PAYBACK TIME FOR THE PFI?

For two decades the PFI has been the only game in town for financing public infrastructure. Now pressure is mounting for the private firms that have done so well out of it to put something back into the public coffers.

The last Labour government was a big fan of the Private Finance Initiative. As chancellor, Gordon Brown would castigate the PFI’s critics for putting new hospitals, schools and transport projects at risk. The alternative, he said, would be ‘reckless and unsustainable borrowing’.

But, as many pointed out at the time, the PFI is itself a form of borrowing, even if its impact on the national statistics is deferred. While upfront capital is provided by private investors, the taxpayer ultimately funds the whole cost of any project. Now, that essential truth is becoming evident in communities across the country.

Take the £256m Queen Alexandra Hospital in Portsmouth. This sparkling new facility was officially opened in October, and is undoubtedly one of the most impressive health care buildings in Europe. But the Portsmouth Hospitals NHS Trust has been forced to take out a £13m loan to pay its bills, while cutting 700 jobs and 100 beds. It is left with a £6m deficit and many more job losses are expected soon.

Yet the scheme has proved profitable for the investors (see box overleaf). Last June, Carillion, a construction group, sold its shares in the project to HSBC Infrastructure Company Ltd for £31m – a healthy return on the £12m it put into the deal in 2006. It will, meanwhile, continue to manage the new PFI facilities under a concession worth about £30m a year.

Answering a question on the Queen Alexandra deal in Parliament recently, Prime Minister David Cameron called the PFI programme a ‘shambles’ that he had inherited (although he was special adviser to Tory chancellor Norman Lamont in 1992, when the PFI was introduced). Cabinet Secretary Francis Maude described PFI profits as ‘outrageous’ last month. The anti-PFI rhetoric is becoming more strident even as ministers cut back on the quantity and quality of its services.

‘We need a deal with all the major PFI firms’

Jesse Norman MP
HEAD OF PFI REBATE CAMPAIGN

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Sir Philip Green’s public procurement practice – or the broader Cabinet Office review of large contracts that followed the Commons’ Public Account Committee that the prices paid for many PFI hospital deals had been too high, reflecting the ‘overheated’ state of the market.

Much of the Conservative-supporting press has eagerly reported stories of government-commissioned ‘crack teams’ tearing up contracts signed by bungling Labour ministers. In reality, however, the scope of the code of practice is likely to be modest and will leave most PFI contracts inviolate.

Announcing the Romford pilot in February, Treasury minister Lord Sassoon said the proposals would drive out costs while ensuring frontline services are maintained. In private, however, Treasury officials insist they will do precisely the opposite. Officials expect a maximum of 2% to be shaved off the cost of contracts, and they stress that even these modest savings will be achieved, not by asking investors to take a profit margin ‘haircut’, but by cutting back on the quantity and quality of the services they are contracted to provide.

Investors do not regard the code of practice – or the broader Cabinet Office review of large contracts that followed the Queen Alexandra Hospital in Portsmouth might be an attractive building but its costs are plunging the trust into ever deeper debt
FEATURE  
Private Finance

Speeding ahead: new transport links are being pushed through under the PFI scheme.

Offering a maximum of 2% to be shaved off the contract costs

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these rebate options as unrealistic. With government capital spending set to fall by an unprecedented 59% over the next five years, from £49bn in 2010/11 to £20.6bn by the middle of the decade, ministers have no strong incentive to antagonise PFI sponsors or other investors.

Chancellor George Osborne’s Comprehensive Spending Review speech last year promised to ‘avoid the errors’ of the early 1990s by slashing spending on new capital investment. However, the reduction in capital budgets that occurred in the early 1990s was significantly less radical than the one outlined in the Review documentation. The chancellor must be looking to the private sector to finance this huge shortfall in capital investment.

A closer look at the reality on the ground reveals that this is exactly what is happening. PFI projects are being allowed to proceed to financial close, and business cases for new projects are being signed off. Lord Sassoon, in a speech to the annual dinner of the Public-Private Partnerships Forum lobby group in November, confirmed that the government remained committed to the PFI, and that such arrangements would continue to play an important role.

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First Minister Alex Salmond castigated the previous administration for landing the SNP government with an annual PFI bill of £800m – ‘a toxic Labour legacy’, as he described it.

The £256m Queen Alexandra PFI Hospital in Portsmouth was completed in July 2005, and opened by Princess Anne in October. The trust has struggled to meet the annual revenue cost of the deal. Chief executive Ursula Ward has said that despite cutting 700 jobs and closing wards, an extra £30m will have to be saved in the next financial year.

A peculiar feature of the Queen Alexandra PFI is the use of ‘credit guarantee finance’, in which 91.5% of the money to build the scheme actually came from the public sector, rather than the banks or commercial bond issues that normally finance these projects. Although the finance was public, it was guaranteed by a private sector insurer, and priced on the basis of ‘contemporary market norms’ – in, well above the rate at which the government can borrow on its own account.

The difference between the government bond rate and the loan rate is, in effect, profit for the Treasury. But neither the Department of Health nor the trust gains from this arrangement, in terms of lower annual charges, compared with purely private finance.

Last June, Carillion sold its shares in the hospital to HSBC Infrastructure Company Ltd for £31m. Carillion, which had invested £12.1m in the deal, earned £31.3m from the sale. HSBC bought a further 15% of the scheme from Royal Bank of Scotland for £13.4m in October, and now owns 85.9% of the equity and 100% of the loan note interest. It expects to earn £610m from the scheme over the remaining 30 years of the contract.

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