Infrastructure and Projects Authority

Managing Fiscal Risks in PPP

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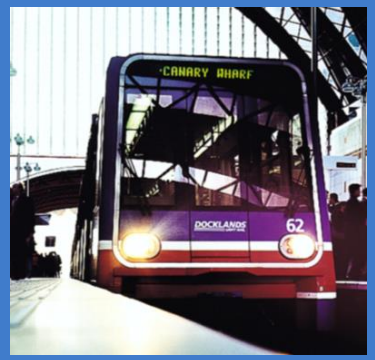

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What we will cover:

- Why use private finance – advantages and disadvantages; affordability and budget treatment;
- Context of private finance in the UK;
- Transparency of off balance sheet liabilities and how that translates to the UK context;
- Controlling the total future commitments: why it is important and how the UK does it;
- Some lessons learned.

PPP Policy in the UK

The UK has been using PPPs as a delivery method for over 20 years.

Over that time the methods used to manage and control future liabilities created by Public Private Partnerships have developed. The UK:

- *reports liabilities transparently; and*
- *caps the overall liability.*

PPP has been subject to extensive scrutiny by the UK's National Audit Office and Parliament's Public Accounts Committee. Both advantages and disadvantages have been identified.

Selected potential benefits include:

- The delivery of an asset which might be difficult to finance conventionally.
- Encouraging the allocation of risks to those most able to manage them.
- Delivery to time and price. The private sector is not paid until the asset has been delivered which encourages timely delivery. The banks providing finance conduct checking procedures, known as due diligence, before the contract is signed. This reduces the risk of problems post-contract.
- Encouraging ongoing maintenance by constructing assets with more efficient
  and transparent whole-life costs. Many conventionally funded projects fail to consider whole-life costs.

Selected potential disadvantages include:

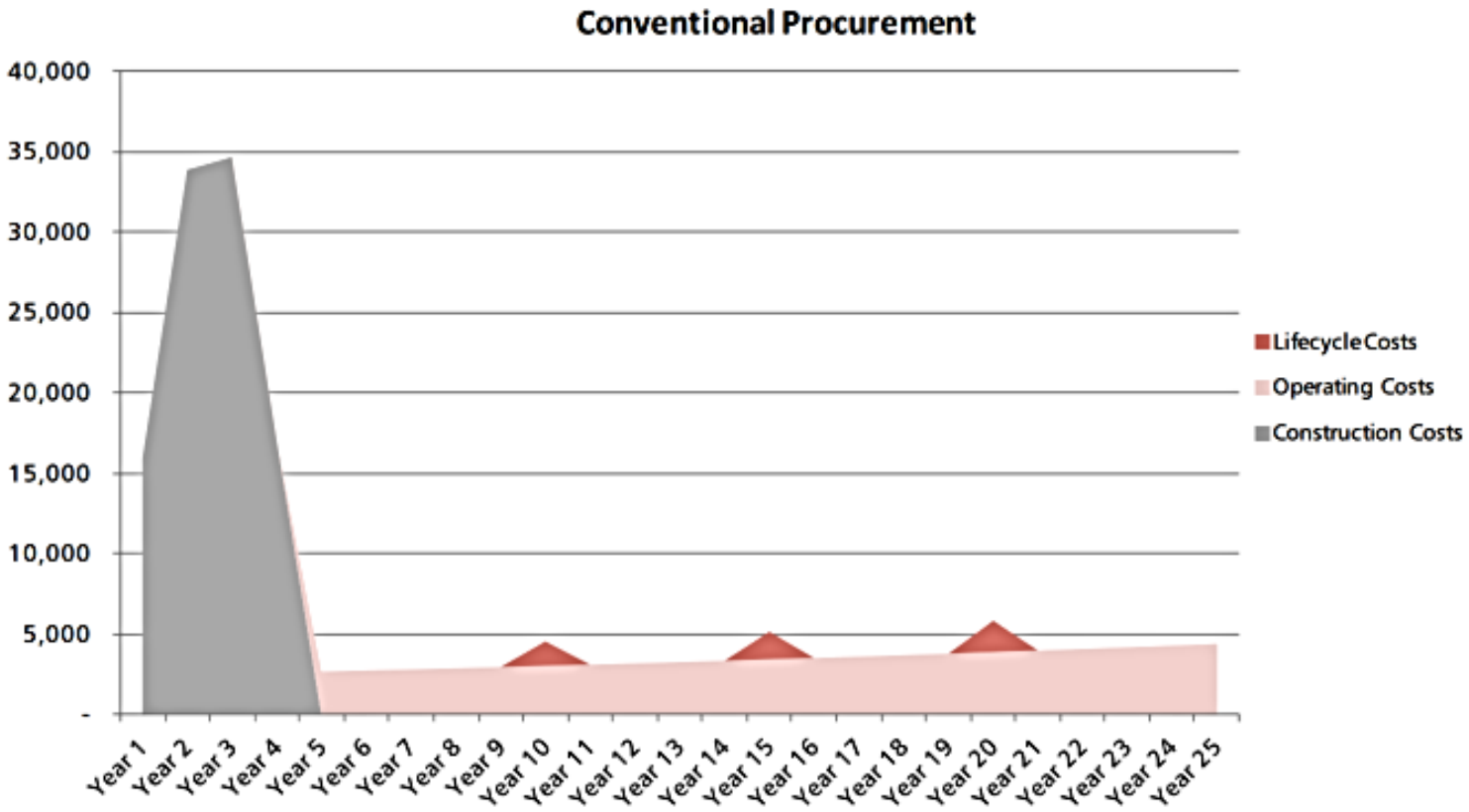
- Reduced contract flexibility – the bank loans used to finance construction require a long pay back period. This results in long service contracts which may be difficult to change.
- The public sector pays for the risk transfer inherent in private finance contracts but ultimate risk lies with the public sector.
- Private finance is inherently complicated which can add to timescales and reliance on advisers.
- High termination costs reflecting long service contracts.

Lessons from PFI and other projects

National Audit Office

Affordability - Conventional Procurement

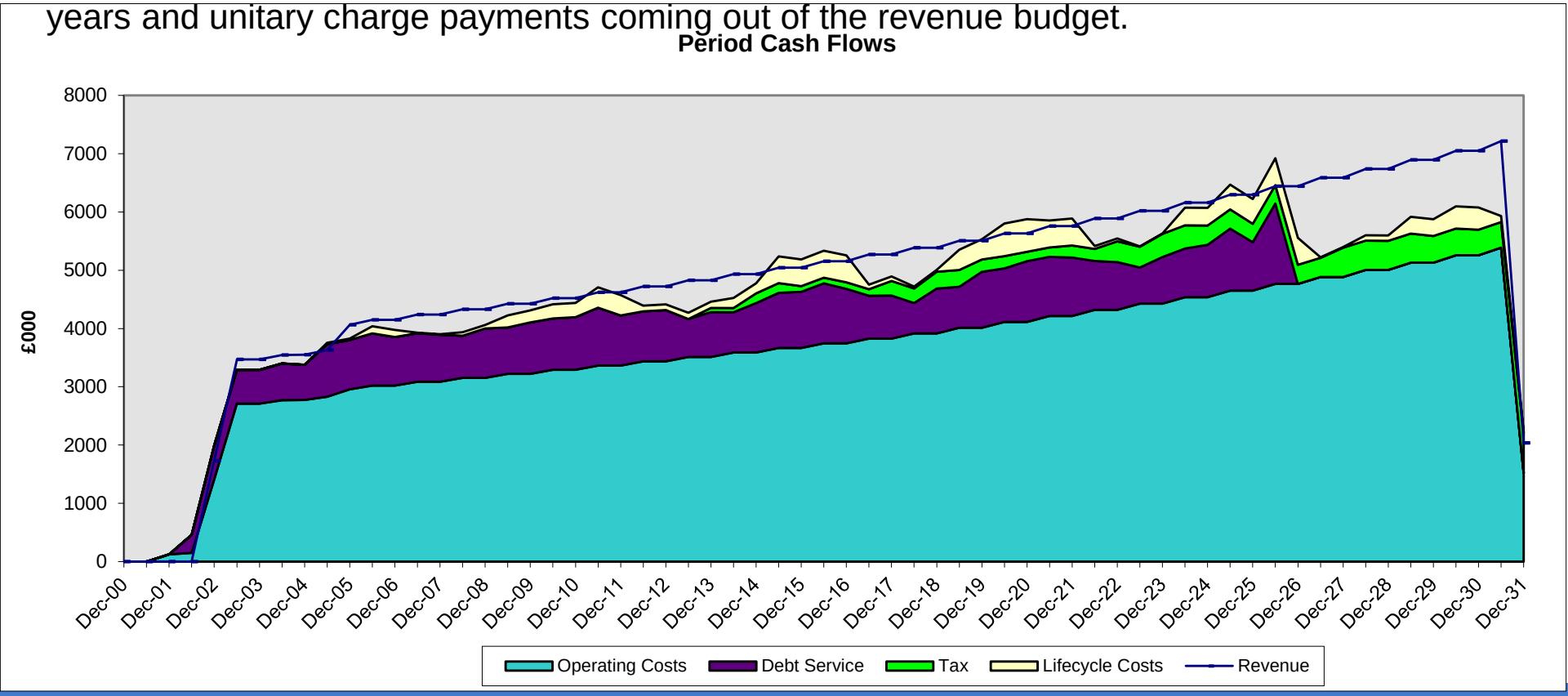
In conventional procurement, the public sector pays for the construction costs whilst the asset is being built, followed by the operating and lifecycle (major maintenance) costs when it is operational.



Affordability - PF2 Costs are Fixed, not Flat

Under PPP, the public sector does not pay for the construction costs, instead the procuring authority pays the private sector a unitary charge *after* the asset is built and is operational covering the debt service costs and all the service period costs incurred by the project.

When public sector capital is limited, PPP projects are particularly attractive as the majority of projects (estimated at between 80-90%) are off-balance sheet; with no payment for the initial years and unitary charge payments coming out of the revenue budget.

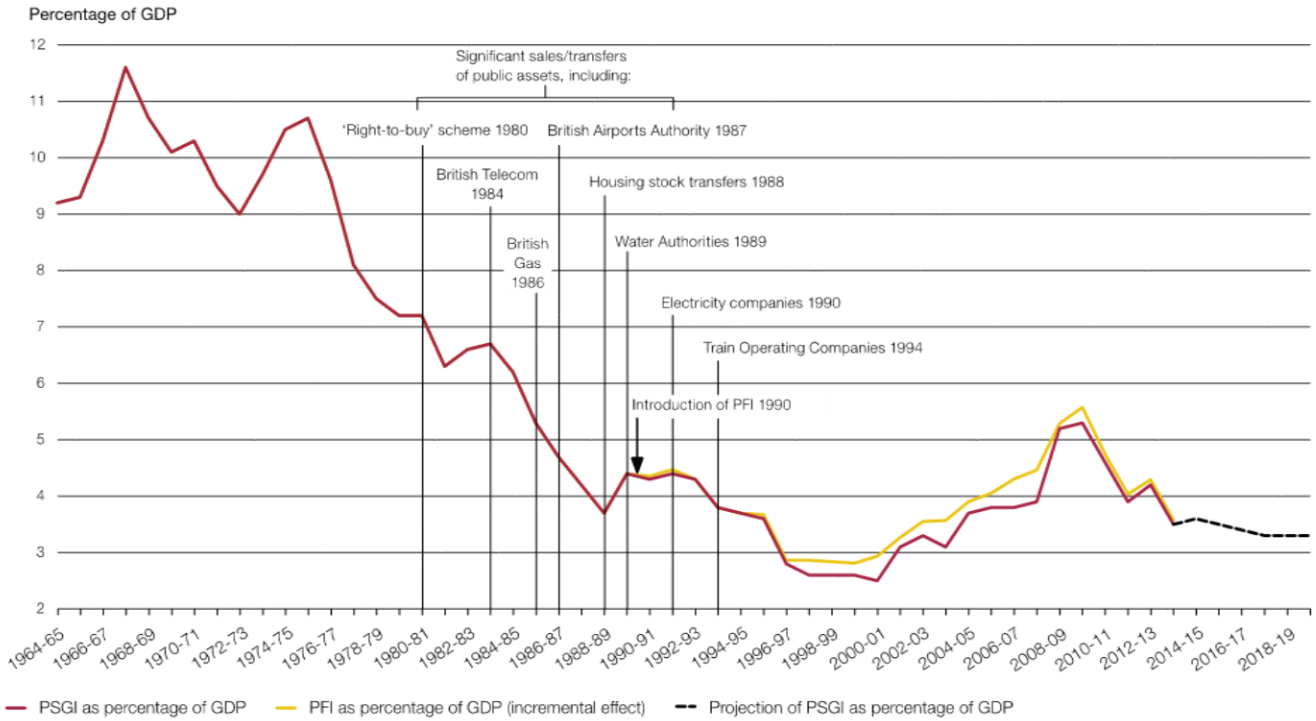


PPP as a Fiscal Risk in the UK

Figure 1

Public Sector Gross Investment (PSGI) and PFI investment – past 50 years

PFI has added to Public Sector Gross Investment



Notes

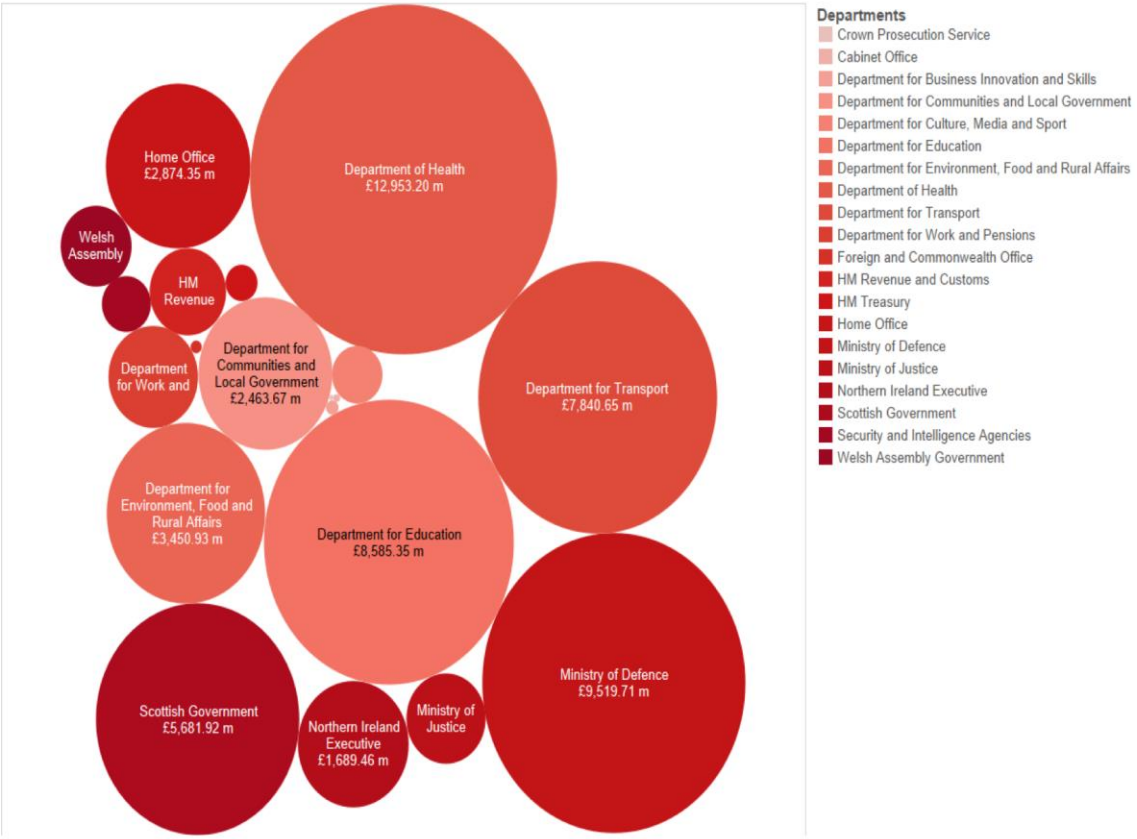
1 PSGI includes investment of local government and state-owned enterprises so these figures are not directly comparable to other data in this report on central government capital spending.

2 The capital investment through PFI has been added to the PSGI figure. A small amount (approximately 10%) of PFI investment is on balance sheet for national accounts purposes so is also included in PSGI spending figures.

Sources: Office for Budget Responsibility, Public Finances Databank, 25 January 2015; HM Treasury PFI database (updated 15 December 2014)

PPPs in the UK are NOT Contingent Liabilities, but they are Liabilities!

Portfolio of current PFI and PF2 projects across government by capital value



Note: Departments which have not been labelled and corresponding capital values: Cabinet Office (£6.7m), Department for Business Innovation and Skills (£21.8m), Crown Prosecution Service (£2.9m), Department for Culture Media and Sport (£352.4m), Foreign and Commonwealth Office (£17.1m), HM Treasury (£141.0m), Security and Intelligence Agencies (£331.0m).

Source: Figures based on departmental and devolved administration returns. Current projects only– does not include projects that have expired or terminated.

Transparency is Vital

IMF - Summary of Disclosure Requirements for PPPs

Considerable emphasis has been placed on disclosure as a means of making the fiscal consequences of PPPs fully transparent. In summary, the disclosure requirements for PPPs called for in this paper are the following.

- PPP contracts should be disclosed, and simplification and standardization should be sought.
- Operating contracts, concessions and operating leases, financial leases, and the transfer of PPP assets to the government should be recorded in the fiscal accounts according to the treatment used by Eurostat.
- The stream of future contract payments under existing PPP contracts should be reported.
- Government guarantees should be disclosed as called for by the Fund's Code of Good Practices on Fiscal Transparency.

Where a PPP program is of fiscal significance, a report on PPPs—covering all of the preceding disclosure requirements—should be included as part of the budget documentation.

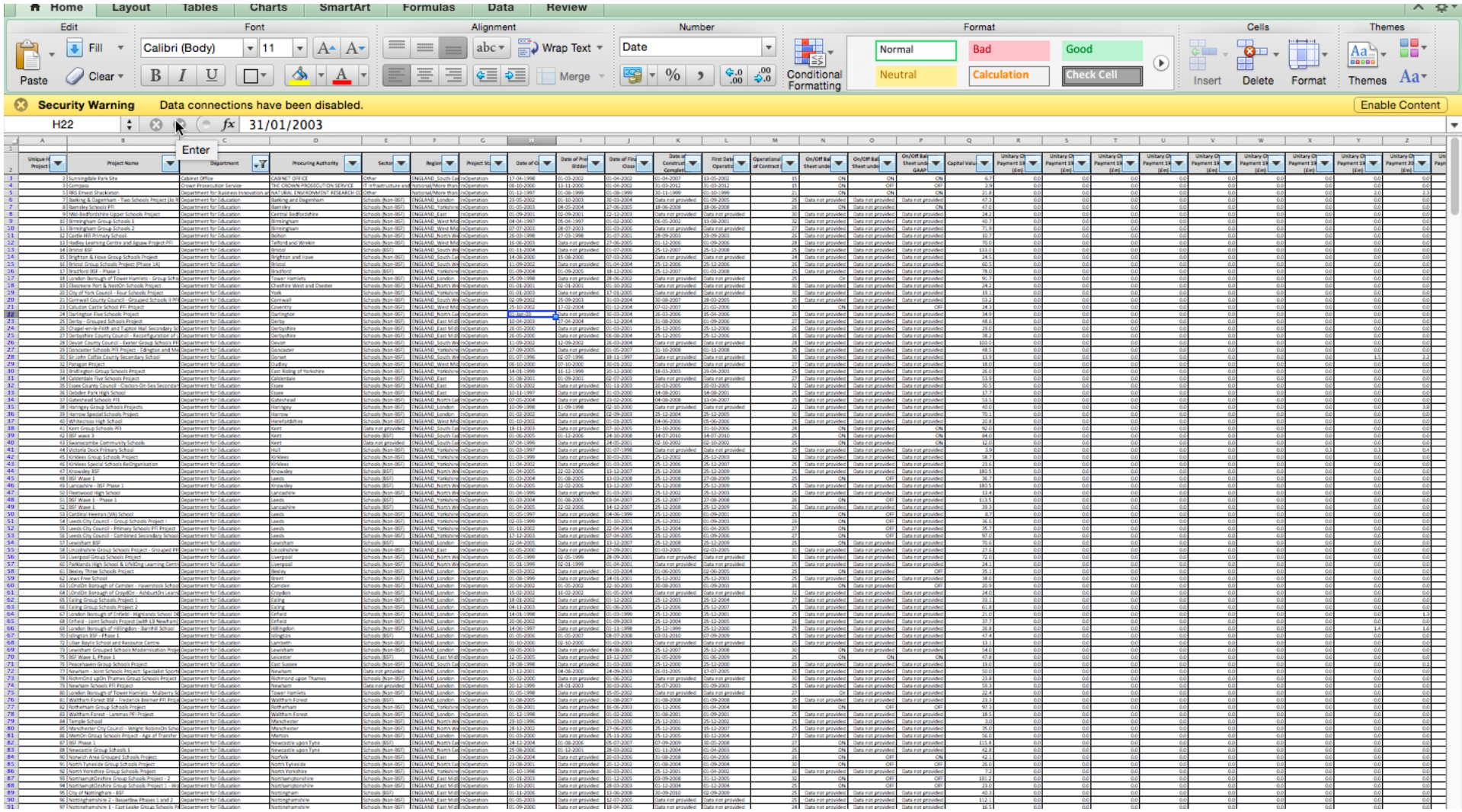
https://www.imf.org/external/np/fad/2004/pifp/eng/031204.pdf

Data is Critical – but Complex; Quality is Variable.

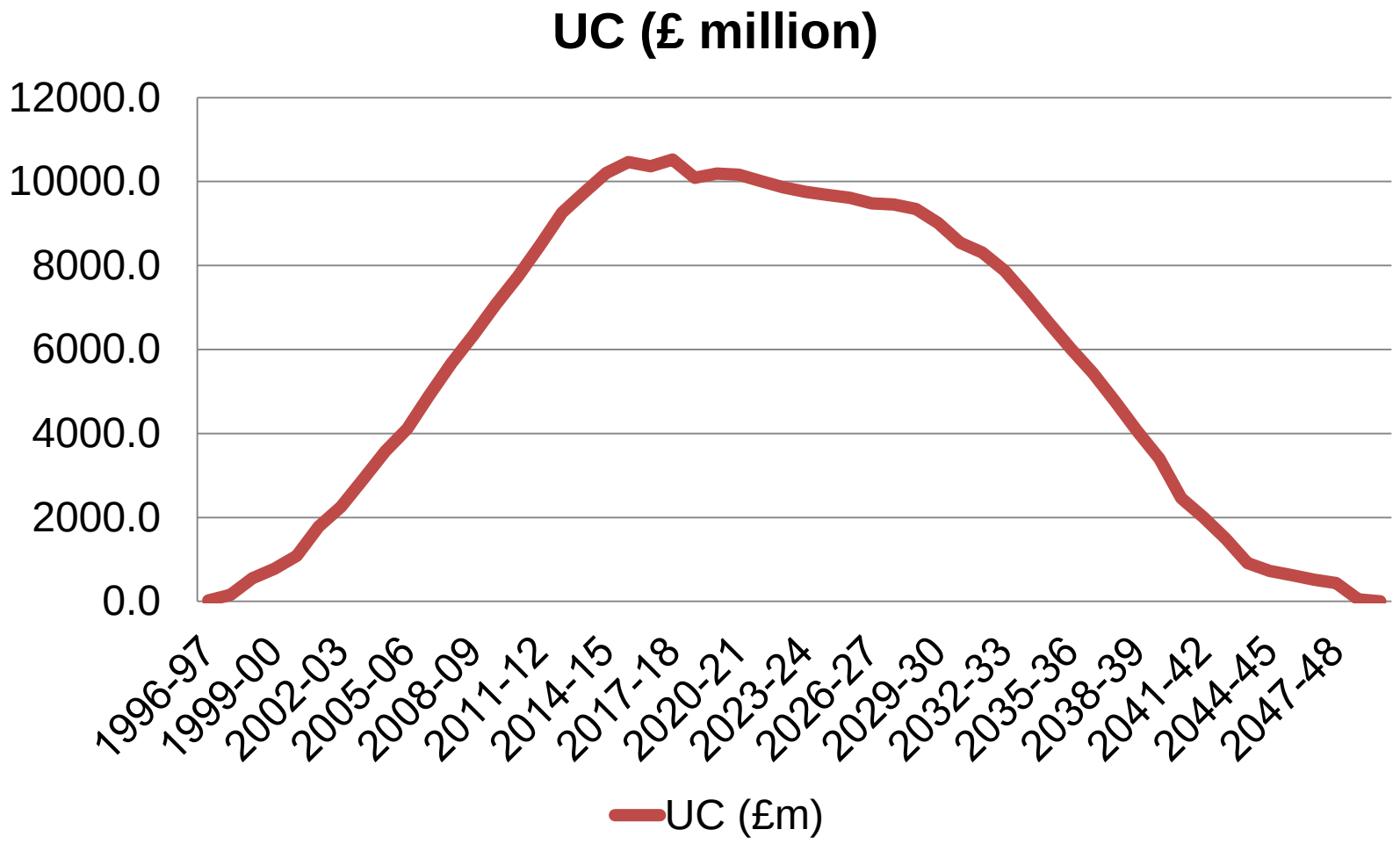
About 750 contracts and 100 data fields required per contract = 75,000 separate pieces of data.

1 IPA data team (2 people) collecting data from - 3 devolved administrations; 17 central government departments; over 330 procuring authorities.

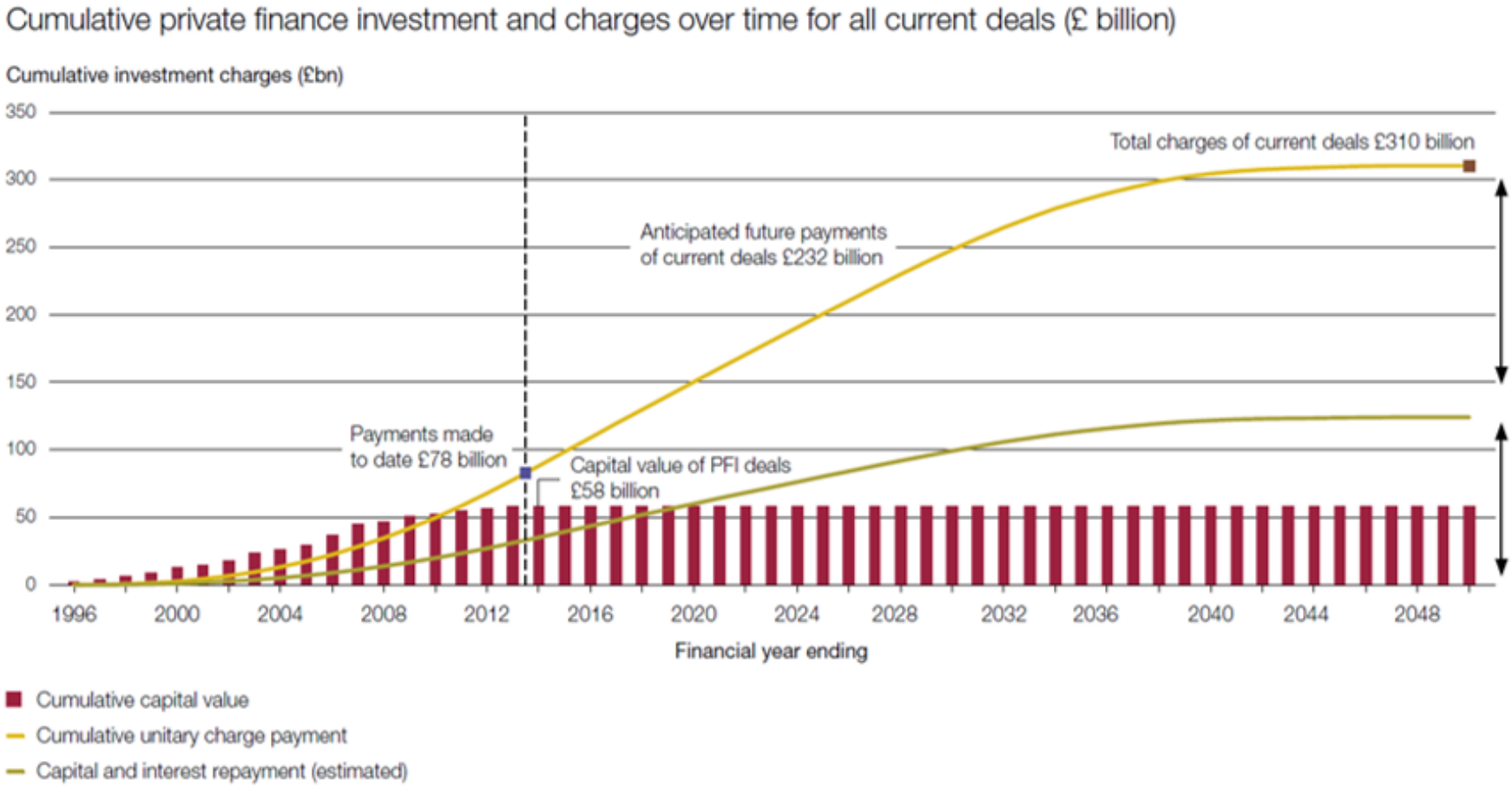
https://www.gov.uk/government/publications/private-finance-initiative-and-private-finance-2-projects-2016-summary-data



Peak UK Unitary Charge payments not reached until 17-18 – Future liability £220bn



PFI – cumulative investment and charges



Source – *The choice of finance for capital investment,* National Audit Office (2015)

PPP Control Total - setting a limit

- The UK Government announced in Autumn Statement 2012 that it would introduce a control total for the commitments arising from off balance sheet contracts.
- The control is a limit of £70 billion applying apply over the five year period from 2015-16 to 2019-20.
- This would cover all payments in respect of private finance contracts, including payments to cover capital, interest and service costs.
- Performance against this control total would be assessed at each Budget.
- Data published in December 2016 showed total cumulative spending from 2015-16 to 2019-20 would be £51.6 billion.
- The remaining headroom below the £70 billion control total will be for projects in procurement and future deals signed over the remaining period up until the end of 2019-20.
- Current forecasts are:
    - Next five year period - £49.5bn
    - The period after that - £46.9bn

UK Lessons Learned after 20 Years

- At the start, fixed price contracting for a 25 year service was innovative and untested – and the risks, including potential for inflated private sector returns, were not fully understood.
- Balance sheet treatment continues to be poorly understood in most of the public sector. Balance sheet risk remains an issue as contracts change over time.
- The UK Parliament and the National Audit Office have been consistently sceptical that private finance can deliver value. In some cases private finance has only delivered marginal value for money.
- There have been failings in PFI in terms of lack of transparency and the inflexibility of 25+ year contracts.
- There is still no evidence base for long term fixed price contracting and whether it provides value for money. This is a substantial risk going forward.