Infrastructure and Projects Authority

16 August 2021

Meg Hillier MP
Chair of the Committee of Public Accounts
House of Commons
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Dear Ms Hillier

Private Finance Initiative (PFI) Contracts

I am writing to you as the Chair of the Public Accounts Committee in response to some of the recommendations in your 51st Report of Session *Managing the expiry of PFI contracts.*

In a number of the recommendations, you asked that the Infrastructure and Projects Authority write to the committee setting out further details of its plans to improve the management of expiring PFI contracts and to help ensure that value for money is achieved as the public sector exits these arrangements.

In the annex to this letter I have provided a response to each of the relevant recommendations.

Yours sincerely,

M. Vickerstaff.

MATTHEW VICKERSTAFF
DEPUTY CEO
Infrastructure and Projects Authority

ANNEX A

Introduction

The government announced at Budget 2018 that it would no longer use PFI or PF2 to deliver public sector assets. In addition, to improve the management of the existing PFI portfolio of contracts, the Infrastructure and Projects Authority (IPA) has developed a PFI Contract Management Programme, designed to address the concerns highlighted by the PAC and the NAO, and other issues with the PFI portfolio that have been identified by Ministers. The Programme is being delivered by the *PFI Centre of Excellence* in the IPA. The Programme is a central part of the IPA business plans for 2020 and 2021. The role of the *PFI Centre of Excellence* is part of the IPA Mandate, published earlier this year.

IPA initially secured funding for the Programme at the Budget 2020 and the Civil Service Board approved the programme of work at its meeting on 25 March 2020. The IPA secured further funding to March 2022 at the Spending Review later that year.

The programme consists of four projects:

> **Project 1:** Managing the exit from PFI contracts
> Produce consistent approaches to managing the exit from PFI contracts to ensure private sector partners meet their end-of-contract obligations and ensure the continuity of public services.
>
> **Project 2:** Operational contract reviews
> Identify ways to improve the operating performance of PFI contracts and measures to reduce the cost and risks of PFI contracts. Make recommendations to take decisive action in response to poor contractual performance.
>
> **Project 3:** Building capability
> Build capability across the public sector through system support and products including a Contract Expiry Health Check tool, contract expiry guidance, technical guidance notes, training courses and sharing of best practice through case studies and networking.
>
> **Project 4:** Expert advice and support
> Provide expert advice to support the implementation of contract reviews and contract expiry health checks. Advise on commercial issues such as refinancing, insurance, value testing, supplier and market engagement, disputes and terminations.

Due to the large number of assets returning to the public sector over the next 10 years and the wider risks around the portfolio, this programme is governed by both an Oversight Committee and a Programme Board. The Oversight Committee is composed of the relevant Permanent Secretaries or Directors General of key departments and the Heads of Functions. It is jointly chaired by Alex Chisholm, Permanent Secretary of the Cabinet Office and Catherine Little, Director-General of Public Spending at HMT. The Oversight Committee meets periodically to discuss the Programme's progress, highlight key risks and provide direction.

The SRO for the programme is Matthew Vickerstaff, Deputy CEO of the IPA. He chairs the Programme Board which oversees the delivery of the programme and brings together the departments which manage or sponsor PFI contracts. The Commercial, Property, Finance and Legal Functions are also represented. The Programme Board meets bi-monthly.

The Programme is subject to funding either centrally, or from Departments and Authorities or a mixture of all three. However, it is important to recognise that funding the Direct Support elements of the Programme will help rebalance the symmetry of skills between the public and private sectors and manage the risks highlighted by the NAO and PAC reports.

Specific recommendations from the PAC Report requiring a written response

Recommendation 1: 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.

Response
The IPA has today published a plan summarising the support we are providing to all public bodies within England to help them better prepare for and manage the expiry of their PFI contracts. This encompasses risk assessment, issues identification and action recommendations and follow-up support through our expiry health check programme, our proposed expiry guidance and supporting toolkit, a specific expiry training programme and the availability of strategic advice and assistance to both contracting authorities and government departments. The plan can be found here.

Our specific expiry guidance with initial supporting toolkit is expected to be published in Autumn 2021 and will reflect the practical lessons and learnings from the programme of health checks undertaken to date.

HM Treasury agrees that sector specific guidance is important and will address the issue with departments through the Oversight Committee that it jointly chairs with the Cabinet Office.

Recommendation 2a: 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.

Response
The IPA completed 52 Expiry Health Checks in the last financial year. We are in the final stages of compiling and approving a full report into our findings and the identified lessons and it is our intention to publish this by the end of the summer. We

will notify you when the report is published.

Our findings are broadly consistent with those of the PAC and the NAO reports. The learning from our analysis has already been shared with Departments at the Oversight Committee meeting in May and has been incorporated into our wider work set out in the responses to other recommendations in the PAC report.

We found that:

- 52% of projects' readiness for expiry were rated as Amber or worse (we have used a 5 tier RAG rating system).
- Projects were, typically, "redder" the closer they were to expiry, with 19 of 21 or projects expiring before the end of 2024 rated as Amber to Red.

We identified ten key lessons for Contracting Authorities:

1. Understand your contract and its performance through the operational phase to be better placed for expiry.
2. Ensure that PFI expiry, as a major contractual event, is captured & prioritised within business and resourcing plans.
3. Start preparing for expiry at least 7 years out.
4. Make sure you have appropriate governance and leadership in place to manage expiry.
5. Put in place detailed, integrated and resourced plans that integrate Business as Usual, expiry, transition and future services provision.
6. Recruit sufficient and appropriately skilled people to enhance the contract management team for expiry.
7. Engage with the private sector early on expiry. Seek to adjust your relationship for expiry and build a good understanding of their drivers at expiry.
8. Invest in understanding the conditions of your assets against the contract requirements.
9. Understand the expiry terms. Build positive commercial strategies to meet your aims & reflect private sector drivers.
10. Align your future services activity with expiry and Business as Usual; and inform future service provision with data from the provided through the PFI contract.

In addition, we identified four key actions for the PFI Contract Management Programme to support expiry:

1. Incorporate learnings from the review into the operational PFI Contract Management Project PFI Programme overall.
2. Develop expiry guidance including on timelines, governance, integrated planning, resourcing, skills, asset condition and surveys.
3. Build capability across the public sector through training, and increase public sector expertise with a focus on commercial acumen to support expiry.
4. Expand private sector engagement on PFI expiry including the development of a public-private PFI protocol on managing expiry including dispute resolution.

Recommendation 3: The Treasury and the IPA should write to the 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.

Response

A key objective of the PFI Contract Management Programme as set out in the introduction, is to help ensure operational contracts are fit for purpose and the public sector gets what it has contracted to pay for.

There is, at present, a notable asymmetry of skills and experience when comparing professional asset managers in the private sector and a fragmented public sector contract management base. There has been a significant consolidation amongst private sector investors and fund managers. The top 10 investors now own more than 50% of the equity across the projects' portfolio. This compares to more than 400 contracting authorities with differing levels of engagement, many with just single projects. Where there has been ineffective public sector management of contracts, this has resulted in contracts not always delivering services to the agreed standards. A centrally coordinated approach will enable the public sector to engage as one for HM Government. Without this there will continue to be missed opportunities to deliver best practice, improve efficiency, refine and ensure projects across the entire portfolio remain fit for purpose and deliver best value for money.

The Advice and Support Project within the Contract Management Programme aims to drive consistent performance of PFI contracts through targeted expert commercial, technical and legal advice. By having a central team of PFI experts we can ensure the quality of this advice, identify and address common issues and negotiate on a level playing field with our private sector partners. We will approach this in a measured way using different avenues of support.

Direct Support

This financial year, subject to the recruitment of additional PFI experts, IPA will be available to provide support to departments and contracting authorities on specific projects. Separately, the PFI Programme is assessing options for further increased central resources for future financial years. IPA will work with departments to help ensure Spending Review bids for the PFI resource overall are appropriately timed and proportionate to the issues and risks faced.

PFI Expert Pool Support

To augment the support the IPA is able to provide, a pool of PFI experts will be developed and funded for this financial year, enabling the advice to be free to users to encourage take up. It may be the case that this support will be provided on a chargeable basis in the future.

In addition to the PFI Expert Pool, resources can be drawn from two quasi Crown consultancies - the Complex Transaction Team (CTT) and Local Partnerships, respectively supporting the central departments and local government. CTT is part of the Cabinet Office. Local Partnerships (LP) are owned 50% by the Local Government Agency, 45% HM Treasury and 5% Welsh Government. Both CTT and LP charge a day rate for their support.

Consultancy Support
We will provide support through the other routes first but expect some expertise will need to be sourced from technical, legal, financial and commercial advisers. It is anticipated that a majority of the consultancy spend will be on technical support, where the requirement for advice will be across a suite of different technical disciplines.

The PFI Advisers' Framework
Alongside direct, associated, and consultancy support, the IPA will work with the Crown Commercial Service to develop a PFI Advisers' Framework for contracting authorities to access. We will also work with the Crown Commercial Service and the Complex Transactions Team in the Cabinet Office on the route to future service provision following the expiry of a PFI contract. Our collective aim is to provide a framework to help ensure a seamless transition to future service provision.

The IPA is currently funded to undertake this work for the 2021-22 financial year on a "free at the point of use" basis and is therefore supporting all authorities including those with limited funds. Decisions on any additional funding will be a matter for Ministers to determine in the forthcoming 2021 Spending Review. The envelope for the Spending Review will be set out in due course.

In addition, the IPA is working with the Cabinet Office's Contract Management Capability Programme and departments, to develop a PFI Contract Management training course. It will comprise eight modules and is currently estimated to be around a week of learning. The contract expiry module is in development and will be launched in early Autumn. Subject to affordability and spending approvals we aim to have the main training programme available from early 2022.

Recommendation 4: The Treasury and the IPA should set out, within 3 months, their plan for providing support to all PFI contracts, especially those owned outside central government. This should cover:

a) **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.**

Response
At recommendation 3, we have set out the current support arrangements that are in place in the IPA. This support is available through the *Centre of Excellence* and is available to all PFI contracting authorities in central and local government. In addition to this, support can be drawn from two quasi Crown consultancies - Complex Transaction Team (CTT) and Local Partnerships, respectively supporting the central

departments and Local Government.

The IPA is currently funded to undertake support work for the 2021-22 financial year on a “free at the point of use” basis and is therefore supporting all authorities including those with limited funds. Decisions on any additional funding will be a matter for Ministers to determine in the forthcoming 2021 Spending Review. The envelope for the Spending Review will be set out in due course.

Where a project is owned by a local authority, the sponsoring department may also provide additional support and funding to the local authorities where budgets allow. For example, DEFRA currently funds 700 days of Local Partnerships' *Transactor* support for its local authority waste projects and has a further arrangement for Local Partnerships to provide technical advice to the core DEFRA PFI Team.

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

Response
At the centre, support for the operational PFI portfolio is shared between HM Treasury and IPA and governed by a Memorandum of Understanding. HM Treasury continues to be responsible for all aspects of private finance policy and IPA provides detailed technical support. IPA continues to hold responsibility for the implementation of the standard PFI contract. However, responsibility for providing support is wider than that provided by the centre and sponsoring departments and contracting authorities also have responsibilities. In broad terms the support responsibilities are as follows:

- HMT - is responsible for setting policy for the use of private finance to deliver investment in public infrastructure, assets and services, including policy on Public Private Partnerships (PFI, PF2 and other forms of PPP).
- IPA - Through the *PFI Centre of Excellence*, IPA provides policy, commercial, financial and technical advice to HM Treasury, authorities and departments on their programmes and projects. Further, IPA is the custodian of Standardisation of PFI/ PF2 Contracts as it applies to existing projects.
- Departments - provide sector specific policy and in-house contract management support. Departments may provide additional financial support to projects.
- Contracting authorities (including local government and ALBs) - day to day contract management.

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

Response
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place in the IPA. This support is available through the *Centre of Excellence* and is available to all PFI contracting authorities in central and local government. In addition to this, support can be drawn from two quasi Crown consultancies - Complex Transaction Team (CTT) and Local Partnerships, respectively supporting the central departments and Local Government.

The IPA is currently funded to undertake support work for the 2021-22 financial year on a “free at the point of use” basis and is therefore supporting all authorities including those with limited funds. Decisions on any additional funding will be a matter for Ministers to determine in the forthcoming 2021 Spending Review. The envelope for the Spending Review will be set out in due course.

As further stated in the response to Recommendation 3, the IPA is working with the Cabinet Office’s Contract Management Capability Programme and departments to develop a PFI Contract Management training course which includes a contract expiry module to be launched in early Autumn.

Recommendation 7: 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 is found to be deliberately non-cooperative.

Response

The IPA is currently developing a comprehensive Market Engagement Strategy, including PFI investor relations. Initial roundtable discussions and some bilateral meetings have been held with the largest investors. This has been well received and investors are showing willingness to engage constructively. It is intended that a framework of regular meetings will be set up to foster good communication and mutual understanding.

A public-private PFI protocol is under development and a draft is expected to be shared with the private sector in autumn 2021 for discussion. The protocol will set out the behaviours expected of investors and authorities in managing the expiry process. The aims are to foster collaborative working, ensure transparency by investors, promote the effective resolution of disputes, and achieve the sharing of lessons learned and best practice. The target is to obtain market agreement to the protocol within 6 months of draft issue.

If an investor is found to be deliberately non-cooperative, the IPA will engage with the investor to understand what is driving the behaviour and endeavour to resolve the situation. Furthermore, where possible and warranted, the IPA can leverage its portfolio and wider market perspective in interactions with investors. Although there is no active PFI programme of new projects coming to market, investors and facilities management companies in the existing PFI portfolio continue to seek other opportunities to work with the public sector. It is also possible that contracting authorities may be uncooperative. Where this is the case, the IPA will engage with contracting authorities on a similar basis.

Finally, to ensure that all departments are fully engaged in improving the management of expiring PFI contracts, the Oversight Committee has written to all Accounting Officers of departments with PFI contracts due to expire to ensure that, where an expiry health check reports that the preparations for expiry are Red or Red/Amber, the issue is raised through the corporate governance arrangements of the department. This includes cases where the contract is formally owned by an arm's length body or local government.

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