European Services Strategy Unit: Research Report No. 8

The financial commodification of public infrastructure

The growth of offshore PFI/PPP secondary market infrastructure funds

Dexter Whitfield

Buying and selling: hospitals, health centres, mental health facilities, schools, colleges, care homes, libraries, trams/light rail, motorways, roads, street lighting, council offices, police stations, courts, prisons, fire stations, defence equipment, social housing, student accommodation, leisure centres, government offices, waste disposal plants, water and wastewater plants.

European Services Strategy Unit
(Continuing the work of the Centre for Public Services)

List of ESSU Research Reports

No. 1: A Typology of Privatisation and Marketisation (2006).

No. 2: Options Appraisal Criteria Matrix (2007).

No. 3: Cost Overruns, Delays and Terminations in 105 Outsourced Public Sector ICT Contracts (2007).

No. 4: The £10bn Sale of Shares in PPP Companies: New source of profits for builders and banks - replaced by No. 6 (2011).

No. 5: The Mutation of Privatisation: A critical assessment of new community and individual rights (2012).

No. 6: PPP Wealth Machine: UK and Global trends in trading project ownership (2012).

No. 7: Alternative to Private Finance of the Welfare State: A global analysis of social impact bond, pay-for-success and development impact bond projects, Australian Workplace Innovation and Social Research Centre, University of Adelaide and European Services Strategy Unit (2015).

No. 8: The financial commodification of public infrastructure: The growth of offshore secondary market infrastructure funds (2016).

No. 9: PFI/PPP Buyouts, Terminated and Major Problem Contracts in the UK (forthcoming).

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http://www.european-services-strategy.org.uk/publications/essu-research-reports/

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40+ YEARS Rigorous Research
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The **European Services Strategy Unit** is committed to social justice, by the provision of good quality public services by democratically accountable public bodies. The Unit continues the work of the Centre for Public Services, which began in 1973. Research and strategic advice for public bodies, trade unions and community organisations includes analysis of regional/city economies and public sector provision, jobs and employment strategies, impact assessment and the effects of marketisation, privatisation, public private partnerships and transformation.

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Abbreviations

AAM	Aberdeen Asset Management
AR	Annual Report
BBC	British Broadcasting Corporation
BBGI	Bilfinger Berger Global Infrastructure
BEIF	Barclays European Infrastructure Fund
BIIF	Barclays Integrated Infrastructure Fund
BSF	Building Schools for the Future
CETA	Canadian-European Comprehensive Economic and Trade Agreement
CIHL	Consolidated Investment Holdings Limited
Co.	Company
CRS	Common Reporting Standard
CRC	Community Resource Centre
DBFO	Design, Build, Finance and Operate
DIF	Dutch Infrastructure Fund
DLR	Docklands Light Railway
EFSI	European Fund for Strategic Investments
EPEC	European PPP Expertise Centre
ESSU	European Services Strategy Unit
EU	European Union
EIB	European Investment Bank
FTT	Financial Transaction Tax
G20	Group of twenty major economies
GCP	Gravis Capital Partners
HBOS	Halifax Bank of Scotland
HICL	HICL Infrastructure Company Limited
HMP	Her Majesty's Prison
HQ	Headquarters
HSBC	Hongkong and Shanghai Banking Corporation
II2	Infrastructure Investors
IMF	International Monetary Fund
Inc.	Incorporated
INPP	International Public Partnerships
IRR	Internal Rate of Return
JLIF	John Laing Infrastructure Fund
LIFT	Local Improvement Finance Trust
Ltd	Limited
LP	Limited Partnership
LLP	Limited Liability Partnership
LSE	London Stock Exchange
NAO	National Audit Office
NHS	National Health Service
NPD	Non-Profit Distributing
OECD	Organisation for Economic Co-operation & Development
PFI	Private Finance Initiative
PF2	Revised Private Finance model
PLC	Public Listed Company
PC	Primary Care
PPP	Public Private Partnership
REIT	Real Estate Investment Trust
RNS	Regulatory News Service
SMIF	Secondary Market Infrastructure Fund
SPV	Special Purpose Vehicle (usually a company)
TISA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
VCT	Venture Capital Trust
UK	United Kingdom
UME	United Medical Enterprises
UPP	University Partnerships Programme
US	United States

Key findings

The sale of equity in PFI/PPP projects to offshore secondary market infrastructure funds continues to increase. Equity in PFI/PPP projects is bought and sold in two ways:

Firstly, shareholders in PFI/PPP companies, such as construction companies, banks and facilities management contractors, decide to sell part or all of their shareholding in one or a bundle of projects.

Secondly, offshore infrastructure funds acquire equity in PFI/PPP projects primarily by the takeover of secondary market infrastructure funds.

- New PFI/PPP secondary market infrastructure funds have accelerated the sale of equity in project companies since 2003 with ownership concentrated in a smaller number of offshore funds.
- There are **nine important reasons why the ownership of PFI/PPP companies is critical** for governments and public bodies, local authorities, service users, community organisations, staff and trade unions (page 12).

The sale of secondary market infrastructure funds and assets

- There have been more sales of equity in PFI/PPP project companies through the sale of secondary market infrastructure funds than there has been through the sale of individual or small bundles of PFI/PPP projects.
- The full or part-sale of 33 secondary market infrastructure funds 2003 - 2016 involved the purchase of equity in 1,151 PFI/PPP project companies (includes multiple transactions in some projects) at a cost of £7.4bn (€8.7bn). The cost excluded six transactions, 115 projects, where costs were not disclosed. Assuming the same average cost per project, **the total cost was £8.1bn (€9.5bn).**
- Offshore infrastructure funds currently have equity in 547 PFI/PPP projects. Allowing for a small degree of duplicate ownership, the total number of projects is estimated to be 500. T**welve offshore infrastructure funds have equity in 74% of the 735 current UK PFI/PPP projects.**
- Furthermore, the offshore funds have a significant influence when they own a majority of the equity in an SPV. **Nine funds own 50%-100% of the equity in 334 PFI/PPP projects or 45.4% of PFI projects in the UK**
- **Education and health projects account for two thirds of PFI/PPP projects in which offshore infrastructure funds have 50%-100% of the project equity.**

Individual and small bundles sales of PFI/PPP equity

- In addition, equity in 980 PFI/PPP project companies (SPVs) has been sold in individual or small bundle transactions since 1998 at a cost of £9bn (€10.6bn) (updated ESSU PFI/PPP Database to be published early 2017).
- The average annual rate of return on the sale of individual/small bundles is **28% (based on 110 transactions involving 277 PFI/PPP projects between 1998-2016)**, a marginal reduction in the 29% average rate for 1998-2012.
- The three-way speculative gain in equity transactions: firstly by the original SPV shareholders, secondly, the rate of return from the sale of secondary market fund assets is assumed to be 12%-25%; thirdly, shareholders of secondary market funds receive annual dividends of 6%-8%. Thus the **total annual rate of return could be between 45%-60% - three to five times the rate of return in PFI/PPP final business cases.**

- The **£877m (€1,031.3m) HM Treasury Offices PFI project is 100%** owned by secondary market funds located in **offshore tax havens** – 75% in Guernsey and 25% in Jersey.

£17.1bn in equity transactions

- The total value of PFI/PPP equity transactions (individual/small bundles and via secondary market infrastructure funds) was £12bn (€14.1bn) in 1998-2012, but had reached **£17.1bn (€20.1bn) by mid 2016, a 42.5% increase in less than four years.**

- The **£17.1bn obtained by speculating in PFI/PPP equity transactions is additional to the profits** made in construction, bank debt and interest rate swaps and provision of facilities management services, plus the plethora of consultants, financial advisers and lawyers. Meanwhile, public sector PFI/PPP contractual commitments for capital repayments, interest and service charges total £232.4bn (€273.3bn), undiscounted, between 2014-15 and 2049-50.

- Value for money assessments never took account of the financial impact of a future sale of equity, even when it was evident that PFI/PPP equity transactions were frequently obtaining super profits for SPV shareholders. This would have made the value for money assessment null and void.

- The PFI/PPP model of public infrastructure is very expensive, exploitative, increases inequalities and deskills the public sector. Claims about achieving 'value for money', 'social value' and 'commissioning for outcomes' are meaningless.

PFI/PPP in Scotland

- **87.5% (280) of Scotland's 320 PFI schools are currently partly or wholly owned by offshore infrastructure funds.**

- Equity in **Edinburgh Schools PPP1 project was sold 13 times between 2003-2014** (Table 10).

- Scotland has a higher ratio of PFI/PPP projects per one million of population – 18.0 compared to the UK average of 12.4.

Tax avoidance

- **The five largest listed offshore infrastructure funds made a total profit of £1.8bn (€2.1bn) in the five-period 2011-2015 but paid ZERO tax.**

- Semperian PPP Investment Partners Holdings Limited is a Jersey registered partnership, not a listed company. Significantly, Aberdeen Asset Management has a 31.3% stake through two subsidiary companies (Aberdeen Sidecar LLP is owned by Aberdeen Infrastructure Finance GP Limited, registered in Guernsey). Transport for London Pension Fund has a 29.1% stake.

- Innisfree Limited is a UK registered private company that has funded 55 PFI/PPP projects in the UK. It is owned by the UK registered Innisfree Group Limited with Coutts & Co Trustees (Jersey) Limited as a shareholder. The Innisfree Group Limited's annual report 2015 gives David Metter, a director of the company and leading advocate of PFI, a 72.2% shareholding. Whilst Innisfree is not an offshore secondary market infrastructure fund, 72.2% of its annual dividends, **£47.4m (€55.7m) in the last decade**, were transferred to the Jersey offshore company.

- The web of secrecy has increased relative to the growth of secondary market fund transactions by both UK and offshore funds.

Wider impacts

- The development of PFI/PPP projects, in particular the Design, Build, Finance and Operate (DBFO) model, combines state and capital interests with a 'corporate welfare' approach that increases the commodification and financialisation of public infrastructure and ultimately widens the potential for privatisation.

- Inequalities are increased in four ways: financial gains from PFI/PPP equity trading; primarily wealthy investors use nominee companies and invest offshore; professional classes gain from facilitating PFI/PPP equity trading; whereas facilities management companies have a chequered employment track record.

- New guides to *The Statistical Treatment of PPPs in Europe* (Eurostat, EPEC and EIB, 2016) and the World Bank's *Benchmarking PPP Procurement 2017* make no reference to PFI/PPP profiteering from the sale of SPV equity or to offshoring. These organisations are either ignorant of these issues or choose to ignore them. Either way, it demonstrates a biased, self-serving and politically selective approach to statistics and procurement, designed to aid the PPP industry and evade key matters of public interest.

Global sale of secondary market funds

- A sample of the global sale of secondary market funds 2013-2016 provides details of 14 transactions that involved 107 PPP and public infrastructure projects. The sample illustrates the average transaction increased to an average of 7.6 projects in the 3.5 years in 2013-2016, compared to an average of 2 projects in the 15 years to 2012.

Recommendations

New UK controls to restrict offshoring public assets

- Make it illegal to transfer equity ownership of PFI/PPP assets from UK registered companies to offshore infrastructure funds, solely for the purposes of tax avoidance.
- Make it illegal to establish offshore PFI/PPP holding companies of SPV assets such as the Lend Lease Birmingham and Sheffield examples.
- Repatriate equity ownership of PFI/PPP SPV companies to UK registered companies.
- Prevent the flotation on the London Stock Exchange of PFI/PPP infrastructure funds by companies registered in offshore tax havens.
- Amend the standard PFI/PPP contract to restrict the transfer of PFI/PPP assets to registered companies in offshore tax havens.

Improved accountability and transparency

- Establish more rigorous monitoring and contract management arrangements.
- Revise governance arrangements to increase democratic accountability and scrutiny of PFI projects including annual or bi-annual reviews to assess performance, contract management and costs/affordability.
- Public bodies should monitor changes in the ownership of their PFI/PPP projects as an integral part of performance monitoring.
- Each change of equity ownership of PFI/PPP project companies (by SPV shareholders and secondary market funds) must be disclosed with the name of the vendor and purchaser, the date of transfer of ownership, the percentage of shareholding, the cost and the expected profit.
- Companies and Partnerships owning equity in PFI/PPP projects should be required to identify every project and the percentage of equity owned in their annual report.
- Each change of equity ownership of PFI/PP should require the approval of local authorities and such notifications should be required to include the full details of ultimate ownership and place of registration.

- Freedom of Information legislation should be extended to the private sector so it is applicable to private sector and social enterprises engaged in the delivery of public services, infrastructure provision and consultancy services to government, local authorities, the NHS and other public bodies.

Termination of the PFI/PPP programme

- The scale of profiteering evidenced in this report, combined with the detailed criticism of PFI by thinks tanks, trade unions, academics and others, makes a powerful case for termination of the programme. It should be replaced by direct public investment.

Selected buyouts and contract terminations

- Public bodies should develop a strategic approach to the buyout of PFI/PPP projects or the termination of contracts where they are not meeting performance requirements and/or user/community needs are not being met.

The case for the nationalisation of SPVs

- Nationalisation of the local PFI project companies (SPVs) is the most effective way of stopping the trade in PFI/PPP equity and secondary market funds and returning to public ownership.

Increased public investment

- The PFI/PPP programme should be replaced by increased public investment – *"…the average cost of all government borrowing is 3% to 4%, compared with an estimated financing cost of 7% to 8% for all private finance projects"* (NAO, 2015).

Radical public management

- Nationalisation alone is inadequate. A new public investment infrastructure model is required, together with radical public management to rebuild the capability and capacity of the public sector to plan, design, finance and manage schools, hospitals and other public buildings and public services.

Oppose free trade agreements

- The ability to implement the above recommendations is gravely threatened by free trade agreements currently being negotiated, namely the Trade in Services Agreement (TISA), the Transatlantic Trade and Investment Partnership (TTIP), Trans-Pacific Partnership (TPP) and the Canadian-European Comprehensive Economic and Trade Agreement (CETA). Continuing opposition is critically important.

(1 GBP = 1.176 Euro or 1 Euro = 0.85 GBP currency converter is used in Key Findings)