



House of Commons
Committee of Public Accounts

PFI in Housing and Hospitals

**Fourteenth Report of Session 2010–
11**



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*Report, together with formal minutes, oral and
written evidence*

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The Committee of Public Accounts

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Eric Joyce (*Labour, Falkirk*)

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Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Philip Aylett (Clerk), Lori Verwaerde (Senior Committee Assistant), Ian Blair and Michelle Garratty (Committee Assistants) and Alex Paterson (Media Officer).

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Contents

Report	<i>Page</i>
Summary	3
Conclusions and recommendations	5
1 Value for money of the hospitals and housing PFI programmes	7
2 Making savings in operational contracts	9
Formal Minutes	12
Witnesses	13
List of printed written evidence	13
List of Reports from the Committee during the current Parliament	14

Summary

The Department of Health and the Department for Communities and Local Government (the Departments) are responsible for sizeable portfolios of PFI projects covering hospitals and social housing. By April 2009 there were 76 operational PFI hospitals in England and over 13,000 homes had been built or refurbished through PFI, representing a small but significant part of investment in social housing. The letting of contracts and the responsibility for managing them is devolved to NHS Trusts and local authorities. The Departments are responsible for overseeing their PFI programmes and reporting to the public and Parliament on value for money. This includes establishing the funding arrangements, approving contracts and providing support to the local projects.

As with previous Reports, we again found no clear and explicit justification and evaluation for the use of PFI in terms of its value for money. However, we accept that the then Government gave the Departments no realistic alternatives to PFI as the procurement route to use for these capital programmes.

Our other concerns are central government's failure to use the market leverage that comes from overseeing multiple contracts, and the lack of robust central data to support effective programme management.

Whilst PFI has delivered many new hospitals and homes which might otherwise not have been delivered, there is no clear evidence of whether PFI is any better or worse value for money than other procurement routes. There were instances where PFI may have been used where there was no evidence that it was the best procurement route. The Government should be doing more to identify the circumstances where PFI works best, capture the lessons learned from PFI procurements and apply clear criteria to future decisions over identifying the best route for particular public infrastructure investments. For instance, we expect any procurement decisions on the housing projects whose future is now being reconsidered in the context of the Comprehensive Spending Review to be made using clear value for money criteria.

It is clear that the implementation of PFI projects could be improved. Many PFI housing procurements have taken very much longer, and cost a great deal more, than originally planned. On hospitals, most are receiving the services expected at the point contracts were signed and are generally being well managed. There are, however, wide and unexplained variations in the cost of hospital support services, such as cleaning, catering and portering.

There are important developments in the PFI market which affect the profitability of these contracts and we are concerned that government is missing a trick in failing to secure the appropriate financial advantages for the taxpayer. Specialist financial institutions have been bundling projects together. This gives them the prospect of greatly enhancing the value of their interests in the projects through economies of scale. We are very concerned that the Department of Health has not approached the major investors and contractors to negotiate a share in these efficiency gains and economies of scale. Departments should exploit the commercial weight and buying power that comes from letting substantial contracts, but at present neither central government nor the local bodies benefit from this. At a time of

public spending constraints there is an obligation on government to secure better deals for the taxpayer, as government has done before when successfully securing a share of PFI refinancing gains.

A lack of good quality central data undermines the Departments' ability to monitor performance, to drive efficiency savings and effectiveness improvements, and to target support to local providers. For example, the Department of Health does not know whether services provided more cheaply in some locations are better value for money, or alternatively poor quality, or reflect inconsistencies in the way costs are recorded.

It seems that the central team in the Department of Health is already under-resourced and unable to secure proper value for money from these contracts. It would be a false economy to have weak central teams that are unable to implement our recommendations, all of which are aimed at delivering better value for money in the long term. The issues facing housing and hospitals will also be relevant to other PFI programmes.

On the basis of two Reports by the Comptroller and Auditor General,¹ we examined the Department of Health and the Department for Communities and Local Government on their management of PFI programmes to deliver hospital support services and procure social housing.

¹ C&AG's Reports: *The performance and management of hospital PFI contracts*, HC 68, 2010-2011; and *PFI in Housing*, HC 71, 2010-2011.

Conclusions and recommendations

- 1. There is no clear evidence to conclude whether PFI has been demonstrably better or worse value for money for housing and hospitals than other procurement options. In many cases local authorities and Trusts chose the PFI route because the Departments offered no realistic funding alternative.** There have, however, been long delays and cost increases affecting many early PFI housing projects, as well as wide and unexplained variations in the cost of PFI hospital support services. The Departments should prepare and publish whole-programme evaluations which assess PFI against alternative procurement routes using clear value for money criteria. The evaluations should include the merits or otherwise of including support services in the contracts.
- 2. PFI housing contracts have cost considerably more than originally planned and, on average, have been let two and a half years late.** The Department for Communities and Local Government must ensure that the actions it has been taking to address previous programme failings will result in future projects being delivered to time and within cost.
- 3. Following the Comprehensive Spending Review, the future of remaining PFI housing projects is uncertain.** In taking forward plans for delivering new and improved housing, the Department should ensure that the choice of procurement route, PFI or otherwise, is based on clear and transparent value for money criteria.
- 4. The Department of Health, in failing to negotiate with investment funds centrally, is not using its own buying power to leverage gains for the taxpayer.** Specialist investment funds have interests in large numbers of PFI projects. One fund, Innisfree, has acquired interests in a substantial portfolio of hospital projects. The bundling together of projects by these investors gives them the prospect of taking added value from economies of scale, with no benefit to the public sector at a time of severely constrained public finances. Central negotiations with investors have proved successful in the past in securing a share of refinancing gains for the public sector. Central government is currently negotiating with major suppliers to seek better deals from a range of existing contracts. The Department of Health and other departments with PFI programmes should similarly negotiate with major PFI investors and contractors to secure better deals for the taxpayer.
- 5. The Departments do not routinely collate sufficient accurate data on the costs and performance of their PFI contracts.** Monitoring and improving value for money depends on local projects having access to good quality information from across the programmes. Both Departments should define minimum data requirements and then take responsibility for ensuring that information collected from and distributed to local projects is complete, accurate and consistent. The Department of Health and the Foundation Trust regulator Monitor should embed these data requirements in Foundation Trusts' terms of authorisation so that they are mandatory.

- 6. There are no mechanisms built into generic PFI contracts to test the continued value for money of maintenance work during the contract period.** The requirement for buildings being maintained to high standards over the life of the contract is supposed to be a key benefit of PFI. Yet around 20% of hospital Trusts were not satisfied with the maintenance service. Unlike services such as catering and cleaning, maintenance is not subject to a value for money review during the contract period, so contractors do not face the threat of losing the contract if they are uncompetitive. The Treasury, in consultation with departments, should identify how value for money tests and incentives to improve maintenance could be built into the life of PFI contracts.
- 7. Local procuring authorities will be at a disadvantage compared to the private sector if the Departments do not provide sufficient central support.** Central departments need to have adequate resources to: collect data and carry out programme evaluations; exert market leverage and identify opportunities for efficiency gains; and share good practice with the local projects and offer support to them. It would be very disappointing if the public sector as a whole lost value for money from its PFI contracts because the Departments were losing their capability through reducing the costs of central administration. We look to the Department for Communities and Local Government to deliver on its commitment to keep its support capacity at an appropriate level. We also expect the Department of Health to firm up plans for the future of its PFI Unit and for Trusts to contribute to a club to procure contract management support. Trusts should confirm that they will actively engage with the club.
- 8. Our recommendations are directed at the programmes for housing and hospital projects but are also relevant to other PFI programmes across government.** In the Government's response to this report, the Treasury should outline its plans to support all departments in maximising value for money from their PFI programmes in the current economic climate. We expect the Treasury to comment specifically on the evaluation of PFI as a procurement route, on using market leverage and on the sufficiency of central data.

1 Value for money of the hospitals and housing PFI programmes

1. Many PFI projects are procured by local bodies, such as NHS Trusts and local authorities, who are the signatories to the contracts and are responsible for day to day contract management. Central government departments are responsible for managing the portfolios of projects, supporting projects to maximise value for money over the lives of the contracts and providing assurance to Parliament on expenditure and value for money. We took evidence at a single hearing, based on two National Audit Office reports – on the operational phase of PFI hospitals, and on the procurement phase of PFI housing – in order to look at the PFI process in a broader context.²

2. As of April 2009 there were 76 operational PFI hospital contracts with a capital value of £6 billion. In addition there are a small number of projects in procurement.³ Over the past ten years PFI has been the major procurement route for major health infrastructure projects. The Department of Health told us that in 1999-2000 the then Secretary of State had said “PFI is the only game in town”.⁴

3. By contrast the Department for Communities and Local Government has made more limited use of PFI for social housing. The Department told us that PFI has accounted for only 2% of investment in social housing where it sits alongside a number of other investment routes.⁵ By April 2009 there were 25 signed PFI housing projects which had built or refurbished over 13,000 homes.⁶ Together with projects currently in procurement the Department told us that PFI housing projects have a capital value of £2.8 billion, which excludes projects worth £1.8 billion for which funding is no longer guaranteed following the recent Spending Review. It is currently reviewing these projects with local authorities to consider different funding options.⁷

4. We questioned the two Departments about the circumstances in which they felt PFI was value for money. The Department of Health believes that at a portfolio level there has been no difference between PFI and ordinary public procurements in terms of value for money, but that PFI has enabled many more hospitals to be built that would otherwise have been the case.⁸ The Department for Communities and Local Government told us that PFI works best for delivering significant transformational change in areas of high deprivation but works less well for straightforward refurbishment schemes.⁹

2 C&AG's reports, *PFI in housing*, HC 71, 2010-2011 and *The performance and management of hospital PFI contracts*, HC 68, 2010-2011

3 Q 129; C&AG's report, *The performance and management of hospital PFI contracts*, HC 68 2010-2011, paragraph 1.2

4 Q 36

5 Q 1

6 C&AG's report, *PFI in housing*, Figure 1

7 Qq 101-103, Ev 20

8 Qq 7-8

9 Qq 2, 159

5. It is hard to get a definitive picture of when PFI is value for money without robust evaluation. The Department for Communities and Local Government has undertaken a limited analysis of capital costs on new build schemes but this did not take account of all project costs such as finance costs. The Department was undertaking a programme level comparison exercise which was due to conclude in December 2010.¹⁰

6. To be approved, PFI projects should be assessed as being value for money compared to other funding options. This usually involves comparison to a theoretical model called the public sector comparator. The Department of Health noted that in some cases PFI deals went ahead with the PFI option marginally more expensive than the public sector comparator.¹¹ As comparators involve estimation a marginal difference is not significant, but we are concerned, given that other funding options were not realistically available, that business cases may have failed to challenge sufficiently the choice of PFI as the procurement route. The National Audit Office also reported that local authorities frequently cited PFI as the only realistic route to secure funding for some housing schemes.¹²

7. Value for money is called into question if projects are consistently late or over-budget. The housing projects signed to date have cost significantly more than originally planned with 12 projects seeing increases over 100%. In addition projects have on average been signed two and half years late.¹³ The Department for Communities and Local Government told us that insufficient time was invested in the beginning of the process for early schemes. For example project teams did not have a good understanding of the condition of existing housing stock.¹⁴ The Department for Communities and Local Government now spends more time evaluating projects at an early stage and told us that only one project has seen a cost increase since 2006, although some projects may need to reduce their scope to stay within budget in future.¹⁵ On hospitals, most PFI hospital contracts, once operational, are well managed and achieving the value for money expected at the point contracts were signed; but there is no evidence that including operational support services in a PFI contract is better or worse value for money than managing them separately.¹⁶

10 Qq 111, Q15

11 Qq 25, 38-39

12 C&AG's report, *PFI in housing*, paragraph 1.12

13 Qq 97-99; C&AG's report, *PFI in housing*, paragraph 2.11

14 Q 3

15 C&AG's report, *PFI in housing*, paragraph 2.10

16 C&AG's report, *The performance and management of hospital PFI contracts*, paragraph 18

2 Making savings in operational contracts

8. Contractors and investors are often involved in multiple PFI projects which gives them the opportunity to drive efficiencies through effective management and economies of scale. There is an active market in the equity in PFI projects and some financial institutions have been buying interests in a large number of projects.¹⁷ For example, one fund, Innisfree, has acquired interests in 24 hospital projects.¹⁸ The price at which equity is traded would give an indicator of the current market value attached to PFI projects, but these trades are not tracked centrally.¹⁹

9. With tight public spending constraints, central government is negotiating with major suppliers to secure better deals and reduce costs. However, the Department of Health has not used its buying power to negotiate with major PFI contractors and investors to secure a share of efficiency gains for the tax-payer. This approach has been successful in the past to secure a public sector share of gains from refinancing contracts even though there was no contractual obligation for such gains to be shared.²⁰

10. The Department argued that it was difficult to ask the private sector to share gains when sometimes they made losses and the public sector does not share in those. For example, one construction contractor had lost around £100 million on a hospital contract. The issue, however, is whether, in most cases, the private sector is making greater than expected profits without any gain sharing with the public sector. There is a lack of data on this issue but reports suggest that in some hospital projects the investors are receiving returns of ten times their initial investment.²¹ When pressed, the Department accepted that it would be possible to try and renegotiate contracts to reduce costs.²²

11. Hospital PFI contracts may include support services such as cleaning, catering and portering. These services are usually tested every five years in order to ensure that prices reflect the market. Trusts may not always report the results of this regular testing to the Department of Health but the Department told us that rates had reduced in all the exercises in 2010 that it knew about. Trusts may also choose to change providers or take services back in-house at this stage.²³ The costs of delivering these services through PFI are, on average, broadly similar to those in non-PFI hospitals, although there are wide and unexplained variations between individual hospitals.²⁴ The choice as to whether to include these services in PFI contracts is left to Trusts and we were told that most recent contracts

17 Qq 17, 48; C&AG's report, *The performance and management of hospital PFI contracts*, paragraphs 15, 3.30-3.31

18 Q 10; <http://www.innisfree.co.uk/projects.html> – of the 24 projects, seven are overseas and one in Scotland. The remaining 16 are English NHS hospitals.

19 Q 59

20 Qq 142-144

21 Q 13

22 Q 142

23 Qq 27, 78 and 85

24 C&AG's report, *The performance and management of hospital PFI contracts*, paragraph 9

exclude them. The Department has not undertaken any evaluation to identify the merits of either including or excluding these services.²⁵

12. One of the stated benefits of PFI is that it should ensure buildings are maintained to a high standard through the contracts' lives, yet 20% of Trusts were not satisfied with the maintenance service provided within their PFI contracts. In addition, unlike support services, the costs of maintenance cannot be revisited and are not subject to regular benchmarking.²⁶ The Department of Health had not addressed this issue. It had been unsure about the viability of negotiating lower maintenance costs, Trusts had not been very supportive of such action and the Department had consequently not taken up the matter with suppliers.²⁷

13. Central departments are best placed to collect and distribute benchmarking data that can be used to understand individual project costs relative to others projects and help local delivery bodies manage their contracts effectively. The quality of data within Whitehall is a systemic problem identified in numerous hearings of this Committee.²⁸

14. The Department of Health told us that it cannot compel Trusts, especially Foundation Trusts, to engage with the support it offers and that about 40% of Trusts do not routinely engage.²⁹ All Trusts, including Foundation Trusts, are required to provide data on the size and cost of their estates using a system known as the Estates Return Information Collection (ERIC). However this does not include PFI-specific information and concerns over data quality, and the fact that since 2007-08 data has only been collected at a Trust rather than an individual hospital level, mean that this data is not appropriate for benchmarking the costs of PFI contracts. The Department has not taken steps to address this.³⁰

15. In contrast the Department for Communities and Local Government has found local authorities willing to cooperate in providing data.³¹ However, in the past it has not collected sufficient data to evaluate the programme and monitor performance. The Department has introduced new mandatory proformas which should provide more systematic and comparable data enabling it to control cost increases and compare PFI to other procurement options.³² The Department is still developing its data collection for operational projects.³³

16. The procurement and management of PFI projects requires there to be sufficient capacity in both central departments and local delivery bodies. The Department of Health has a team of only four people to support Trusts with operational PFI contracts and there is

25 Qq 74-75, 82

26 Qq 54-56, 72-73

27 Qq 58, 69

28 Q 119

29 Qq 90-92, 95

30 Qq 118-119, 172; C&AG's report, *The performance and management of hospital PFI contracts*, paragraph 17 and Figure 11 Notes

31 Qq 88-89

32 Qq 15, 45 and 46

33 Q 88

uncertainty about the future of this team.³⁴ In addition, 36 % of Trusts have less than one full time person managing their PFI contract and a further 12% do not have anyone spending at least a day a week managing their contract.³⁵ The Department welcomed the National Audit Office recommendation to form a “PFI club” whereby Trusts would receive the benefits of central support and in return would provide benchmarking data. The club has yet to be implemented but the Department proposes to ask NHS Trusts to contribute financially to such a club so that support could be commissioned to cover for any shortfall in support the Department is able to provide.³⁶

17. The Department for Communities and Local Government and the Homes and Communities Agency oversee a number of housing projects that are still in procurement and between them have a team of 11 staff. The Department has also introduced additional support to some local authorities via ‘transactors’ - a flexible team of people with commercial expertise. The Department told us that it would maintain this capacity for as long as it is needed.³⁷

34 Qq 50, 114-117 and 150

35 C&AG's report, *The performance and management of hospital PFI contracts*, paragraph 3.6

36 Qq 114-117

37 Qq 6, 97

Formal Minutes

Wednesday 12 January 2011

Members present:

Rt Hon Margaret Hodge, in the Chair

Mr Richard Bacon	Ann McGuire
Mr Stephen Barclay	Austin Mitchell
Dr Stella Creasy	Nick Smith
Matthew Hancock	Ian Swales
Chris Heaton-Harris	James Wharton
Jo Johnson	

Draft Report (*PFI in Housing and Hospitals*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 17 read and agreed to.

Conclusions and recommendations 1 to 8 read and agreed to.

Resolved, That the Report be the Fourteenth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Tuesday 18 January at 10.00 am

Witnesses

Wednesday 24 November 2010

Page

Sir Bob Kerslake, Permanent Secretary, Department for Communities and Local Government and **Peter Coates**, Director of Capital and Investments, Department of Health

Ev 1

List of printed written evidence

1 Department for Communities and Local Government

Ev 20

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010–11

First Report	Support to incapacity benefits claimants through Pathways to Work	HC 404
Second Report	Delivering Multi-Role Tanker Aircraft Capability	HC 425
Third Report	Tackling inequalities in life expectancy in areas with the worst health and deprivation	HC 470
Fourth Report	Progress with VFM savings and lessons for cost reduction programmes	HC 440
Fifth Report	Increasing Passenger Rail Capacity	HC 471
Sixth Report	Cafcass's response to increased demand for its services	HC 439
Seventh Report	Funding the development of renewable energy technologies	HC 538
Eighth Report	Customer First Programme: Delivery of Student Finance	HC 424
Ninth Report	Financing PFI projects in the credit crisis and the Treasury's response	HC 553
Tenth Report	Managing the defence budget and estate	HC 503
Eleventh Report	Community Care Grant	HC 573
Twelfth Report	Central government's use of consultants and interims	HC 610
Thirteenth Report	Department for International Development's bilateral support to primary education	HC 594
Fourteenth Report	PFI in Housing and Hospitals	HC 631