shared with the authorities, but has not yet set out what this will look like in practice. The IPA is also looking to develop a protocol outlining how investors should operate during the expiry process, but this is not yet available. Authorities can withhold a proportion of their annual payments to encourage non-cooperative PFI companies to carry out maintenance, but this is not always an option. Some authorities can also build up retention funds to pay for any identified rectification work but there is a risk that these are not sufficiently large and as these are contractual arrangements they cannot be unilaterally increased later in the process. IPA does not yet have a solution to these scenarios or the actions it would take in response.

Recommendation: ***The IPA should write to the Committee within 3 months outlining the steps it is taking to ensure PFI investors are being fully transparent and compliant with contracts, and what action, if any, it will take if an investor if found to be deliberately non-co-operative.***

1 Government's response to the expiry of PFI contracts

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from HM Treasury (the Treasury), the Infrastructure and Projects Authority (IPA) and Local Partnerships about managing the expiry of PFI contracts.[1]

2. The Private Finance Initiative (PFI) is a way of engaging the private sector to deliver public infrastructure such as roads, schools and hospitals. The government has used PFI, and its successor Private Finance 2, for over 25 years.[2] There are currently more than 700 operational PFI contracts in place across the UK worth around £60 billion. PFI involves the government entering into a long-term contract with a private sector company which then designs, finances, builds, maintains and operates the assets over a period of 25 to 30 years. During this period the government makes annual payments to the PFI company covering debt repayment, financing costs, maintenance and any other services provided.[3]

3. In 2018, the government announced it would no longer use PFI.[4] We examined the PFI model in 2018 as part of our "Private Finance Initiatives" inquiry. We concluded that after more than 25 years the Treasury still had no data on benefits to show whether the PFI model provides value for money.[5] Existing PFI contracts, however, remain in place and the oldest ones are now starting to expire. Over the next 10 years more than 200 PFI contracts will end, covering assets worth in excess of £10 billion.[6] On expiry, in most cases, asset ownership will transfer to the public sector which will then be responsible for ensuring they are run as before, and well maintained. The public body (the authority) that entered into the original contract therefore needs to closely monitor the performance of the PFI company to ensure maintenance is carried out and the assets are returned in the agreed condition. The authority must also decide whether services, such as running a hospital, are either provided in-house, by a new contractor or by the current provider. Failure to prepare sufficiently far in advance may result in the taxpayer becoming liable for expensive rectification work or disruptions to important public services.[7]

Preparedness for PFI contract expiry

4. In 2020, the Treasury awarded the IPA an additional £2 million budget to develop a programme to help manage the expiry of PFI contracts.[8] The IPA subsequently launched its PFI contract management programme.[9] The IPA told us that this programme consisted of four pillars, with the first relating to contract expiry. As part of this, the IPA explained that it had developed a health check tool to evaluate the expiry risk for all PFI contracts

1 C&AG's Report, *Managing PFI assets and services as contracts end,* Session 2019–21, HC 369, 5 June 2020
2 In December 2012 the Treasury launched Private Finance 2 as the successor to PFI. This was in response to concerns that the PFI model was too costly, inflexible and opaque. Only six projects used PF2 before the Treasury withdrew the model in Budget 2018. Despite the minor differences between PFI and PF2, we do not separate the two models throughout this report.
3 C&AG's Report, paras 1, 3
4 HM Treasury, Budget 2018, HC 1629, October 2018, para 1.51, p.29
5 Committee of Public Accounts, Private Finance Initiatives, 44th Report of Session 2017–19, HC 894, 20 June 2018
6 C&AG's Report, para 1.4, Figure 1
7 C&AG's Report, para 9, 2.7, 3.8, 3.11
8 C&AG's Report, para 1.15
9 The IPA's PFI contract management programme consists of four pillars: 1) contract expiry; 2) contract management; 3) building capability; 4) expert support and advice.

ending the next seven years—the amount of time the IPA estimated is needed to adequately prepare for expiry. It also told us that it had undertaken 23 health checks so far using this tool and aimed to complete 55 by 31 March 2021. The IPA expected that the programme will continue beyond these 55 contracts, and it would automatically review any contract that will expire within seven years.[10]

5. The second pillar of the IPA's contract management programme involves improving general contract management. The IPA committed to conducting several detailed contract reviews to "formulate solutions and ideas" around what training and capabilities authorities require to better manage their PFI contacts. It explained that pillar three was about building this capability and it was working across government to develop training programmes. Lastly, the IPA described pillar four as providing expert support and advice to where there are disputes, problems or major events such as the need to amend existing contracts.[11]

Understanding the challenges

6. Authorities face a range of challenges in managing the expiry of PFI contracts, such as ambiguous hand back clauses, restricted access rights to information and limited recourse options.[12] The PFI contract itself is central to understanding the challenges an authority may face. However, these contracts are long, complex documents and will have been revised over time to change service requirements or to deliver savings. Local Partnerships highlighted one contract where there had been seven major variations and 75 smaller ones, none of which had been gathered together into a complete document. The NAO similarly highlighted that the authority should hold a complete and up-to-date copy of the PFI contract, but found examples where part, or all of the contract had been lost.[13] We were surprised to hear that these contracts are not always easily accessible as they can be held on older technology. Local Partnerships told us of an instance where a copy of a contract was held on a CD-ROM.[14] A lack of standardisation in earlier PFI contracts means the clarity of expiry clauses may vary, depending on when the contracts were entered into. The Treasury first published standardised PFI contract guidance in 1999, and since then there has been more than four iterations, each one building on the experiences of past PFI projects.[15]

7. The NAO report recommended that the IPA should assess the costs and benefits of developing an electronic repository of PFI contracts.[16] We asked the IPA why it did not hold a central registry of contracts and whether it thought that this would be a useful addition. The IPA told us that it did not hold a central registry of all contracts even though the data on PFI contracts is "not great". It explained that it did not consider creating a registry to be value for money given the complexity of the contracts and the size of the recording that would be required. The IPA added that it has started to collect key parts of contracts, on a small scale, as part of its health check tool, and that it had discussed with "key departments" about them holding registries of their contracts.[17] We received written

10 Qq 13, 27, 92; C&AG's Report, para 1.15
11 Q 13
12 C&AG's Report paras 14, 2.13–2.16, 3.29
13 Q 34; C&AG's Report, para 3.3
14 Q 49
15 C&AG's Report, para 1.12
16 C&AG's Report, para 16
17 Q 37

evidence from Affinitext, which told us that the Ministry of Defence had implemented a central electronic repository for 18 of its PFI contracts, and that this was also common practice for investors across the portfolio of PFI projects they own.[18] Affinitext added that a central repository would allow sponsor departments, the IPA and Local Partnerships to identify high-risk projects and enable a more consistent approach across government, allowing the public sector to catch-up with the best practice of the private sector.[19]

8. The IPA maintains a publicly available PFI database, which includes information on each of the 700 contracts, such as the value of the project, annual payments, date the contract was signed and contract length. The database does not, however, include the date each contract will expire.[20] The IPA told us that this was something it could look to include in future versions of the public database. The IPA aimed to update the database annually, but noted that it relied on returns provided by each department to create the database. It admitted it was not 100% confident that all PFI contracts were actually reported, especially those owed by local bodies.[21]

18 Affinitext is an information technology and services company. It uses artificial intelligence technology to allow complex documents such as contracts to be easily read, understood and managed.
19 MPC0003 – Affinitext, para 8.1a
20 Q 12; C&AG's Report, para 3.4
21 Qq 31–33

2 Providing support to authorities

9. Each individual authority is primarily responsible for managing its PFI contract, including the expiry process. However, when an authority needs help, varying degrees of support are available from multiple sources across government. In the first instance, each authority will be supported by its sponsoring department which acts in an advisory capacity. The IPA, in its role as government's centre of expertise for infrastructure and major projects, provides further advice and support to authorities.[22] Rather than being involved in individual contracts, the Treasury told us it was responsible for making sure there was a support system in place and that this was properly resourced. It explained that this was why it had provided £2 million of additional funding to the IPA to set up the PFI contract expiry programme.[23] Support is also available from Local Partnerships, a joint-venture between the Local Government Association, the Treasury and the Welsh Government, which has a small team of experts who have been involved in all aspects of the PFI lifecycle. Local Partnership explained that its involvement was typically to assist with identifying savings or issues that had arisen within the contracts, or to provide training and assistance to authorities when requested.[24]

10. The IPA recognised that more support was needed to address the "huge demand" for expertise, skills and capability in contract management—all of which were currently insufficient. It explained that contracts owned by local bodies, which made up more than 80% of all PFI contracts, were "the most concerning area" as local bodies' investment in contract management expertise had "not always kept pace with the extent required".[25] Local Partnerships added that the best prepared authorities were those with multiple PFI contracts, as they were more likely to have maintained a PFI team during the life of the project.[26] The NAO found that 182 authorities owned just one PFI contract.[27]

11. The IPA estimated it takes seven years to adequately prepare for the expiry of PFI contracts.[28] The Treasury recognised the importance of starting preparations early, both to ensure maximum value is extracted from the contracts in their final years and to plan for the transition to new ownership arrangements.[29] We received written evidence from Leeds City Council, which told us that as a PFI contract comes to an end, the authority would need to manage the expiry process alongside its daily operations, which can put pressure on already stretched resources. It asserted that it was therefore not possible to start early expiry preparations alongside other work without additional resources.[30] The NAO report found that the expiry process required a different set of skills, such as contract negotiations and asset management, compared to managing the day-to-day operations, and that many authorities would be unable to provide these in-house. Some smaller authorities have just one person managing multiple PFI contracts, with limited additional support, meaning the resourcing challenges of PFI expiry are magnified.[31]

22 C&AG's Report, paras 2, 1.8
23 Q 11
24 Q 18
25 Q 14
26 Q 41
27 C&AG's Report, para 1.16
28 C&AG's Report, para 3.15
29 Q 94
30 MPC0002 - Leeds City Council, paras 8, 9, 11
31 C&AG's Report, para 2.2–2.4

12. We asked the IPA what assurance it could give that local authorities would be properly supported and resourced to manage the expiry of their PFI contracts without having to fill gaps with potentially expensive consultants. The IPA accepted that procuring expertise from the private sectors was not the best value for money solution. It told us that it would be essential to provide additional resources to deal with technical, financial, commercial and legal issues and that it was developing a central pool of people that could provide these skills. It explained that this team so far consisted of 17 people, and it expected to recruit additional staff in the next financial year, and aimed to bring the team to 21 in total. It explained that it was working on further plans and proposals about how to develop additional resources and whether this would be best done by departments or through regional hubs.[32] Written evidence from Wiltshire Council told us that it specifically appointed a PFI contract lead with a broad range of skills, covering contract and project management experience as well as legal, commercial and procurement expertise which will help eliminate the need for consultancy support.[33]

13. The IPA acknowledged that its existing team of experts was not enough resource to provide support to all 700 PFI contracts in a complex environment. Across the UK, 328 authorities are responsible for PFI contracts, with 182 authorities responsible for only one contract. In contrast, the 10 largest private investors in PFI owned more than 50% of the contracts. This concentration allowed the private sector to take a portfolio approach to managing the expiry process, which risks putting the public sector at a disadvantage. To address this, the IPA told us that it had requested from each department their strategies for managing the PFI contracts for which they are responsible. The IPA told us that it will work with departments, focusing on these strategies, to ensure that it was able to get help and support to the contract management teams within the authorities.[34]

14. In light of its recent £2 million budget increase, we questioned the IPA on whether it was adequately funded to support the expiry of assets worth around £60 billion. The IPA told us that the resource requirement for PFI expiry was a big and complex subject, and it was considering the size and level of resource that it needed while attempting to be as efficient as possible. It planned to submit additional resourcing requests to the Treasury in the future.[35] Local Partnerships told us that managing PFI expiry needed to "be done correctly" and "the more resources, the better". It also told us that it could be more proactive in its support to authorities if more resources were made available.[36]

15. Local Partnerships recognised that in order to prepare for the expiry of PFI contracts, authorities needed both to start early, but also to know what they need to do through each stage of the process.[37] The IPA started developing guidance on managing PFI expiry in 2019, and we asked when it expected to publish this. The IPA told us that it planned to issue guidance and technical notes "over the next year" but was unable to give a precise date owing to the impacts of the covid-19 pandemic. We similarly asked the Treasury whether it expected departments to publish sector-specific guidance. It explained that

32 Qq 22, 69, 70
33 MPC0001 – Wiltshire Council, para 2
34 Q 15; C&AG's Report, paras 8, 1.4, 1.16
35 Qq 16, 50
36 Qq 20–21
37 Q 20

this would be a matter for each department once overall guidance was available, but this could be a very helpful initiative given that some specific expiry issues could be common in similar types of assets.[38]

38 Qq 65–66; C&AG's Report para 1.15, 3.15

3 Relationship management during contract expiry

Managing investor relationships

16. Once a PFI contract has expired, any cash remaining in the PFI company is distributed to shareholders and the company is closed. If any maintenance or rectification work is outstanding at this point, it will be almost impossible for the authority to recover any money owed. It is therefore vital that authorities monitor and enforce compliance against the PFI contract.[39] PFI contracts are, in theory, self-monitoring which means the PFI company is responsible for reviewing performance and reporting back to the authority. Nevertheless, the authority still needs to monitor the PFI company's performance to ensure it is receiving the services it has paid for.[40] The NAO found that special attention needs to be paid to monitoring on-going maintenance and the lifecycle fund, a pot of money built up over the life of the project to pay for planned, periodic maintenance. It found that failure to monitor maintenance increased the risk of assets transferring to the public sector in a poor condition. It also found that, as the PFI company keeps any remaining lifecycle fund on expiry, there can be perverse incentives to underinvest in assets, making them last longer than originally planned, leaving more cash in the pot for investors.[41]

17. A PFI contract should grant an authority access to any information reasonably required to monitor the PFI company's performance. The NAO found that of the survey respondents who monitor the maintenance programme, 35% reported they had insufficient access rights to allow them to do so. In one PFI hospital, the authority identified a large gap between the money paid into the lifecycle fund and what was being spent on maintenance. The difference could indicate that the PFI company was not carrying out the maintenance work as planned but the authority was unable to challenge whether this was the case because the PFI company denied it access to the relevant information. When asked whether this is acceptable, the IPA acknowledged that there were some "difficult investors" who "liked asymmetric information" on key parts of the contract. This means that the PFI company holds much more information on its performance compared to the authority, which limits the authority's ability to challenge the PFI company. The IPA recognised that this information was "absolutely critical" in managing the expiry of PFI contracts and told us that it was working to get investors to share assets registers and the financial information needed.[42] The IPA also explained that it was working with "key investors" to remind them of their responsibilities and planned to develop a protocol outlining how investors should operate during the expiry process.[43]

18. Local Partnerships explained that asset condition surveys are the most critical aspect of the expiry process as they tell the authority whether or not the assets are in a fit state. These surveys should identify the amount and cost of any rectification work required before expiry. Local Partnerships highlighted that if the surveys were completed too close

39 Q 36; C&AG's Report, paras 2.7, 3.29
40 Qq 34, 44; C&AG's Report, paras 3, 2.7
41 C&AG's Report para 2.8–9, 2.11–12
42 Q 85; C&AG's Report, paras 2.13–2.15
43 Q 39

to the end of a contract, there could be insufficient time to remedy any defects identified.[44] The IPA told us that the Treasury's standard PFI guidance recommended surveys should be conducted 18 months to two years in advance of the contract's expiry, which the IPA believed is too late. The IPA recommended that health check reviews take place seven years before the expiry of the contract, and that this could include requiring an asset condition survey.[45] In its written evidence to us, Leeds City Council was concerned that there may not be enough technical experts to complete these surveys, and that creating a "lucrative new industry overnight" may create risks such as surveyors being under-qualified, inadequate surveys being produced in order to quickly move onto the next job or high prices due to lack of competition.[46]

19. Authorities have tools to encourage non-cooperative PFI companies to act but they vary from contract to contract. As a minimum, all PFI contracts allow authorities to withhold a portion of their annual payments in the event of poor performance. Local Partnerships told us that authorities will be better positioned if they make these deductions while the debt providers, such as banks, are still involved in the project. It explained that the threat of debt not being repaid would encourage debt providers to put additional pressure on the PFI company to complete any outstanding work. However, the IPA noted that debt was often paid off several years before expiry, meaning authorities need to take early action.[47] Withholding annual payments is not always a solution; the NAO identified an example where an authority could only make deductions on the grounds of non-performance or unavailability. This means that if information is not being shared or the assets are not being maintained, but they remain in a usable condition, then the authority cannot withhold any payment.[48]

20. In its written evidence to us, Affinitext told us that the primary objective of withholding annual payments was to ensure contractual compliance rather than maximising cash savings for the authority through imposing high penalties. It explained that if the process of withholding payments, which can take place many years before contract end, is seen by both parties as a means of "catching the other out," this could damage relationships before the really challenging aspects of expiry need to be faced.[49]

21. Any rectification work required should be completed before the expiry of the contract. Once the PFI company has closed, authorities have limited options to reclaim any money owed. One option for protecting against this is to build a retention fund, whereby a portion of the authority's annual payment is set aside specifically to pay for any rectification work at expiry. The NAO found that of the 28 contracts in its survey which contained a retention fund, 10 respondents did not expect it to be large enough to cover the expected rectification work.[50] We asked the IPA how an authority should manage this risk. It told us that the solution was "a larger retention fund". It recognised that the retention fund was a contractual obligation and could not be unilaterally changed, but noted that the amount paid into the retention fund is linked to the asset condition survey.[51]

44 Qq 36, 45; C&AG's Report para 3.18
45 Qq 75–76
46 MPC0002 - Leeds City Council
47 Qq 71–72, 89; C&AG's Report, paras 3.30–3.32
48 C&AG's Report, para 3.30
49 MPC0003 - Affinitext
50 C&AG's Report, paras 3.29, 3.31
51 Qq 86–87

Resolving disputes

22. In managing the expiry of a PFI contract, all parties will want to maximise value from the PFI contract. Authorities will want to inherit an asset in the best possible condition, as this will minimise any future maintenance costs and the risk that services are interrupted. Meanwhile, PFI companies have an incentive to limit expenditure on maintenance and rectification work in the final years of the contract as any savings will be passed through to investors. These misaligned incentives can lead to disputes. The NAO found that more than one-third of authorities who responded to its survey expected to have formal disputes near contract end, with the majority relating to the volume of rectification work and its cost.[52]

23. Each PFI contract should set out a formal dispute handling procedure. The IPA told us that typically the process required a panel of experts, selected based on the nature of the dispute, to reach a judgement. If the panel cannot reach a judgement, or either party challenges it, the dispute will go to either arbitration or the courts. It explained that, under most PFI contracts, the arbitration process has to be voluntary. Even before reaching the courts, the disputes process can be long, in some cases taking a minimum of 10 months. The NAO found that the process can be expensive, which can prohibit authorities from pursuing disputes, especially when success is not guaranteed. There are some examples of good practice in this area. Highways England has agreed an informal disputes resolution process with the PFI company. Designed to be quicker and cheaper, this informal approach takes place before the formal contractual disputes process and involves discussions between nominated individuals from both parties, first at an operational level and then at a project manager level.[53]

Protecting taxpayer interests

24. The authority is responsible for managing the PFI contract until expiry, at which point it inherits the assets.[54] In some instances, ownership of the PFI assets can transfer between different public bodies before the contract expires, creating a potential conflict between those who will own the assets in the future, and those who are responsible for their management now. We asked the IPA how this was expected to work, particularly in areas such as the education sector. For example, an authority—usually the local authority—signed a PFI contract for a school and remained responsible for the contract until its expiry. The original contract would have stated that, on expiry, ownership of the school passed to the local authority. But in some cases, during the contract, the school was converted to an academy run by an independent trust funded by the Department for Education rather than the local authority. The NAO found that a local authority could find itself in a position that it still had to manage the PFI contract, but on expiry, the school would be transferred over to the academy trust.[55]

25. Over 300 PFI schools have been converted to academies. We asked whether local authorities might be incentivised to protect their budgets by limiting expenditure on managing the contract rather than maintaining the assets as they would not own them at

52 C&AG's Report, para 13, 3.22

53 Q 82; C&AG's Report, paras 3.26–3.28

54 The ownership of assets at expiry will be dictated by the contract. Assets will either fully or partially transfer to the public sector or remain with the private sector. In most case the authority will inherit the assets on expiry.

55 Qq 55, 63; C&AG's Report, paras 9, 3.9

contract expiry. The IPA accepted that this was a very complex issue and a very real risk which needed clarification. It explained that the Department for Education, which had one of the "more resourced and capable PFI teams" was "highly focused" on resolving this issue. In the example of schools, the IPA asserted that there was "every incentive to ensure that the school is in a good condition and well maintained" and that it thought the interests of academies, local authorities and the Department for Education were aligned.[56] We asked the IPA whether academies were nonetheless at risk of inheriting liabilities in the form of large rectification bills to bring the assets back to a useable condition should the authority not manage the contract properly. The IPA told us that it did not expect these to be large liabilities.[57]

56 Q 51–52, 56–57, 64; C&AG's Report, para 3.9

57 Q 54

Formal minutes

Monday 15 March 2021

Virtual meeting

Members present:

Meg Hillier, in the Chair

Mr Gareth Bacon	Sir Geoffrey Clifton-Brown
Shaun Bailey	Peter Grant
Olivia Blake	Mr Richard Holden

Draft Report (*Managing the expiry of PFI contracts*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 25 read and agreed to.

Summary agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Resolved, That the Report be the Fifty-first of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Thursday 18 March at 9:15am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Monday 8 February 2021

Charles Roxbourgh, Second Permanent Secretary, HM Treasury; **Matthew Vickerstaff**, Deputy Chief Executive, Infrastructure and Projects Authority (IPA); **Sean Hanson**, Chief Executive Local Partnerships, Local Government Association Q1–96

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

MPC numbers are generated by the evidence processing system and so may not be complete.

1 Wiltshire Council (MPC0001)

2 Leeds City Council (MPC0002)

3 Affinitext (MPC0003)

4 i3PT (MPC0004)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

Session 2019–21

Number	Title	Reference
1st	Support for children with special educational needs and disabilities	HC 85
2nd	Defence Nuclear Infrastructure	HC 86
3rd	High Speed 2: Spring 2020 Update	HC 84
4th	EU Exit: Get ready for Brexit Campaign	HC 131
5th	University technical colleges	HC 87
6th	Excess votes 2018–19	HC 243
7th	Gambling regulation: problem gambling and protecting vulnerable people	HC 134
8th	NHS capital expenditure and financial management	HC 344
9th	Water supply and demand management	HC 378
10th	Defence capability and the Equipment Plan	HC 247
11th	Local authority investment in commercial property	HC 312
12th	Management of tax reliefs	HC 379
13th	Whole of Government Response to COVID-19	HC 404
14th	Readying the NHS and social care for the COVID-19 peak	HC 405
15th	Improving the prison estate	HC 244
16th	Progress in remediating dangerous cladding	HC 406
17th	Immigration enforcement	HC 407
18th	NHS nursing workforce	HC 408
19th	Restoration and renewal of the Palace of Westminster	HC 549
20th	Tackling the tax gap	HC 650
21st	Government support for UK exporters	HC 679
22nd	Digital transformation in the NHS	HC 680
23rd	Delivering carrier strike	HC 684
24th	Selecting towns for the Towns Fund	HC 651
25th	Asylum accommodation and support transformation programme	HC 683
26th	Department of Work and Pensions Accounts 2019–20	HC 681
27th	Covid-19: Supply of ventilators	HC 685

Number	Title	Reference
28th	The Nuclear Decommissioning Authority's management of the Magnox contract	HC 653
29th	Whitehall preparations for EU Exit	HC 682
30th	The production and distribution of cash	HC 654
31st	Starter Homes	HC 88
32nd	Specialist Skills in the civil service	HC 686
33rd	Covid-19: Bounce Back Loan Scheme	HC 687
34th	Covid-19: Support for jobs	HC 920
35th	Improving Broadband	HC 688
36th	HMRC performance 2019–20	HC 690
37th	Whole of Government Accounts 2018–19	HC 655
38th	Managing colleges' financial sustainability	HC 692
39th	Lessons from major projects and programmes	HC 694
40th	Achieving government's long-term environmental goals	HC 927
41st	COVID 19: the free school meals voucher scheme	HC 689
42nd	COVID-19: Government procurement and supply of Personal Protective Equipment	HC 928
43rd	COVID-19: Planning for a vaccine Part 1	HC 930
44th	Excess Votes 2019–20	HC 1205
45th	Managing flood risk	HC 931
46th	Achieving Net Zero	HC 935
47th	COVID-19: Test, track and trace (part 1)	HC 932
48th	Digital Services at the Border	HC 936
49th	COVID-19: housing people sleeping rough	HC 934
50th	Defence Equipment Plan 2020–2030	HC 693