House of Commons Committee of Public Accounts

**Private Finance Initiatives**

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**Written evidence submitted by Professor Dexter Whitfield**

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**Summary**


- Value for money in UK PFI/PF2 projects has fundamentally failed to take account of the growth of the secondary market in the sale of SPV equity and the takeover/merger of infrastructure funds.
- The average return on equity on the sale of SPV equity was 28.7% between 1998-2016, twice the rate expected in PFI/PF2 business plans.
- Offshore infrastructure funds have an average equity stake of 67.3% in 546 PFI/PF2 projects, including 100% ownership of 206 PFI/PF2 projects.
- The scale of buyouts, terminations and major problem contracts imposes significant risks and costs on the public, as well as the private sector, but this is not recognised in value for money assessments.


These findings are based on providing advice to local authorities, trade unions and community organisations at different stages of the planning and procuring PFI projects, mainly in the 1997-2007 decade. In addition, I have undertaken research into many aspects of PFI over two decades. The last eight years research has focused on the growth of the PFI secondary market. I submitted evidence to the Public Accounts Committee and the Treasury Committee in 2011 on the sale of PFI equity when the government were considering the reform of PFI. In my view, PF2 was a rebrand, not a reform, and did nothing to stem the growth of the secondary market nor the level of subsequent unplanned gains.

**1. Rate of return twice that cited in PFI/PF2 business cases**

1.1. Analysis of 118 transactions that involved the sale of equity in 334 PFI/PF2 projects between 1998-2016 revealed an average annual rate of return of 28.7%. This is more than double the 12%-15% annual rate of return in PFI/PF2 Final Business Cases. It is a significant sample reflecting different sectors, size, geography and a spread of vendors and purchasers of PFI equity and part of a total of 462 transactions that sold equity in 1,003 PFI/PF2 projects in the same period at an estimated cost of £10.3bn.

1.2. In 2016, 100% of equity transactions were to offshore infrastructure funds in Jersey, Guernsey and Luxembourg, based on the ESSU sample of 334 projects. The percentage in 2011 and 2014 was 70% for both years and 60% and 61% in 2015 and 2013 respectively.

1.3. Education and health PFI projects account for 62.7% of projects in equity transactions followed by transport with 10.4% and criminal justice with 8.4%.

1.4. There has been little change in the average 6.47-years gap between the date of financial closure of projects and the sale of equity. This is consistent with other findings. An average of 43.4% of project equity was sold in each transaction in the sample.

1.5. Further details can be obtained at:

https://www.european-services-strategy.org.uk/wp-content/uploads/2017/10/PPP-profiteering-Offshoring-New-Evidence.pdf

**2. Current ownership of PFI/PF2 equity**

2.1. A new analysis of PFI equity stakes in January 2018 identified that fourteen offshore infrastructure funds had an average equity stake of 67.3% in 546 PFI/PF2 projects. This includes 100% ownership of 206 PFI/PF2 projects.

2.2. Equity ownership of an estimated 699 current PFI/PF2 projects in January 2018:

| | % |
|---|---|
| Offshore infrastructure funds | 51.3 |
| Other private ownership | 42.1 |
| Pension funds | 4.7 |
| Public sector | 1.9 |

(Source: forthcoming current research)

**3. Offshore tax avoidance**

3.1. The five largest listed offshore infrastructure funds made a total profit of £2.9bn in the five-year period 2011-2017. They paid a total of £13.5m taxes or a tax rate of 0.47%, when the £21.2m of tax credits is included. The five funds collectively paid ZERO corporate tax in the offshore territories where they have been registered for six years**.** Two of those funds published accounts to include 2017 and jointly paid no tax in the seventh year. This represents a potential loss of over £600m in UK tax revenue had these companies been registered in the UK (based on UK corporation tax rates of that declined from 26% in 2011 to 19% in 2017. A Table detailing this evidence is available from the link below:

https://www.european-services-strategy.org.uk/wp-content/uploads/2017/10/Offshore-infrastructure-funds.pdf

**4. The sale of secondary market infrastructure funds**

4.1. The sale of infrastructure funds, or partial sale of their assets, constitutes another element of the secondary market trade in PFI/PF2 assets.

4.2. The full or part-sale of 33 secondary market infrastructure funds in 2003 - 2016 involved the purchase of equity in 1,151 PFI project companies (includes multiple transactions in some projects) at a cost of £7.4bn. 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.

4.3. Education and health projects account for two thirds of PFI projects in which offshore infrastructure funds have 50%-100% of the project equity.

4.4. The total value of PFI/PF2 equity transactions (individual/small bundles and via secondary market infrastructure funds) was £17.1bn by mid 2016, a 42.5% increase in less than four years.

4.5. The £17.1bn obtained by speculating in PFI/PF2 equity transactions is additional to the profits made in construction, bank debt and interest rate swaps and provision of facilities management services, plus fees obtained by consultants, financial advisers and lawyers.

4.6. Value for money assessments never took account of the financial impact of a future sale of equity, even when it was evident that PFI/PF2 equity transactions were frequently obtaining super profits for Special Purpose Vehicle (SPV) shareholders. This should have made the value for money assessment null and void.

4.7. Further details available at:

https://www.european-services-strategy.org.uk/wp-content/uploads/2017/01/financial-commodification-public-infrastructure.pdf

**5. PFI buyouts, bailouts, terminations and major problem contracts**

5.1. There have been 74 projects under this heading - 11 Buyouts, 20 terminations and 43 with major problems of which 57 are in England, 12 in Scotland, 4 in Wales and 1 in Northern Ireland. They represent 28% of PFI contracts by capital value that have been subject to buyout, termination or major problems. The public cost of buyouts, terminations and major problem contracts to date is £3,755m; however, public costs have yet to be determined for many major problem contracts, so this total is expected to rise significantly. New evidence has revealed one further contract termination, and at least two more under review, and several additional contracts suffering from major defaults.

5.2. The Department of Health was forced to provide a £1.5bn bailout fund to NHS Trusts with significant PFI projects because *"…the trusts' plans are not viable without some level of central support"* (NAO, 2012). More trusts have since accessed this fund, particularly those engaged in mergers. On this basis, the £1.5bn allocation will be spent by 2027, well before many NHS PFI projects conclude. NHS trusts are likely to require a further £1.5bn in additional support for PFI projects over the next 20 years.

5.3. Sixteen PFI projects were cancelled at a cost of £114.3m. The cost would be significantly higher if information was publicly available for other cancelled projects.

5.4. The public cost of buyouts, bailouts, terminations and major problem contracts is estimated to be £27,902m, when combined with the additional cost of private finance, interest rate swaps and higher PFI transaction costs**.**

5.5. This sum could have built 1,520 new secondary schools for 1,975,000 pupils, (equating to 64% of 11-17 year old pupils in England) based on 1,300 pupil schools (National School Delivery Cost Benchmarking, 2015 and Department of Education and National Statistics, National Tables, 2016).

5.6. The combined UK total of buyout and terminated contracts is 6.8%. In other words, the UK's ratio, an industrialised country, is higher than the 5.4% average of World Bank projects in developing countries for cancelled (terminated) contracts as a percentage of the cost of investment. Furthermore, the UK combined buyout, termination and major problem contract ratio, excluding projects being bailed out, rises to 17.7% as a percentage of investment.

5.7. PFI projects are a product of neoliberalism, in particular the Design, Build, Finance and Operate (DBFO) model. This combines state and capital interests that increase the commodification and financialisation of public infrastructure, expands markets and ultimately broadens the potential for privatisation of buildings, transport and utility networks and public services.

5.8. A large and complex contract is at the centre of every PFI, but no matter how comprehensive they are, virtually all contracts are incomplete in practice, because they cannot predict future events, changing levels of demand, revised public policy priorities, or technological and operational changes in service delivery.

5.9. Further details available:

https://www.european-services-strategy.org.uk/wp-content/uploads/2017/02/pfi-ppp-buyouts-bailouts-and-terminations.pdf

**6. Recommendations**

6.1. PFI equity assets are totally dependent on UK taxpayer funding of PFI projects. Infrastructure funds rely on the stable unitary payments made by government, the NHS and local authorities, which further facilitates increased value of the assets. New regulations should include:

- making it illegal to transfer equity ownership of PFI assets from UK registered companies to offshore infrastructure funds, which is solely for the purposes of tax avoidance;
- making it illegal to establish offshore PFI holding companies of SPV assets;
- repatriating equity ownership of PFI SPV companies to UK registered companies;
- preventing the flotation on the London Stock Exchange of PFI infrastructure funds by companies registered in offshore tax havens;
- amending the standard PFI contract to restrict the transfer of PFI assets to registered companies in offshore tax havens.

6.2. Nationalisation of the local PFI project companies (SPVs) is the most effective way of stopping the trade in PFI equity and secondary market funds and returned to public ownership and investment.

**Other references**

Department of Education and National Statistics (2016) *Schools, Pupils and their Characteristics: January 2016 – National Tables*, https://www.gov.uk/government/statistics/schools-pupils-and-their-characteristics-january-2016

Hampshire County Council and East Riding of Yorkshire Council (2015) *National School Delivery Cost Benchmarking: Primary and Secondary Schools,* January, http://www.nacframework.org.uk/docs/National_School_Delivery-Cost_Benchmarking-Primary_Secondary-Jan2015-V5.pdf

National Audit Office (2012) *Securing the future financial sustainability of the NHS*, HC 191, Session 2012-13, July, https://www.nao.org.uk/wp-content/uploads/2012/07/1213191.pdf