Written evidence from Dexter Whitfield

Sale of Equity in PFI Companies

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Sources of Profits in PFI

1. An average rate of return of 13%–15% is built into PFI projects before they are signed.

2. Additional profits may be obtained if a project is refinanced. Once a project is operational, it may be refinanced with gains shared on a 50%/50% basis between the public and private sectors.

3. The special purpose company for each PFI project reports profits and losses annually like any other company. The financing of PFI projects is complex. A John Laing example illustrates how equity invested in 2005 and is repaid at the end of the contract in 2034. Significant loan stock invested in 2007 is repaid between 2008 and 2024. Loan stock interest commences in 2008 and reduces up to 2023. Dividends commence in 2024 and continue until 2034 with a significant dividend in the final year (Cashflow to Shareholders, John Laing) http://www.laing.com/top/industry_information/financial_aspects/shareholder_returns.html

4. Additional profits are obtained from the sale of equity in PFI special purpose companies. Secondary market equity sales became established in 2003 (see Table 1).

5. The termination or construction/operational problems of some PFI projects may result in financial losses, but to date they small compared to speculative profits obtained from the sale of equity in the secondary market.

6. The sale of equity is significantly higher than that the sales identified in the HM Treasury PFI database, the Partnerships UK database or estimated by the National Audit Office. None report on profits/losses. The ESSU PPP Equity Database identifies:

- 240 PPP equity transactions involved 1,229 PFI projects (including multiple sale of some projects) valued at £10.0 billion.
- Average profit was 50.6% (compared to average operating profits in PFI construction companies of 1.5% between 2003–09).
- £517.9 million profit from a sample of 154 PFI projects. If the same level of profit were maintained for the 622 PPP project equity transactions the total profit would be £2.2 billion.
- Profits could be as high as £4.2 billion if the same level of profits is obtained by the sale of secondary funds as in the direct sale of equity in PFI companies.
- Two sectors had higher than average profits, health (66.7%) and criminal justice (54.9%) with transport (47.1%) and education (34.1%) below average.
- An increasing number of PFI projects are registered in tax havens.

Sale of PFI Equity and Growth of the Secondary Market

7. There are basically two types of PFI equity transactions. Firstly, SPV shareholders selling equity in individual projects or in a group of projects. Secondly, the sale of secondary market infrastructure funds that have a portfolio of PFI equity stakes in SPVs. In both cases the partial or full ownership of equity in the SPV transfers to a new owner. Four trends are evident in the secondary market: portfolio building by some construction companies; recycling and profit-taking by other construction companies; the growth of joint ventures between PFI construction companies and banks, infrastructure funds and pension funds; and the growth of secondary market infrastructure funds (listed and unlisted).

Government Adopts "Hands-Off" Attitude

8. Although public sector consent and profit sharing is required when PFI projects are refinanced, there are no requirements when the equity of PFI companies is sold. The Treasury has regarded the sale of PFI equity as a transaction solely between private companies in which the government has no involvement. It argues that a change in the equity ownership of the project is part of the normal takeover or merger of companies and is different from refinancing projects.

New Database

9. The ESSU Database was compiled from Stock Exchange Regulatory News Service and Company Notices and Press Releases; Company Interim and Annual Reports & Accounts; UK Companies Houses filings;

Infrastructure fund share prospectuses; Construction and PFI company websites; HM Treasury PFI equity holders database; Partnerships UK Database; Securities & Exchange Commission 8K filings for US stock exchange companies; and financial, construction and infrastructure journals and web sites.

10. There are significant problems regarding access to, and the quality, of equity transactions in PFI companies. Many publicly listed companies will issue a Regulatory Notice or Stock Exchange announcement disclosing the acquisition or disposal of PFI equity, but in some cases companies consider the transaction is not of material financial interest. Privately-owned companies and private equity funds have no comparable disclosure requirements. A company may report the details of an equity sale or acquisition in their interim or annual report, but may not indicate the price, level of profit nor to whom they sold their shareholding. There is no common practice or standard requirement.

11. The SPV shareholders usually have pre-emption rights, which allow them the right to acquire the shares of other shareholders who want to sell their equity.

Growth of PFI Equity Sales 1998–2010

12. The Database records 222 UK equity transactions between 1998–2010 covering 622 PFI projects. The annual rate of PFI equity transactions, not surprisingly, increased rapidly between 2000–04 during the formative years of the secondary market. There are inevitably variations in the number, and the total value, of transactions on an annual basis, reflecting the completion of PFI projects, recycling decisions of PFI contractors depending on their contract win-rates and secondary market funds seeking to expand their portfolios. The financial crisis appears to have had a minimal effect on PFI equity transactions.

Table 1

ANNUAL RATE AND VALUE OF UK PFI DIRECT EQUITY SALES

Year	*No. of equity transactions*	*No. of PFI projects (includes those with multiple equity sales)*	*Value of equity sold (£m) (No of transactions)*	*Estimated total value based on average (£m)*
1998	1	1	3.4 (1)	3.4
1999	1	1	n/a	n/a
2000	5	6	n/a	n/a
2001	5	15	117.4 (4)	146.7
2002	3	3	n/a	n/a
2003	16	30	135.6 (8)	271.2
2004	33	95	190.6 (14)	449.3
2005	38	59	306.3 (16)	727.5
2006	35	127	1,431.7 (24)	2,087.9
2007	21	66	401.8 (16)	527.4
2008	16	92	333.0 (8)	666.0
2009	29	60	370.4 (20)	537.1
2010	19	67	586.7 (14)	796.2
Total	**228**	**622**	**3,876.9**	**6,212.7**

Sources: ESSU PPP Equity Database, 2011

Sector Differences

13. Health and Education PFI projects account for half of individual PFI equity project sales between 1998–2010—see Table 2. Transport, primarily roads and motorways, public transport and street lighting projects account for just over 10% followed by criminal justice—prisons, courts, remand centres—with 9%.

Table 2

INDIVIDUAL PFI EQUITY TRANSACTIONS BY SECTOR 1998–2010

Sector	*No. of PFI projects in equity transactions*	*%*
Health—hospitals and health centres	166	26.7
Education—schools & collages	148	23.8
Transport—public transport, roads & street lighting	65	10.5
Criminal Justice—prisons, courts, remand centres	57	9.2
Waste/Water	17	2.7
Defence	14	2.2
Housing—rehab of council estates & MoD housing	10	1.6
Leisure	10	1.6
Misc	35	5.6
Unknown	100	16.1
Total	**622**	**100.0**

Source: ESSU PPP Equity Database, 2011

PFI Projects Sold Multiple Times

14. The ESSU PPP Equity Database records 370 PPP projects in which equity in the SPV has been sold. For example, the equity in the Barnet Hospital PFI project was subject to five transactions as HSBC Infrastructure increased its equity from 30% to 100%. The Calderdale Hospital PFI company was involved in nine equity transactions between 2002–10 (Whitfield, 2011).

Table 3

PFI PROJECTS IN MULTIPLE SALE OF EQUITY

No. of PFI projects	*No. of transactions*
267	1
59	2
24	3
10	4
4	5
3	6
1	7
1	8
1	9

Source: ESSU PPP Equity Database, 2011

Sale of Secondary Funds

15. Thirteen sales of secondary market funds between 2003–10 had a total value of £3.1 billion and involved an additional 607 PPP projects (Table 4).

Table 4

SECONDARY FUND EQUITY SALES IN UK

Owner	*Sold to*	*No. of PFI projects*	*Price £m*
Grosvenor House Group plc (2003)	n/a	5 (estimate)	4.0
Babcock Brown and Abbey National (2003)	Star Capital Partners, Bank of Scotland and AMP Capital Investors	23	n/a
Infrastructure Investors LP (Barclays, Societe Generale and 3i) (2005)	3i Group	31	150.0
HSBC Infrastructure Ltd and HSBC Infrastructure Fund (2006)	HSBC Infrastructure Company (HICL). PFI assets transferred to new listed company.	15	250.0
Investors in the Community Ltd (2007)	Trillium (Land Securities)	16	7.4
PFI Infrastructure Company (2007)	Infrastructure Investors LP (Barclays, Societe Generale and 3i)	22	156.0
Star Capital Partners, Halifax Bank of Scotland, AMP Capital Investors (2007)	Trillium (Land Securities)	79	927.0
Land Securities plc (2008)	Land Securities launches Trillium Investment Partners, a PPP Joint Venture	100 (estimate)	n/a
3i Group plc (2009)	Placed in market	n/a	60.8
Land Securities (2009)	Telereal	108	750.0
Telereal (2009)	Victorian Funds Management Corporation (Australia) and Transport for London Pension Fund	108	n/a
Infrastructure Investors LP— Barclays acquire Societe Generale (31.7%), 3i (31.7%) and Fleming (4.9%) (2009)	Barclay Private Equity Integrated Infrastructure Fund	84	558.6
John Laing (2010)	John Laing Infrastructure Fund (John Laing has 23% stake)	16	242.3
Total (13 transactions)		**607**	**3,106.1** (10 transactions)

Source: ESSU PPP Equity Database, 2011

16. When the sale of equity in individual and group transactions is combined with the transfer of ownership when infrastructure funds are sold, the total number of equity transactions increases to 240 involving 1,229 PFI projects, including multiple transactions of some projects (Table 5).

Table 5

TOTAL OF PFI EQUITY AND SECONDARY FUND EQUITY SALES

Year	*No. of transactions*	*No. of PFI projects (includes multiple sales)*	*Value of equity sold (£m) (No of transactions)*	*Estimated total value based on average transaction (£m)*
Sale of PFI equity	228	622	3,876.9	6,212.7
Sale of secondary funds	12	607	3,106.1	3,727.3
Total	**240**	**1,229**	**6,983.0**	**9,940.0**

Source: ESSU PPP Equity Database, 2011

17. Joint ventures between PFI companies and infrastructure funds accounted for about 10% of equity sales. The sale of secondary funds accounted for only 5% of transactions but nearly half (49%) of PFI project equity sales.

Profits from PFI Equity Sales

18. The ESSU Database contains 63 transactions involving 154 PFI projects, where the sale price and profit from the equity transaction, are identified from reliable sources. The total value of equity sold was £1,026.6 million with £517.9 million declared profit (50.6%). The transactions were spread across the 2003–10 period with a diversity of construction companies and infrastructure funds, types of project, geographic location and size of project (Whitfield, 2011).

19. There are wide differences in the average profit rates between sectors with the average profit being 50.6%. Two sectors have higher than average profits, health (66.7%) and criminal justice (54.9%) with transport (47.1%) and education (34.1%) below average. The "multiple" category in Table 6 includes transactions covering a number of different types of assets and where the total profit was stated for a group of projects.

Table 6

PROFIT ON SALE OF PFI EQUITY IN UK (INCLUDES MULTIPLE EXAMPLES)

Sector	*No. of PFI transactions*	*No. of PFI projects*	*Value of equity sold (£m)*	*Total Profit (£m)*	*Average % profit*
Health	14	18	129.3	86.3	66.7
Education	6	8	47.8	16.3	34.1
Transport	8	12	101.8	48.0	47.1
Criminal Justice	6	15	122.4	67.2	54.9
Housing	1	1	5.2	4.2	80.8
Waste/Water	1	1	12.0	8.0	66.7
Leisure	1	5	6.5	5.6	86.2
Defence	2	2	9.3	12.5	134.4
Multiple	24	93	587.7	269.0	45.8
Total	**63**	**154**	**1,022.0**	**517.1**	**50.6**

Source: ESSU PPP Equity Database, 2011

20. If the same profit level of the sample of PFI projects were maintained for the 622 PFI projects involved in equity transactions, **the total profit would be £2.2 billion.**

21. Similarly, if the same rate of profit was achieved in the sale of secondary funds, the profit from PFI equity sales would be a further £2.0 billion, giving a total profit of **£4.2billion.**

22. The rate of profit achieved by PFI construction companies is exceedingly high with two companies achieving over 70% (Lend Lease Corporation and Balfour Beatty) and four companies over 50% (John Laing, Interserve, Kajima Partnerships and Kier Group). Table 7 includes only the PFI equity transactions where profit information was available (none declared a loss) and does not reflect the full performance of PFI equity investment by these companies.

Table 7

MAJOR SELLERS OF PFI EQUITY IN UK BETWEEN 1998–2010 (BASED ON TABLE 5)

Company	*No. of PFI projects*	*Sale value (£m)*	*Profit (£m)*	*%*
Carillion plc	24	278.8	114.1	40.9
John Laing	22	170.3	100.6	59.1
Interserve plc	15	70.3	37.9	53.9
Lend Lease Corporation	11	14.7	11.5	78.2
Costain Group plc	8	37.1	16.2	42.9
Serco Group plc	7	79.9	16.0	20.0
Balfour Beatty plc	5	37.8	27.0	71.4
Kajima Partnerships	6	30.2	18.0	59.6
Kier Group plc	4	26.1	14.7	56.3

Source: ESSU PPP Equity Database, 2011

23. The profits in PFI projects contrast sharply with construction operating profit rates of the same contractors. These have remained low throughout the last decade. The average operating profit in UK construction/building activities for four major PFI construction companies (Balfour Beatty plc, Carillion plc, Costain plc and Kier Group plc) was 1.5% between 2003–09 (Company Annual Reports).

Use of Tax Havens in PFI Equity Transactions

24. The equity in 91 PFI projects is owned by secondary market infrastructure funds located in tax havens (Table 8).

Table 8

PPP INFRASTRUCTURE FUNDS LOCATED IN TAX HAVENS

Company	*Tax haven*	*No. of PFI assets*	*PFI projects*
HSBC Infrastructure	Guernsey	33	Substantial stakes in hospitals, schools, police stations, Home Office Headquarters, London.
John Laing Infrastructure Fund	Guernsey	19	Range of schools, social housing, hospitals, courts, police stations and street lighting projects.
3i Infrastructure Fund (3i Groups owns 33.2%)	Jersey	18	Norfolk & Norwich University Hospital (26.0), Alpha Schools, Highland (50.0), Elgin Infrastructure Fund (joint venture with Robertson Group)
International Public Partnerships (formerly Babcock Brown Public Partnerships)	Guernsey	14	100% shareholding in schools and criminal justice PPP companies.
GCP Infrastructure Fund Ltd— Gravis Capital Partners	Jersey	7	4 investments in Grosvenor PFI Holdings and 3 in Investment in Leisure Infrastructure Investors Ltd
Total		**91**	

Source: ESSU PPP Equity Database, 2011

Transfer of PFI Equity Assets to Contractor's Pension Funds

25. At least five companies, Interserve, Amec, John Laing, Costain and Vinci, transferred PFI equity to their pension funds in lieu of cash payments or the transfer of other assets. The pension funds records ownership of the asset in its accounts and receives future dividends (Whitfield, 2011).

Longer-term Consequences

26. The focus on profits masks other important issues about the potential effects of the sale of PPP equity and the growth of secondary market infrastructure funds.

27. Firstly, the scale of profits indicate significant overpayment for risk transfer and could invalidate the original value for money assessment at the procurement stage. This can only be addressed by a new comprehensive and rigorous assessment framework.

28. Secondly, the privatisation of gains from publicly financed investment and development must be reversed, so that the public sector has a 50% share in any profit above a specified level.

29. Thirdly, new transparency and disclosure requirements should be introduced as a matter of urgency to require full public notification of equity sales.

30. Fourthly, the public sector can only effectively access benefits from operational efficiencies at five or seven year periods when facilities management contracts are reviewed either via benchmarking or competitive tendering of the services.

31. Finally, PFI equity sales and the growth of a secondary market results in further erosion of democratic control. As infrastructure funds increase their offshore portfolios of PFI assets, they will use their power to influence decisions affecting the future management and provision of key public facilities (Whitfield, 2010).

32. The NAO recognises that the risk of the consolidation of PFI equity could lead to *"…disproportionate market power, and particular asymmetry of power over small public authorities tendering and managing single PFI contracts. We would be concerned if we started to see a few consolidated owners dictating contract and commercial terms. We do not have evidence that this is happening"* (ibid). It concedes *"…the lack of visibility over the secondary market it is difficult to ascertain the effects that the secondary market has had to date"* (ibid).

Recommendations

1. The standard PFI contract should be re-written to include a ceiling imposed on the level of profits that can be extracted from PFI equity together with a requirement that the public sector should have a 50% share in any profit above a specified level.

2. A new value for money methodology should be devised to take account of the profiteering in PFI equity transactions and the other flaws in the current evaluation methodology.

3. New transparency and disclosure requirements should be introduced as a matter of urgency requiring more expansive notification about equity sales.

4. The Treasury PFI database should be significantly extended to include historic and future PFI equity sales, be publicly available and regularly updated.

5. The National Audit Office and Treasury should research the longer-term effects of the growing secondary market.

6. Ultimately, the negative effects of the PFI equity secondary market can only be solved by the termination of the PFI programme combined with new regulatory controls on existing projects.

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