# The Private Finance Initiative in the UK National Health Service

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# What this talk will cover

- The scale of PFI in the United Kingdom
- The implications of PFI for public finances
- The link between PFI and NHS deficits
- The extent of profit-making through PFI

# The dominance of PFI in UK Public Sector Investment

- PFI is "a small but important role in the Government's investment in public services" comprising around 10-15% of investment in public services (Treasury 2006).
- But for large infrastructure developments, this form of financing is overwhelmingly dominant throughout the United Kingdom.

# Public Investment - England

- Of the 86 'major', hospital projects approved since May 1997, 80 have been taken forward through the PFI. Public financing accounts for less than 3% of the total value of these investments.

- Going forward, all 25 hospital schemes in planning or being negotiated are PFIs.

*Source: Department of Health (www.dh.gov.uk)*

# Public investment - Scotland

- Since 1997, three major hospital schemes have been delivered – at Edinburgh (£180 million), Hairmyres (£68 million) and Wishaw (£100 million). All are PFI schemes.

- A further six 'major' schemes are planned with a combined capital value of more than £1.5 billion. All are PFI schemes.

*Source: Hellowell and Pollock (2006)*

# Public Investment - Northern Ireland and Wales

- Capital starvation in recent times, but eight schemes are now in planning, with an estimated total capital cost of £2bn. All are "likely" to proceed under PFI.

- Since devolution in 1999, Wales has effectively ended its PFI programme. As a result, there have been no new major investments.

*Source - Public Private Finance Conference, February 2006*

# PFI and public finances - England

- In the financial year 2005-06 the NHS in England made PFI payments of £4.35bn.

- Total repayments to be made on existing PFI deals, which have a capital cost of £8.3 billion, is £53 billion in nominal terms

*Source – Department of Health, Freedom of Information Response, 30 November*

# The make-up of the charges

- Government figures show that, on average, around 60% of repayments are availability charges (that is, the payment of debt principal and rolled-up interest), and 40% service charges.

- Total availability charges for existing deals are around £31 billion in nominal terms - almost four times the amount of capital expenditure.

*Source: Department of Health 1999-2000 Public Expenditure Memorandum*

# PFI and public finances - Scotland

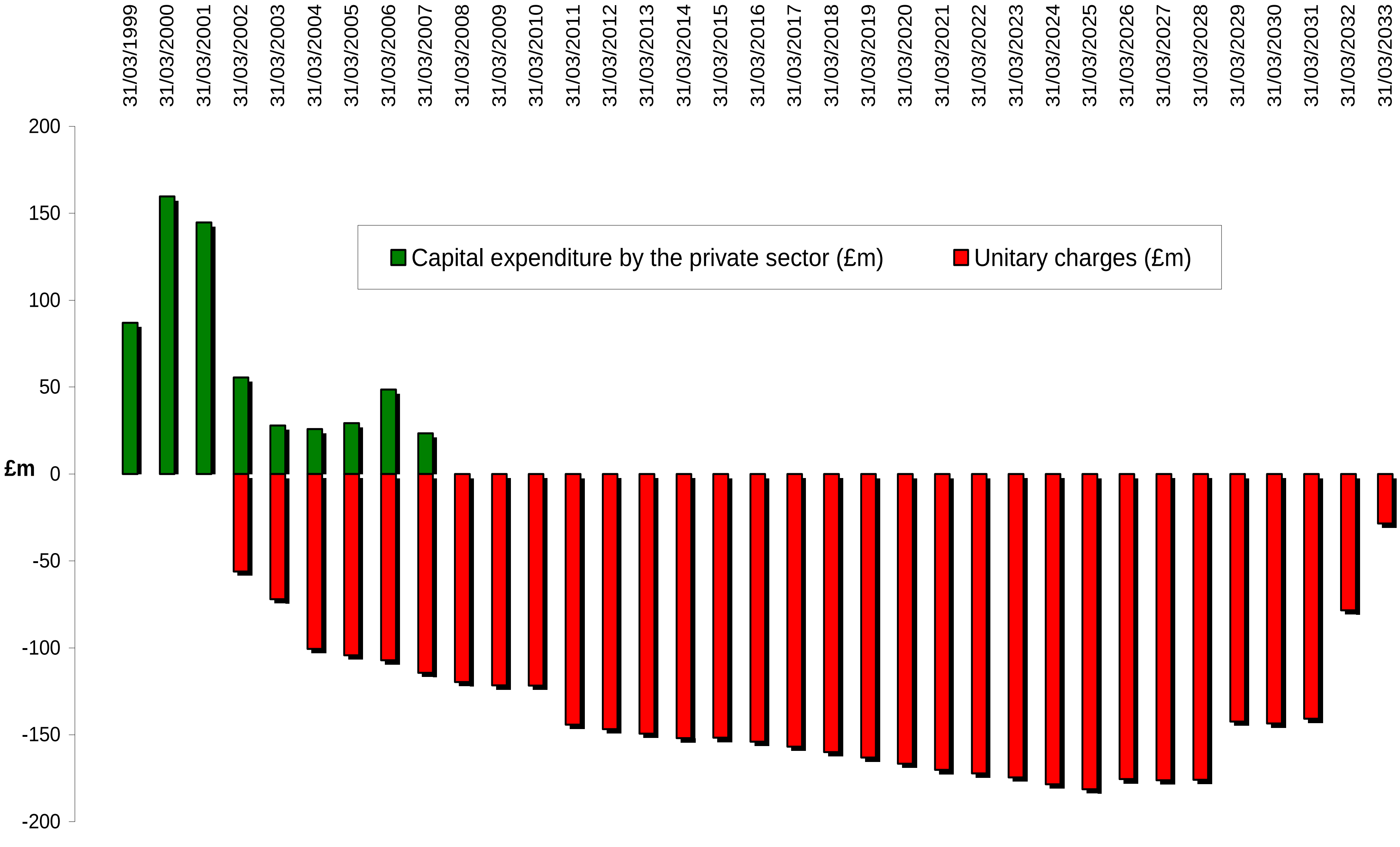
- As of 28 November 2006, the capital value of signed schemes in Scotland was £602 million, compared with projected expenditure of £4 billion on PFI over the life of the contracts.

- The availability charge component was an estimated £2.4 billion, almost four times the capital expenditure.

*Source: Hellowell and Pollock (2006)*

# Scotland (continued)

Figure 1. Payments incurred by the NHS in Scotland under signed PFI contracts[i,ii]



# Affordability (1)

- PFI facilities cost more than NHS buildings. The average annual PFI availability charge for acute PFI facilities is around 15% of hospital turnover, compared to 7% in non-PFI facilities.

- This creates an 'affordability gap' that must be bridged by diverting revenue from clinical care, staff and supplies. All PFI business cases discuss major bed reductions and other service cuts.

# PFI and cost escalation

- There is greater cost inflation for PFI schemes than for traditionally financed schemes during the planning and negotiation stages.
- For currently operational schemes, the average price increase between Outline Business Case and contract close was 52.2%. For schemes currently being built, the average increase was 114.6% (total average across all schemes – 74.5%).
- Not only are these figures very high by comparative standards, they also suggest that the problem of PFI inflation is getting worse.

# Cost and Time overruns – The government's case

- The alleged ability of PFI to deliver buildings 'on time and to budget' with more consistency than public procurement is key to the government's case for using PFI (HM Treasury, 2006).

# PFI and NHS deficits

- Documents from the Department of Health and Monitor (the regulator for the quasi-independent 'foundation trusts') show that 81 of 272 trusts were in deficit in 2005-06, or 29.78%.

- Meanwhile, of the 28 NHS trusts with major PFI schemes in operation, 14, or 50%, recorded a deficit in 2005-06.

*Source - Department of Health, 'Public Expenditure Memorandum,2005-2006',; and Monitor, 'NHS Foundation Trusts – preliminary results for 2005- 2006'*

# The Queen Elizabeth Hospital

- The Queen Elizabeth Hospital NHS Trust in Greenwich attributes its deficit of £19.6 million in part to the PFI contract.

- The trust estimates that this contributes £9 million in "excess costs".

*Source - PricewaterhouseCoopers, 'Queen Elizabeth Hospital NHS Trust: Public Interest Report', December 2005, Audit Commission.*

# Worcestershire Acute Hospitals

- Worcestershire Acute Hospitals NHS Trust has a cumulative deficit of £31.8 million, £7 million of which the trust attributes to "additional annual costs" accruing to its PFI scheme.

- The Trust is now planning large-scale staffing cuts, and "a comprehensive review of services" in each of its three hospitals (including the already downgraded Kidderminster hospital).

*Source - Worcestershire Acute NHS Trust, 'Health Committee Written Evidence'*

# Affordability (2)

- It is now evident that 'efficiency savings' made prior to financial close in an attempt to reduce costs did not go far enough.
- There is a clear association between PFI and budget deficits.
- In response, ministers in both England and Scotland are developing plans for a further programme of service closures.

# Refinancing and VfM

- The process of refinancing has brought to light the amount of money being generated for the private sector through PFIs – and the true level of risk being borne by firms.

- The main effects of refinancing are:
  - an increase in the rate of return to shareholders;
  - freeing up cash, allowing for a 'windfall' gain;
  - an increase in public sector termination liabilities; and
  - a longer senior debt repayment term.

# The Norfolk and Norwich PFI

| Financing status | Capital raised by the consortium to deliver the project (£m) | Payments to Octagon over contract term (£m) | Base case internal rate of return to Octagon (%) | Net Present Value of refinancing gain to consortium (£m) | Contract length (from financial close) (years) | Increase in termination liabilities (£m) |
|---|---|---|---|---|---|---|
| Before refinancing | 233<br>Of which:<br>Equity 1<br>Sub Debt 32<br>Snr. debt 200 | unknown | 18.9 | N/A | 34 | N/A |
| After refinancing | 339<br>Of which:<br>Equity 1<br>Sub. Debt 32<br>Snr. debt 306 | 1.300 | 60.4 | 115.50 | 39 | 257.7 |

*Source: National Audit Office (2005; 2006)*

# Conclusion

- PFI's pre-eminence in large-scale hospital procurement in the UK is set to continue.
- The annual public expenditure burden is set to least triple by the middle of the next decade – from £4.5bn to around £15bn.
- This is despite the service reductions that PFI has motivated before and after financial close – and the degree of profit that has been shown to accrue to these schemes.