PFI AND THE NHS IN LONDON

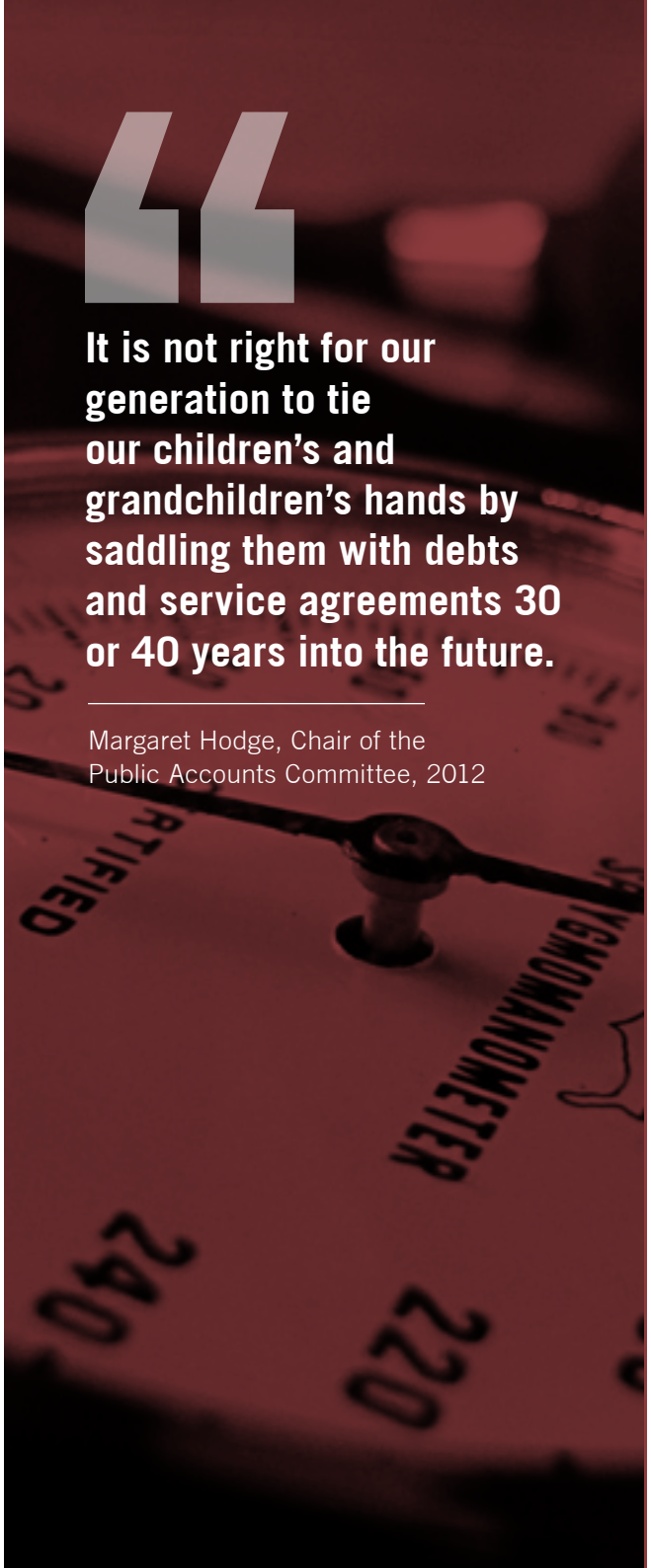
Dealing with the growing pressure of the Private Finance Initiative on our hospitals in the capital

NHS SUPPORT FEDERATION

unite the UNION

Contents

Introduction	2
Executive Summary	3
What is PFI	4
Securing the future of the NHS	4
The cost of London's PFI debt in the NHS	5
Impact on patients and services	7
The wider effect on London's health services	8
Why does PFI offer poor value?	9
Getting a fair deal for London's NHS	12
Time for a new approach	14



It is not right for our generation to tie our children's and grandchildren's hands by saddling them with debts and service agreements 30 or 40 years into the future.

Margaret Hodge, Chair of the Public Accounts Committee, 2012

Introduction

For twenty years PFI has been the main route for capital projects in the NHS. What we now know is that there are negative impacts that last long after the doors of a new hospital are open. In financial terms alone a high price is paid over the life-time of the contract. The number of NHS trusts now in deficit is surging and for many the burden of PFI costs is ramping up the pressure. PFI problems have been exposed in successive reports and inquiries, but there has been little progress in solving the issue. Year on year these debts are affecting the services that are available to patients and limiting the resources for NHS staff. When PFI began it was during an era of rising funding for the NHS but in recent years the NHS has seen flat funding and unprecedented cost cutting.

We have seen how PFI contracts wrap NHS trusts up in a schedule of rising payments. For some the debt has become toxic, but most contend with PFI pressure that will not recede without intervention. Despite growing consensus about its limitations there is little momentum around change. There are however options that could help to relieve the burden of PFI on the NHS, some of which have already been successfully executed.

This report examines the scale of PFI debt in London and the extent to which it influences the financial position of the capital's NHS trusts. We look at some of the impacts on planning and services and how this affects patients. We explore the options for reducing the burden of PFI debt in an attempt to move policy makers to taking action that can help to secure the future of our NHS.

Executive summary

Together the hospital PFI schemes in London cost £2.7bn to build. These twenty schemes will require payments totalling £20.2bn from the fifteen NHS trusts that are involved in these contracts.

The annual cost of PFI to London's NHS trusts was £477m in (14/15) but will rise to £542m by (2019/20). The way that the contracts are set up means that PFI payments will increase year on year throughout their term. This escalation is one reason why PFI schemes offer poor value to the public and yet have generated large profits for the PFI consortia and their shareholders.

Some trusts are allocating a significant proportion of their operating revenue to PFI. In 2013/14 – the last year that all accounts are available, nine of London's acute trusts ended the year in deficit, six of these have PFI debts. The two most indebted, are spending over 10% of their income on PFI.

In line with previous research, our analysis identifies that NHS trusts across London are overpaying for the capital that they are borrowing. On average the schemes in London could have borrowed 1.5 times more capital if they had been financed through public lending (discounting at 4%), such as a municipal bond. This equates to a waste of around £2.7bn across the lifetime of these projects. For an individual scheme like Barts this could amount to an over payment of between £600-900m compared with public borrowing.

Newham University Hospital project (now part of Barts Health) represents the poorest deal on finance in London, paying back over four times more than the public option (@4%) – overall £735m on a project that cost £35m to build. Barnet and Chase Farm (now part of the Royal Free London Trust) are paying back over 3.5 times more than the public option (@4%) – £775m on a project that cost £54m to build.

The position of each scheme will be different, but action to rectify the problems with PFI is achievable. In the NHS and other sectors renegotiation, buyouts and refinancing have all been used to successfully reduce the burden of PFI. With such a tight financial situation and cuts prevalent, it is imperative that a coordinated strategy is put in place.

Contract terms, ownership and compensation all vary between schemes. An expert public commission needs to look at the detail of each scheme to help devise a strategy. Public support and strong political leadership will be essential to remove the inertia around this issue.

Renegotiation of PFI costs down to a fair value remains the most cost effective approach, but requires the co-operation of PFI investors.

Despite widespread recognition of the problems with PFI very little action to reduce existing debts has followed. Meanwhile developments at a local level have produced examples of how PFI debts in the NHS can be reduced. Alternatives to private finance, such as bonds issued by local authorities, could help some NHS trusts to buy their way out of PFI deals and substantially reduce the costs of their debts.

Around 100 NHS hospitals have been built under the Private Finance Initiative. Through our research we have found that the ownership of these hospitals has undergone a dramatic shift over the last decade. Nine out of ten of these assets are now effectively owned by international investment funds. The sale of equity in PFI companies has generated big profits for investors. Six international investment funds now control the majority of this equity and all of them have dealings with offshore tax havens.

“PFI IS A POLICY OF ONE HOSPITAL FOR THE PRICE OF TWO”

Dr Jim Cuthbert

What is PFI?

A PFI contract is a long-term agreement between the public sector and private sector lasting from 30 to 60 years. Under PFI a consortium of investors, usually investment banks, construction contractors and service contractors, raise finance in order to build new infrastructure. This consortium then designs, builds and operates the facilities for the public authority. The contract is between the public authority and what is termed a ‘special purpose vehicle’ or SPV.

The SPV is a shell company set up by the consortium of investors and has no assets of its own. The finance this company needs is of two types: senior debt, usually lending from a bank, which is low-risk because it is guaranteed by the government; and equity and subordinate debt that comes from a range of investors and is not legally guaranteed and therefore carries a higher risk of non-payment.

In general, 90% of the finance for PFI schemes is low risk senior debt and 10% is higher-risk equity. When the construction work is complete and the facility is up and running the public authority (in the case of a hospital – the hospital trust) pays the SPV an annual fee, known as a unitary payment. The unitary payment consists of two parts:

An availability fee – which covers interest and principal payments on the PFI debt and an accumulation of cash reserves to meet life-cycle costs (e.g., maintenance and upgrade costs)

A service charge – which covers facilities management

Securing the future of the NHS

The NHS faces an urgent challenge – how to find the funding it needs to cope with growing demand. The gap in funding has been estimated by the Institute of Fiscal Studies at around £30bn between now and 2020/21.[1] Accepted by the Department of Health these figures form the backbone of the scenarios in Simon Steven’s, five-year forward view. In it he predicts that the NHS can find £22bn of the shortfall through efficiency savings. This is an inflated re-run of the Nicholson Challenge, which demanded savings of £20bn over the last four years.[2] Economists and analysts have already cast doubt on whether this can be done.[3]

NHS staff are making tough choices because of the pressure on resources, some times working at and even beyond safe limits. The impact upon patients in areas like emergency care has been widely covered in the media but staff from right across the NHS can attest to the impact of financial pressure over last few years. Perhaps in more abundant times the excessive costs of PFI would set off fewer alarms, but austerity has stripped the NHS to its leanest state just as further demands are being heaped upon it. The imperative to take action on PFI and release funds towards patient care could not be clearer.

In a wider sense, the long term failure of PFI is a survival issue. Its drive towards debt contributes to the belief that the funding model of the NHS is broken. We have seen recent calls for us all to take more personal responsibility for the cost of our healthcare. However this is a direction that could challenge the central idea of our NHS - that we share the burden of ill health fairly, through the tax system. Like the penetration of the market structures, PFI has been stitched into the NHS. The evidence shows us that, amongst other issues, costs have risen as a result.[1] So addressing the waste generated by PFI and the market in the NHS will ultimately make our NHS more sustainable.

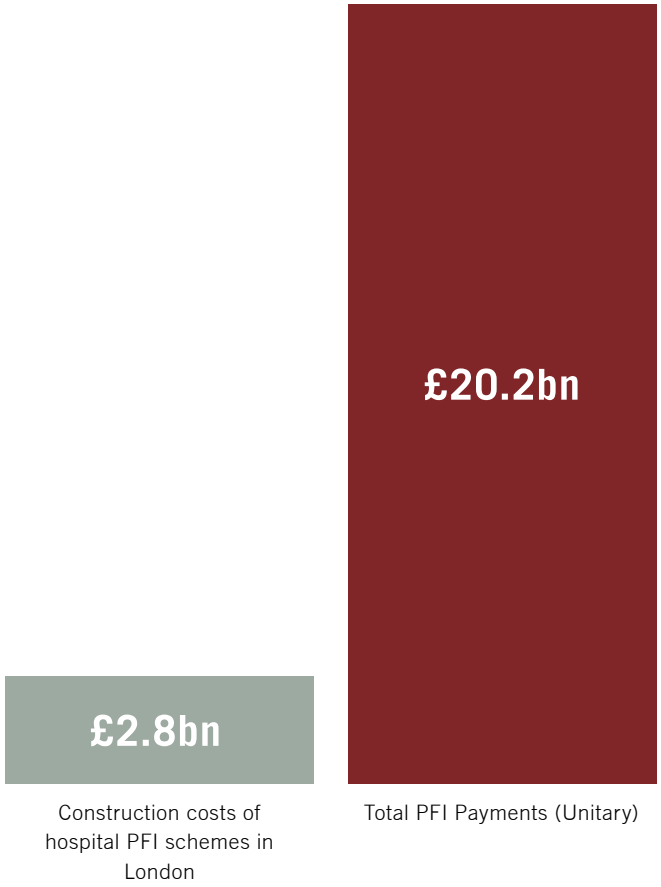
What is the cost of London's PFI debt in the NHS?

The financial cost

Together the hospital PFI schemes in London cost £2.8bn to build. These twenty schemes will require payments totalling £20.2bn over the 30-35 year term. The 15 London trusts that have signed contracts are paying the PFI companies for the finance, construction and a whole range of services that they need to keep these buildings running.

The annual cost of PFI to London's NHS trusts was £477m in (14/15) but will rise to £542m by (2019/20). The way that the contracts are set up means that PFI payments will increase year on year, throughout their term. This escalation is one reason why PFI critics say the schemes offer such poor value to the public and yet have generated large profits for the PFI consortia and their shareholders.[2]

Rising costs means greater debt and this connection is confirmed by the fact that in 2013/14 nine of London's trusts ended the year in deficit and six of these have PFI debts (see Figure 1, p7). A similar trend exists nationally. Our analysis found that seven out of the ten NHS trusts with the biggest deficits for the year 2013/14, also had large PFI obligations.



Construction costs of hospital PFI schemes in London

Total PFI Payments (Unitary)

Some trusts are allocating a significant proportion of their operating revenue to PFI. The two most indebted in London, Barts Health and Barking, Havering and Redbridge University Hospitals are are spending over 10% of their income on PFI (see Figure 2, p7), and in 2013/14 they finished the year with combined debts of nearly £80m.

The worst cases are now being propped up by hand-outs from central government, and nationally the government has created a £1.5bn bailout fund.[3] Some schemes have been investigated to see how such unsustainable deals could have been signed-off in the first place. MPs on the Public Accounts Committee asked the National Audit Office to probe the Peterborough City Hospital PFI deal. The trust had huge deficits of £40-50m in the years after the deal was signed and the NAO investigation concluded that the deal was "unaffordable".[4]

The majority of PFI trusts do not receive compensation for their high costs. The pricing system in the NHS takes no account of this factor and therefore PFI trusts are under greater financial pressure.

Figure 1
The nine London NHS Trusts in deficit in 2013/14
Those with PFI schemes are in red.

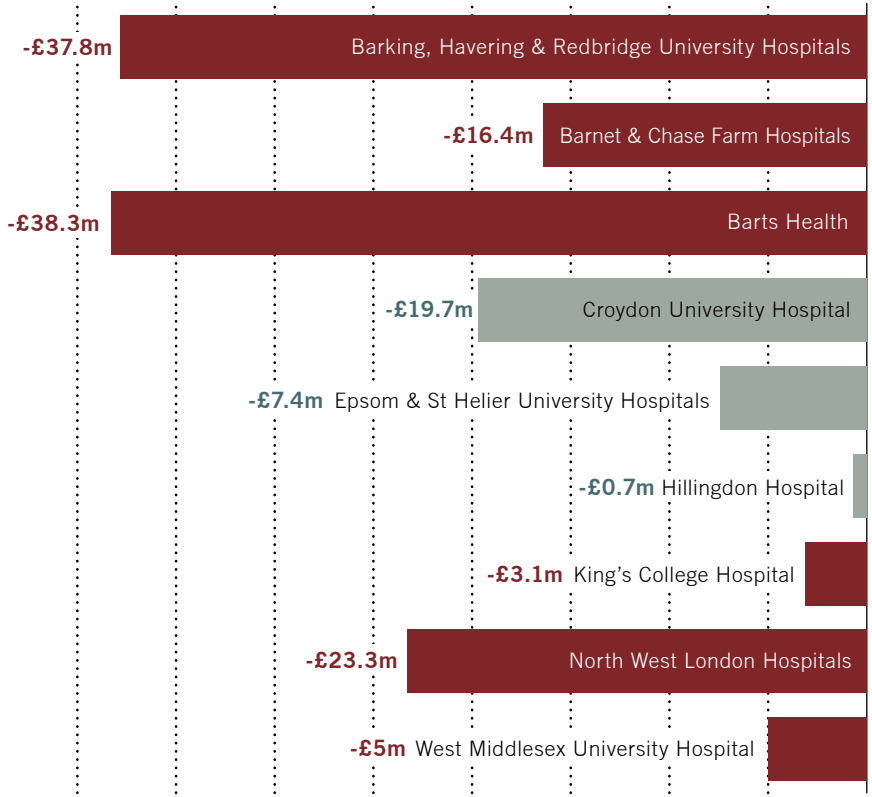
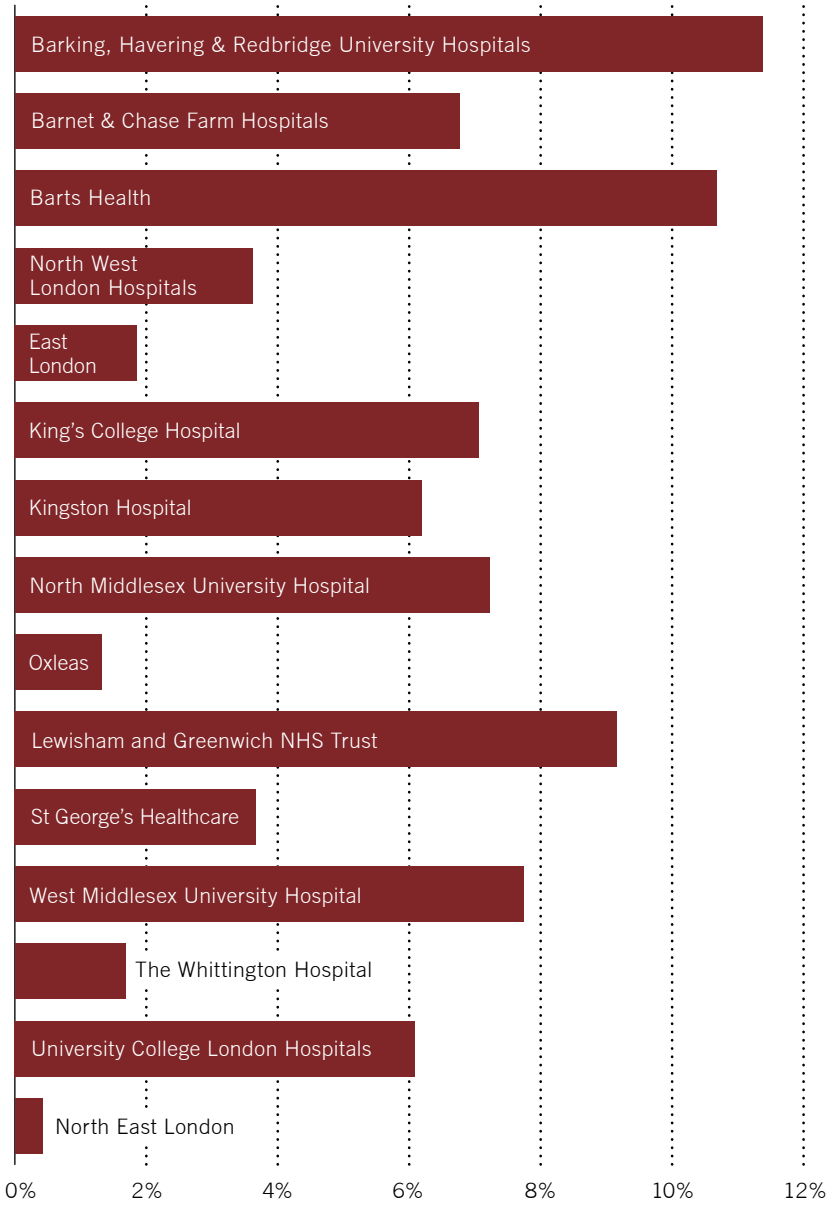
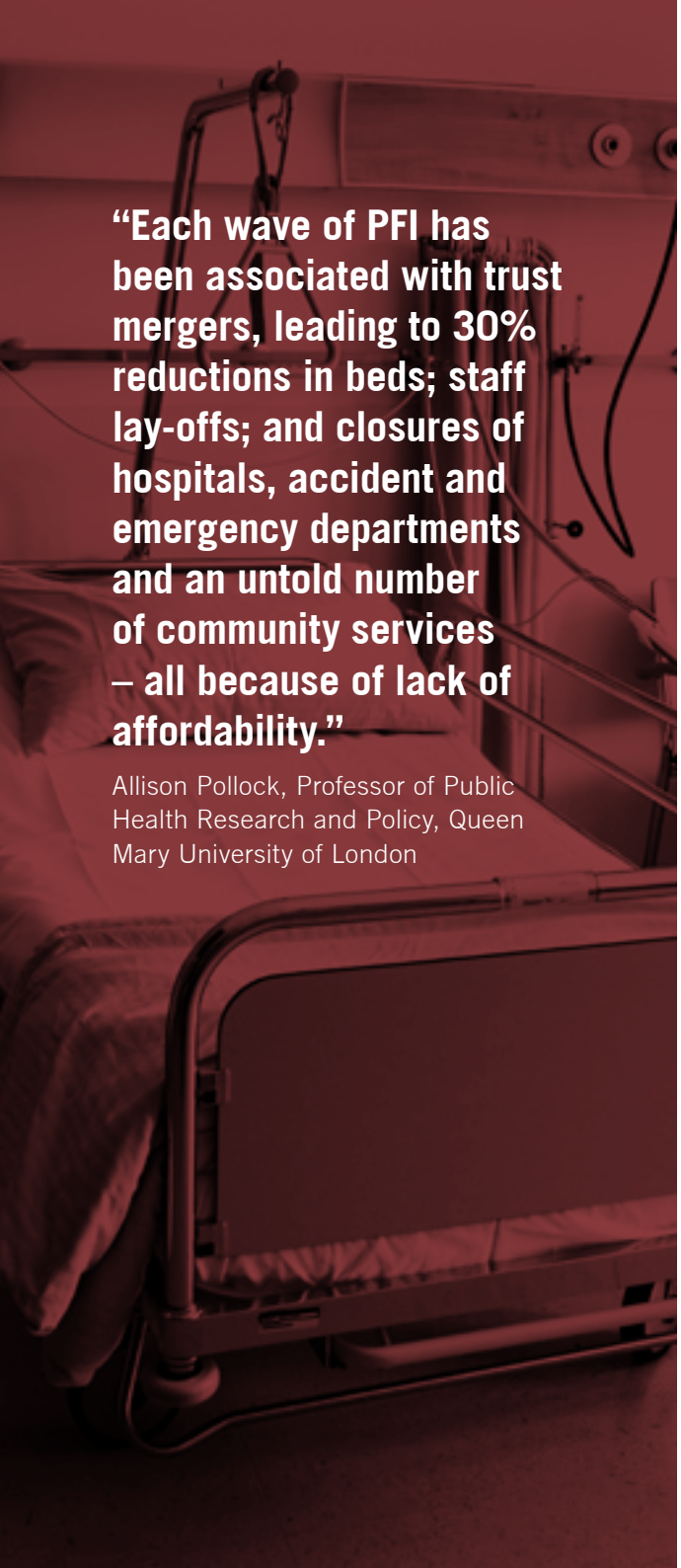


Figure 2
PFI payments as a proportion (%) of operating revenue for the fifteen London NHS Trusts with PFI projects





“Each wave of PFI has been associated with trust mergers, leading to 30% reductions in beds; staff lay-offs; and closures of hospitals, accident and emergency departments and an untold number of community services – all because of lack of affordability.”

Allison Pollock, Professor of Public Health Research and Policy, Queen Mary University of London

Impact upon patients and services

High PFI costs leave NHS trusts with less to spend on staff and equipment and have a significant impact upon patient care and services. The British Medical Association’s consultants’ committee has said that PFI debts are “distorting clinical priorities” and impacting the treatment given to patients.

Perhaps the heaviest impact so far concerns Barts Health NHS Trust, the largest NHS trust in the country, with 14,000 staff and an annual turnover of £1.25bn. The PFI scheme for Barts began in 2006, costing £1.1bn – it is the largest single NHS PFI project, and was in fact scaled down from an even larger £1.9bn proposal.

The trust now finds itself in deep financial difficulties, with a projected deficit for the financial year 2014/15 of £93 million, as revealed in the papers of a February board meeting. This figure is more than double the £44 million deficit that was predicted at the start of the year.[5]

Barts Health was put in to special measures in March 2015 after a damning CQC report criticised several aspects of care at Whipps Cross hospital in Leytonstone, East London – one of the six hospitals which are run by Barts.[6] Criticisms included insufficient staffing levels to provide safe care, a high use of agency staff, low staff morale, a bed occupancy rate that is too high, a culture of bullying and failures to meet national waiting time targets.

30%
of cuts in bed numbers occurred in the first wave of PFI hospitals

TWO THIRDS
of A&E closures and proposed closures come from PFI hospitals

CQC inspectors also criticised care at The Royal London and Newham hospitals in a further inspection, citing insufficient staffing to patient ratios and an over-reliance on agency staff, as well as raising concerns about safety and the cancelling of operations due to a lack of bed space. Only 32% of staff recommended Barts as a good workplace, the third lowest score in the NHS.[7]

The PFI scheme involves the redevelopment of the trust’s sites at St Bartholomew’s itself and the Royal London Hospital in Whitechapel. Although the initial cost is a little over a billion pounds, over the next 34 years the trust is due to pay out more than £7bn to pay off the scheme’s construction and maintenance costs.[8]

The wider effect on London's health services

"We now have indexed payments for the next 35 years which at a time of growing concern over NHS budgets can only be a millstone. It isn't just that our scheme was expensive. Its very existence distorts whatever else needs to happen in this part of London and beyond."

Peter Dixon
Chair of University College Hospital, 2009

Research has also shown that PFI can have a negative impact on health planning and the wider services in its area.

A study of the first wave of PFI hospitals found that bed numbers were reduced by an average of 30% in the new hospitals. Research by the Telegraph found that the majority of proposals to close A&E units occurred at PFI hospitals. However The most high profile example of the influence of PFI on other services involved the now defunct South London Healthcare Trust.

In 2012 the SLHC trust declared a £150 million deficit and was placed into administration, the first NHS trust to face this fate. Its financial situation was complicated, but the large proportion of the trusts annual income allocated to PFI was a significant factor in its demise. Subsequently the administrator proposed that other services across South London be reduced to help deal with the deficit. Both the maternity and A and E units at the neighbouring Lewisham hospital were marked for closure, although this proposal was eventually blocked by a legal judgement and a strong local campaign.

In a prophetic statement before the problems with Bart's PFI scheme emerged, Peter Dixon, Chairman of University College Hospital, the second largest PFI-built hospital in England, said: "We now have indexed payments for the next 35 years which at a time of growing concern over NHS budgets can only be a millstone. It isn't just that our scheme was expensive. Its very existence distorts whatever else needs to happen in this part of London and beyond. And that is before we get to paying for the much larger scheme at Bart's and the London in a few years' time."[9]

Professor Nick Bosanquet of Imperial College London has argued that the government commissioned some PFI hospitals without a proper understanding of their costs, resulting in a number of hospitals which are too expensive to be used. He said: "There are already one or two PFI hospitals where wards and wings are standing empty because nobody wants to buy their services. There will be a temptation to say 'right we are stuck with these contracts so we will close down older hospitals', which may in fact be lower cost. Just closing down non-PFI hospitals in order to up activity in the PFI ones is not going to be the answer because we may have the wrong kind of services in the wrong places."[10]

Why does PFI offer poor value?

The complexity of PFI schemes makes it difficult for the public to assess their value. However twenty years on from the first schemes in the NHS there is now a wealth of academic work analysing the impact of PFI.

The high cost of private finance

Many of these studies share one important conclusion, that public finance offers substantially better value. In fact these reports estimate that for the levels of PFI payments being made, between 1.5 and 2 times more capital could have been borrowed, which implies there is a considerable waste and a pressure on resources from PFI. Cuthbert noted that funding a hospital through a PFI contract is akin to a "one hospital for the price of two policy."[11]

Supporters of PFI would argue that the price of the schemes includes the risk taken on by the private sector. However investigations by the Treasury committee and by the Public accounts committee in 2011 both support the conclusions that overall PFI offers poor value.

In July 2011, the Commons Treasury Committee noted that: "The cost of capital for a typical PFI project is currently over 8% – double the long term government gilt rate of approximately 4%. The difference in finance costs means that PFI projects are significantly more expensive to fund over the life of a project … We have not seen clear evidence of savings and benefits in other areas of PFI projects which are sufficient to offset this significantly higher cost of finance." (House of Commons Treasury Committee, Private Finance Initiative, 19th August, p3)

After these Parliamentary reports were published the Coalition government initiated a review of current schemes and launched PF2, an attempt to improve the value of future schemes. However as we describe later, little progress has so far been made in lessening the burden of PFI costs within the existing schemes in the NHS.

The high rate of profit

The rate of profit achieved for the private investors in PFI projects has been found to be excessive – considerably higher than conventional levels of profit for equivalent projects. This was noted by the National Audit Office in 2012: "the public sector may often be paying more than is necessary for using equity investment." Profit from PFI projects can be made in more than one way:

- by the initial investors from the index-linking to inflation of the unitary charge (annual PFI fee paid by the hospital).
- through refinancing by the investors and paying a lower rate of interest on the debt;
- and, from selling the equity of the PFI company.

Profit from the Unitary Charge

The PFI contracts are set up with the unitary charge index-linked to inflation or some fraction of inflation so that over time the amount paid each year increases. However, as the debt is paid off so debt charges fall over time as the payment of interest each year falls. The difference between that increasing element of the unitary charge which covers financing costs and profit, and the declining cost of servicing debt, is available to take as a large profit.

"PF2 is essentially a rebranding of PFI. It does nothing to address profiteering from equity sales in PFI."

Dexter Whitfield, author of *The PPP Wealth Machine*

One example that has been cited is of a hospital project in England with a capital cost of just under £70 million. To finance the building the consortium borrowed over £60 million from banks, at an interest rate of just over 6% (the senior debt), and provided almost £10 million in subordinate debt for the project, for which the consortium will receive repayment at an interest rate of 15%. The consortium also put in an equity stake of £1,000. The senior debt is paid off quickly and therefore senior debt charges fall rapidly. But the whole unitary charge is indexed-linked for thirty years at 3% per year, therefore, the projected returns to the consortium are that a £1,000 equity input could earn dividends totalling more than £50 million.

The consortium's own financial projections indicate that on a total investment of £10 million, the consortium is expecting to get a cash return of more than £90 million.[12] In 2013, other researchers calculated that sponsors of a sample of UK PFI deals had returns of almost 10% above the market rate.[13]

Profit from refinancing

Profitability for investors increases still further when the process of refinancing is considered. After the facilities are up and running the original investors can then use refinancing to reduce the interest they pay. Now the building is complete the period of high-risk is over and the consortium of investors can swap borrowing at high interest rates to lower interest rate borrowing. Under the PFI contracts the NHS trust must receive a share of any profits if refinancing takes place, however this can be small in comparison to the profit taken by the consortium.

A good example is the Norfolk & Norwich University Hospital (NNUH) project, where Octagon Healthcare refinanced the project moving from higher-interest bank financing to lower-interest bond financing. The immediate cash gain to Octagon's investors was £95 million and the NNUH received £34 million in the form of reduced rent over the lifetime of the project. Octagon's windfall profit of £95 million represented an annual rate of return on £1.47 million of share capital (in 2003 prices) of more than 120%; this did not take into account net profits after tax of £3.6 million in 2001 and £1.6 million in 2002.[14]

The supporters of PFI still say that it provides good value as it transfers risk from the pubic sector. However the Treasury select committee concluded that PFI was no more efficient than other forms of borrowing and it was "illusory" that it shielded the taxpayer from risk.

Excessive profits at taxpayer's expense

Huge profits are being made by the private companies investing in PFI. Firstly by the building companies and the initial lenders and then by investment companies who have brought shares in the schemes because of the large, low risk returns. 85% of PFI hospitals are now owned by international investment companies, who control the Special Vehicle companies that run each PFI scheme (see Figure 3). They offer investors returns 30% higher than the stock market.

After publishing their 2011 report in to PFI, Margaret Hodge Chair of the Public Accounts Committee commented, "We have even seen evidence of excess profits being priced into projects from the start [...] The Treasury review must find a private finance funding model that allows flexible delivery of public services and ends the era of investors receiving eyewateringly high rewards while taking ever decreasing risks."

"Tax revenue is being lost through the use of off-shore arrangements by PFI investors."

Public Accounts Committee Report 2011

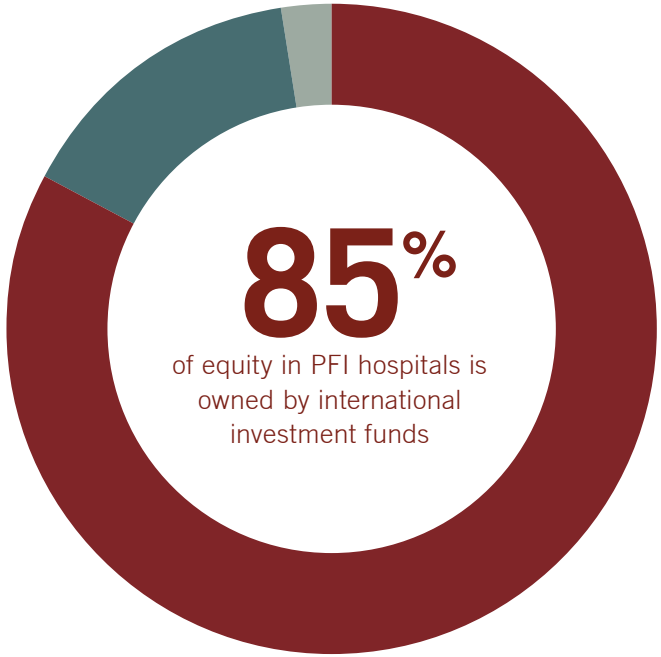


Figure 3
Who invests in PFI Equity?

- Tax-Haven Infrastructure Fund **72%**
- Infrastructure Fund **13%**
- Venture Capital **4%**

Other: Pension Fund (2%); Facilities Management (1.75%)

Getting a fair deal for London's NHS

The implication for the NHS in London is that it is still spending more than it needs to on capital borrowing because of PFI.

As we have seen the scale of this overpayment affects the planning of care and has resulted in cuts in services and closures and the financial pressure is rising.

What is the extent of the overpayment for PFI in London's hospitals and what are the options for taking action?

Comparing the public and private finance

Around 60% of PFI payments by NHS trusts are made up of the finance costs of raising the capital. A number of analysts have examined existing PFI deals to estimate the additional cost involved in financing hospital building through PFI. This can be done by comparing the existing PFI repayments with those from alternative forms of investment, like a government or municipal bond.

The current interest on municipal bonds is around 4%. Discounting the project cash flow stream for a given PFI scheme at this rate produces a net present value. This accounting process is a standard method for comparing the outcome of two investments in today's terms.

Dr Mark Hallowell – an adviser to the treasury investigation in PFI, has used this approach to assess the value of a number of PFI schemes. He describes what the net present value of these PFI cash flows tell us: "This figure represents the additional financial cost of using private, rather than public finance, to deliver that amount of capital expenditure."

In other words by discounting at a public bond rate to find the NPV we can estimate the size of the extra cost in existing schemes compared to using public finance.

The finance of London's PFI hospitals: Public v Private

To assess relative value we have taken the stream of PFI cash flows outlined by the treasury for the all the acute PFI schemes in London and calculated the NPV of these payments against two forms of public finance.

1) Government bonds or gilts, currently offered at an average of 3% over the last year.

2) Municipal bonds offered by local authorities at around 4% on 30 year arrangement.

Table 1 (p13) is an estimate using these treasury figures of how the current hospital PFI schemes compare with a publicly financed option. We assume that the schemes adhere to the 60:40 divide between finance and service costs, a figure established by Department of Health analysis.

The table shows that in every case there is an overpayment and that for the price of PFI being paid, on average each hospital could have borrowed 1.5 more capital through public finance. Across all the current schemes this implies substantially poorer value from private finance than from the public alternative. This equates to a waste of around £2.7bn because of the high cost of private finance across all of London's PFI schemes. Clearly further poor value can also be wrapped up in the service side of contracts that account for the other 40% of PFI payments by NHS trusts.

These figures indicate there could be substantial savings to be made from refinancing PFI deals.

Table 1

NHS PFI projects in London

This table shows the Trust currently responsible for the repayment of the project, the cost of construction, and the NPV of their total PFI payments at discount rates of 3% and 4%. Trusts responsible for more than one project are colour-coded and Foundation Trusts are marked with an asterisk.

Project		NHS Trust	Capital cost (£m)	NPV @4%	NPV @3%
A	Oldchurch hospital in Romford	Barking, Havering and Redbridge University Hospitals	266	-339.92	-451.80
B	NHS Treatment Centre	Barnet and Chase Farm Hospitals	54	-190.95	-229.52
C	Acute site rationalisation	Barts Health	1149	-604.84	-993.84
D	Willesden	London North West Healthcare	21	-19.97	-27.27
E	Mental Health services reprovision at Newham	East London	14.5	-38.66	-49.10
F	New block	King's College Hospital	75.5	-139.73	-177.87
G	Kingston Hospital	Kingston Hospital	33.1	-109.24	-133.23
H	Newham University Hospital	Barts Health	35	-171.15	-210.28
I	Reconfiguration of Acute Hospital services	North Middlesex University Hospital	152.5	-42.92	-78.68
J	Central Middlesex Hospital	London North West Healthcare	69.3	-44.78	-64.29
K	Joint procurement to reprovide mental health services	Oxleas*	25	-6.18	-12.10
L	Princess Royal Hospital (Bromley)	King's College Hospital*	117.9	-292.82	-378.88
M	Queen Elizabeth Hospital (Woolwich)	Lewisham and Greenwich	96.1	-173.67	-219.27
N	Neurological & cardiac units	St George's University Hospitals	46.1	-67.18	-90.56
O	New District General Hospital	West Middlesex University Hospital	60	-77.02	-103.05
P	Riverside Building (University Hospital Lewisham)	Lewisham and Greenwich	58	-33.65	-49.60
Q	Redevelopment of Acute Hospital services	The Whittington Hospital	38.4	-9.22	-18.21
R	University College Hospital	University College London*	292	-298.80	-433.76
S	Queen Mary's, Roehampton	St George's University Hospitals	75.4	-81.78	-107.29
T	Goodmayes Hospital	North East London*	11	-5.00	-7.22

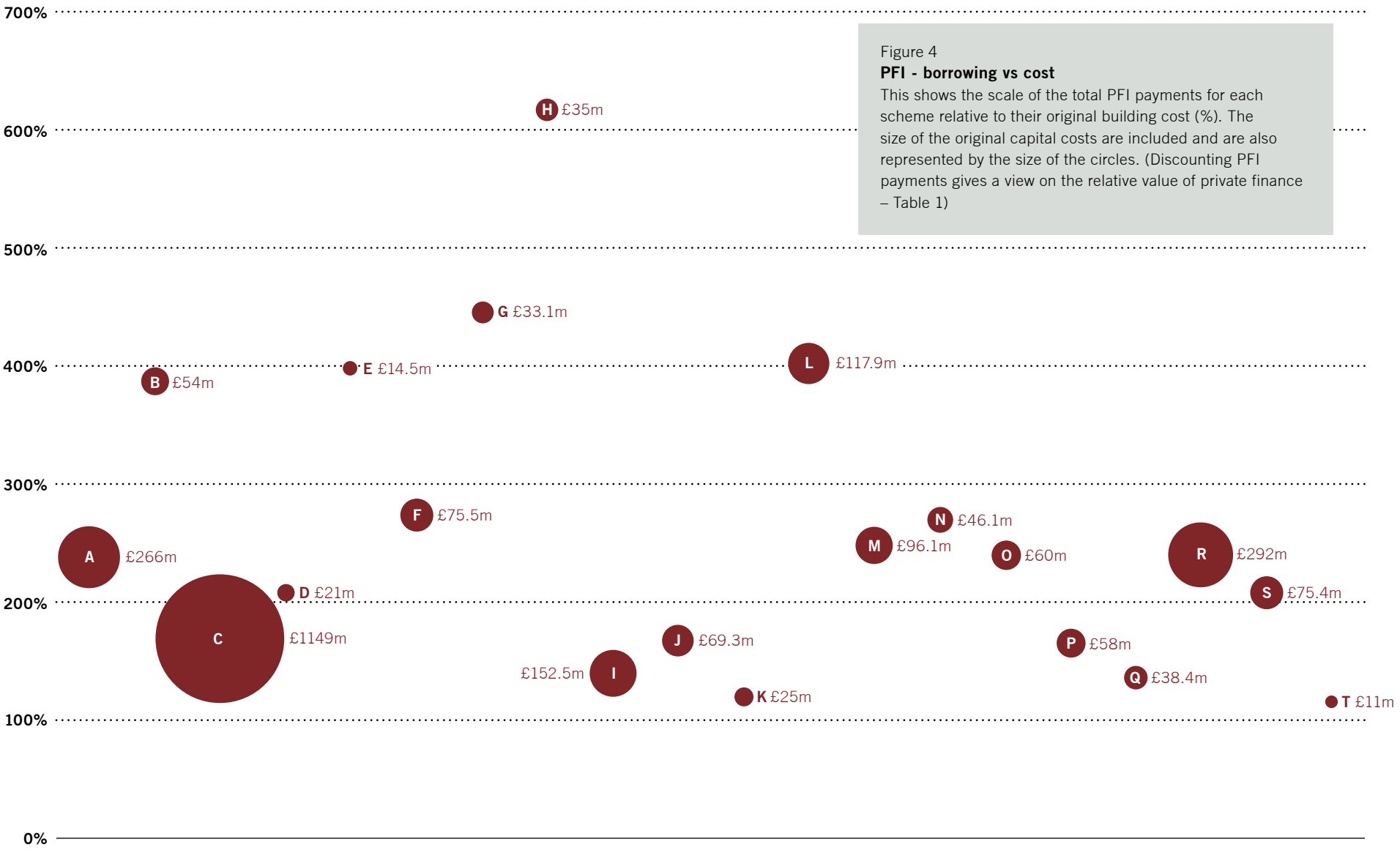


Figure 4
PFI - borrowing vs cost
This shows the scale of the total PFI payments for each scheme relative to their original building cost (%). The size of the original capital costs are included and are also represented by the size of the circles. (Discounting PFI payments gives a view on the relative value of private finance – Table 1)

Time for a new approach

So far the government has achieved only minimal PFI savings of £61 million, which is just 0.09% of the total unitary charge remaining on PFI in the NHS – a drop in the ocean.

With many NHS trusts in dire financial circumstances, it is time to look at other measures to save money in the long-term and recoup a proportion of the excessive profits made by the private companies involved. The options under discussion include the following:

Renegotiating the PFI contracts to reduce the annual payments either to be closer to that which would have been paid if public money had been used or at least to some 'fairer' level. Whether such negotiations should cover retrospective changes to the deals or not should be considered;

Buy out of the PFI contract either through the use of reserves or through borrowing from a different, much cheaper, source;

A tax on the profits made by companies that sell their PFI shareholding;

Closure of the loophole that allows companies not domiciled in the UK to hold share holdings in PFI contracts leading to increased tax payment.

0.09%

A DROP IN THE OCEAN

So far the government has achieved £61 million of PFI savings, which is just 0.09% of the total unitary charge remaining on NHS PFI

"£200m a year could be saved"

McKinsey & Company

"It is a bit like taking out a pretty big mortgage in the expectation your income is going to rise, but the NHS is facing a period where that is not going to happen ... I don't see why the NHS can't go back to its lenders to renegotiate the deals, just as we would with our own mortgages."

John Appleby, Chief Economist at The King's Fund

Renegotiate PFI deals

In 2010 management consultants McKinsey & Company noted that a reduction of 0.02%-0.03% in interest charges paid to the contractors by NHS hospitals could save £200 million a year. Research by Cuthbert shows that there is wider scope to make savings. PFI payments are indexed and increase annually, often above inflation.[2] Meanwhile the outstanding loan is decreasing, creating rising profits for PFI companies.

Most of the risk in PFI is within the construction phase. In nearly all PFI schemes the original PFI partners including the construction companies have sold on their equity to other investors, who are still taking large profits but did not bear any of the major risk. Andy Friend, ex CEO of major PFI builder John Laing, stated in his evidence to the Treasury committee, "that once the construction stage had been completed and the operational stage had started there was a case for allowing the public sector to refinance the debt. This has been done in some cases."[15]

Public opinion could be harnessed to help bring companies into negotiation. There is growing public realisation that the original deals were unfair, with excessive profits being made, but not much tax paid due to the use of offshore companies. The reality that PFI schemes are draining large sums of public money away from services that are struggling for funding, provides a justification for seeking to renegotiate deals down to a fair value.

Buyout

This option aims to reduce the cost of PFI, usually by refinancing and taking advantage of the lower interest on public finance. In a similar way to a homeowner switching to a more favourable mortgage deals, NHS trusts that borrow through government or a local authority can pay less for the finance. In the current financial climate it is likely that public bodies might be reluctant to fund a buy out from their own reserves, but they can organize their own cheaper borrowing to support it. Local authorities have access to capital through the Public Works Loan Board, but can also issue their own bonds, an option that is now becoming more viable.

There are several factors which could affect whether a buyout is feasible, such as

- how big the PFI debt is;
- the availability of cheaper sources of borrowing;
- and, the level of compensation payable if the PFI deals are terminated early.

PFI deals vary in size considerably, from around £15 million to over £1billion. Apart from a few larger schemes 15 of the 20 schemes acute PFIs in London have construction costs of under £100m. This could be an advantage in terms of making of making options like buyout more viable.

Example 1

Buyout through local authority refinancing

In August 2012 Northumbria Healthcare reported that it had been given in-principle approval buy out for two PFI schemes using a £120 million loan from the local authority. The trust estimated that it will save around £4.7 million per year on the combined cost of its two PFI schemes, which each have more than eighteen years left to run, according to Treasury data.

This was made possible through a 25 year loan from Northhumberland County Council, charged at 0.25% above the Public Works Loan Board rate. The loan is intended to reduce the burden of PFI contracts for Hexham hospitals and Ashington's Wansbeck General Hospital. The council has taken security on some of the hospital assets but importantly was not deterred by the risk that the local hospital may at some point be unable to pay its debts.

"The trust has a very high credit rating. There is a risk with anything you do, but the council's view was that this risk was an acceptable one," Steve Mason, lead executive director corporate resources at the council explained. "Our rationale for the loan is protecting local health services and reducing the necessity for cuts by the trust."

Example 2

Buyout through NHS trust reserves

In February 2011, Esk and Wear Valleys Mental Health Foundation Trust paid off its PFI contract for the re-building of West Park Hospital in Darlington. The 30 year contract meant the Foundation Trust would eventually have paid £32.15 million for the hospital; by buying out of the deal the Trust paid just £18 million to release itself from the contract. The original capital value of the project, which began in April 2004, was £16 million and the Trust paid all senior and junior debt plus legal fees. The contract was with the Norwich Union Public Private Partnership Fund, now known as Aviva. Buying its way out of the PFI contract saved the trust £2 million a year (£1.4 million in interest and £600,000 in maintenance and paying back the principal debt) or around £14 million over the lifetime of the contract.[16, 17] The Esk and Wear Valleys buy-out was only possible as the foundation trust had built up a surplus of £41.6 million according to its 2009-10 accounts and the PFI contract was relatively small. Similar small contracts do exist, with data from the Treasury showing that, as of March 2013, 24 NHS trusts in England had PFI schemes with capital values of £25 million or less. However, for cash-strapped trusts trying to save money, the accumulation of such reserve capital is unlikely to meet the level even to pay off a small PFI contract.

For many NHS trusts accumulating such reserves in the current financial climate is impossible.

Example 3

Buyout in the care sector

There are also examples of PFI buy-outs in other areas, including the buy-out of a PFI deal for 25 care homes by Southwark Council in April 2013. Southwark Council agreed the original deal with Anchor in 2000, under which the company rebuilt and refurbished four care homes in the area. Anchor agreed to allow the council to complete the repayments early, which will save the council around £930,000 in fees. Anchor provided care services in the homes and will continue to do so, even though the contract has been terminated.[18]

Compensation payments

A major consideration for any Trust wanting to buy-out a PFI contract are the compensation payments to the investors. As has already been noted, the profit that can be made on PFI schemes means that investors are reluctant to let them go. Generally, the contracts have a compensation payment included for investors, should a trust ever be in the position to pay off the debt. During the refinancing of the Norfolk and Norwich PFI deal it was established that the provider, Octagon would need to be paid £300 million if the project were terminated early. Although there is a great amount of confidentiality surrounding many of the contracts, the treasury does supply guidance on how compensation for private providers should be calculated in the event of the early termination of a PFI contract. Assuming that all the relevant figures are available then it is possible to use this to estimate the buy out costs for a proportion of PFI contracts. This would be an estimate, but using the treasury guidance would make these calculations a valid starting point for debate. The limitation to this approach is that older PFI contracts may vary and involve different compensation costs.

There are two substantive objections to the principle of buying out of PFI deals.

Firstly, by paying off these deals further large sums of public money will be taken away from patients to give to private investors.

Secondly, many may consider it wrong to further compensate investors when they have already been handsomely rewarded, particularly when pay-offs would be large and the tax paid on them minimal. This could potentially be viewed as rewarding these private investors for their ability to strike an 'unfair' deal.

Municipal Bonds – a local solution for PFI?

Finances are tight across the public sector. The 2015/16 settlement could mean that local authorities will have less to spend. They are being forced to look at alternative methods of funding, especially for capital projects. New options for borrowing have emerged with the formation of The UK Municipal Bond Agency (UKMBA) which will provide an alternative to borrowing from the Public Works Loan Board (PWLB) and at lower rates, which could save as much as £1bn for local government in the coming decades. It predicts it will be lending £2-3bn annually within a short period.

This new stream of finance could open up the possibility of refinancing local PFI schemes back by municipal bonds.

What are Muncipal Bonds?

Municipal bonds are debt obligations issued by government bodies. When you buy a municipal bond, you are loaning money to the issuer in return for a stream of interest payments over a set time. At the end of that period, the bond reaches its maturity date, and the full amount of your original investment is returned to you.

London became the first UK local authority to use the capital markets in 17 years when it launched a £600m bond to help finance the construction of Crossrail. This approach was estimated to reduce the Great London Assembly's finance costs for the project by £65m.[19]

Greater Manchester is reported to be setting up an issue of over £500m of bonds via its Transport Authority to fund the cost of its tram network.[20]

Examples

1. Sweden: Kommuninvest, part of the Co-operative movement, is triple-A rated and borrows using bonds. It lends the funds to 260 local authorities to fund such projects as roads and renewable energy.
2. Finland: Munifin was established in 1990 and is owned by the Government and the body which arranges public sector pensions. It has so far lent £11bn to local authorities and bodies, with 39% of the funds going to provide housing.
3. New Zealand: The Local Government Funding Agency was set up in 2011 and is owned by 18 local authorities. It already has a better credit rating than any NZ bank.
4. USA: The municipal bond market here extends to some $2,800bn.

The integration of social and health care can improve services for patients. Clearly not all plans announced under this banner will work. There is already debate about the devolution plans in areas like Manchester. In recent years local authority involvement in health has grown taking over responsibility for public health. The line between health and social care is becoming more blurred as more healthcare is delivered in community settings. Ultimately looking at how to treat patients more effectively will depend on getting services working together. Hospitals play a key role in this and local paople have a huge stake in their future.

Control of the investment market

There are two approaches that could be considered to control the PFI investment market and by doing so gain increased tax revenue, 1) a tax on the profit made from the sale of equity or at least a requirement to share this profit with the public sector and/or 2) the introduction of regulations to ban the sale of PFI equity to companies based offshore thus forcing the companies to pay tax on profits from equity sales.

The rise of PFI in the UK and similar schemes in other countries has spawned a market in trading in PFI equity. Although public sector consent and profit sharing is required when PFI projects are refinanced, there are no such requirements when the equity of PFI companies is sold. The change in the equity ownership of the project is considered by the Treasury to be part of the normal takeover or merger of companies and is different from refinancing projects. At the moment it is extremely difficult to track this market as freedom of information provisions do not apply to private companies.

Data from the ESSU compiled by Dexter Whitfield comes from a variety of sources, including Stock Exchange Regulatory News Service and Company Notices and Press Releases, Company Interim and Annual Reports & Accounts; and UK Companies Houses filings, and represents the most comprehensive database on the ownership of PFI companies. The ESSU has come up with startling data about the market in sale of PFI equity, including the large proportion of companies that are registered in offshore tax havens and the number of times equity in PFI companies is sold.[21]

The changes in PF2 do not address the fundamental problems of disclosure of the trading in the secondary market, according to Whitfield.[22] For any tax or profit share requirement to be able to be put in place the problem of transparency will have to be dealt with first. Conservative MP, Jesse Norman, has argued for some time that trading in PFI assets is not a purely private matter, but that there is a public interest in PFI and "there should therefore be mandatory transparency to government on sales of PFI equity and debt as to amount, duration and beneficial counterpart."[23] Whitfield noted to the Treasury enquiry in 2011 that "contractual terms and/or legislation should require profit sharing with the public sector and be accompanied by improved governance, rigorous monitoring and radical changes to disclosure requirements."[15]

Norman has also put forward the suggestion that "consideration should be given as to whether the government should have a right to block secondary market sale," and he has also pressed for a rebate from the companies that have made excessive profits trading in PFI equity of between £500 million and £1 billion.[24] In some respects the lack of payment of tax on profits and equity sales could be solved if the sale of PFI equity to companies based outside the UK were put in place.

Just not paying

There are some advocates of just not paying, i.e., for hospital trusts to refuse to pay the availability charge. George Monbiot has written that the PFI debt can be classified as 'odious' debt a legal term usually applied to the debts of dictators in the developing world. It applies to debt incurred without the consent of the people and against the national interest. For example, in 2008 Ecuador refused to pay debts which, it argued, had been illegitimately acquired by previous governments. Monbiot believes that this concept applies to at least some of the PFI liabilities.[25] Taking this approach to debt repayment has certain consequences, however, with Lucy Reynolds noting that just not paying is an option that would "risk disastrous consequences or countermeasures under the contracts leading to hospital site ownership loss and thus immediate closure and redevelopment/full privatisation." However, a refusal to pay en mass might prompt the investors to take offers of renegotiation seriously.

References

1. http://www.bmj.com/content/349/bmj.g6340
2. http://www.cuthbert1.pwp.blueyonder.co.uk/papers%202/c_invest-JimandMargaretCuthbertsubmission1.pdf
3. http://www.bbc.co.uk/news/health-16874630
4. http://www.publicfinance.co.uk/news/2012/11/nao-slams-peterboroughs-unaffordable-pfi-hospital
5. https://www.opendemocracy.net/ournhs/john-lister/bart%E2%80%99s-flagship-hits-rocks-of-pfi
6. http://www.bbc.co.uk/news/health-31918670
7. http://www.theguardian.com/society/2015/may/22/barts-nhs-trust-london-failing-safety-care-quality-watchdog
8. http://www.building.co.uk/redeveloping-barts-and-royal-london-hospitals/5032263.article
9. http://www.theguardian.com/commentisfree/2009/nov/13/pfi-hospitals
10. http://news.bbc.co.uk/1/hi/programmes/file_on_4/6740895.stm
11. Cuthbert J, Cuthbert M. Response to Scottish Futures Trust: consultation paper. http://www.cuthbert1.pwp.blueyonder.co.uk/
12. Cuthbert, J.R., Cuthbert, M.: 'Lifting the Lid on PFI': Scottish Left Review, Issue 43, November/December 2007. http://www.cuthbert1.pwp.blueyonder.co.uk/new_page_9.htm
13. Pollock A., 'PFI and the National Health Service in England' June 2013 http://www.allysonpollock.com/wp-content/uploads/2013/09/AP_2013_Pollock_PFILewisham.pdf
14. Edwards, C., 'The Private Finance Initiative and the National Health Service – time to buy out the contracts?' Compass, February 2009. http://www.compassonline.org.uk/wp-content/uploads/2013/05/CTP45EdwardsPrivateFinancesmallpdf.com1_.pdf
15. Parliament, 'Treasury – Seventeenth Report, Private Finance Initiative' (2011). House of Commons Treasury Select Committee, 18 July. At: http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/1146.pdf
16. Clover, B., 'NHS Trust Buys Back its PFI Debt', Health Services Journal, 1 February 2011. http://www.hsj.co.uk/news/finance/nhs-trust-buys-back-its-pfi-debt/5024890.article#.U0fhhVVdV8E
17. Beckford M., 'Hospital Saves £14m by Getting Out of PFI Deal', The Telegraph, 2 February 2011. At: http://www.telegraph.co.uk/health/healthnews/8296685/Hospital-saves-14m-by-getting-out-of-PFI-deal.html
18. Lloyd T., 'Council Pays to End Care Home PFI Deal', Inside Housing, 19 April 2013. At: http://www.insidehousing.co.uk/council-pays-to-end-care-home-pfi-deal/6526607.article
19. http://www.telegraph.co.uk/finance/newsbysector/transport/8613090/Crossrail-financed-by-600m-bond.html
20. http://lfig.org/could-muni-bonds-fund-uk-social-housing-investment/
21. Whitfield, D., 'PPP Wealth Machine: UK and Global Trends in trading project ownership.' European Services Strategy Unit Research Report 6, 2012. http://www.european-services-strategy.org.uk/news/2012/ppp-wealth-machine-uk-and-global-trends-in-tra/ppp-wealth-machine-final-full.pdf
22. Whitfield, D., 'Fingers in the PFI' Red Pepper, April 2013 http://www.redpepper.org.uk/fingers-in-the-pfi/
23. Norman J., http://www.jesse4hereford.com/pdf/After_PFI.pdf
24. Norman J. Hard times call for a new rebate on PFI deals. Financial Times 2010 Aug 16. www.ft.com/cms/s/0/b5a2d048-a968-11df-a6f2-00144feabdc0.html#axzz1BNroQHXE.
25. http://www.monbiot.com/2010/11/22/the-uks-odious-debts/

This report was published with the support of Unite the union.