Private Finance Initiative

Introduction

Private Finance Initiative (PFI) schemes were first introduced in 1992 by the then Conservative government to bring the private (business) sector in to public sector projects. These were grouped under the umbrella title Public Private Partnership (PPP). PFI involves injecting private capital into essential public services in return for long-term service contracts.

As well as education, they have been developed in health (e.g. to fund hospital rebuilding) and transport. PFI was expanded by the Labour government after it came to power in 1997, although these policies were never discussed openly during the election. The first two schools to be run by the private sector opened in 1999. The new government building programme (Building Schools for the Future – see Briefing) uses PFI funding.

How it Works

Under PFI schemes a public authority such as a Local Authority (LA) buys the services of a private company or group of private companies (a consortium) to design, build, finance and operate a public facility, such as a school. Private consortia are usually made up of building firms, finance companies and service providers.

Having built the school the private consortium usually takes over the maintenance and management of the premises and frequently also provides other services such as catering, cleaning and grounds maintenance. This contract typically lasts 25 years and effectively passes the ownership of the school to the private consortium. Schemes could in theory be design, finance and build only. However, government advice was that schemes would not meet value for money criteria unless services could be included

PFI contracts to build new schools are delivered via competitive tendering. Consortia, led by large contractors, bid to deliver packages of new schools to LAs, and bids are scored according to weighted measures. The subsequent contracts are also extremely complicated and only what is written and agreed in signed contracts can be relied upon so every detail must be included

The private sector borrows the money for the scheme and then the LA makes regular payments to the consortium to pay back the loan plus interest, shareholder profits and for the contract to cover the services provided. The Government repays the LA an agreed sum which has been negotiated to repay the capital. These promises to pay are the 'PFI credits' which the LA obtains from the Government. PFI contracts would usually be with the LA, not with individual schools. They are very attractive to an LA which needs to raise capital to carry out much needed works or provide services and is not allowed to raise the money in any other way.

However, the new academies have all opted out of PFI, preferring to keep control over the building of their schools and the long-term ownership of them. In 2007 one head of an academy sponsor trust, who asked not to be named, said: "Why would we want to not be in total control of our buildings?" For LAs this may not be an option if they want capital for school buildings (see BSF Briefing)

Government Rationale

- PFI credits can be used in place of public sector borrowing. The Public Sector Net Cash Requirement (PSNCR), which used be known as the Public Sector Borrowing Requirement (PSBR), is a measure used to judge the prudence of a government, and keeping it low is attractive to the Treasury.
- There seems to be a belief in government that public sector management is intrinsically inefficient and the private sector is both more efficient and better value for money.
- PFI schemes share 'risk'. In theory if PFI contractors fail to perform at an agreed standard they don't get paid and the client can spend the money elsewhere to put things right
- For schools it is sometimes argued that a PFI scheme can take some of the administrative burden away from teaching professionals by placing 'non-core' functions in the hands of more efficient 'experts' who reduce costs, generate a profit for the contractor and potentially save the schools money.

What CASE thinks

CASE is opposed to the privatisation of state education because it removes local accountability and control. It also makes education subject to the vagaries of the private sector and makes the profit and interests of private companies a priority in the provision of education.

Value for Money

- CASE believes there must be fair and independent measures for assessing value for money and this is not currently the case. Such

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assessment would depend on the comparison of how much it would cost to do if built in the traditional way, i.e. the 'public sector comparator', being fair. Several critics have said the traditional method is always made to look less favourable than the PFI route.

We believe there is clear evidence that, in the long term, the cost of capital raised through a PFI scheme will be higher than the cost of a loan raised by the issue of a public sector bond or low cost public sector government loan. In 2007 the Public Accounts Committee (PAC) reported that reduction in the number of companies tendering for PFI contracts means that there is sometimes only two companies at short listing stage which must reduce the competitiveness of the process. The average cost of advice was £3 million, reflecting the length of the process, and delays to projects cost the taxpayer at least £67 million.

- It has been very difficult for schools and LAs to assess the real costs and long term implications of paying for a PFI project, especially as the final cost has often been over budget. In addition, the payments for PFI schemes will have legal 'first call' on school revenue and must be paid before any other budget decisions — including retention or recruitment of teachers — are made. This limits the ability of school governors to protect the teaching of the curriculum or other services if funding is reduced in the future.

In many cases the private sector has been able to negotiate price increases for the provision of existing contracts (e,g, catering, cleaning) Such increases put at risk any value for money case for the provision of these services in the long term. LAs have found it hard to find effective benchmarking for these costs and this has put them at a further disadvantage when it comes to keeping down contract prices.

PFI schools also run the risk of big rises in management fees that headteachers say will jeopardise pupils' education. There have been examples of increases of 25% for fees to PFI companies on cleaning and grounds contracts or maintenance. Heads say the increased fees will cost them thousands of pounds that will have to be cut from elsewhere in their budgets.

- Government policy effectively imposes PFI on desperate LAs and schools because "there is no alternative"

Accountability

- The government claims PFI is a means of transferring 'risk' to the private sector but in reality failed PFI contracts have usually been rescued by the public sector meeting additional costs. Whatever the terms of the contract, the government remains the guarantor for essential public services. As an example, PFI money was used in Northern Ireland, for Balmoral High School which closed because of a fall in pupil numbers, which was predicted before the project began. The Northern Ireland Office is obliged to pay £7.4m (without inflation) to continue leasing the school until 2027.

- CASE is opposed to the control of the school premises being transferred to the private sector which is the effect of PFI. PFI contracts are increasingly held by large national or multinational firms, who are likely to place far greater emphasis on profit margin.

Through a series of corporate takeovers and mergers, one enormous property company, Land Securities Trillium, reputedly owns PFI contracts for 150 schools with a £1.9 billion replacement value and 25-35 year leaseback arrangements. They include schools originally built by Investors in Education, WHEP, SMIF and Jarvis. Land Securities Trillium is part of Land Securities Group (a publicly listed London company that describes itself as the biggest property company in Britain) though the two announced in 2007 that they were to de-merge and become separate companies. This also indicates the extent to which schools have no control over who will eventually own their premises.

- PFI contractors generally provide the management of the property, running the maintenance and caretaking services through a long term lease. This lease will govern the hours which a school is open and the costs of using it after hours. As a result PFI schools, staff, parents and local community may not be allowed or able to afford to use them for e.g. for extended school activities or additional revision classes and will be tied into a long term lease which they cannot change. The school will also have no control over PFI owners renting out the school to other users.

- Under a voluntary code, companies originally agreed to share 30 per cent of refinancing gains on early PFI projects with the public sector. More recent projects stipulate that half of any refinancing gains should be paid to public sector clients. The Public Accounts Committee (PAC) found that a voluntary code to allow public bodies to share the proceeds of lucrative Private Finance Initiative refinancing deals has fallen "well short of expectations", yielding just £93m by the end of 2006, far lower than the £175-£200m that had been predicted in 2002.

In some cases refinancing deals have produced very high returns for the investors and increased risks for the public sector on renegotiated deals. In response, the PAC wants the Treasury to approve the final terms of any refinancing arrangement that give substantial gains to investors. The committee also expressed concern at the way the Government has missed out on gains made by PFI investors selling their equity interests on to third parties. It warned that consolidation among PFI investors could see a small number of investors dominate the market. Again there is little control over who finally owns PFI investments.

Quality

- If the original and very complex PFI contract is poorly drafted, it may mean that key elements are left out of the building contract and have to be added in at additional cost. Often school governors and staff are expected to study the detail of these contracts and building specifications without any prior experience and with insufficient leadership and support from the LA. Critics (like the PAC) say that education authorities are inexperienced in dealing with major building programmes.

A Brighton head commented: "When firms are bidding, they'll give you anything you want. They put user-friendly people in the bids team and it all seems nice. But, later on, it's all, 'We're not building that wall' and you're saying, 'But we can't have a classroom with only three walls' and they're saying 'Well we're just not building it.....And if your local authority's rubbish at dealing with it, you've basically had it."

- It has also proved impossible to ensure adequate standards for subsequent service contracts for such things as maintenance, catering and cleaning, particularly if these vary across a number of schools covered by a single scheme. For example, one school might have a sub-standard service when the average standard is deemed satisfactory under the contract. This school might find it extremely difficult to obtain a remedy in such a situation. If the scheme involves catering, contractors may be able to sell food of poor dietary value and market a limited range of proprietary products on the premises.

The LA must have a clear role in monitoring PFI contracts, ensuring high standards are set and maintained. Governors must be sure the LA is able to carry out that role and sanctions can be imposed if standards drop. It is common for school meals and cleaning contracts in PFIs to be given to subsidiaries of the consortium's members for 25 years without tendering or competition

Other government policies

- PFI is inconsistent with other government education policies e.g. extended schools, more academies and closure within a year for weaker schools. Under PFI, schools being renovated are leased to the company that carried out the refurbishment and the work is paid for mortgage-style over the next 25 years. Merton, in south London, has turned two PFI-improved schools into academies. As a result, the schools had to be bought out of the last 24 years of their lease with the private company, at a cost of nearly £1.4m. Some campaigners in Merton thought this was a small price to pay to be free of the PFI contract! The Department for Children, Schools and Families (DCSF) underwrote the cost of the buy out. This highlights the potential to waste public money on PFI commitments when LA and government plans change.

Wisely, Liverpool City Council has told the DCSF that it would prefer not to carry out a £300m-plus refurbishment of its schools through the PFI, on the grounds that the White Paper proposals make it impossible to give the PFI contractor the necessary 25-year guarantee of the school's life. Any school, the city council argues, could be closed under the provision to allow popular schools to expand and weaker ones to go to the wall if they fail to improve in a year. Unfortunately this rationale does not seem to have been adopted by the DCSF.

External Evaluation

In 2003, the **Audit Commission** produced a damning report " PFI in Schools". It compared 12 recent and traditionally funded schools with 17 PFI schools completed by the end of 2001. It found that the quality of PFI schools was not as good, and the best examples of innovation came from traditional schools. PFI schools were not even completed more quickly and it did not save taxpayer's money. In addition, the costs of cleaning and caretaking appeared to be higher in PFI schools, common build problems included classroom size, storage space and heating and ventilation and inadequate natural light.

The report calls on ministers to open up PFI to competition by allowing local education authorities to use other methods to pay for building work and for schools to be given a greater involvement at crucial stages of projects. The Audit Commission also called into question ministers' claims that PFI provides better value for money. The Commission also warned that LAs have an incentive to overestimate the cost of non-PFI alternatives in order to get PFI schemes approved because they have little prospect of securing other means of funding.

The House of Commons Public Accounts Committee (PAC) has produced a number of critical reports concerning long term value for money and highlighting the high price for additional services as a particular area of concern for LAs. One report found that civil servants faced being "outwitted by their commercially-sophisticated private sector counterparts" when private finance initiative deals are renegotiated. It also found that a voluntary code to allow public bodies to share the proceeds of lucrative Private Finance Initiative refinancing deals has fallen "well short of expectations", yielding just £93m by the end of last year, far lower than the £175-£200m that had been predicted in 2002." In some cases this has produced very high returns for the investors and increased risks for the public sector on renegotiated deals.

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The latest PAC report in 2007 highlights the fact that since 2004 the proportion of tenders attracting only two bidders has more than doubled with the risk of no competition if one bid is weak or drops out. Lengthy tendering periods and high bid costs are cited, partly the result of new procurement regulations. The PAC also report that benchmarking and market testing , which might have been expected to improve prices during the contract period have in fact resulted in rises of up to 14%. Public authorities have found it difficult to find appropriate data to benchmark PFI service costs placing them at a disadvantage in price negotiations. The PAC also found a continuing lack of PFI experience and skills within public procurement teams across the public sector. One third of procuring authorities admit to insufficient resources or in house expertise for all of the PFI tendering process.

The National Audit Office has criticised the value for money exercise as so complicated that not even experts were really able to understand what was going on. It has also produced evidence to support the PAC concerns about refinancing and equity deals.

The Commission for Architecture and the Built Environment (CABE) is the government funded architectural watchdog.

In 2006 it produced a report which raised concerns about the quality of design with the head reporting that there has been a general under-performance in terms of "functionality, build quality and aesthetics" One commissioner described some PFI schools as "little better than agricultural sheds with windows". CABE found that, nationally, 50% of the schools built between 2000 and 2005 were poor, with only 19% rated as excellent or good. Nine out of 10 of the worst were built using PFI money.

The Department of Trade and Industry report on PFI schools between 1996 and 2002 could find no clear link between project costs and those of external advisors. "For the most part the advisor costs did not appear to be closely related to the duration of procurement and there was no clear cut link between the size of a project and their magnitude" Average costs were £600,000 and appeared to be higher when there was less in house LA expertise.

Further Information

Department for Children, Schools and Families www.dfes.gov.uk

Unison www.**unison**.org.uk

National Audit Office www.nao.org.uk

Treasury www.hm-treasury.gov.uk/documents/**public_private_partnerships**

Audit Commission www.**audit-commission**.gov.uk

Public Accounts Committee www.parliament.uk (then find relevant report)

Department of Trade and Industry Report www.berr.gov.uk/files/file26071.pdf

CABE www.**cabe**.org.uk

Feedback on this document will be gratefully received. You can contact CASE xxxxxxxxxxxxxxxxxxxxxxxxxx by email at

contact@campaignforstateeducation.org.uk

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