The cost of using private finance to build finance and operate the first 12 NHS hospitals in England

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PFI - the policy and the evidence

- Background to the policy
- Scale of PFI
- Evidence to date in relation to cost, value for money and accountability for public money
- Financial analysis of 12 Hospital Trusts' and PFI companies' accounts

PFI - background

- PFI - what it is
- Access to finance
- Value for money- ambiguous concept - 3Es
- Economy: greater private sector efficiency and risk transfer over life of project
- VFM - comparison of discounted whole life financial flows - ex ante
- Methodology and process critiqued

PFI - development and scale

- Little financial information
- Inconsistent construction costs
- 155 hospitals worth £8.67bn capital value
- No estimate of annual payments on project basis
- No estimate of aggregate total payments
- Business Cases available after financial close
- Contracts and supporting documentation not available - commercial sensitivity
- PFI >85% capital budget

Prepare a full business case

- Must show that it is value for money (VFM) and affordable
- Se out costs of PFI
- Prepare a public sector comparator (PSC) – the hypothetical annual costs under public procurement
- Identify, quantify and cost the risks to be transferred and add to the PSC
- Discount costs each year at 6% for each option to yield a net present cost
- Choose the cheapest as VFM

Full Business Case Analysis

- PSC < PFI before risk transfer and after discounting at 6%
- So risk transfer crucial
- Methodology? Assumptions? Evidence?
- After risk transfer, difference but marginal
- Uncertainties in quantifying PSC
- Gov ‘letters of support’
- So who is bearing the risk?
- >>> PFI expensive

Credit ratings agencies' reports

- Financial information to the capital markets
- Main risk = construction risk, refinancing
- Contracts complex, difficult to enforce, few penalties
- Now required to assume more risk
- "Significant government support" to offset additional risk"
- "Continue to offer a comparatively safe haven in times of economic downturn"

First 12 PFI hospitals

- New build and refurbishment
- Capital value £1.2bn
- Expected annual payments £214m
- £6bn over 30years

The Trusts' accounts (1)

- Financial reporting is limited and opaque
- Don't show how payments split, penalties, etc
- 12 - total construction cost £1.2bn
- 9 off balance sheet
- 3 on balance sheet
- Some of these were expected to be off balance sheet – risk?
- About £240m per year – total >£6bn over 30years
- Contract length extended

The Trusts' accounts (2)

- Payments rising
- Payments higher than expected – no explanation
- Contract length extended – without explanation
- Income risen 56% since 2000
- Income risen 29% since 2003
- Some increase explicitly for cost of PFI
- Still taking 11% income
- Affordability?

The Trusts' accounts (3)

- Extra capital costs taking 30% new money
- Despite extra income, financial position precarious
- Several have been or are in deficit
- Greenwich QEII technically insolvent
- PFI charges = variable element but no control over it
- PFI a 'fixed cost' that must be paid
- Reduces budget flexibility
- Must mean cuts in jobs, pay and conditions of remaining staff – main cost

PFI companies (1)

- Shell company – no employees
- Complex web of subcontracting to sister companies
- 95/5 - debt/equity
- Disclose little financial information
- Rising income and > Trust accounts
- Cash surplus/income 47% in 2005 AFTER subcontracting to sister companies
- So only 53% payments going on hospital services

PFI companies (2)

- Surplus
- Before debt and equity returns £123m in 2005
- 8% interest rate on debt (public debt 4.75%)
- Post tax return on capital of 58% in 2005
- Higher than government had said was normal
- More than Meridian expected
- £62m is additional cost of private finance

Risk premium or leakage

- £62 p a = risk premium
- Conservative estimate because:
  - Profit on construction, subcontracting and financing
  - User charges, eg car parks, canteen, etc
  - Refinancing
  - Sale of equity stakes
- Must pay maintenance costs in future
- For 155 projects of £8.76bn, leakages = £500m pa
- Value for money?
- Can it even be measured ex post facto?

Financial implications

- High cost, affordability and implications for service provision – cuts must follow
- Extra public finance and investment eaten up by cost of private finance
- Risk transfer limited and creates additional risks
- VFM?
- Instead of levering private finance in, public money flows out
- Outcomes are inconsistent with the claims

Accountability

- Little financial information available to public
- More to capital markets
- Commercial confidential - smokescreen to hide cost from public
- Makes scrutiny, control and accountability all but impossible
- Creates potential for future liabilities and calls on public finance

Broader implications

- High cost must reduce access to healthcare and other public services – cut in social wage
- PFI redistributes wealth
- Gives increasing wealth and political power over direction of public policy to financial elite
- Lack of reporting and accountability obscures what government dos not wish to reveal to the public at large