SESSION 2000/2001 SEVENTH REPORT

COMMITTEE FOR FINANCE AND PERSONNEL

Report on the Inquiry into the use of Public Private Partnerships

VOLUME 4 — MINUTES OF EVIDENCE AND RECORDS OF INFORMAL BRIEFINGS

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COMMITTEE FOR FINANCE AND PERSONNEL

POWERS

The Committee for Finance and Personnel is a Statutory Departmental Committee established in accordance with paragraphs 8 and 9 of Strand One of the Belfast Agreement and under Standing Order No. 45 of The Northern Ireland Assembly. The Committee has a scrutiny, policy development and consultation role with respect to the Department of Finance and Personnel and has a role in the initiation of legislation.

The Committee has the power to:

- consider and advise on Departmental budgets and annual plans in the context of the overall budget allocation;
- approve relevant secondary legislation and take the Committee Stage of relevant primary legislation;
- call for persons and papers;
- initiate enquires and make reports;
- consider and advise on matters brought to the Committee by the Minister of Finance and Personnel.

MEMBERSHIP

The Committee has eleven members, including a Chairperson and Deputy Chairperson and a quorum of five members.

The membership of the Committee since its establishment on 29 November 1999 is as follows:

- Mr Francie Molloy (Chairman)
- Mr James Leslie (Deputy Chairman)
- Mr Alex Attwood
- Mr William Bell
- Mr Seamus Close
- Mr Nigel Dodds MP*
- Mr Derek Hussey
- Ms Patricia Lewsley*
- Mr Alex Maskey
- Mr Peter Robinson MP*
- Mr Peter Weir

* Mr Oliver Gibson was replaced by Mr Dodds on 2 October 2000.

* Mr Gardiner Kane was replaced by Mr Robinson on 2 October 2000.

* Mr Donovan Mc Clelland was replaced by Ms Lewsley on 15 January 2001.

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PS	Business Services Association
PS	Confederation of British Industry
PS	Construction Employers Federation
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PS	Irish Business and Employers Confederation
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PS	Major Contractors Group
ROI	Department of Education and Science
ROI	Department of Finance
ROI	Department of Public Enterprise
U	Irish Congress of Trade Unions
U	Northern Ireland Public Service Alliance
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MINUTES OF EVIDENCE

Thursday 17 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Ms Lewsley
Mr Weir

Witnesses:
Prof Stephen Glaister,
CBE Professor of Transport) Imperial College
and Infrastructures) London
Professor Allyson Pollock) University College
Professor of Public Policy) London

1. **The Chairperson:** You are welcome. Can we move straight to the presentation before opening for questions.

2. **Prof Glaister:** Between 1984 and 1993 I was a member of the London Regional Transport Board. I am currently a member of the Transport for London board which was set up last July. Although I am about to make some critical comments about Private Finance Initiative (PFI), I am entirely happy with the idea of using the private sector fully and in the most sensible way to provide the services that the public sector needs. I do not make any distinction between PFI and public-private partnerships (PPP), because I do not understand the distinction. I therefore use the terms interchangeably.

3. There are three distinct issues; I will comment on each of these and then finish with comments on the London Underground PPP, which I have been working on. The three issues are efficient procurement for the public sector, finance for projects, and the administrative matter of evasion of rules — departments achieving what they want in spite of what senior Departments might wish.

4. We all understand the phrase "sensible procurement". It means using the private sector, which is profit-driven, to do things in an efficient, low-cost way to achieve what the public sector may want to achieve, according to a contract, an agreement, or a specification. To make that work successfully you must have risk-transfer, because that is what provides the incentive to the private sector to be efficient, rather than merely seeking to achieve excessive profit without any benefit to the public sector.

5. One of the attractive features of such arrangements, which have been developed under PFI over many years, is that a good procurement contract will give incentives to the provider to construct and maintain an asset in an integrated way. It follows, therefore, that when they are carrying out the construction work they will take account of the long-term maintenance requirements. This will serve as a whole-life costing arrangement, which is a desirable and sensible feature.

6. To make this procurement process work well, the public sector must be able to specify exactly what it wants. This has to be incorporated into a contract or agreement, and it must be possible to enforce this contract credibly, otherwise the arrangement will not work well. One of the central issues in PFI schemes is therefore the ability to specify and enforce contracts.

7. The evidence on how successful PFI has been is mixed. The chairman of the Institute for Public Policy Research's independent commission, Mr Martin Taylor, was reported in 'The Guardian' on 16 May as having described the evidence as being thin, and I agree. However, there is strong evidence of the private sector's ability to do things more cheaply, through simple procurement contracts, by comparison with the cost incurred by the public sector in the past. There is good evidence that if the private sector does work which was previously done by the public sector, and if the contracting regime is genuinely competitive, you might expect to save around 20% of the original cost. I can talk later about examples of that.

8. The critical point is that the regime under which the private sector is working is genuinely competitive, both when the contracts are being procured and in the operation of those contracts. One of the critical elements of that is competition in the labour market, as a result of which labour becomes used more efficiently, and this is why utility privatisation has been very successful in reducing costs.

9. When making an appraisal, one has to take account of the costs of administration and drafting contracts, and that has in practice been a big issue. There is a need to be frank about the extent to which risk has genuinely been transferred. Some terms that look good might not turn out to be so, because if the contract fails the public sector ends up picking up the risks even though it believed that it had transferred them. Recently there have been several such examples, particularly in the IT sector, where PFI contracts have failed and it has been impossible to enforce them.

10. There is a need to look at contracting costs and risk transfer. It is therefore important — and Prof Pollock might have something to say about this — that when the decisions are made they are put through an open-handed and objective public sector comparator test. The public sector needs to be convinced that the project will provide good value for money. If the test is objective there is good reason for proceeding, if it is not there is a problem.

11. The second feature is financing. These deals are financing; they are not funding. Sooner or later the

public sector has to pay for the service. If it is not a genuine, commercially self-supporting deal, by definition it has to be paid for. It is not paid for in the year of procurement but over a period of years, under the contract. That is financing — moving money from the present to the future, or vice versa. It effectively means borrowing from the private sector; it is not funding, by which I mean providing the resources to pay for the asset over the period of the contract. That distinction has become very confused in many people's minds with the result that many members of the public, and some politicians, somehow expect the private sector to provide something when the public sector itself is not willing to pay for it. There are many examples of this mindset. The private sector is not going to produce this unless it is paid under contract. The PFI bundles together into one contract the procurement and the financing.

12. My third point relates to the rules and control mechanisms, an issue which has a long history. Originally, in the '80s, the Treasury was firmly opposed to PFI because it thought that the initiative constituted a way for the private sector and Departments to sidestep the control mechanisms which the Treasury was enforcing. There still is a strong element of truth in that. Departments of state have regarded PFI, which the Treasury is now very keen on, as a mechanism by which they can procure more physical assets from the annual budget than they would have been able to do under conventional funding. The Departments have driven PFI forward as a way of getting underneath the Treasury's expenditure controls. Of course things have to be paid for in the end and a big liability is being built up for future payments, which do not appear in the current year's financial budgets.

13. The Treasury has changed the rules in an attempt to retain control of this process, and as a result it has become very Byzantine. There is some evidence to show that the whole set of regulations relating to PFI has become a serious barrier to the outgoing Government's ability to achieve their aims in regard to public expenditure increases and investment in infrastructure. I have constructed a simple diagram which illustrates how this Government have failed to increase the amount of investment in public infrastructure — just as the previous Government failed to do so.

14. The issue is whether procurement under PFI is actually obstructing the Government from achieving the investment in infrastructure they seek. If PFI is going to work well the Government, local authorities, or whoever will be responsible for the projects must decide what it wants, how much it is willing to pay for it, how to finance it, and how to procure it — those are separate considerations.

15. I will now talk briefly about the PPP for the London Underground, a vast undertaking. It is of around the same value as all the other PFIs combined. The aim is to bundle into long-term contracts, procurement and financing of the maintenance and improvement of the London Underground. The Government have introduced 30-year contracts to do that, and I believe that this was a very unwise decision. You cannot say what you will want over 30 years and you cannot enforce a contract over that period of time. That is one of the big failings of the PPP for the London Underground.

16. Furthermore, commitments were made, for political reasons, to protect the terms and conditions of the workforce, and this compromised one of the successful features of utility privatisation, essentially eroding the terms and conditions. If the PFI were to go ahead, I doubt that it would achieve everything that the Government are looking for. There is a very complicated set of contractual splits — a vertical split into three big contracts and a horizontal split between operations and infrastructure.

17. Openness, an essential element of the public sector comparator, does not exist, and Mr Kiley, whom I trust, has alleged that it is not even-handed. There is therefore a big question over whether PPP for the London Underground would be good value for money if the scheme were to go ahead. However, we cannot be sure since everything is being held privately and the information is not in the public domain.

18. Finally, the workings of the safety and economic regulatory regimes are very unclear. It is uncertain how the Mayor will get what he wants under that regime. If the PPP were to go ahead it would take control out of the Mayor's hands and bring it into the Treasury's control, and I believe that this would be by design. This is what it is really all about. There is a better way of dealing with this issue, but I can talk about that during the questions.

19. **Prof Pollock:** Prof Glaister has given a good overview of the issues therefore I will try to complement rather than repeat what he has said. My background is as a public health physician so just as I regard you as stewards of public funds, I see myself as a steward of the public health.

20. PFI should be considered as part and parcel of a raft of policy changes; it should not be examined in isolation. You must consider it in conjunction with resource accounting, the setting up of trusts and their new statutory financial duties, agency status and other policies including externalisation.

21. I want to readdress some of the principles of PFI. Until the 1980s there was a consensus of opinion that the market, not the private sector, could not deliver public services in health, education, et cetera. One of the reasons for this was that the funding and financing of all public services requires an element of risk-pooling — sharing the risks across the board, from wealthy to poor, from healthy to sick. This element of risk-pooling

exists in every sector, including water, transport, housing, education and health. I mention this first because it is very important in providing an understanding of the way that PFI and privatisation work.

22. Risk-pooling allows there to be elements of redistribution, but also risk-sharing. It is a very important concept, because there has been a consensus among all political parties that this has been the way to deliver public services since 1948.

23. There are several ways that the risk pool can be fragmented. First, by introducing charges or local taxation, which off loads the risks on to the individual. An example would be the introduction of charges for personal and social care whereby the elderly now carry the risks. Similarly, in optical and dental health care those in greatest need of services carry the individual risks.

24. Secondly, fragmentation of the risk pool by excluding people and/or services. For example, rich people could opt for private health insurance or private education. That would exclude a significant portion of the risk pool. You could also exclude the sick, which would be creating a separate risk pool, as happens in Germany with social insurance funds. It also happens in America with Medicaid, the system for the poor. Your ability to share risk would be minimised.

25. Thirdly, the risk could be fragmented through privatisation and externalisation. The World Bank and the World Trade Organisation describe this as "service unbundling". One of the features of public services is the ability to share risks across expensive and poor services — cross-subsidisation, if you like. The World Trade Organisation considers public service monopolies to be one of the foremost barriers to trade. Therefore, when thinking about risk pools one also has to consider what will happen when they are broken up or fragmented.

26. It is very important to have a contextual framework —you should be thinking about what you are doing to your risk pool, where the risks will go when you break up the pool, and what will happen to your services.

27. I have carried out a lot of empirical work on PFI. The unit has examined health, education, and even the London Underground. I have looked in detail at the policies, the outline and full business cases and their effects. I will not go into that now because I know you have been given a good deal of the evidence.

28. Prof Glaister rightly pointed to the fact that private finance is not a source of new investment since it has to be paid for over a 30-year period. One of the big issues is what this means for the revenue stream —it will be paid for from the revenue budgets over a 30-year period. In the Health Service and the education sector there was no revenue stream to pay for these services. It is very important to remember that. The question then is from which budget will it be paid. We found that 12% to 18% of the Health Service's revenue stream has to be used to pay for new PFI hospitals every year.

29. The question arises of how to do that in the NHS when there is no new source of money, apart from the capital charging revenue stream, which was set up in 1991. There is therefore a major gap in funding. We have found that there is a major affordability problem. PFI devolves the problem of investment to local hospitals. There is no longer a regional or national responsibility for capital. It is up to local hospitals and schools to work together to come up with investment plans.

30. In our work on health and education we found that there are major affordability issues, and these have been met in a number of ways. The first is by real reductions in services. All of the first wave PFI National Health Service hospitals are seeing a 30% reduction in bed provision and up to a 25% reduction in clinical staff provision. This is happening at a time when the NHS is at maximum capacity. A national bed enquiry announced that no further NHS bed closures could take place safely — especially where a PFI is involved. The affordability issue is such that the problem is being solved at local rather than national level, and the cuts are falling on services and staff. This has an effect, a political impact.

31. In its new Health and Social Care Bill the Government have introduced a mechanism to allow for more funding — not financing — through user charges. The NHS has experienced major cuts in services, and there is a general recognition that affordability has driven further service externalisation.

32. PFI cannot be considered in isolation; it is not a more technical change. Hospitals, schools and public services have been reconfigured as a result of it. In the NHS, hospital trusts or care trusts are being established, but their statutory duties are not to meet the public health needs, nor to provide for the sick, the poor, and the old. Their duties are purely financial: they must break even, pay a depreciation charge, and make a return of 6% on all capital employed. That really changes their ethos. Increasingly, the trusts are thinking about how to make ends meet, and how to bridge the affordability problem due to PFI. The new NHS Bill allows them not only to introduce user charges for personal care, but to get into income generation. Once trusts become involved in income generation, the profit motive distorts the provision of public services, and this can have a major impact.

33. Prof Glaister commented that the private sector seems to do things more cheaply and more efficiently. One of my big points to the Committee is that there can be enormous cost escalations under PFI. During our work in health and education we have seen threefold, fourfold and even fivefold cost escalations from the time of the outline business case to the signing of a full

business case. That is not the end of the cost escalation, because any changes made after the signing of the full business case have to be paid for again. That has a knock-on effect on the revenue budget.

34. I do not know why PFI is so expensive, but I will outline two examples of the costs involved. The Edinburgh Royal Infirmary when it signed at £230 million a year-and-a-half ago, was the most expensive hospital in Europe. University College London Hospitals (UCLH), which was supposed to sign off at £130 million, signed a year later at £430 million. That would be fine, if the funds were being met from the capital budget. Remember, however, that that is now translated into an annual revenue charge to NHS trusts, payable over thirty years and linked to the retail price construction index.

35. How do these hospitals afford these massive cost escalations? When they go into the planning phase, they calculate what they can afford on the basis of their land sales and current capital charges. When they sign off, often at a cost which is three or four times greater than they expected, they have a major affordability issue.

36. Our research has shown that the affordability gap is being met in a number of ways: first, through the Treasury with a so-called "smoothing mechanism", or loans; secondly, by diverting much-needed capital away from other public services, which has a detrimental effect on the rest of the system; thirdly, by cutting services across the whole health authority, or boards, as they are known in Northern Ireland; and fourthly, making cuts in staff and bed budgets at a local hospital level.

37. Why are the cost escalations so high? How does that translate into implications for the revenue budget, and what are the implications? What are the long-term consequences of tying up public funds in this way? There are also constitutional and democratic issues for future Governments and local authorities.

38. There is an inexorable logic and momentum behind PFI and the setting up of trusts, but it may not constitute stewardship of public funds for the public good. Another problem with PFI is that it prohibits proper planning for population needs, whether in education, housing or transport, because the affordability envelope must be considered at all times. Other problems include stewardship and accountability of funds, confidentiality and the democratic deficit.

39. Much is made of the risks transferred and value for money. As Prof Glaister said, those are all ex ante. We have no evidence in the business cases because many of them are very flimsy. They do not give a proper account of the risks transferred, how they are quantifying those risks, what those risks are, how they are measured, or what is their rationale, nor is there a proper evaluation in place of what has happened in practice. Prof Glaister has spoken of some of the high-profile disasters in the IT sector, and Siemens Business Services' PFI contract with the Passport Agency is a further good example, as is the PFI involving the National Insurance Resource System (NIRS)

40. The issue of value for money hinges on the 6% discount rate. The report on value for money commissioned by the Treasury showed that in those few business cases that did mention risks, very few risks were transferred, and they mostly all relied on the discount rate of 6% to justify V.F.M. There is much economic sorcery going on without much evidence to underpin it.

41. PFI involves many major issues, and we need to think about it in the context of all the policy changes that are taking place, the availability of capital and the fact that chief executives have been told that there is no alternative — this is the only show in town. We also must consider the way in which PFI distorts the planning process and public accountability as well as the potential risks for the public further down the line. I have not discussed the staffing issues, but you may wish to bring that up.

42. **The Chairperson:** It is refreshing to hear another side of the debate on PFI/PPP because before now we had only heard one viewpoint. I am sure that your submissions have brought many questions to mind.

43. **Mr Leslie:** I am going to resist talking about the London Underground because we cannot really apply such a scheme to Northern Ireland, although there are probably relevant lessons involved. I want to focus on cost and value for money, first looking at it from a conceptual point of view. It seems that the Government have woken up to the fact that after over a 100 years of providing public services, they have ended up as an enormous owner and manager of property. They have not necessarily managed those properties well. They certainly have not provided enough money to maintain those properties. However you describe it, they have ended up with a deficit, some of which must be rectified by bulldozing and rebuilding, and some of which might be fixed by maintaining what is already there.

44. The Government seem to have simultaneously come up with several mechanisms for trying to address their problem. One method is to recognise that they are not very good at the task, and to find out whether the public sector can do it better. It is a difficult issue, and we have not examined it in as much detail as you have; we have not done any number crunching. What proportion of those costs will genuinely address the problem by maintaining a service to a certain standard for 30 years in cases where perhaps the public sector would not have done? Do you think that the Government are simply being ripped off, and that that is one of the reasons why these projects seem to be unaccountably expensive?

45. The Government have also introduced resource account budgeting which in part, at least, is an effort to

have a balance sheet by which they can track their assets, the state which they are in, and identify cases where they are not being maintained. Only now are we getting to have our first look at these figures, and we are still learning how to carry out this type of work. It will take a few years for the Government to draw up the accounts and for us to scrutinise them. Only then will a final picture emerge. That is another way to address why the system has not worked.

46. Finally, on the subject of figures, you said that the cost of one hospital increased from £130 million to £400 million.

47. **Prof Pollock:** That was the case with UCLH.

48. **Mr Leslie:** What proportion of the original cost quoted accounted for the construction of the hospital, and how much of it related to the estimated cost of maintaining the hospital throughout the contract period? We looked specifically at a hospital in Calderdale two weeks ago.

49. It is funny how different people think that different things are important. I thought it was important to discover that the trust would own the hospital in 30 years time, given that the body of the hospital would then be in a predetermined state. It will therefore have an asset at the end of the contract period. It seemed that the asset would be more valuable than anything that could be built following a public procurement, but they were paying for it.

50. Conceptually, what do you think about the Government estate? If part of PFI is, in reality, an attempt to manage the Government estate more effectively, do you thing that this is the right way to go about it? Do you think that resource-based accounting would simply be a mechanism to identify the problem, and that nothing would actually be addressed?

51. **Prof Pollock:** I challenge the perception that the Government have not been good at managing properties. Their main priority has been to deliver public services from them, and they have done that well, both in education and health. You are right to say that there has been huge under investment in capital. That is historic, it is a tragedy, and it is one of the problems. We need an analysis of the cause of the problem, and that is major under-investment.

52. The second point is that labour costs account for the biggest proportion of the revenue budget in education and in health — they are about 65% to 75%. One of the problems is that PFI prioritises the estate over the staff and services, and that is what we are observing. When the squeeze comes it is the labour costs and staff costs which are squeezed. This is particularly the case in the health and education sectors, which are labour-intensive.

53. You have to decide whether you would rather have a shiny, new building that is serving 30% less of your population — because that is what you are saying — or a crumbling infrastructure. Neither of these is satisfactory, but it should not be an either/or situation. You have to think about the way that PFI distorts and changes the planning process away from the public needs. You also have to consider that there might have been a more effective, efficient and cheaper way of making capital investment.

54. While the NHS has had a huge injection of PFI capital, the backlog in maintenance and repairs has gone from £2.5 billion to £3.1 billion in the course of seven years. That is partly because the capital budgets intended for the rest of the health service were not there; secondly, they were being diverted into the PFI and, thirdly, the effect of capital charging — making trusts reliant on having to pay a charge on capital — meant that they failed to invest. This is because they were so panicky about increasing the capital charge, which they saw as a real cost at local level. That is why it is capital charged as a part of the system as a whole.

55. You have to think about what you are doing when you go into a PFI. You must consider the way that you are changing the structure of costs and the imperatives that drive it. I do not have a view on whether or not we are being ripped-off. I have not done the analysis on that, but it seems very bizarre that we should be seeing fourfold and fivefold escalations in costs of PFI buildings. I do not think it would matter if all the costs were being met out of the capital grant. You are the people who would determine whether it was right or wrong — instead it is being left to local negotiations.

56. The real issue is affordability — how does that translate at local level, year-on-year? What does that mean for your annual revenue budgets if you see a threefold or fourfold cost escalation? That is the real issue.

57. **Prof Glaister:** I agree with a lot of Prof Pollock's comments. The move to resource-based accounting is a great step forward. It creates an understanding of the state of the assets and of how much will have to be spent in the future. I do not think that there is a direct connection between that and the PFI.

58. **Mr Leslie:** I do not think that there is either, but it is another mechanism that highlights a similar issue. It is pure chance that the two happened at the same time.

59. **Prof Glaister:** On the one hand you are trying to decide what you want to do, how much you want to spend and what you are going to have to do to keep the assets. The next step is deciding how to do it — how to finance and procure it, and those are two separate exercises. As to whether you are being ripped off by the private sector, there will always need to be a judgement on whether a project should be carried out

under PFI or in any other way. If you make a big capital investment, you must need to make a judgement about discount rates, risks and other related matters — you cannot get away from that.

60. The difficulty of the issue faced by Prof Pollock, and which I face in the transport sector, is that with PFIs everything tends to go on behind closed doors. The openness and the ability to have public scrutiny of whether or not people are being ripped off are lost.

61. **Mr Weir:** I was very interested in your comments about cost escalation, a point which the Department of Finance and Personnel had not heard of before. You said that the cost of a £130 million project grew to £430 million; can those figures be directly compared, like for like?

62. Was it the case that the cost of the new build was quoted as being £130 million, but that £430 million was the cost of having the private sector build the hospital and then maintain it over a fixed period? If this is based on a like-with-like comparison, what other reason could there be for this such an extraordinary escalation?

63. **Prof Pollock:** It must be remembered that cost escalation in the NHS and the public sector is running between 8% and 12% during the procurement phase.

64. One reason for the extraordinary escalation in cost might be affordability. The private sector might be putting in a bid based on what the health authority and the trust can actually afford, pitching the bid in accordance with the availability fee is. The private sector will cost the bid at £130 million, because it knows that the health authority can afford it, and later in the process, when there is political commitment, the real cost can be expressed.

65. Another issue is the financing costs, which can create increases of up to 60% of the total construction costs. Those are not expressed in the public sector alternative. In the Worcester and Kidderminster PFI projects, for example, a 60% increase resulted from the rolled-up interest and the financing costs. That is an important component to examine.

66. **The Chairperson:** Do those increases also occur when the traditional route is followed?

67. **Prof Pollock:** No, they do not.

68. **Prof Glaister:** The Treasury does say that if the public sector were to carry out the work, there are financing costs but that they are not visible. The PFI, by definition, shoves all the financial costs and risks into the open. That is a very difficult argument to handle, and I do not know how powerful it is.

69. **Prof Pollock:** You should then look at the public sector comparator, but the 6% discount rate swings that.

70. The third issue is that the Department of Health will argue that you are not comparing like with like on the cost escalations, perhaps claiming that the Department has added in more beds. One of the notable aspects, which we have seen, is the way in which services are removed from the business case. When the cost escalation becomes apparent, people start to panic. It might be suggested that the cost of purchasing equipment be taken out of the final price, only to be listed as a separate procurement. That new business case will have an additional implication for the revenue budget. Equipment and even beds often fall out between the outline business case and the full one, and little changes will be made. However, in general, they comprise a similar amount of services.

71. The other major factor which must be remembered when considering cost escalations is that the NHS has a system of capital charges, whereby the land and buildings are valued on actual replacement cost and depreciated. The land valuers can work out what it would cost to build the same buildings today. Those costs are a fraction of the cost of these new PFI hospitals which are being signed.

72. In addition, new PFI projects often involve disposing of two or three hospitals, and building one in their place. According to the land valuers, the cost of rebuilding all three of these would be a fraction of the price of one new PFI hospital. That is a confusing point, but it creates an interesting comparative measure. A comparison can be made with the NHS, which might not be possible in other sectors, and this is because of land valuation of estate.

73. **Mr B Bell:** It is nice to meet someone who just can't quite tell the difference between PPP and PFI — I am in the same boat. It is useful to hear the other side of the story. Until now, we have heard only the positive aspects of PPP and PFI.

74. The Committee is here because after 30 years, Northern Ireland now has control of its own fixed Budget. We have discovered that, during that time, there has been a lack of investment in infrastructure, health, education, et cetera. Given that we have a fixed Budget, I believe that PPP/PFI is the only way in which we can rectify the effects of under investment. You seem to say that PPP and PFI is more useful for infrastructural projects such as roads, and that it is not so useful for health sector projects. Is this the case?

75. **Prof Glaister:** That is not necessarily so. As I understand it, you can expect to have a certain amount of money each year for a number of years in the future. The problem is that you are trying to address the problem of catching up with historic under investment in your infrastructure. There are two separate ways of dealing with that situation. First, by entering into PFI contracts. Under this system, you would effectively borrow from the private sector, because it does the work before they

get paid. You would get your infrastructure, and pay it off in the future.

76. In principle, another way of catching up is to use the promise of those future budgetary moneys to finance debt. In this way, you would borrow from the finance houses and issue bonds. This would leave you with a large amount of capital in the bank at the beginning of the process. You would then use that capital to buy in the work that you want under conventional public sector procurement contracts, as opposed to PFI agreements. Those are two fundamentally alternative ways of catching up.

77. There are advantages and disadvantages of those two schemes, and there are also institutional obstacles to the bond. I am unsure about the situation in Northern Ireland, but in England the Treasury is implacably opposed to raising debt because that causes it to lose control of what happens. However, as I mentioned in my paper, that would be the sensible way to go.

78. **Prof Pollock:** There is also a third way. That is to make capital available and go back to the grants system. There has been a problem, because there has been historic underinvestment, but there are generous surpluses.

79. **Mr B Bell:** I do not think that you realise the scale of the underinvestment. That is the problem that we face.

80. **Prof Pollock:** As somebody who works in the public sector, I do realise that problem. There is a huge surplus that could have been used to fund capital investment upfront. We could have done it all. The amount that we are spending now, fiddling around with complex PFIs and so on, could have funded a generation of investment using capital grants. That is a political will.

81. **Prof Glaister:** Rather than paying back the national debt, we could have used that capital in a conventional mode.

82. **The Chairperson:** Are you saying that a lot of money is going in to putting together several PFI contracts that could be used for another way of procurement?

83. **Prof Pollock:** I suggest that while you are here you walk round the square mile of London, and that you look at the big new institutions. Those are legal commercial lawyers who are now mainly or wholly dependent on public sector money through PFI arrangements. That will give you a good idea of what that means.

84. **Mr Bell:** Is that the cheaper Westminster sector?

85. **Ms Lewsley:** I have not heard some of the presentations, and I do not have as much knowledge of this subject, by comparison to the other Committee Members. I have reservations about PFI/PPP, especially with regard to accountability. One of our first PFI ventures has been a school, and it will be interesting to see how that progresses. Concerns about the cost have already been raised, particularly from the teachers' unions which think that the cost is higher than it would have been had the alternative route been taken. Our problem is the horrendous condition of our schools estate, which is detrimental to children's education. We have just received capital funding for a new school to amalgamate three schools that were each over 150-years old.

86. Many regard PFI and PPP to be a new beginning for everybody, all at once. However, we need to be cautious. One of my major reservations is the potential lack of accountability, because there needs to be openness. The bonds scheme appears to be a much more favourable one. I know that others in the Assembly are examining this matter.

87. **Prof Glaister:** One of the issues that probably arises in the debate is the profit to be earned by the private sector in doing this work, which can be a bit confusing. Whatever way you do the work, there are going to be private sector construction companies under contract who will profit from the job. There is nothing wrong with that; they have to cover their costs and the cost of capital. The issue is whether or not they will make excess profit.

88. If a PFI deal is well devised, if the risks are properly specified and the contract is enforceable, there is no reason to assume that there will be excess profits. The cases in which the private sector will make excess profit are when things go wrong and contract specifications are not met. In these cases you cannot enforce the contract, because the private sector has a one-sided bet — if things go well, it gets the money; if things go badly, it still gets the money, and the public sector stumps up. Profit in itself is not a bad thing, but it is important to get clear and enforceable contracts — that is the central issue.

89. **Ms Lewsley:** In Northern Ireland, there will be so many projects vying to go ahead at the one time that haggling will take place, with the result that it might be more cost-effective for us — the costs might not be as high. Even if we had the money for all our capital fund building in the education sector, we would not be able to get people to build — there would be too much work.

90. **Prof Pollock:** You have hit upon a very important issue for both Scotland and Northern Ireland, and that is the overall fiscal financial framework — the way in which these countries are completely tied in. In Northern Ireland, you do not even have recourse to local taxation. You only have user charges, at the end of the day, and that puts enormous pressure on the Assembly.

91. With regard to schools, you may even get cheaper financing arrangements with bonds, but you still have to remember that there could be an affordability issue.

You might want to look at this, because we have reviewed some of the schools and the effects on budgets. The way in which these revenue support grants are made could result in these schools being hit by a shortfall, which can only be met by cutting staff and services further down the line.

92. Prof Glaister mentioned contracts, but they are incredibly difficult to manage because they rely on the public sector's having retained some in-house capability and capacity. There have been some notorious failures where local authorities have been encouraged to get rid of all their in-house capability and capacity. There is also a monitoring cost; because even a cleaning contract is very difficult to manage — just look at the effect on the NHS. One chief executive told me that the NHS would have to renegotiate our contracts at a higher price; that is an extra cost which has to come out of the clinical-services budget.

93. The costs of monitoring contracts are not always taken into account when the public sector goes out to tender under best value. The local authorities also have to have some ability to retain capacity and to manage that risk. The main question is where the risks fall when things go wrong? In high-profile PPP and PFI disasters, such as in IT systems, cleaning and catering, the risks have always been political and come back to rest with the local authority or the responsible agency and ultimately the public.

94. **Prof Glaister:** They might do.

95. **The Chairperson:** We will be meeting with UNISON officials on Tuesday and they have supplied us with a copy of the document.

96. **Prof Pollock:** We do not go into contract theory, which is why I was elaborating on certain contracts.

97. **The Chairperson:** At that meeting we discussed unpredictability, the high price of taking a risk, and ways in which risk can be transferred. What areas are unsuitable for PFI/PPP?

98. **Prof Glaister:** It is important to think about what must be in place to make PPP/PFI work successfully. The public sector must specify what it wants. An enforceable performance regime should be included in the contract. There has to be a mechanism to monitor whether the private sector is delivering what it said it would deliver.

99. If a certain public service cannot specify what it wants over the next 30 years, it is not appropriate for a PFI contract. It could possibly be done on a year-by-year basis, which is what is happening with the London Underground.

100. **Prof Pollock:** I agree with Prof Glaister. You can tie yourself up, and it can be very inflexible, therefore you might have to renegotiate the contracts. No one is dealing with the fact that health and education, for example, are changing all the time. There is a distorting effect when you start to go down this route of using PFI.

101. **The Chairperson:** Would you agree that one reason why we are looking at PFI and PPP is because of past failures by the public service? One explanation could be Government underfunding, but some local Departments have told us that the public sector is reluctant to admit failure and to come up with alternatives.

102. **Prof Glaister:** Whitehall is trying to discipline local government and is advocating that more use be made of the private sector. I am very sympathetic to that viewpoint but, as you have pointed out, it has not been conducted very efficiently in the past. Whitehall will not give money to local authorities unless they go down the PFI route, and this mechanism ensures that the private sector is more involved.

103. **The Chairperson:** Can contractors ask for anything they like because of this Government direction and the fact that no public money will be available for alternatives?

104. **Prof Glaister:** Yes. Many hospital trusts and health authorities have gone down the PFI route not necessarily because they wanted to but because it was the only way to raise money.

105. **The Chairperson:** The Government's election manifesto implies that more services will be controlled in this way. The situation could arise where teaching or the running of the clinical service in a hospital could also be brought down the PFI route.

106. **Prof Pollock:** That is already happening and will do so increasingly with the introduction of the Health and Social Care Bill. Hospitals are subcontracting with other hospitals. Quality of care will become a major issue because private sector hospitals do not deliver the same high quality and standards as the NHS. How will this unregulated sector be managed when the necessary legislation is not even in place?

107. I am prepared to challenge you because I think it is an ideological mantra that public services have failed to deliver. In some instances public services have been appalling and have indeed failed to deliver. On the whole, their goals have been the creation of universal services for health and education, and they have delivered within the constraints of Government funding.

108. Many more people and services will continue to falling outside of that coverage and the risk pool will break up. We need to seriously examine how the PFI and privatisation is affecting our ability to manage risks and deliver services equitably, accessibly and universally. There is no monitoring in place to assess what is happening to the people in services who are falling outside the public sector.

109. **Prof Glaister** I am not clear to what extent the failures that you describe are caused by PFI, or whether

they are due to the lack of money — the unwillingness of Government and local authorities to spend enough to achieve the level of care that you have talked about.

110. **The Chairperson:** Another cause of the problem is that the trusts and boards allowed chief executives of these bodies to finance themselves with large pay increases — there was no accountability. Therefore, money was not being used to provide services but to fund the surrounding bureaucracy.

111. We are running out of time, but this is a very important area that we need to develop. Your evidence has been very beneficial in that it has highlighted the alternative argument. We might wish to ask you further questions.

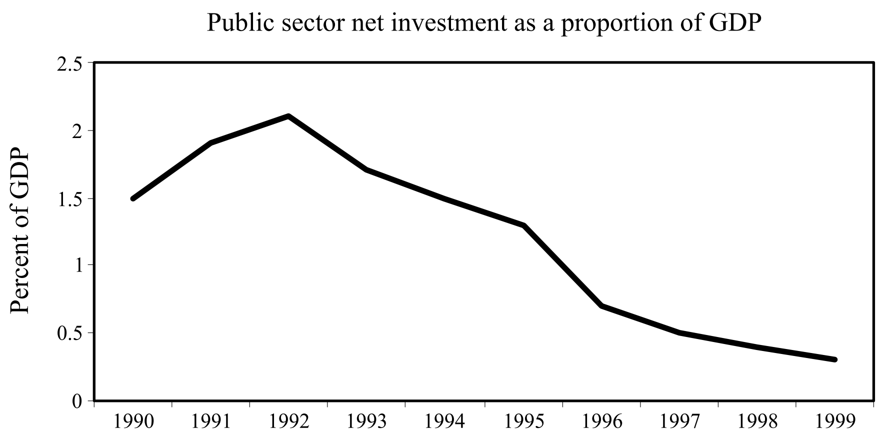
112. **Prof Pollock:** I have written a number of reports which contain a good deal of hard data, because I know that this is data which counts. I urge you to read some of it, if you have time. If you wish, I will send you a separate submission.

113. **The Chairperson:** It would be beneficial to have a separate submission.

114. **Mr Leslie:** I wish that I had read your critique of Peter Coates's paper before I had met him, which was two weeks ago. I read it last night.

115. **Prof Pollock:** Perhaps you could call him back.

116. **The Chairperson:** Thank you very much for coming along and giving your evidence.



Source: HMTreasury, Spending Review 2000, July 2000

MINUTES OF EVIDENCE

Tuesday 22 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Mr Close
Mr Weir

Witnesses:
Dr L Fawcett) Transport 2000
Mr G Ellis)

117. **The Chairperson:** You are welcome to this morning's Committee session. Following your opening presentation the Committee will put some questions to you.

118. **Dr Fawcett:** Transport 2000 welcomes this timely inquiry by the Committee for Finance and Personnel into public-private partnerships (PPPs). A thorough public debate is needed before any further decisions can be made on PPPs or other private finance initiative (PFI) projects in Northern Ireland. Transport 2000 urges the Committee to do all that it can to ensure that individuals and organisations at every level in society may participate in this debate, and the Committee should encourage the Executive to do likewise.

119. Transport 2000 acknowledges the technical assistance of the business journalist Jamie Delargy, acting in a personal capacity, in producing the submission. However, the views expressed in the submission are those of Transport 2000 and not necessarily those of Mr Delargy.

120. The scope of our submission is limited to the funding of public transport, which is the policy area of most concern to Transport 2000. The submission outlines our serious reservations about the PPP formula which is currently being considered by the Department for Regional Development. The Department would be better advised to fund public transport infrastructure investments through Government-backed bonds, or through revenue bonds backed by revenues from measures such as congestion-charging and workplace car park levies.

121. Transport 2000 also set out the case for leasing rail rolling stock rather than purchasing it outright. Most of the benefits of PPP and PFI deals are outweighed by disadvantages or remain impossible to guarantee with any certainty. When compared with the relative attractiveness and security of financing investment in the public sector through bond issues, PFIs and PPPs seem an unduly risky means of funding. Transport 2000 does not recommend that the Executive proceed with such deals unless it can clearly be shown that the benefits outweigh the risks involved.

122. Transport 2000 provisionally welcomes the tentative conclusion reached by the Minister for Regional Development in his Department's submission to this Committee. He concluded that a not-for-profit company might be preferable to the PPP and PFI arrangements that your inquiry is dealing with. We would like to see the Department's proposals in greater detail before we comment in detail on that idea.

123. However, the report commissioned from PricewaterhouseCoopers by the former Department of the Environment, which was published in December 1999 and to which we refer in our submission, still remains under active consideration by the Department for Regional Development. That report examined a number of public sector and PPP options for public transport. We requested and received a summary copy of the report which is entitled 'Public Private Partnerships: Outline Business Case Summary Report'. It concluded that PPP options looked more attractive than the public sector options considered by the report. The problem with the summary report is that it contains insufficient information to properly assess the conclusions reached.

124. We asked the Department for Regional Development to provide us with further information, but this request was refused. We were also refused access to the full report on the grounds of the commercial sensitivity of some of the information. This highlights one of the main problems with PPP's: accountability. We urge the Committee to request the full version of this report, as we understand it has done with similar reports produced for the Department of Health, Social Services and Public Safety. We gathered from that Department's submission to the Finance and Personnel Committee that the Department of Health is prepared to release full versions of outline business cases for PFI projects provided that the Committee takes into account issues of commercial confidentiality. The Department for Regional Development should do likewise. I hope that we have fully understood the Department's submission when we say this.

125. The report to which we were denied access was also the full version of an outline business case. It appears to be a parallel document. Moreover, any organisation or individual should have a right to such information at this crucial stage in the formation of policy. The submission of the Department for Regional Development to this Committee shows that the Department shares many of our concerns over PPP arrangements. However, accountability is one of our chief concerns.

126. We are also concerned about the length and complexity of the contracts involved with PPP arrangements; the difficulty of assigning responsibility when problems arise; the high cost of setting up and

monitoring such deals, and the provision for legal costs in the event of a dispute between the Government and the private sector providers. Transport 2000 does not believe that it is an equal partnership. As per our submission, we are persuaded by the arguments in a report entitled 'Getting Partnerships Going: PPPs in transport' by Prof Stephen Glaister and his colleagues Rosemary Scanlon and Tony Travers. We agree with the authors that PPPs really amounts to a win-win situation for the private sector providers.

127. If things go badly wrong and there is an economic downturn, it will be very difficult for the Executive to resist a plea from a private provider to renegotiate a PPP deal. The private provider might go out of business if it is not allowed to renegotiate terms. However, if things are going well, the private provider still gets the profits. Again, we are drawing very much on what Prof Glaister and his colleagues say. From their evidence, the risk does not genuinely seem to fall on the private sector partners.

128. We are also concerned by some of the points made by Prof Glaister and others about value for money. He assessed the proposals put forward by Pricewaterhouse-Coopers for the London Underground, and concluded that the arguments for PPPs looked less convincing when 15 year projections were lengthened to 30 years. The document from PricewaterhouseCoopers relating to public transport in Northern Ireland only projects 15 years ahead. The Committee will also be aware that the National Audit Office criticised the public sector comparator (PSC) used by PricewaterhouseCoopers to justify the PPP proposals for the London Underground.

129. We forwarded a letter to this Committee from the Department for Regional Development relating to our request for further information. That letter specifically declined to give us details of the public sector comparator (PSC) used in this summary report to compare public-private partnerships (PPPs) and public sector options for public transport in Northern Ireland.

130. We believe that any PPP deal involving a large programme of transport investment should be subjected to independent scrutiny, prior to any contract being signed, as was the case with the National Audit Office's examination of the proposed PPP deal for the London Underground. We recommend that the Northern Ireland Audit Office be asked to carry out a similar examination of any PPP deal involving transport investment in the region.

131. We go on in our submission to talk about the relative merits of bond finance. Essentially, we believe that bond financing offers greater accountability, flexibility, and, from the evidence that we have seen, value for money, than a PPP arrangement. The Committee will be aware that this is the option for the London Underground favoured by Prof Glaister, with whom the Committee met last week.

132. If the Northern Ireland Executive decides to proceed with the issue of bonds for public transport, two options are open to it. It can issue Government- guaranteed bonds of the type issued to part finance the Channel tunnel rail link, or revenue bonds guaranteed by dedicated revenues from sources such as Government grants, fares, and congestion charging.

133. Prof Glaister and his colleagues estimate that every additional £100 million of annual revenue source would support a bond issue of £1·2 billion over a 30-year term. They further propose that a trust company could be established, which could issue its own revenue bonds. This arrangement appears to be cheaper and much more flexible than the PPP option, while securing a guaranteed long-term revenue stream for investment. We recommend that the Department for Regional Development, and the Executive as a whole, should consider the option of revenue bond finance very seriously, and we welcome the fact that the Department is investigating this option.

134. The last part of our submission relates to leasing. We feel that a valuable opportunity to invest in rail infrastructure in Northern Ireland is about to be forfeited, unless the Executive acts now. Transport 2000 has consistently argued that given the limited public sector funds currently available in Northern Ireland for transport, Translink should lease new rail rolling stock, and spend the considerable sum saved on upgrading the railway infrastructure.

135. As the Committee will be aware, Translink and the Department currently have an additional £105 million to invest in rail improvements over the next three years. They propose to spend £70 million on purchasing 23 train sets. We estimate that leasing the trains instead would leave approximately £90 million to be spent on infrastructure improvements over the next three years. Moreover, leasing through an operating lease, the industry standard, enables the burden of risk to be transferred wholly to the lessor. One of the benefits of leasing is that rail rolling stock can be updated and changed with much greater ease as technology improves and circumstances change. By contrast, outright purchase is much more inflexible, and the risk is borne entirely by the purchaser.

136. We ask the Committee to urge the Executive to give serious and urgent consideration to leasing rolling stock. The Department has told us that any savings achieved through leasing would automatically go back into the Executive's overall funds, and that there is no guarantee they would be spent on transport. We believe that the Executive must agree to ring-fence any such savings, to ensure that they are spent on upgrading railway infrastructure.

137. **The Chairperson:** Thank you very much. We are open for questions.

138. **Mr B Bell:** Thank you for your very interesting submission. You seem to latch on to Prof Glaister's opinions on this. We met him last week, and he seemed to be the only person we have spoken to who was very sceptical about the idea of PPPs. Last week we met with representatives from the National Audit Office who have completed 21 reports on PPPs, and they are upbeat about it.

139. When devolution took place we discovered that there had been very little investment over the past 30 years. The roads and railways infrastructure was in a mess; it was ready to close down. The £9 billion block grant is needed to run the country and there is very little provision in that for investment in infrastructure. You have mentioned bonds. What other way can the Assembly finance infrastructure except by PPPs?

140. **Dr Fawcett:** We are presenting an alternative. Stephen Glaister and his colleagues have presented a viable alternative in their report.

141. **Mr B Bell:** It is refreshing to hear an alternative.

142. **Dr Fawcett:** We did not want to make a submission to the Committee that failed to recognise the reality. Of course we would like to see the Barnett Formula renegotiated. Of course we would like to see greater public funding in Northern Ireland.

143. There is a very strong case to be made to the Treasury. The British Government has to take some responsibility for the fact that it failed for so long to put adequate funding into public transport here. There may well be a case for some type of one-off grant. If that is not possible, then raising money through bond financing looks very attractive from the perspectives of value for money, flexibility — and crucially — accountability.

144. We are already experiencing exactly what Prof Glaister and his colleagues have stated, and they are not alone in saying it. The Industrial Society produced a report that expressed concerns about accountability as regards the PPP proposal for London Underground. The Transport Commissioner for London, Robert Kiley, is not happy with PPP, even though he was brought over from New York where he is well used to private-sector arrangements.

145. Part of the scepticism comes from the accountability question. There is the aspect of public scrutiny and whether the body overseeing the various contracts — ultimately the Executive — would be able to hold different companies to account.

146. We now have devolution, and people seem to welcome the idea that decision making is being opened up. We know that Members of the Legislative Asembly (MLAs) are supportive of the idea that the public should participate in decision making and that greater access to information should be provided. Nevertheless, one could argue that PPPs are going in the opposite direction by making full accountability more difficult to achieve.

147. **Mr B Bell:** We are being forced into it.

148. **Dr Fawcett:** We do not agree that one has to be forced into it. We commend the Department for Regional Development for looking so closely at the bond finance option. However, we are concerned that Treasury has clearly been very supportive of PPP and PFI arrangements. Both the Department for Regional Development and the Executive may be faced with the more political decision of whether to go along with what appears to be the Treasury's preference, or to be more innovative.

149. It comes down to what measure of devolution we actually have in Northern Ireland. If the Executive decides that bond financing is good for public transport and other areas, should it not be allowed to do as it wishes?

150. **Mr Leslie:** You advance a strident case for leasing train sets. I see the compelling argument that having spent a load of money building a new railway line, it would be silly if we could not get people to use it. The effect of leasing rolling stock, as you pointed out, is that the leasing company has got to finance and build the train sets and then provide them. If the lessor decides that it does not want them any more, subject to the terms of the lease it can give them back at any time and get different ones. What is the difference between that arrangement and PPP as regards transferring risks and financing obligations?

151. **Dr Fawcett:** PPP deals are much more complex. We are talking about a simple leasing arrangement — very much really like hiring a car. The type of PPP deal being proposed for the London Underground and in the PricewaterhouseCoopers report is much more complex.

152. We are concerned about the administration costs and monitoring that would be involved. A leasing arrangement would involve a certain amount of administration and monitoring, but it would be a much more straightforward deal. Essentially, the lessor would lease the trains for a period, and they would have to be in satisfactory condition — but that would be it.

153. The PPP arrangements looked at in the PricewaterhouseCooper's report are not fleshed out in great detail in the summary. It would appear that they are quite similar to the London Underground proposals in that a private sector provider is being asked to deal with the infrastructure, the rolling stock, and the services.

154. Where leasing is concerned, it would be a simple case of taking the trains for a certain period. Maintenance

may or may not be part of the deal. It is a simple arrangement.

155. **Mr Leslie:** The London Underground is massive and highly complicated. I am not sure just how close the parallels are to our situation. There may be some parallels but there are degrees of complication that we would never be likely to have to contemplate. We keep coming back to the same issue. If we are going to lease the train sets, why not lease the whole service? Boiled down to their component parts, that is what some forms of public private finance actually are.

156. **Dr Fawcett:** The two key differences would be complexity and responsibility. We are arguing for leasing in light of the present position of the railways and the amount of money which is being made available, because we are conscious of the danger that vital infrastructure work will not be carried out.

157. The Committee will be aware of the A D Little Review on railway safety, which found that £183 million needs to be spent — much of it on infrastructure. We are concerned that under the present proposals, vital infrastructure work is not going ahead. If the line between Derry/Londonderry and Belfast were upgraded, which Little suggested, then you could have faster journey times.

158. When the Bleach Green line is opened, journey times will be 40 minutes shorter than they are at the moment. The journey time from Derry/Londonderry to Belfast will still be 1 hour 58 minutes. We are told that, with the proper investment and upgrading of infrastructure, it could be reduced to around 1 hour 35 minutes. That would make a big difference to the number of people who might use the line.

159. There is a danger that we shall get wonderful, brand-new rolling stock but still have long journey times and delays because there are so many problems with infrastructure. We should perhaps mention that it was generally a great problem with the railways in Britain. Of course, we are witnessing the results of that at the moment, but we have also seen it in the past where British Railways tended to opt for buying new rolling stock instead of investing sufficiently in infrastructure.

160. **Mr Ellis:** Perhaps I might add another example regarding flexibility. A 30-year PFI deal on the railways would be relatively fixed, although we might be able to get out of the contract. In 30 years' time Transport 2000 would like to see a different type of railway system, perhaps a light rail system, for Belfast. The introduction of PFI to the railways would lock us in, but if we leased trains we could return them and build a different type of transport system over the 30 years. It adds flexibility to achieve efficiency.

161. **Mr Weir:** I am not sure that you are comparing like with like in comparing the London Underground with here. Accountability is important in both cases, but the complexity of the London Underground is massively different from what is suggested. The London Underground network has had to be divided into different contracts as its sheer scale could not even be contemplated by one consortium; and within each of those contracts several companies carry out the work. A great deal of infrastructure is required in Northern Ireland, but its scale would not involve anywhere near the same complexity as does the London Underground.

162. **Dr Fawcett:** It is hard to tell. You mentioned consortia with regard to the London Underground, but it is also possible that consortia would bid in Northern Ireland. There might be a great deal of subcontracting. It is very difficult, particularly as we have not had access to all the report, to see how simple or complex the options might be. However, even if it were simpler, many questions would remain unanswered about who will be responsible for what.

163. For example, if the railway line were affected by bombs or hoaxes — as has happened for many years in Northern Ireland — who would be responsible under a PPP arrangement? Who would be responsible if there were delays due to bad weather? These must all be decided in advance. If they are not there will be problems in future. If it were decided, and proper contracts were drawn up, the necessary administrative and consultative costs would grow very large.

164. **Mr Weir:** Surely subcontracting is fairly commonplace, even in traditional Government procurement of services or contracts. Indeed, it seems to have been a large part of many PPP schemes. For example, when building a school a large company may subcontract certain functions to a local builder. Does the practice necessarily create any problems?

165. **Dr Fawcett:** Not necessarily, as long as the procedures are in place. However, it is very hard to judge a PPP arrangement when not all the details have been made available and the public cannot make an informed decision.

166. In its submission to the Committee, the Department for Regional Development pointed to a few of the PPP and PFI schemes that have been in operation in Northern Ireland, and there have been problems with some of them. Of course we can learn from our mistakes, but if non-profit making trusts and bond financing are more straightforward, why not go for them?

167. **Mr Weir:** According to the Department for Regional Development about £3 billion will be required over the next 10 years for Northern Ireland's transport and water services infrastructure. One of the Department's principal reservations about PPP was that it was not sure whether PPP could cope with that scale of problem. Equally, it was unsure that a non-profit making company or bond system could raise the necessary finance.

168. You would prefer a revenue stream or revenue-based bonds funded by fares and congestion charges. Do they generate enough revenue to cover the required investment? Can PPP play a part, even as a supporting element, to investment in infrastructure?

169. **Dr Fawcett:** We are very much in favour of Government guaranteed bonds, if the Executive could persuade the Treasury to allow it. Our understanding is that the Treasury views Government guaranteed bonds as a form of borrowing; although I may be wrong. The Executive could cite the Channel Tunnel rail link as an example. It is clear that exceptions can be made. The lack of past investment in public transport is a strong case for making an exception here.

170. The Belfast to Dublin railway line generates considerable income, and we believe that if the investment were made the revenue stream would follow. There are already profitable bus routes. It is because investment has been so inadequate that public transport in Northern Ireland does not generate more revenue.

171. **Mr Ellis:** Presumably part of that £3 billion includes upgrading the water system.

172. **Mr Weir:** All infrastructure, not just transport, is in the remit of the Department for Regional Development. That includes water services.

173. **Mr Ellis:** There is a mix of revenue sources, such as the regional rate for water, which could be used. We do not expect bus passengers miraculously to find £3 billion. There would have to be a mixture of revenue sources.

174. **Dr Fawcett:** Some of the revenue could come from Government grants. We spoke of needing an annual revenue source of £100 million to generate £1·2 billion over 30 years. However, that means that we would need £10 million a year to generate £120 million and we would need £20 million a year to generate £240 million. When the revenue is reduced to those figures, it may be possible to set up such a system for public transport, but obviously the system could not rely entirely on fares.

175. The Department has looked at congestion charging in Belfast and can probably give the Committee figures showing its assessment of the income that might be generated. It would probably go some way towards the £10 million or £20 million that is needed.

176. **Mr Close:** I found your submission thought-provoking and I had some sympathy with it. There is an illusion that we would be spreading the risk to the private sector; I consider that to be nonsense. The private sector cannot lose: if things do not work out it will withdraw and the public sector will be left to carry the can. How much money can we raise from our own resources?

177. We have suffered 30 years' underinvestment and the inequities arising from the Barnett formula, and the Treasury has abdicated its responsibilities on Government bonds. Has in-depth research been carried out to show that revenue bonds are the best way of raising money? We need concrete evidence if we are to adopt them, as I fear that an inexorable drift towards PPP means that our hands will be permanently tied.

178. Why has leasing rolling stock not been considered? Why are they intent on spending the capital?

179. **Dr Fawcett:** I apologise that we do not have detailed figures today, but we can provide them. Some work has been done on the sums that could be raised from congestion charging in London and taking larger volumes of traffic into account. We have produced a figure, but I do not wish to quote it today as it might be incorrect. However, we can provide it and ask Translink and the Department for figures on the other elements. It could cover £20 million a year with such sources of revenue; it is not a huge sum by the Executive's standards.

180. Leasing has not been considered because the Treasury regards it as a form of borrowing. That seems to be the fundamental problem. We refer in our submission to PricewaterhouseCooper's advice to the Department suggesting that there might be a case for leasing, even in value for money terms. It depends on the assumptions. We do not know whether the Department took that any further; if it did not, the Committee should certainly raise the matter with it.

181. Whether dealing with public-private partnerships or with leasing, advice given to Government in the 'Public Private Partnerships Outline Business Case' depends a great deal on assumptions. We are not financial experts but we do know that altering the discount rate by even one per cent can make a tremendous difference to the calculations and to the outcome. We hope that we are not being too sceptical, but the Executive must tread very carefully before taking final decisions and should carefully consider all options rather than plump for the preferred ones.

182. **Mr Ellis:** The problem that you mention is common to PFI and bond financing; it comes down to how we pay for things. Bond financing has some advantages, and as we will have to pay for PFI anyway we face the same problem as finance through revenue. Revenue might be a cheaper and more accountable way of addressing that problem in the long term.

183. **The Chairperson:** How can the commercial confidentiality of contracts be protected while ensuring that information is open?

184. **Dr Fawcett:** We are not absolutely sure but we do believe that at the early stage of policy formation public interest should outweigh commercial confidentiality. We sent the Committee the parliamentary ombudsman's

ruling that public interest must be taken fully into account when reaching such decisions.

185. It is a fundamental problem when contracts are being drawn up, and it is difficult to know what should be done about it. It does not arise when non-profit making trusts are set up because they can —and should — be fully accountable. Value for money is very important, and we are not convinced that public-private partnerships are good value for money. However, accountability must be as important.

186. **The Chairperson:** What is the difference between bonds and PFI? What are the benefits to the Departments of bonds over PFI or PPP?

187. **Dr Fawcett:** A major difference is that they are not locked into legal contracts. A Government Department or a non-profit making trust can raise money through bonds and can use it as Translink does. We agree with Professor Stephen Glaister that it should not be assumed that public-private or private finance arrangements equate to efficiency. There are other ways of doing it. One of the benefits of bond finance is that the financial markets keep an eye on what is happening to make sure that a non-profit making trust, the railway system or the buses, is being run efficiently. If there is concern that a publicly-run transport system is not being run as efficiently as it would be in the private sector, bond finance should help.

188. **Mr Leslie:** The bond market will look at it anyway. If the private sector must borrow the money it will go to the same market. The same people will look at the same expenditure. There will be some differences, but they will not be fundamental. It will be pretty similar.

189. **Dr Fawcett:** It comes down to accountability and complexity. A non-profit making trust raising money through bond finance is a much simpler and more transparent arrangement. Why should the Executive set up a bewilderingly complex arrangement which, if things go wrong, it will have difficulty in getting out of, but from which the private sector partners can escape without too much difficulty? A much simpler system is available.

190. **Mr Ellis:** The public sector's going directly to the bond market also cuts out the private sector profit. It is better value for money, in theory at least.

191. **Mr Leslie:** Yes. However, if the public and private sectors borrow £100 million from the market and build two railway lines, the private sector may borrow at perhaps 1% more. If its projections are wrong and the railway traffic is not as profitable as it expected, the private sector would be in a great deal of trouble. What will it do? It might decide to back out of the deal and leave behind a brand new railway line.

192. **Dr Fawcett:** We are going on what Professor Stephen Glaister and his colleagues say. Under the PPP deal proposed for the London Underground the private sector would still get its operating profits. The Government would make up the difference if things turned out badly. The private sector cannot lose.

193. **Mr Leslie:** I am not talking about the London Underground.

194. **Dr Fawcett:** He was making a general point. We would not be completely opposed to a PPP arrangement, provided all our concerns were satisfied. However, our concerns have not been allayed by the summary report on Northern Ireland's public transport.

195. The public debate and the evidence which we have seen have provided more questions than answers. PPP arrangements have been considered in much greater depth by the Government at national level and in Northern Ireland than bond financing arrangements or other alternatives. Let us at least have a thorough examination.

196. We are grateful to the Committee for giving the same scrutiny to bond finance as to PPP. We hope that your report reflects that.

197. **The Chairperson:** What must be done to make PPP financing more accountable and better value for money?

198. **Dr Fawcett:** There would have to be full transparency for the initial assessments and for the public sector comparator in particular. Professor Stephen Glaister considers it important that a public sector comparator should ensure that the public sector is allowed to borrow bond finance. We may be wrong, but this does not seem to have been done with the PPP analysis in Northern Ireland.

199. It is very important that an independent body, preferably the Northern Ireland Audit Office, scrutinise any arrangements before they are put in place. You will probably find that it is wary of doing that. The National Audit Office told us that it was not happy about scrutinising the PPP proposals for the London Underground, but it recognised that it was of great concern to Londoners and to the mayor, Ken Livingstone. We believe that that is important.

200. **The Chairperson:** Thank you for your presentation and for answering our questions.

201. **Dr Fawcett:** We are honoured. Thank you.

MINUTES OF EVIDENCE

Thursday 10 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr Close
Mr Maskey
Mr Weir

Witnesses:
Mr P Gray) Department for Social Development
Mr T McKenna

202. **The Chairperson:** Thank you for coming — I am sorry for the delay.

203. **Mr Gray:** I am the business development director for the Social Security Agency, and Mr Tony McKenna is the project manager for the PPP deal that the Social Security Agency has entered into.

204. The Committee will have seen the submission sent to the Committee by the Social Development Minister. The submission makes clear that the DSD experience of PPP relates solely to the deal entered into by the SSA. The deal covers two main areas: strategic advice to the agency — which we can call for as and when we see fit; and, more importantly, operational services which at this stage of the contract covers the modernisation of disability benefits.

205. The contract is widely cast so if the modernisation of disability benefits goes well the contract may be extended to cover other aspects of the delivery of social security services. In fact, the contract is very widely cast and the agency can do almost anything involving its partner in the delivery of services. It is entirely up to the agency.

206. The SSA is totally committed to providing a better and more modern customer service. It is important that social security services are provided well, and the agency has to meet its e-business targets.

207. The SSA sought the private sector input for two reasons. The agency did not have the skills or experience in-house, and it did not have the money. Truth to tell, even if the money had been available proceeding without the necessary skills and experience would have been highly risky. It is a skills and experience issue.

208. The consortium that the SSA has contracted with has extensive experience of computer systems in its sister organisations in Great Britain. In fact, it heads up the developments in the Benefits Agency, the Employment Service and the Inland Revenue. So it is well placed to help the agency. The SSA depends on the Department of Social Security; that department operates the large payment systems which handle the payment of benefits in the UK.

209. Government policy requires the agency, in the future, to merge the job-broking functions of the Training and Employment Agency with the delivery of many social security benefits. The partnership and the experience of our partner gives us a valuable insight into the thinking in Great Britain and helps us to ensure that we are fully on top of developments there.

210. Northern Ireland is much smaller than Great Britain and is therefore able to build up working models quicker. Therefore, our partnership is giving the agency the opportunity to influence national strategy through acting as a test-bed for some important developments in Northern Ireland.

211. The value of the contract is just over £19 million, but it is extendable and that makes it more important. I do not think that any of the bidders would have come forward for £19 million. They would have wanted this to be extendable to give them a further opportunity. The project was so important that the Treasury taskforce declared it to be of national importance, and it gave support during the process of achieving the contract. However, it was difficult and expensive to negotiate. That was not an easy job. In an IT project one is seeking to transfer risk — in fact, in any PFI deal one is seeking to transfer risk. However, IT projects in particular are so inherently risky that the private sector was wary about accepting risk. The private sector examined the level of risk in minute detail before accepting that it would take responsibility. The negotiations reflected the nature of the risk allocation, and it was difficult.

212. IT contracts of this nature are developing continuously, and the contract signed by the SSA included a number of novel features that have never been seen before in Government contracts. They will benefit other public sector organisations in the development of similar contracts. The job of designing and building the new system for disability benefits is proceeding well, and we are on schedule for live running to commence in October of this year.

213. However, as we have not completed the work, we are unable to comment on the final outcome. Nevertheless, we are well qualified to comment on the process of creating the PFI deal. So far it looks good — touch wood. I will now hand over to Mr Tony McKenna who will cover what we consider the key issues.

214. **Mr McKenna:** Mr Gray pointed out that the timetable was prolonged. A two-year procurement exercise started in January 1999 and concluded in January of this year. Its main element was the construction of an invitation to tender. That is the expression of all our contract condition requirements, against which the

private sector provides an offer of services. Once we received that offer of services, we started to negotiate the terms of the contract and the nature of those services. We touched on discussions on our requirement and what was driving cost in terms of EDS's deal and its capacity to deliver.

215. That is a feature of a PPP relationship whereby we discuss what we would like. We had expectations that the private sector could be engaged and rewarded by the quality of the service that we offer. Our contract contains an annex describing our current performance levels for payments and overpayment recovery et cetera. We set targets that we would expect to achieve with the private sector's help.

216. We sought to drive a deal that would reward EDS if we achieved those new targets. That caused difficulties because our staff are processing the work, not EDS, which is only providing equipment. Therefore we had to think about the other ways EDS gets rewarded for supplying the service to us, which are commercial aspects that come out when you establish a position and imagine a deal. Through discussion and negotiation you agree the nature of services and the specific nature of requirement.

217. That was a lengthy operation. We eventually agreed a position on the contract, which included the requirement, the contract terms and the services, by November 2000. EDS put a price against that. We started to close the deal with regard to price, the full business case et cetera. That deal came into operation on 15 December 2000. However, some conditions had to be provided by 9 January 2001 before the deal became legally operational. We surmounted any difficulties and the deal is now in place.

218. I mentioned the quality issues. The deal has certain characteristics. We have provisions for benchmarking prices and performance. Cost rises are capped in accordance with the Retail Price Index. Open-book accounting is in place. We have full audit access to EDS's accounts and papers et cetera. We have a direct agreement with the sub-contractor in the event of failure on the part of the prime contractor. A whole host of features are already incorporated into the contract to help protect our position.

219. A novel feature in the contract was what is known as a verification point. Three months into the deal we formally took stock of whether or not the contract was likely to deliver the performance improvements at that cost. That exercise was conducted by 8 April and we have moved ahead on the contract.

220. **Mr Leslie:** Thank you for your detailed written submission. I need to know a bit more to understand a specific point of detail in your written submission. Page three, paragraph 10 states

> "We do not consider that value in relation to capital investment should be assessed."

You are paying £19 million over 10 years. Is that evenly spread, or is there a bit of front-end loading on it?

221. **Mr McKenna:** There is front-end loading on that. The profile of payments sees a payment of £3.9 million in February next year. It takes one year to construct the service. There is an immediate payment, but it is not quite immediate. It waits on the demonstration of service which releases £4·8 million. The monthly payments for four years are approximately £220,000 a month. Then for the last five years they drop to approximately £76,000 a month. It is profiled, but it is not an even profile.

222. **Mr Leslie:** Page three, paragraph 10 states

> "We do not consider that value in relation to capital investment should be assessed."

We are concerned about the standards of service received and the price to us of that service.

223. I can see that the price you are paying for the service is the essential determinant for you.

224. **Mr McKenna:** That is correct.

225. **Mr Leslie:** How did you compare doing it yourself to doing it this way? Did you conclude that you could not have done it yourself?

226. **Mr McKenna:** The Social Security Agency could not have done it as well. Our public sector comparator sets that out. We were not disinterested in capital but we were not particularly interested in it, because this deal is not driven by the capital that is invested in it. The total amount of investment in IT hardware and software amounts to approximately £5 million. Most of the cost is in the analysis, design, training, culture change, implementation work and the support of an IT system over the 10 years of the contract. It is largely driven by people costs.

227. **Mr Leslie:** Was the essence of it that the private sector had a developing and better expertise that you could tap into in this way that you could not have done as effectively?

228. **Mr McKenna:** Absolutely.

229. **Mr Weir:** In your submission you made reference to the idea of having a PPP unit across all areas in Northern Ireland. In dealing with this project did you deal with Partnerships UK?

230. **Mr McKenna:** Yes.

231. **Mr Weir:** First, did you have any problems getting enough attention from Partnerships UK? Why are you pushing for a PPP unit for Northern Ireland? Are there particular areas of expertise locally? What are the advantages? Is there not a danger that it would simply be duplicating what is done by Partnerships UK?

232. **Mr Gray:** It depends on the number of PPP or PFI projects that Northern Ireland would have. Our experience of Partnerships UK was very positive, but with the best will in the world they could not give us any more than one day a month, or even less. We had full-time advisors from PA Consulting. The value which Partnerships UK added was quite significant and they were very useful people to have to look at our problems.

233. The suggestion that there could be a similar organisation for Northern Ireland was based on the fact that there was not that much coming from Partnerships UK. It does not support a lot of deals in Great Britain. It only supports those declared to be of maximum importance. That is why we got support. I do not want to knock the support that we received, but it is not as much as we would have liked.

234. **Mr Weir:** If a unit was established here, does the expertise exist in Northern Ireland to provide the level of support and knowledge for that?

235. **Mr Gray:** We got support from PA Consulting, from our legal advisers and from Partnerships UK.

236. However, there was not much other support coming from within Northern Ireland because people were in a similar boat, they were all learning. Now that we have gone through the process we have a nucleus of people whom we do not want to get rid of, because that level of knowledge and expertise is very valuable. We would be happy to see other people make use of that expertise. We are also conscious that other Departments have gone through PFI deals. Between all of us we should be in a position to give good advice to other people.

237. **Mr Weir:** That is just as well from your experiences. Finally, if you had a central unit or some sort of pool which would be able to provide expertise in-house, presumably you would be able to cut down on the amount of help that would be required from consultants? Also, in your experience was there any question that a lot of money had to go to consultants for expertise on various projects, which perhaps could have been provided cheaper if the expertise had been there in-house?

238. **Mr Gray:** I think that is true. We could not have done the job without the advice that we were given. However, looking at the whole thing in retrospect, had we known then what we know now, the whole job could have been done much sooner. We could have saved many months on the job.

239. **Mr Weir:** And saved a good deal of money as well.

240. **Mr Gray:** Indeed. Consultants are expensive, so I think that there were lessons that we learned from that, and it would be sad to see it dissipate.

241. **Mr Maskey:** I am looking at the contract with Electronic Data Systems Ltd (EDS). It is over a ten year span, with the potential for an additional two or five years. I am wondering whether the reason for that was, in view of projected advances in technology, that you might want to renew the contract after that time anyway? Is there any kind of work being done to try to build capacity in-house, so that you may not need to renew a contract in 10 or 12 years, or will the technology be such that you will need to renew it anyway?

242. **Mr Gray:** One of the reasons we held up the carrot of a two or five year extension was to ensure that the quality of the service that we were getting over the whole period of ten years was consistently high. From their point of view, it is good business. If the contract was final — closing at ten years — we wondered what kind of service we might get in the last few years. Therefore we wanted to keep the option open.

243. As far as developing the in-house expertise to take on this sort of thing ourselves, I do not think that option is at all feasible. These systems are extremely complex and to create and maintain that level of expertise would be out of the question for most organisations the size of ours. Once this sort of thing goes out, it tends to stay out.

244. Back in the late 1980s we gave up on developing our own computer systems and plugged into those that were being developed in Great Britain, because we could not get the staff then. We could not get the expertise, so this problem has been about for a long time.

245. **Mr McKenna:** The duration of the deal is also linked to the business cases. Part of the problem with the idealistic approach — were you seek a single flat payment across the period of the deal — was that in this contract the total value of those payments would be very high. We had to sculpt those payments and taper them so that we paid more earlier and less later.

246. What that did, unfortunately for us, was that it pushed the time for payback out, so that the time it took for us to break even on the deal was about five years. The time that they took to break even on the deal was about three years. We needed a sufficient time after breaking even to break into profit. Those commercial aspects also affect the duration of the contract.

247. **Mr Close:** There is only one bidder, is that right?

248. **Mr Gray:** Finally, yes.

249. **Mr Close:** How can you be sure that you were getting value for money if there was no benchmark competition?

250. **Mr Gray:** When the two bidders dropped out the Treasury Taskforce, Partnerships UK and our advisors were extremely concerned that the remaining bidder would not hang us out to dry. A great deal of attention was paid to our public sector comparator, and its construction was more robust than it would otherwise

have been. We had a good comparator against which to judge what the bidders put forward.

251. We also had what we call a “should cost model.” We looked at the bidder’s solution, and we costed it ourselves to make sure that they were not bringing in unreasonable profits. We took a lot of advice on that matter, and we sat back and took time to discuss whether we should continue with one bidder. However, the protective measures that we built in were good enough to allow us to proceed. Mr McKenna mentioned points such as benchmarking as well as the opportunity for us to change our payments if the benchmark shows that alternative suppliers offer better deals.

252. **Mr Close:** Is that focused on the payment of disability benefits?

253. **Mr Gray:** Initially, yes.

254. **Mr Close:** Has benchmarking been done on how those payments are currently made up?

255. **Mr Gray:** Yes.

256. **Mr Close:** Are you referring to the payment as opposed to the processing of the benefit? Will the Social Security Agency (SSA) still do the processing?

257. **Mr Gray:** The main processing systems that calculate the payments that are to be made to our customers are handled in Great Britain. The new system will provide us with a mechanism to deal with customers locally — by telephone, post and by visiting, and through the Internet in due course. Customer handling is taking over the front end of the process. However, we will still rely on the main processing systems in Great Britain.

258. **Mr Close:** Will there be any sense that the “customer” — I hate using the jargon, but it is the local term — will feel more removed from the system? The recent public sector comparator (PSC) report on the SSA said that clerical error led to the wrong expenditure of money. Approximately £6 million or £7 million did not go on benefits for those who were entitled — that is a collective figure, and does not refer to disability. Will the new system make incorrect expenditure more or less likely from the customer’s perspective?

259. **Mr Gray:** It is considerably less likely. The targets that we have set for the administration of disability benefits in future are such that the clearance times will be greatly reduced. The service levels that we provide through telephone call and visits will be improvements on the current status. We are looking for a step change in customer service. Customers will not feel more remote from the system — it is designed to give them an infinitely better service than they are currently getting.

260. **Mr Close:** I welcome that reassurance — thank you.

261. **The Chairperson:** Will you explain what you mean when you state that

> “We do not consider that value in relation to capital investment should be assessed.”

262. Given the fact that there is only one bidder, are there ways of ensuring that we have a broader scope that is possibly along the lines of European businesses that are interested in this type of project, or that would be interested in putting a package together?

263. **Mr Gray:** This was a particular project. It appealed to a number of people at the start, but they gradually got thinned down when we went forward on our ITT with three suppliers — all three could have done the job, we had no difficulty with that.

264. However, two of them pulled out because they thought that the deal was so tightly structured that there was not a commercial deal in it for them. They did not see sufficient profit for the effort that they would have to put in. One organisation was already dealing with the Benefits Agency, the Employment Service and the Inland Revenue, so I think that the other two felt that they were not playing on a level playing field because one organisation was already so deeply involved with the agency’s sister organisations.

265. **The Chairperson:** Will that lead to a difficulty in getting bids if there is a review in 10 years?

266. **Mr Gray:** I do not think so. It is a consideration in PFI deals whether or not the deal ties you to a single supplier or a small set of suppliers. Therefore I do not think that there would be a problem getting bids in 10 years time. The way in which the IT field is moving is making it increasingly easy for suppliers to create systems of this nature. Therefore I expect that more people will be capable of handling this type of work.

267. It is also a problem for our colleagues in Great Britain, and they would like to create a market in Northern Ireland where a number of suppliers could handle that work.

268. **The Chairperson:** Would possible opportunities for other suppliers and companies to come on board infringe on the equality opportunity legislation as specified in section 75 of the Northern Ireland Act 1998?

269. **Mr Gray:** I do not think so.

270. **Mr McKenna:** The SSA looked at the impact of section 75 of the Northern Ireland Act 1998 and we do not believe that it disadvantages the suppliers. The new staffing organisation has not been worked out and we do not know what jobs will be required in the new business, so I cannot say that there will be no impact on staff or what impact there will be on staff with a disability.

271. Our service will include such features as more use of the telephone, which will require the introduction of call centre-type operations. Other features that are

related to handling post, scanning, et cetera, will be required. At present we are not clear what the particular jobs are and what impact they will have. We suspect not because we cannot envisage it, but we do not know.

272. With regard to interaction with our customers, we expect to provide a more outreach service — more visiting. That is expected to improve positively. The model for that has not been determined, and the IT assistance that will be given to visiting officers has not been determined. Therefore I cannot be completely clear on that.

273. **Mr Gray:** A full assessment will be done in due course.

274. **The Chairperson:** Thank you for attending the Committee session.

MINUTES OF EVIDENCE

Thursday 10 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr Maskey
Mr Close
Mr Weir

Witnesses:

Mr M Durkan	)	Minister of Finance and Personnel
Dr A McCormick	)	Department of Finance and Personnel
Dr J Livingstone		
Mr K Millar		
Mr B McGuigan		
Mr G McKenna		

275. **The Chairperson:** I welcome everyone here today.

276. **The Minister of Finance and Personnel (Mr Durkan):** I welcome the opportunity to put forward the Department's position on the use of public-private partnerships (PPPs). I will begin by talking about the overall policy on PPPs in public services. I will also deal with PPPs with regard to the operations of the Department of Finance and Personnel.

277. In the Budget and the Executive programme funds, we have allocated as much money as we could to the renewal of public services and to addressing the infrastructure problems that we have inherited. As the Committee and the Assembly know, the scale of the problems is daunting, and the total investment needed in coming years runs into billions of pounds. Many of the problems need urgent attention, as we are constantly reminded. The crumbling fabric of many schools, inadequate health facilities, key water and sewerage projects, public transport and problems with vital road links all require early action. There are also other areas in which we want to make new investment to help achieve our ambitious educational, social and economic goals for the benefit of all our people.

278. How can that be achieved, given that the resources are finite? If we use all the resources in the Northern Ireland block for investment in the conventional public procurement manner, we will fail to achieve our goals. Even the most pressing problems will not be overcome as early as they should be. The infrastructure deficit is a moving target. We risk falling further behind, as time goes on. It is, therefore, necessary to take advantage of every means open to us to pursue our aims.

279. The use of public-private partnerships, where appropriate, is one alternative that has been presented. It offers many possibilities and is being used throughout Europe and further afield. Potentially, PPPs offer improved value for money, high quality services and acceleration of the pace as well as the quantum of investment in public services. In other words, when used properly, PPPs can allow us to do more than would otherwise have been possible and to do it earlier, faster and — this is important — well.

280. We have been on a learning curve with PPPs in Northern Ireland. Departments have gained valuable experience in how and where to make the best use of PPPs. We have confidence that PPPs can deliver. We have also established a degree of market credibility with contractors and financial institutions. New opportunities in schools and further education colleges have been considered, and we are already building on our experience. However, there is scope for much more. I do not claim that PPPs are the panacea for all our problems, but we simply cannot afford to let such opportunities pass us by, while the rest of the world develops new and imaginative ways of delivering and supporting public services.

281. In the Programme for Government, the Executive made a commitment to examine opportunities for using PPPs. With the Office of the First Minister and the Deputy First Minister, my Department is setting up a working group to report on how to make progress. The group will require considerable expertise to identify the scope for developing the PPP approach. I also wish it to explore innovative ways of harnessing private finance to provide services, in partnership with the public sector. Obviously, it will be challenging work, and we are considering the composition of the team very carefully.

282. We look forward to this Committee's report. The Committee has shown initiative in examining the issues, and we appreciate particularly the extensive and intensive efforts that have been made to get a handle on this important concept and opportunity. We are certainly keen to hear the Committee's assessment of the issues and options, and we will be mindful of those as we take the work forward.

283. Public-private partnerships have, potentially, a direct and practical role to play in the provision of some of the key services for which the Department of Finance and Personnel has responsibility. For example, the Land Registry's landweb computer system was the first financially free-standing IT project in the PPP field. The innovative nature of that project won it the coveted prize in the IT category at the PFI awards 2000. We are also considering the use of PPP in several other major IT developments, including, for example, the next phase of the development of the public service network, which will enhance voice-call arrangements across the Northern Ireland Civil Service, and the

replacement of the Valuation and Lands Agency's VALCOM computer system, which holds rating lists for all Northern Ireland properties. The use of PPP is also one of the options under consideration in the context of the Rate Collection Agency's quinquennial review. Finally, PPP is one of the options that we will explore in the accommodation review if, in the light of the recommendations made, there is a significant investment deficit.

284. There is a strong commitment to explore fully the opportunities offered by the PFI and PPP in the specific business areas of the Department of Finance and Personnel. We could face an investment deficit of £7 million for the further development of the public service network and some £1.5 million for the VLA IT project. If, however, we were to replace and refurbish some of the poorest parts of our office estate, we could face a deficit of £70 million. We all recognise that the PPP environment is not homogenous. It must be tailored to specific circumstances, including institutional arrangements and legal frameworks. PPP is only one of a number of options that need to be considered in examining the procurement of services. Other alternatives, such as leasing or the more conventional form of public sector funding for capital projects, may be appropriate in other circumstances.

285. **The Chairperson:** What has changed? All of a sudden, public-private partnerships are seen as the way forward for procurement.

286. **Mr Durkan:** It is not that something has suddenly changed. Because of the experiences that we have had, people appreciate the value of PPPs and the contribution that they can make. There is also greater appreciation of the limitations, in certain circumstances, of PFI options. There is much more realism in everybody's approach about the value of the PPPs themselves.

287. There is also realism about the moneys that are available to us for public investment in infrastructure and key services. There are not sufficient resources in the Northern Ireland block to allow us to make the expenditure that we need to make to deliver the outcomes that we want. Public-private partnerships offer a means of marshalling resources from outside the frame of public expenditure in ways that support the principles, priorities and purposes of public expenditure.

288. **Mr Maskey:** We have heard a great deal of evidence about this matter in recent weeks. I understand that there are benefits with PPP. For example, the contractual nature of PPP at least ensures that services will be delivered and that standards will be maintained. However, whether a service is procured through public sector borrowing or through PPP, the money must be repaid. Does PPP allow the public sector to pay back over 25 years as opposed to 10 years? No matter what way it is done, it is inevitable that the budget will be tied up for the next 25 years. What is the difference in the arrangements for repayment between procurement through public sector borrowing and procurement through PPP?

289. **Mr Durkan**: We should all be clear about this, because sometimes there is confusion. People think that PPP somehow takes things out of public expenditure, but it all runs out as public expenditure. What is delivered counts as public services. We should be clear that we are talking about public expenditure and about public services. Public-private partnership does not mean that we do not have to commit public expenditure to public services; it simply enables us to undertake a greater spread of investments than would otherwise be possible. We know what the requirements are and what our ambitions are. We know that we cannot make progress on some of those ambitions if we restrict ourselves to the traditional public procurement model.

290. **Dr McCormick:** With resource budgeting, the difference between a PFI procurement model and a conventional capital model is that the latter is a direct call on a capital budget. Because of the changes under resource budgeting, the capital charge and depreciation will be a call on the resource budget. In other words, the 6% charges will have to be found from our budget, as well as the facilities management costs connected with delivering the service. Those three big components must be found. That is what makes it difficult — finding enough to commit to the services that are needed.

291. Under PFI, we have to find the service charge from public spending; that is an annual contractual cost. That cost will last for 25 years, or whatever the length of the contract is. That must be found from the resource budget. In practice, the call on the resource budget will be of the same order of magnitude, but we will go down the PFI route if value for money shows that it is a better way to go. It might represent less from the resource budget, which would make it worth doing, or it might be that, although the charge is higher, the value obtained is better. That is the benefit to the management of public spending.

292. **Mr Leslie:** You are understating the difference. There is a fundamental difference, and it applies particularly to the devolved Governments. We do not know whether we can borrow money, but let us say for the time being that we cannot. If we build a school through public-private partnership (PPP), the private sector borrows the money, and we pay them over a number of years. We have looked at some projects that never really get paid for. Quite a lot of it is paid, but the real value is in the underlying revenue contract. There may be some asset value as well. There are several ways to skin a cat.

293. Under existing procurement procedures, if we had the money, we could build ten schools a year every

year for ten years. Under PFI, we could build one hundred schools right away and pay for them over the next thirty years. Provided that all the other parts can be pulled together, we could make a quantum leap in addressing the infrastructure deficit. That is a significant change of gear, which is not available to us. The Westminster Government can borrow as much money as they want on the gilt market — they will have to borrow a lot in two or three year's time, because they do not have enough money to pay all their bills — but we do not have that facility. That advantage is not available in any other way, as far as I can see.

294. **Mr Durkan:** It is novel to be accused of understatement: understatement is better than over-statement, because you can always add to understatement. It is more difficult to retreat from overstatement. I take Mr Leslie's point. I note his enthusiasm and look forward to its being reflected in the Committee's report.

295. Notwithstanding some of the points that Mr Leslie made, there are limits to all of this, including those imposed by the sums that we have for public expenditure. There are limits on how much we can do — even with PPP — and that should be borne in mind. There are also some circumstances in which, for a number of operational and other reasons, PPP does not necessarily offer anything better than a more conventional option. I am not arguing with the thrust of the point made by Mr Leslie; I am qualifying it.

296. **Mr Weir:** There is to be a working party involving the Office of the First Minister and the Deputy First Minister. Has the remit for that group been set? Will the work be ongoing, or is the group meant to report back by a certain date? What lessons learned from experience of PPP will the Department of Finance and Personnel bring to the table in its contribution to the working group?

297. **Mr Durkan:** The Office of the First Minister and the Deputy First Minister and the Department of Finance and Personnel are engaged in setting up the working group. We have to work out its composition. There are only general terms of reference at this stage. Although the Department of Finance and Personnel and the Office of the First Minister and the Deputy First Minister are setting up the group, the subject is not of concern only to those two Departments; it will affect the work of a wide range of Departments. There must also be the right involvement with key interests and organisations outside Government. We are trying to work through those different requirements and see how we can reflect them, while keeping the exercise manageable. We do not want a Tower of Babel with everybody speaking in different tongues according to their departmental, sectoral or professional interest.

298. As the working group takes shape, we will be in a better position to issue a precise timetable. We made it clear in the Programme for Government, which was approved by the Assembly, that we wanted to do more. We recognise that there has been some difference in the effort made by Departments in relation to PFIs and PPPs. There have been different experiences, so not all the lessons that have been learned are lessons purely for the Department of Finance and Personnel or the Office of the First Minister and the Deputy First Minister. The Department of Finance and Personnel is trying to learn from the lessons and experiences of other Departments. The Committee's investigations will probably turn up some new insights for us as well.

299. **Mr Weir:** As well as playing an important role in working out the extent to which PPP projects are appropriate, the Government — the Department of Finance and Personnel in particular — have a role to play in encouraging PPPs or, at least, ensuring that structures and legislation do not act as a deterrent or an obstruction to PPP. The Confederation of British Industry was particularly concerned that business tenancies legislation was acting as a barrier — or, at least, a restraint — on PPP, to the extent that we were out of line with the rest of the UK. Has the Department any plans to consider changes to the business tenancies legislation to deal with that problem? Are any other legislative changes needed to facilitate PPP or, at least, to ensure that any obstructions are removed?

300. **Mr Durkan:** The working group is trying to identify any undue limits on what we are doing, at departmental level or at governmental level. We want to examine our own guidelines and practices and any impediments on the non-Government side. We have picked up some of those impediments, but some relate more to some projects than to others. We shall use the working group exercise as a means of getting a fix on all of them, rather than just responding anecdotally to some, without knowing fully what we should do elsewhere.

301. **Dr Livingstone:** For education projects, the Business Tenancies (Northern Ireland) Order 1996 was initially perceived as an obstacle, but, in fact, deals were constructed on the basis of licences rather than leases, particularly if land was involved. A deal made on the basis of a lease can lead to problems in later years because of the Order. The use of licences and concessions is on the increase, not just in Northern Ireland but in Great Britain as well. It is an alternative way of achieving the same end.

302. **Mr Weir:** The CBI's concern was that, although licences provided some kind of answer, it was not as satisfactory as having the legislation brought into line with the rest of the UK.

303. **Dr Livingstone:** I would not dispute that. In education, that was seen as an obstacle, but they dealt with it by using licences. An increasing number of PFI

projects involving land and property in England and Wales have started using licences, even though they do not have to, because there are some advantages to it. I agree that the Department of Finance and Personnel has a role in encouraging a review of any general legislation that may be an obstacle. Equally, Departments have a responsibility to review their own legislation, to see whether obstacles may be hidden away in the depths. A check on legal obstacles and an examination of whether they can be altered are prerequisites for PPP projects.

304. **Mr Close:** VAT is zero rated for the Department of Education's new build. Under PFI, there is a single payment, and that is a disadvantage. Is there any way round it?

305. **Dr McCormick:** It is a disadvantage, as was strongly argued by the Department for Education and Employment in England. The outcome was that additional resources were provided. That would have fed through to us in Barnett consequentials. As is so often the case with the Barnett formula, it would not have been enough proportionally, especially given the nature of our school structures. It is a bigger issue for us, and we have argued with the Treasury about it. It is in the melting pot of overall resource issues that we intend to raise with the Treasury. We see it as Exchequer- neutral, and that was the basis of the argument put forward by the Department for Education and Employment. We are persisting with that — we want to see it as part of our income — but it is hard to do it on our own.

306. **Mr Close:** What are the borrowing restrictions on the public sector? Could the Department borrow from the European Investment Bank at more advantageous rates than the private sector?

307. **Dr McCormick:** The Department of Finance and Personnel and other Departments can borrow, but there is no advantage. The money that we would borrow could not be spent without an increase in the departmental expenditure limit. We are controlled by expenditure, not by financing. The net expenditure limits what we can do. If we borrowed on our own account, we would get less from the Treasury. It would not help us. The Treasury borrows, and it gets the best rates of interest.

308. The trick in the package lies in what the private sector people do in managing and delivering the service. That produces the cost advantage, and that has to outweigh the cost disadvantage of interest rates. That is another reason why large projects tend to be better. Private sector borrowers can get lower rates of interest on the bond market. It is a complicated combination of factors that needs to come together to make it work. However, if it works, it can produce acceleration of activity.

309. **The Chairperson:** The Department has to implement New TSN. Would the Department lose control of implementing both New TSN and the equality agenda by going to the private sector? Will staffing in schools or hospitals ever be part of a PPP project?

310. **Dr McCormick:** No. The procuring Departments set the agenda, and they can say what they need and where they need it. Particular projects are managed and organised on a departmental strategy and agenda. If we handed over an entire service, the private sector would take control of the strategy. Under PFI/PPP, the agenda is set, and responsibility for professional teaching or health issues remain with the public sector. There is no intention to go beyond that.

311. **Dr Livingstone:** In case anyone is under a misapprehension, a PFI contract is not set in stone. In every PFI contract that I have seen, one of the most important chapters relates to change control or change orders. It anticipates that things will change. Twenty-five years is a long time, and the needs of the public sector will change. There is an opportunity to amend the arrangement over time in light of changes in public policy, for instance. It is not immutable and, therefore, does not hand over all control.

312. **The Chairperson:** That is the point that I raised about staffing. A company set up to provide a school with catering and cleaning services might suggest, at some stage, that they could also provide teachers. There is so much part-time teaching now. How can we control that?

313. **Dr Livingstone:** They are not contracted to provide teaching; they are contracted to provide a building, the services supporting that building, and the infrastructure. It is not part of their contract to deliver teaching, and they cannot take it over. They may, in some cases, own the building, but they do not own the school corporate. That is owned by the school management or the education authority, and those bodies will make decisions on teaching. The private contractors will have responsibility for ancillary and maintenance services — it is up to them to decide how to deliver those services — but they have no control over teaching or healthcare.

314. **Mr Close:** In the pursuit of value for money, the provision of a service often suffers. That has been demonstrably so recently, particularly with compulsory competitive tendering in local authority areas. Private contractors took over local authority parks and recreation grounds and made a hash of it. It was decided that it was too expensive to employ a park ranger, so they employed one person to cover a number of different areas.

315. I am also concerned about ownership of buildings. I have pushed the idea that dual use of facilities represents value for money. Under the local management of schools programme, we have seen how the governors of a school may prevent anyone from coming onto their property when the pupils are on holiday, because it is too much hassle to employ a caretaker to remove

chairs, for example. The same thing could happen with PPP. We must redefine the concept of value for money, to ensure that no short cuts are taken. I am concerned about that, especially as Dr Livingstone mentioned that nothing is set in stone.

316. **Dr McCormick:** The initial specification must be tight and clear and that the contract must set out the standards and limits that the Department or the procuring authority wants. A contract could give the private sector supplier the opportunity to use the building for alternative uses at different time. What matters is that the building is available and clean. Availability charging is one option, and the public sector pays only if the building is available in the specified state. Specifying such things is detailed work and translating everything into contractual detail is difficult, but it is the only way to achieve value for money.

317. **Dr Livingstone:** We need to consider what happens when the contract has been awarded. That has been overlooked for many years. Treasury guidance focused only on the procurement of the contract. We asked the Treasury why they were not focusing on how to manage the contract to get the delivery of services. The Treasury eventually published guidance last year, most of which was drafted by people from Northern Ireland. We have recognised for some time that procuring the deal and getting the contract is only the beginning. Managing the contract from the public sector side to make sure that we get what we pay for — more, if possible — is the real trick.

318. **Mr Close:** Could we see a copy of the guidance?

319. **Dr Livingstone:** Yes.

320. **Dr McCormick:** When Jim says, “People from Northern Ireland”, he is being modest.

321. **Mr Leslie:** During the inquiry, we have become familiar with the fact that it takes a long time to set up the contract. It is expensive to set up, and both sides complain. However, it is evident that it is becoming less of a problem. Expertise has been developed, and lessons have been learned and passed around. I note your comments about the work that you are doing with the Economic Policy Unit. However, Northern Ireland will have problems of scale, even with the improvements due to the development of expertise on both sides. Is it appropriate for each Department to develop a pool of expertise for putting the contracts together? Should we have a central squad that would bring in the appropriate expertise? There is Department-specific expertise in areas such as education or healthcare, but it seems that many aspects of contracting would be fairly similar in all fields. The most sensible thing would be to keep together the people who will develop the experience.

322. **Dr McCormick:** We have not yet found the right balance. There is a need for a degree of centralisation, but in some respects it will help for each Department to deal with the aspects. So much work will be conditioned by legislation. Departments will need to work within the legislation and develop expertise in that context, as well as learning from experience of similar work in the South or in Great Britain. We need to find a balance. We are gearing up, which is why Dr Livingstone joined our team recently, but we should not ignore the need for Departments to have the facility themselves. The sum of £2 million a year has been set aside in the service modernisation category of the Executive programme funds. That is there to pump-prime this work, and will need to be shared appropriately between the centre and the Departments.

323. **Mr Maskey:** Mr Leslie said that the private sector borrows the money, but the public sector still has to repay that. I am not knocking PPP; there are many valuable lessons to be learned from it. We visited a school last week where the vice-principal, who had been the facilities manager, was now liaising with someone else who was the facilities manager. I wonder how much time is taken from people who are supposed to be delivering education rather than looking after the building.

324. Contracts will be different and are supposed to be based on public sector comparators. At the end of 25 years — if that is the contract period — will the public sector have paid more or less?

325. **Dr McCormick:** That will vary case by case.

326. **Mr Maskey:** There is a ceiling on capacity. We might accelerate projects, but we will still reach the point beyond which we cannot go. If the money is tied up for 25 years, will we pay substantially more?

327. **Dr McCormick:** That is a central question. We are not repaying the private sector’s borrowing; we pay them for what they deliver. That will include money that they use to repay their borrowing, but the key thing is what we get for our money. If there is dual use, the proportion paid by the public sector may end up quite a lot lower than if it was delivered by the public sector alone. If there were a separate revenue stream created through a charge — road tolls, for example — public expenditure would be lower. Those permutations can be explored. The point of using a public sector comparator or a competitive process is to get value for money and choose the best of the choices available on the basis of a rigorous economic appraisal.

328. **Dr Livingstone:** It is an important point and goes back to what the Minister said. PPP is not a panacea for all our problems. There is a price; it is not free. There is still a limit on how much we can do through PPP, but we can still do more by PPP than we can by conventional means.

329. **The Chairperson:** What gaps does the Department see in the overall scheme and how would those gaps be

filled? The representatives from the Confederation of British Industry (CBI) said that having different businesses and contractors involved in the deal can create gaps and inconsistencies.

330. **Dr McCormick:** I am not certain of the nature of those gaps. Each Department should be geared up to manage the procurement process and the contract management. Those issues should be explored by the Department of Finance and Personnel and individual Departments.

331. **Dr Livingstone:** The banks like to know what projects the Department will announce this year and how many will be announced next year and the year after. That allows them to make preparations, and they know that it is worthwhile taking the risk. That is the approach that the Minister of Education, Mr McGuinness, is taking. The private sector has been given a signal that the projects for this year will be followed by projects next year and the year after, without our actually putting a quantum on it.

332. It is a question of balancing Departments' commitment to projects in year two and year three. It is not easy to commit that far ahead, because priorities can change, even in a year. We should help the private sector to gear up, so that it can do business with us.

333. **The Chairperson:** The smaller contractors may not be able to take advantage of the present procurement because of the size of the projects, but, if there were a continuous flow, it would be easier to build up that expertise.

334. Thank you for answering our questions. It was helpful.

MINUTES OF EVIDENCE

Thursday 17 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Ms Lewsley
Mr Weir

Witnesses:

Mr Peter Fanning,	)
Chief Executive	) 4Ps – Public Private
Mr Rob Hann,	) Partnerships Programme
Executive	)

335. **The Chairperson:** Good morning, gentlemen. Thank you for joining us. Will you make your presentation, and then we will begin our questions.

336. **Mr Fanning:** I am the chief executive of the 4Ps, a company owned by the Local Government Association, and set up by local government in England and Wales to support local authorities in developing and delivering public-private partnerships (PPPs). Most of our resources are committed to supporting local authorities' work on the private finance initiative (PFI) programme.

337. Local authorities in England using the PFI approach have procured various projects. All these projects are operational; that means that you can go and touch, see or feel something that has been procured using this approach.

338. In Manchester, there are five tower blocks with heating systems which were procured through the PFI. There is a similar system in Tower Hamlets in east London, close to my home. If you walk the streets of Brent in north London, you will see street-lighting columns which were procured using the PFI approach. Waste management systems have also been procured as have a whole group of secondary schools such as Colfox Secondary School in Dorset, and secondary schools in Enfield and Portsmouth. Some small schools have also been procured, for instance a primary school in Kingston upon Hull, which is in the Deputy Prime Minister's own constituency. I would also draw your attention to the Lewisham schools catering project, a rather grand title. Some say that following the PFI transaction truancy rates in Lewisham have fallen as the quality of the food has increased. I have no opinion on that, I can only report what is alleged. Some of the rumours have come from the contractors involved in that project.

339. If a police helicopter in Wiltshire has chased you, the chances are that it would be the helicopter that was procured using a PFI approach. If you were a police horse in Northumbria, you would be looked after in what is rather coyly called a "mounted police facility". In plain English that means a stable.

340. There are around 30 projects in operation, with approximately 150 at some stage of procurement. Of those, about 60 are signed and 30 are operational. The significance of that is that we have moved from evangelising about this way of buying public-sector services and assets to a position where policy can be developed and members can draw conclusions based on the experience of real people using these procured services. Whatever course of action you choose as a result of this inquiry, you should take the opportunity to examine some of the projects, see them in operation and talk to those who are experiencing the work being done.

341. The programme is big in England with £7 billion of Government resources allocated to the PFI programme. That is £7 billion capital equivalent to March 2004.

342. I have not explained what PFI is. You might come away with the thought that you should look at the evidence yourselves rather than examining the theory. PFI is not about finance, which is a secondary issue; it is about buying things, and how one goes about buying a school, a road, or a stable for the horses.

343. An example of the procurement approach is that the rules say that a local authority in England does not have to start paying for the service until the service is delivered. For example, a local authority does not have to put one penny towards a school until the school is available for use by the governors, who are the legal guardians of that school.

344. This means of buying assets enables the local authority to manage the risks of that procurement in a different way, which is not necessarily a better way. For example, if during a spell of bad weather something goes wrong with the heating pipes in that school, who is responsible for sorting that out? In the case of a PFI-procured school, it is the contractor's problem. The contractor will not receive his money under the service payment until the piping is sorted out. The local authority can transfer the risk of, for example, the effects of severe weather. That means that the local authority can focus on what is important, the "outcomes", to use the jargon, which it wants to achieve. Generally speaking, those who want to procure schools are not interested in pipework. Their chief interest is in the school being available for the education of children. The local authority can focus on that without having to worry about how the school is heated or maintained.

345. Another very positive consequence of the PFI approach is that it forces the participants in a transaction, the sellers and the buyers, to look to the long term. The

contractor gets a stream of income and payments over the long term if the school is available. However, he must ensure that the school is available over that period. He must make decisions about investing in the right materials and design to ensure that the school is available over the long term, because if it is not, he will suffer financially.

346. On the other side, the local authority must pay the contractor if the school is available as set out in the contract. That means that local government can no longer build a school without having to worry about its maintenance. The first budget to suffer cuts is the long-term cyclical maintenance budget. It is very difficult to make these cuts if one buys services or assets through PFI. One is locked into long-term contracts, which is good in one sense. However, they can pose problems of flexibility. The Committee should weigh those considerations before it takes a decision to buy in this way.

347. We are involved in working with the private sector in other ways, not just through PFI. I will give you examples of two joint ventures. Two local authorities wanted a private sector partner to provide corporate services such as information technology, treasury services — money in, money out of the authority — and their human resources management, for example, arranging temporary staff for the local authority.

348. Both authorities wanted a private sector partner to help them in this way. The key feature in both projects from a management point of view was strong leadership from both sides; strong political leadership as well as strong managerial leadership. Both were pioneering projects; neither had been involved in this before — there was no manual to consult. Another key feature was that the local authorities focus very much on choosing somebody with whom they wanted to work, someone whom they considered to be a "soul match", rather than a very big company which could supply them with the services they wanted at the best price.

349. The first example is the partnership between Lincolnshire County Council in the East Midlands and Hyder Business Services. The project is in operation; it was procured by a Conservative council which chose to work with Hyder, a Welsh utilities company. Hyder has since been taken over by a Japanese company, although that is bye the bye. The contract, it is claimed, is saving about £5 million per year for the local authority, which it is diverting into frontline services. The contract is for 10 years and was procured through a design, build, finance and operate (DBFO) contract, which is another way of saying a PFI contract. If someone talks of PFI he means a way of buying things by which the local contractor designs, builds, finances and operates the underlying services.

350. A key feature of the Lincolnshire contract was that the staff were transferred under the Transfer of Undertakings (Protection of Employment) Regulations 1981(TUPE) and are now employees of the business centre which is owned by Hyder Business Services. A similar contract, signed a few months ago, is in operation in Liverpool City Council. We rang the council on the day the contract was signed and we could hear the champagne corks popping in the background.

351. The Liberal Democrat council chose to work with British Telecom (BT). The council made significant savings, about the same as Lincolnshire County Council. However, it adopted a different approach. Instead of a DBFO/PFI contract it set up a jointly owned company with BT. BT owns about 60% of the company and Liverpool City Council owns the remaining 40%. We can send the Committee the details if you wish.

352. The local authority will provide a series of subcontracts to the jointly owned company for 10 years — it is a similar 10-year transaction. A key feature of this one is that the staff is being seconded to BT from the city council rather than transferring. That is the rule — the employer does not change. If, for whatever reason, things do not work out, the staff can return to Liverpool City Council.

353. **Mr Leslie:** What does it do?

354. **Mr Fanning:** It provides the same sorts of services as I mentioned earlier — IT, treasury, human resources and call centres.

355. I must mention that jargon pervades this area. Perhaps the most difficult piece of jargon is "partnership". Sometimes it is used as a legal form, such as the legal arrangements that bind together groups of professionals — for example, lawyers and accountants. Sometimes it is used as a management style, as in the cases of Liverpool and Lincolnshire, where there is interdependence between the local authority and the contractor — for services and income respectively. Other times it refers to a different political viewpoint. Some political parties tend to use the word "partnership" more than others.

356. When you are dealing with large and complex capital projects, which is often the case in this area, precision of language is very helpful, if not important, to ensure that you know what you are signing up for. I counsel you to ask people what they mean if they start talking about partnership. It is a loaded word.

357. I will give some background about the 4Ps. It is a company owned by local government. We are essentially public servants, and 90% of the income that I am responsible for comes by way of grant. We operate as a consultancy. We do three things for local authorities. First, we work on projects. If you were to come to my offices now, no one would be there — the staff are all out working on projects with local authorities. They spend most of their time at the grass roots. Secondly,

the staff gain a lot of experience, and we are able to harness that into what we call "know-how" — contract documentation or formal guidance. For example, two people could be working on school projects. That work enables them to take a leading role in the development of standard contracts for buying schools. Local authorities on the second and third wave of such contracts are able to pull a contract off the Internet that can be the base of a transaction, rather than spend a lot of money on lawyers to reinvent the wheel.

358. Thirdly, the work on projects and know-how gives us influence and leverage with the Government and the private sector. We are on the committee that allocates £7 billion to individual projects. We do not vote at the committee, but we are the only representatives of local government who sit inside the system which allocates the money to individual projects. We therefore have some influence over that system, and it is a very valuable service to local authorities.

359. I will draw out some lessons from our experience on this. The first is that money moves things. Many people will claim responsibility for the success of PFI and PPPs in local government. There are about 160 transactions in procurement. However, it is important to recognise that the reason why people were initially enthusiastic about PFI in local government, and, to a certain extent, why there is still momentum, is that there is a big pot of £7 billion that local authorities can get their hands on. We help them to access that £7 billion and make sure that they spend it wisely. That is the core of our job. In policy terms, if you want to make the programme work, you have to have money behind it. That is a clear message worthy of repetition.

360. Another point, which cannot be stressed enough, is that it is critical to develop a flow of transactions. Unless there are a number of transactions in the procurement at any time, the private sector, for example, will lose interest. Equally, however, local authorities will never gain the experience that will enable them to deliver such transactions cheaply and efficiently. Indeed, members will not gain the experience to know to ask the right questions and scrutinise, evaluate and manage the public responsibilities in the procurement process. One of the key things public policy-makers can do, therefore, is maintain a flow of transactions. If that is done, many other things people talk about, such as training and capacity building, will happen anyway. However, if you have no deal flow, it becomes very difficult to keep the process going on its own.

361. The other issue concerns the certainty of the process. It is not enough to have large quantities of money allocated to the projects; you must have an allocation process. We say to Ministers that if they tell local authorities what they want, those authorities are more likely to offer projects that meet Ministers' requirements. That clarity in the process is very useful in making the whole system work effectively.

362. Individual projects need not just management, but leadership. By that I mean projects which tend to go wrong often have a similar theme running through them. It is often the case that a project goes wrong because politicians are anxious about it and are not providing enough support you need. Then the chief executives start to lose interest, and the poor fellow somewhere down in the bowels of the finance department responsible for developing the project has no support.

363. If the project is to be effective and deliver services to the community, it needs direct support from the leadership of the public body doing the buying; I cannot stress that enough. The other thing not being done enough, though we are trying to improve things, is helping local authorities at the early stages of procurement to learn from the experiences of the more advanced.

364. Local authorities and other public bodies can benefit from a simple, independent peer reviewer coming in from outside. He will ask if they are sure that they are doing it right, suggest alternative models and so on. There is a great deal of value in the public sector learning from its own experience, something it does not necessarily do as well as it might. We should certainly say in no uncertain terms that in setting up a system it is extremely helpful to get some sort of regular independent peer review of projects, both at member and officer level.

365. Finally, I shall give you my address and contact details should you wish to pursue today's theme either individually or collectively.

366. **The Chairperson:** We shall be swift in our questions, taking one each.

367. **Mr Leslie:** It would be much easier for us to carry out this inquiry in 10 years, when we could draw very robust conclusions, because we would have 10 years' experience to draw on rather than two or three. There is, I suppose, a certain amount of what one might term "optimistic guessing" going on in regard to how well certain things are going to work out. What are your main areas of concern? How do you see that things might not work out as well as expected?

368. **Mr Fanning:** You must draw breath if you are going to do an extremely large project. There is a trade-off between value for money and flexibility. For example, if you did a project covering all the schools in a particular area, you would find that it generates very considerable financial benefits compared with alternative forms of procurement. However, if anything went wrong with that contract, you would have just one supplier to deal with. Clearly it is a decision for members, but I believe that means that someone must

balance the financial benefits against the limitations on future flexibility.

369. There is also a counter-argument that you can have a great deal of leverage over a strong partner who is dependent on you. Nevertheless, the bigger the project, the greater the need for clear and well-informed discussion and decision making. I am not suggesting that you should not do this, but you need to think very hard before making a decision.

370. We need to ensure that there is investment in the monitoring arrangements for these projects. That needs to be carefully thought through. It is crazy to spend hundreds of thousands of pounds on buying a school — a large secondary school costs £20 million — but then spend little or nothing on monitoring the project's effectiveness and if the contractor is meeting its obligations in five, 10 or 15 years' time. That is a clear risk, therefore we should not put all our eggs in one basket.

371. PFI accounts for 20% of local government capital expenditure. I do not want to put a figure on it, but the more you invest in this approach, the greater the risk that you will become dependent on it and that you will not have enough information to make informed decisions, which is the best guide to getting it right.

372. **Mr Leslie:** You mention that at the moment 20% of local government expenditure is in PFI. Do you think there is a notional or practical limit?

373. **Mr Fanning:** There are limits, including the capacity of the industry and the public sector to absorb a programme of that size, as well as the appetite of the public to fund it.

374. I do not wish to propose a figure, I will simply make the observation that the more you embrace one programme, the more confident you have to be that it is the right one. You therefore have to put more effort into analysing the projects that are coming through, and there are already many projects in operation. However, not enough is known about whether they work well or not, because there is not enough research, and my team and I intend to do something about that.

375. **Mr Weir:** You said that your group advises on which projects should be given the green light. Large Government Departments have the expertise to analyse the public sector comparator in a reasonably calculated way, but is there central provision for local government to be able to do this. The level of expertise needed to do this might not exist at local government level.

376. Many projects that fall within the remit of local government in England would, if they were operating in Northern Ireland, come under the control of the devolved institution. Are there any areas that would be particularly suitable as PPP schemes within the remit of local government, or others which you could identify as being unsuitable.

377. **Mr Fanning:** I would challenge the argument that skills exist at the centre, but not in local government. A large metropolitan council, such as Manchester or Birmingham, has chief officers with high expertise who run large organisations. Birmingham Metropolitan Council has a turnover of £2 billion to £3 billion per year and it looks after one million people.

378. **Mr Weir:** You could consider the applicability of a much smaller council, which could be more closely compared to the devolved institution in Northern Ireland, and whose budget would be much smaller. Local government in Northern Ireland operates on a much smaller budget than large metropolitan councils in England.

379. **Mr Fanning:** I agree, and it is therefore useful to have a support system. My team's job is to turn up at the local authorities to provide direct support. We publish a great deal of information that can be accessed on the Internet at no cost. There is a good deal of information out there.

380. If you decide to develop a programme in Northern Ireland I suggest you create a central resource like the 4Ps, if only to show people where to go for the information that already exists, as opposed to providing direct and active support.

381. In response to your question on what things you should and should not do, the jury is still out. Almost every local authority service that involves physical assets has been the subject of a PFI contract. I would rather distinguish between good contracts and bad contracts than between services that are appropriate for this and services that are not. In England, 80% of the social services budget for residential care is spent in the private sector. The soft services — the ones that involve a very high level of direct contact with the public — are already being provided by the private sector.

382. **Mr B Bell:** We have heard both sides of the story this morning. The academics were very sceptical about this. They seemed to be saying that, in fact, certain projects are more suitable than others. For example, the building of a hospital, which has to be managed for 30 years, is a different animal from the building of a road or a railway. Have you any comment on that? The hospital would be dealt with as a package, whereas the other projects would not require the same level of management by the partnership.

383. **Mr Fanning:** That is a very perceptive question. Anything involving people is harder, and a hospital involves a lot of people. About 60% of the cost of providing a hospital is to do with —

384. **Mr B Bell:** That is the point that I am making.

385. **Mr Fanning:** The conclusion that I would draw is that it is much harder to deliver a hospital or school than a road. The jury is still out as to whether one is better than the other. The issues are more to do with the quality of management, both of the contracts by the public sector and of the projects by the private sector, than with complex modelling or legal arrangements. The quality of the way in which people are managed, on both sides of the divide, is what will determine whether these things are successful or not.

386. **Ms Lewsley:** You talked about one project under which staff were transferred from one sector to the other, and another in which they were seconded. The worry about secondment is continuity. If the staff do not like it, they have the flexibility to move. Do you find that that is a problem?

387. In Northern Ireland, ancillary hospital staff and hotel staff are already privatised. What would be the benefit of PFI over traditional procurement for ancillary services?

388. **Mr Fanning:** To answer your first question, the reasons why Liverpool City Council took a different route to Lincolnshire County Council were partly to do with members' choices. Also, the situation in Liverpool was different because there are very significant staff changes happening in Liverpool City Council at the moment. The risk of taking staff back, therefore, was lower than the same risk would be in Lincolnshire. It is horses for courses. Anyone who tells you that they have the answer to everything is probably trying to sell you a pup. There are lots of ways of doing things, and it is the quality of the management and the underlying quality of the transaction that matters.

389. On the issue of ancillary staff, without an example of a specific transaction, there is a danger of becoming too involved in theory. Larger companies can provide better services, better conditions, better training and more investment in staff than, for example, an individual hospital can. My background is in the private sector, and I have found that big private companies value their staff highly. If a large company is providing cleaning services to a hospital it will do so to the best of its ability. The company will be good at it because that will be all that it does. It may provide cleaning services not just for the hospital but for organisations all over the country — perhaps all over the world. It is that expertise which generates value.

390. One must pay close attention to the details of the transaction. One must be pragmatic rather than dogmatic in analysing each case to decide its merits or otherwise. I cannot stress enough the importance of management in determining success or failure.

391. **The Chairperson:** We must finish there. Thank you for your interesting and informative presentation.

392. **Mr Fanning:** It was a pleasure. Good luck to you all in the elections.

MINUTES OF EVIDENCE

Thursday 17 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Ms Lewsley
Mr Weir

Witnesses:
Mr P Airey) National Audit Office
Mr J Colman
Mr D Finlay
Mr H Revill

393. **The Chairperson:** If you would make a short introduction, we will then have some questions.

394. **Mr Colman:** I am Jeremy Colman, I have been in charge of the National Audit Office's (NAO) work on private finance initiative (PFI) and public-private partnerships (PPP), since it began about six years ago. David Finlay is the head of PFI development at the NAO, Philip Airey is audit manager, and Howard Revill is principal auditor. We are all long-standing members of the NAO's PFI/ PPP team.

395. There are three important points: our credentials, our general attitude towards PPP and the principal risks to value for money in PPP. Our credentials are that we have been in the business of looking at PFI and PPP deals for many years. We have published over 20 reports, usually produced by a small core team, which gives us a great deal of expertise in the subject. We are a completely independent body, and we have no axes to grind. We are not in favour or against PPP — we report as we find on value for money of individual projects.

396. Our general attitude towards PPP is that each case should be explored individually. The PPP approach has the potential to deliver superior value for money to conventional procurement. For that potential to be realised, however, many things must be right. The deals are long-term and they need to be fitted into the procuring authority's long-term strategy. Likewise, the success of the deals depends on innovation. Innovation can be achieved by widening the field of people who are given the opportunity to bid, so fully competitive procurement is essential. In our experience, that point often proves difficult. A successful competition should produce the right winner. That does not necessarily mean the bidder offering the cheapest price or the one taking on most risk — I would counsel against that. The deal must make sense, be consistent with the long-term strategy and have a sensible price.

397. What are the risks to value for money? Failure to observe any of those four principles is a big risk. There is a valid value-for-money case for pursuing the PPP approach. However, there may be unworthy motives for pursuing it on the part of a particular authority. There is an element of "buy now, pay later" in the PPP approach, which is not necessarily bad, but we all know from personal experience that the excitement of buying now can dull the mind to the price to be paid later. There is a clear risk of paying too much.

398. A careful financial analysis is necessary to ensure that the deal makes sense. However, we have discovered that financial analysis can have errors in it. There is a risk of producing an elaborate, highly complex financial analysis with answers that look more robust than they really are. You find people taking decisions on a narrow financial margin emerging from this sort of calculation. By narrow I mean, for example, £100,000 out of a total of £700 million. I am not making those numbers up — they are from a real case.

399. Treating that financial analysis as a pass or fail test risks poor decisions. Wise decisions on PPP depend upon a thorough understanding of how the PPP approach will give something different to the conventional approach. That might be different and better, or different and worse, but you must thoroughly understand what the differences are and what drives them.

400. **Mr B Bell:** I am Chairperson of the Public Accounts Committee in the Northern Ireland Assembly; therefore, I understand, to some extent, where you are coming from in the National Audit Office. I am interested in your article and report, and I am impressed that the NAO has published over 20 reports on PPPs in less than four years.

401. Our problem in Northern Ireland, and the reason that we are here, is that we now operate our own budget. We have discovered that, for 30 years, we have been underfunded in capital investment across the board. When dealing with the different projects did the NAO find that lessons were learnt from the reports that it made?

402. **Mr Colman:** That is something that we look at carefully. The whole purpose of our existence is that people should draw lessons from our reports, and we try to change the way that people behave. We know that behaviour has changed. The Treasury, with whom we discuss these matters, accepts and agrees that our reports have influenced behaviour.

403. The NAO has had a large impact on the use of public sector comparators — the financial analysis to which I referred. It is not always done well, but at least it is done. In the early years deals were done without any proper financial analysis of what the alternative was. The NAO has changed the behaviour there. Its next objective is to try to get people to focus on

understanding the strengths and weaknesses of the financial analyses.

404. The NAO has also had a big impact on peoples' understanding of the role of competition. Good competition is essential but you must look at the whole life cost — it is not simply a matter of the price that is offered at the start. Generally the NAO has an influence because it is continually asked by Government Departments to advise them on what they are currently doing. We speak at a lot of conferences, conveying a message along the same lines as I have spoken to you this morning. They are not complicated messages but they must be pointed out to people.

405. **Mr B Bell:** The fact that the NAO has written 20 reports on PPP would indicate that there is huge experience in the mainland with PFI and PPP. It would show that there is quite a lot of experience among Departments, whereas Northern Ireland is only at the beginning. Have you found that the most recent projects that you have been involved in show a better and more sophisticated use of PFI than some of the earlier projects such as the Skye bridge?

406. **Mr Colman:** I wish I could say that the general standard is much higher than it was when we started but that is not true. In some cases the standard is distinctly higher. We are just about to examine a big deal called "Steps", carried out by the Inland Revenue and involving their property. Without prejudice to the future examination, that deal has learnt enormously from earlier property deals. The people running that deal were very determined to learn lessons.

407. Government Departments tend to put the civil servant who happens to sit at the relevant desk in charge of these projects, rather than the civil servant with previous experience. My strong advice to anyone starting on this road is to find someone with experience and put them in your team somewhere. One person would suffice.

408. This is also a lesson that applied to privatisation. I have been working in the field of privatisation and PFI/PPP for nearly 17 years, and it is very disheartening to see people making the same mistakes that I made 17 years ago. It is very important to learn from previous cases. It is also very important to have someone on your team with experience of previous cases.

409. **Mr Finlay:** While it is undoubtedly true that errors are still occurring on current deals, there is an aspect where current deals should be helped and there is now a lot more central guidance available. This is guidance from the Treasury and also from individual Departments. A lot of that guidance has been developed to take on board the lessons that came out of our earlier reports. We are quite closely involved with Treasury and Departments in the development of such guidance. Mr Colman was right in saying that people have to look now at what experience is available. They need to speak to advisers who have been through deals and use the guidance that is now available. That picks up on a lot of the messages in our earlier reports.

410. **Mr B Bell:** John Dowdall, the Comptroller and Auditor General, intends to cross-reference your reports as we develop along this road in Northern Ireland. Departments in Northern Ireland should constantly refer to your reports to learn lessons, so that the mistakes that have happened in England will not happen in Northern Ireland. However, the difference is that we cannot afford to make mistakes as we have a fixed budget.

411. **Mr Colman:** I agree. One of our main functions is to promote beneficial change in the provision of public services. That is not just in the central government of the United Kingdom. We have frequent contact with our colleagues in other audit offices in the United Kingdom. That includes the Northern Ireland Audit Office and the Auditors General for Wales and Scotland. We are very happy to talk informally to people any time. We spend quite a lot of time talking to people from Government Departments and other bodies from all around the world.

412. **Mr Weir:** There is now a degree of central guidance, which should help with the deals. With regard to the public-sector comparator, you said that careful financial analysis is vital for deciding whether to go ahead with a project and for getting the project right. What is the level of central guidance for making the public sector comparator? There would be a terrible mess if projects such as this went wrong. Are Departments learning from experience? Is there a support mechanism that provides expert financial advice?

413. **Mr Colman:** This area is a work in progress. The existing guidance is comprehensive and highly technical. Some of the people who use it do not understand it, and that is a problem. In the PFI and PPP world there is a well-established practice for how public-sector comparators are done. Last year we looked at the financial analysis for the London Underground project and we now have very grave doubts about the established practice.

414. We think that there is a danger that, because the work is seen as technical, it is delegated to technical experts. However, people who are not technical experts interpret the results of the work. Therefore, there is a risk that false conclusions will be drawn from the data. In the case of the London Underground, for example, we noted the inherent uncertainties of the situation. You have to forecast the costs of projects and propose two alternative ways of doing the same project over 30 years. Those forecasts are hugely uncertain and there a is clear limit to how accurately it is worth doing the arithmetic because of those inherent uncertainties.

415. We also found the methods used in the financial analysis brought their own difficulties. No one was

ever sacked for employing the financial advisers working on the London Underground case. However, despite even their efforts, the robustness of the figures that emerged from the analysis left a lot to be desired. Therefore, we said that it would be unwise to make a decision based solely on the financial analysis. A lot more work needed to be done.

416. **Mr Weir:** A previous witness expressed a lot of concern about how much the costs would escalate from the time that the project was envisaged to the time that it was completed. That would be a particular concern in the Health Service where costs have sometimes doubled, tripled and quadrupled during that time. I was not sure that what we were told was an example of comparing like with like. What is your experience, as an auditor, of that problem in the Health Service?

417. **Mr Colman:** I will ask Mr Finlay and Mr Revill, who worked on the one hospital report that we have done, to comment on specific Health Service aspects. You are correct to question whether like is being compared with like. Cost escalation is, by definition, an uncertain issue because you are dealing with changes to a forecast of a future cost over 30 years at different stages in the maturity of the project. It would be very surprising if the figures did not change.

418. The changes I worry about are the changes in cost after a preferred bidder has been selected, but before the contract is signed. Those changes take place without any competitive tension and there is a very clear risk to value for money in such circumstances. Changes while the project is still being bid for are much more explicable. It is reasonable for the authority to change its mind about what it wants while it is still asking people to bid for it. Once the bids have come in, in my view it is very dangerous for the authority to change its mind on anything. Maybe one of the advantages of the PPP approach is that it makes it rather more difficult for authorities to change their mind than with conventional procurement.

419. **Mr Leslie:** I would have thought that would be to your disadvantage.

420. **Mr Colman:** It is an advantage. The client in conventional construction contracts, particularly the public sector client, is notoriously changeable, and changes are made to the basic design throughout the process, including the construction process, and that has a very heavy cost.

421. With the PPP approach, it is much harder for the authorities to change their mind once the contract is signed. We have some evidence — and we are going to do a more detailed study on it — that construction times under PFI deals are dramatically shortened by comparison with conventional projects. That the authority is inhibited from changing its mind may be a factor.

422. **Mr Finlay:** We have looked formally at one hospital project, which was the first hospital contract to be let under the PFI — Dartford and Gravesham. The comments we make specifically relate to that project, not about PFI and the NHS as a whole. On that particular project, there was a certain amount of cost escalation after the preferred bid was selected, but the NHS took steps to try and benchmark whether that was reasonable.

423. Another general issue that came up is that the trust which let the contract — these PFI contracts are let by individual trusts — found that the total costs arising under the new contract were more than they initially anticipated. In fact, that is a failure about estimating the cost of any hospital procurement, not an issue about using PFI. Clearly, bringing on board any new hospital, by whatever form of procurement, is going to involve a lot of cost.

424. What we found in terms of the value for money for that particular deal was that it was fairly marginal. There was a small prediction of savings from using a PFI, but it was fairly marginal. Overall, there were cases for using it. The final outcome was that the hospital was opened about six months ago and there has not been any variation to the cost since the contract was let. The hospital was opened to a very quick timetable — much faster than could have been achieved under the traditional procurement.

425. **Mr Revill:** Before being involved in the PFI, I was involved in looking at traditionally procured publicly financed construction projects. One I looked at was the Chelsea and Westminster Hospital, where the cost had seemed to double from £100 million to £200 million. It was simply because that initial cost estimate of £100 million was not prepared on the same basis as the £200 million. You get the same sort of claim cost escalations on publicly financed projects, where the whole of the cost escalation can be explained quite simply, and the project has not gone out of control at all.

426. **The Chairperson:** One trust seemed to be going for one contract for the hospital build and a second contract for equipment — making it look as though the cost is less. However, when the total package is put together it may be more than traditional procurement. Have you found that type of situation, where contracts have been broken up to give two different procurement methods?

427. **Mr Finlay:** I can only comment on the one that we looked at, where the private sector was being asked to design the hospital, build it, include certain equipment and then manage it and provide facilities management. That was the package that was being provided in that case.

428. **Mr Leslie:** You made some interesting comments about the criteria used for picking the contractor and

the idea of not taking too financial an approach to the decision. You implied that quite a lot of judgement would ultimately be involved there. Allow me to narrow this down. Our scale of operation is very small, compared to what you are looking at. We have questioned some people who have gone through the process of building schools. When we asked them how they attributed a value to getting out of maintenance responsibilities so that teaching staff can concentrate on teaching, they became a bit shifty — as well they might. Perhaps most interesting of all for us, therefore, was our visit to Dublin. There, the Department of Education regarded getting rid of the headache of maintenance as so valuable that they felt they almost did not need to put a price on it. All things equal they had the money to build it with public procurement. However, they were so taken with the reallocation of teaching resources exclusively to teaching that they wanted to do it the other way.

429. How do you feel about that? Do you think that that is a fair approach and that it is rather a difficult thing to put a price on? The trouble is that I got the impression that you could tweak the public sector comparator sufficiently to make sure you got the right answer, because that was rather an arbitrary price.

430. **Mr Colman:** You are quite right to say that there is a lot of subjective judgement in choosing between these two approaches. A few minutes ago I told you that I came into this work with a background in privatisation. In the privatisations done in this country there was no question of a public sector comparator. The Government decided as a matter of policy that, for example, it was no longer the business of the state to manufacture luxury cars. The state could make a fantastic job of manufacturing luxury cars, and the public sector comparator, if one had been constructed, might have shown that, but I doubt it actually. In theory it might have been possible, but nobody did that calculation. They decided they did not want to be in that business anymore and decided to sell it.

431. In my view, quite legitimately, it is open to public authorities to decide that their core activity is not maintaining buildings, for example. That is why I laid such emphasis on the purpose of the public sector comparator as a means of understanding differences, rather than the production of numbers that are compared with each other. I am not an expert in schools projects; we have not looked at any, because central government is not involved in that. An authority can decide that they really cannot be doing with maintaining schools and invite bids on that basis. They should, of course, explore how much it will cost to get out of maintaining schools — it is certainly prudent to look at the numbers. If they conclude that it will cost a lot, they should continue to do the maintenance themselves — but this is very much an aid to judgement. If their inclination is to get out of maintenance responsibilities and not to worry too much about the cost, that is not objectionable — provided they are aware that is what they are doing. A widespread problem in regard to PPP projects is that authorities kid themselves that the numbers are telling them the decision, but the decision is actually being made on wider grounds, not purely financial grounds.

432. **Mr Leslie:** Would it be better for them to admit it?

433. **Mr Colman:** Yes. That is our view.

434. **Ms Lewsley:** This is a whole new sphere in Northern Ireland, and we need to fix a lot. Many people think that this is a quick fix operation, but I am not so sure. One of our schools has just gone out to PFI for the first time. How it rolls out and how cost effective it will be will form a benchmark for us. However, as it will take time, we cannot wait to find out how it goes before we start the next one.

435. An important issue for me is the accountability that is lost once a venture goes into that PFI or PPP structure. The trade unions in particular have argued that secrecy surrounds PFI projects. For that reason, they feel that it is very difficult for outside bodies to comment on the value for money outcome of the scheme. What action do you recommend to ensure that maximum openness and public accountability become a part of the PPP process?

436. **Mr Colman:** There was certainly a tendency to shroud some of the earlier deals in secrecy — for both the public and private sector — giving commercial confidentiality as the reason. In a small way we had a favourable impact on that. When we reported on the first four roads projects, the Department of Transport and the Highways Agency were very surprised at the financial information we proposed to disclose in our report. Indeed, they questioned our right to do so, because the projects were subject to commercial confidentiality agreements. However, we did have that right, we acted accordingly and the Government subsequently changed its policy.

437. The current procedure for "design, build, finance, operate" (DBFO) roads is that bidders are told that anything in their bid may be disclosed. The contracts will be publicly available. If the know-how on something is sensitive for good commercial reasons, bidders are to say so and the case for that confidentiality will be examined up-front. Perhaps it is not for us to comment on that policy, but I personally find it a much healthier approach than the original, where everything was kept so secret.

438. There is also an issue of openness between the public authority and the PFI or PPP contractor. We are increasingly coming to the view that open-book accounting is an essential part of the relationship. The

last word in PPP is "partnership", and the essence of this type of partnership is that parties work together to achieve a common objective. You cannot have that if one of them is suspicious that the other is ripping it off, and open-book accounting is a way of providing reassurance to all the partners that they are proceeding jointly towards a common objective. Of course they will have their separate interests within that. We are not saying that the private sector is not allowed to make a profit; of course it must do so, but it should be understood that it must not conceal that profit from the other side.

439. **The Chairperson:** One of the issues that came up was the retention of expertise within the Department. We have found that when somebody gains expertise putting together a contract, you lose them to the maintenance of that particular contract. Have you found that a loss to the public service?

440. **Mr Colman:** I began my career in privatisation when I was a Treasury official. Having done half a dozen privatisations, I privatised myself — that will inevitably happen. I enjoyed the work, but I would not have gone on doing it in the public service. I have now been back in the public service for a number of years auditing such activities. I do not believe it unhealthy for people to circulate, but that seems to me to make it all the more important for the public service to husband its skills. When someone has negotiated a deal of this kind, the public service should attempt to find ways of re-using their skill. Speaking for myself, I would have stayed in the Treasury if it had found a way of re-using my skill, rather than sending me off to do something completely different, which is what would normally have happened.

441. **Mr Leslie:** I want to raise the completely different subject of IT projects, which seem to be in a category of their own. The critics of the approach have been quick to call down a few unsuccessful examples as evidence. Coming from the private sector myself, I am entirely familiar with IT projects failing despite the best brains being set to work on them, and one need only look at the London Stock Exchange to see how badly wrong they can go. Have you formulated any particular disciplines or suggestions as to how one might avoid the bear traps?

442. **Mr Colman:** I am glad you mentioned that IT failures are not confined to those financed through PFI or PPP. It is a paradox, because in the IT world there are very well established methods for identifying separately what is wanted and then how it is to be done. It is said that the key to securing good value from the PPP approach is an output specification — you tell the provider what you want, leaving them free to decide how to achieve it. The provider then innovates to provide exactly what you want. In the IT world there are many techniques for enabling clients to specify in great detail what they want without at all specifying how it is to be done. That ought to mean that IT projects work better than any other kind of PFI or PPP. It does not look as if that is what happens in real life.

443. One of the factors we mentioned in the paper is that external finance is not generally a feature of IT projects, so IT companies will claim to be able to deliver a particular solution with them taking the risk. They do not have external financiers looking at the proposals, saying, "If we are to put our money into this, you are not going to take that risk." That moderating effect is missing in many IT deals. There is a chicken-and-egg question of why no financiers are involved, and the answer is that the track record of IT projects is notoriously bad. It does not therefore look like an attractive line of business.

444. It seems to us that the answer to IT projects is to admit that there is a generic problem. There is now very substantial and thoroughly thought-through guidance on IT projects from central government following the McCartney Review. The Public Accounts Committee has also published a very substantial report on failures in IT projects, and our advice to anyone considering an IT project would be to read that guidance and follow it. Whether the arrangement is PFI or PPP seems to us to be a secondary issue. If you get the project right following that guidance, it does not matter how you finance it.

445. **The Chairperson:** Thank you for the presentation and for taking our questions.

MINUTES OF EVIDENCE

Thursday 17 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Ms Lewsley
Mr Weir

Witnesses:
Mr N Salisbury, Director) Barclays Bank
Mr K Wall, Managing Director) Barclays Capital

446. **The Chairperson:** You are very welcome to this meeting of the Committee.

447. **Mr Salisbury:** I am a director of Barclays Business Bank's private finance initiative (PFI) unit and Mr Wall is managing director of Barclays Capital.

448. I will start by outlining Barclays' involvement in PFI and public-private partnerships (PPP). Barclays Capital has an underwriting and debt-arranging role for infrastructure and can call on syndicated bank loan experts and bond market experts. The Barclays Private Equity Infrastructure Fund is a source of third-party equity for PPP projects. It has committed £75 million to around 30 projects in the UK. Barclays Business Bank provides senior bank debt to PPP projects. We currently have about £400 million of commitments to about 30 projects. Barclays has a long history of involvement in structured project finance and recently took a shareholding in Partnerships UK. In geographic terms, the senior debt and equity side is primarily based in the UK and Ireland.

449. **Mr Wall:** We have been involved in PFI, PPP and the variants thereof for a number of years, and have a long track record in the UK. Overseas, we are seeing more and more opportunities on the continent. I understand that you have taken evidence from the European Investment Bank, which probably gave you a perspective on that.

450. In countries like Portugal, Spain, the Netherlands, and increasingly in eastern Europe, we are starting to see a lot of toll roads being financed through PFI/PPP structures. Some of the western European countries are starting to put in place initiatives very similar to those that have taken place in the UK, such as hospitals, prisons and schools. It is fair to say that the continent is far less developed than the UK in what gets financed in a PFI or PPP structure. A little closer to home, the Republic of Ireland is embarking on a PFI/PPP initiative now, including roads and some schools, which we are involved in. Further afield, in places like Hong Kong there have been PFI or PPP type initiatives, which have been used mostly for transport infrastructure such as tunnels, roads and bridges. PFI and PPP are spreading across continental Europe now.

451. **Mr Salisbury:** The sectors we cover, and we have touched on them all, are health, education, housing, transport and prisons. I want to mention some recent mandates where we are seeking to arrange the finances at the moment. We mentioned the Irish PFI market that has opened up. We are mandated to arrange the finance for a bundle of schools in Ireland and the Cork School of Music, which are both £50 million projects.

452. **Mr B Bell:** We heard about those when we were down in Dublin. Jarvis plc have got the contract.

453. **Mr Salisbury:** That is right. We are very excited about the projects, and we do a lot of work with Jarvis.

454. **Mr B Bell:** How much work do you do in Northern Ireland? You mentioned the figure £75 million for work in the United Kingdom, and, as you know, we are part of the United Kingdom.

455. **Mr Salisbury:** My side did bid on a number of projects in Northern Ireland but we have been unsuccessful. I know Jarvis are working on one deal there, but we have not been successful.

456. **Mr Leslie:** Would you be lending to the constructor or contractor, for example, Jarvis?

457. **Mr Salisbury:** Generally we lend to a project company, which may include a service provider as well.

458. **Mr Leslie:** Our understanding of this is sketchy, but it is building up over time. These projects seem to provide you with a guaranteed revenue stream to service a loan. The asset is not helpful, on the whole, because a school is a pile of bricks unless someone else needs it. To what extent has that made life more difficult for you in trying to assess a project and make it secure.

459. One of the complaints from the public sector, who are trying to construct the projects, is that it is bad enough dealing with the contractor without the financial institutions, who have a whole list of their own boxes that have to be ticked in considerable detail. What are the security and the key things that you are looking for?

460. **Mr Wall:** You are right. On a school for example, we are not lending on the assumption that we will have to dive in and physically take possession of the bricks. We are lending against the cash-flow forecast. It is not as if the cash flows are always guaranteed — far from it. There may be elements of cash flow that are more certain than others, but part of the risk that we take is that those cash flows might not come through. That is why we charge a margin on the loan.

461. Contractors and Government have learned, as the processes have unfolded, that some of the things UK banks were asking for five or six years ago have

had to be modified regarding security and insisting that the terms of the loan be the same as any other. There has been a learning process, which means that some of the more conventional banking requirements we might have asked for years ago have been amended as it became clear that dealing with a school is different to dealing with an oil refinery or power plant. On the market side, we have tried to adapt and show flexibility, to reflect the fact that we are dealing with very different types of assets, in many respects.

462. **Mr Leslie:** Jarvis, for example, would set up a specific company to handle a bundle of projects. How does the interest rate that you charge that company compare to lending to Taylor Woodrow, for example, as part of their general package of financing?

463. **Mr Salisbury:** It does depend on the structure. In general, for 25-year finance, lending to a project company, where there is a robust cash flow from a public sector authority, will be cheaper than if you were lending to the corporate itself.

464. **Mr Leslie:** One of the criticisms we have been fielding is that financing costs are relatively high. Looking at that I see that there is a 30-year gilt there, and it is yielding 4·7% at present. Where do you think the market would be for a hospital over thirty years?

465. **Mr Salisbury:** On the bank side, it is measured against LIBOR, which is higher than the gilt. The margin would be in the region of 1% over LIBOR, which makes it about 6%.

466. **Mr Leslie:** So this is about 5% plus 1.

467. **Ms Lewsley:** Earlier I raised the whole issue of high risk for many firms, and the issues being raised by our Department of Finance and Personnel on the reluctance of many firms to become involved in a number of projects, because of the risk. How do think we could encourage greater involvement by national and local firms to get involved? You mentioned that you have applied, but have not been successful. We have a PFI initiative going on at present at St Genevieve’s High School, and maybe that is the one that Jarvis is involved in — I do not know. How enthusiastic is the financial sector to invest in Northern Ireland?

468. **Mr Salisbury:** I would say that the financial sector is very enthusiastic to invest. Barclays does not have a very strong representation in Northern Ireland. It is quite a small office compared to the Irish Republic, where there is a much larger presence. It has certainly come across to us that there needs to be a strong Northern Irish flavour to the bid, so it is important to try and associate with local contractors. My personal opinion is that it is quite hard for someone who does not have contacts in Northern Ireland to break into the market. That is partly the reason why we have had some difficulties. The local banks there have been quite aggressive.

469. **Mr Wall:** Trumpeting PFI and PPPs as an initiative is very important in attracting the attention of banks, contractors, and all the other parties that get involved. The public relations aspect to any one of these initiatives is quite important. Around continental Europe, you can see examples of where it has been done well and not so well. Whether you are launching or relaunching, or whether it is related to a particular project, the ‘splash’ — trying to get as much profile as possible — is quite important.

470. **Mr Salisbury:** People like Jim Livingstone from the Department of Education have done an excellent job being ambassadors for PFI in Northern Ireland.

471. **Mr Weir:** On the wider experience, you indicated that you thought that Government had now caught up on some of the things you were telling them five or six years ago. Given that there is an evolving of Government thought in terms of the Treasury’s views, guidelines or rules, would you like to see any changes in those guidelines? Do any aspects of facilitating PPP require legislation at this stage?

472. **Mr Wall:** My earlier point was directed more to issues such as documentation. Five years ago we had the usual cumbersome project finance documentation, and everyone got a bit frustrated. For a lot of the PFI contracts there is now more standardised documentation coming through. I do not see the need for legislation to speed up the process or make things any easier.

473. **Mr Weir:** There are a couple of smallish aspects particular to Northern Ireland. Business tenancies are a particular problem and maybe there is a need for new legislation. Are there any specific areas that you can think of where there is still a degree of restriction that legislation or change of policy would facilitate?

474. **Mr Salisbury:** Not that I am aware of. There were some blockages five years ago but those have been cleared. Standardisation of documentation is important. In England, the documentation for health transactions is pretty well agreed, and the first few deals have been signed over during the last couple of months using a standard form. We would like to see Government Departments working more closely together to share what has been learned from the standard forms.

475. **Mr Weir:** You may know that we are probably lagging behind in these things. The level of enthusiasm in the reaction and attitudes to PPP differs in various Departments. Regarding the pooling of resources, the Departments have different levels of expertise regarding PPP.

476. **Mr Salisbury:** There is not so much of an adversarial feel now in negotiating PFI as there was five years ago, but it is still a problem that the public

sector experiences. Experience has been developed through particular deals but is not being recycled sufficiently. In local authority transactions for schools the project manager will often do his PFI deal and then do something else. It is very stressful making PFI deals, and he may not want to do any more of them, but it would make more sense for him to go to another local authority and use what he has learned.

477. **Mr Wall:** Central co-ordination is quite important. From a bank's perspective, there are lots of opportunities over here in the health, education and defence sectors. From the Government's perspective, sorting out the priorities and giving a consistent message to the market as to the priority projects are quite important. Co-ordination across the different parts of Government is needed on an ongoing basis.

478. **The Chairperson:** How is it possible to make sure the financing guarantees and requirements are met — the contracts, structures and repayments, which leads on to the whole issue of refinance and transfer concessions? At some stage the public sector may have to step in again before the contracts fall apart.

479. **Mr Wall:** From my perspective the biggest guarantee that everything happens as it should is the legal system in Northern Ireland, the UK, and the Republic of Ireland, which, from a banker's perspective, we have tremendous faith in. This is in contrast to some of the emerging markets in Europe where they want to do PFI but one does not have the confidence that if there are problems you can resolve it as set down in the documentation. A broader guarantee of making sure the financing aspect of these things works is the underpinning legal framework, and the precedent has been set for these deals.

480. **The Chairperson:** With contracts over a 30-year period, local authorities may not have worked out exactly what they want or need. If the public sector has to step in again near the end of that time, how do you see the refinancing and the restructuring of that?

481. **Mr Salisbury:** It is accommodated in the project documentation, but there is also flexibility in that for the private sector to make changes if its requirements change over a 30-year period. I am not sure if that answers your question.

482. **The Chairperson:** If there must be re-financing in that 30-year period because of default or change in need, is that an opportunity to hike up charges so that it becomes expensive to renegotiate or is that written into the contract?

483. **Mr Salisbury:** It is not an opportunity to hike up charges.

484. **Mr Wall:** It may be the opposite. Most banks hope that the initial financing would be re-financed over a 30-year period. Usually it is re-financed because, with the benefit of a track record, the project can raise finance at more attractive rates than it could at the outset when the risks were perceived to be higher. The bank loan market initially finances a lot of these projects for 25 to 30 years. Then after something is constructed and it has a couple of years of track record, re-financing it into the bond market, which tends to loosen the covenants, may result in a more attractive pricing. Therefore most of the re-financing that we have seen in past benefits the project and the local authorities. Clearly, if it is a default situation, it is difficult to know where that will end up.

485. **Mr Bell:** An earlier witness said that it is better to get the construction done first and re-finance afterwards. Is that what you are saying?

486. **Mr Salisbury:** The unitary payments do not normally start to flow until the construction is complete. If you are going into a different financial market you will probably want to give the investors an assurance that cash will flow. Therefore, when the construction is completed, you should wait to see how the operating period goes to make sure that there are no major deductions from the unitary payment and go into the re-financing at that stage. Most deals signed now will have clauses built in so that any benefits that come from re-financing are shared between the public and private sector.

487. **Mr Leslie:** I was going to ask about that because, prima facie, the benefit would go to the private sector and it could coherently argue that it had taken the risk and therefore if it could shape the terms — bully for it. I am interested that that is starting to be heard.

488. **Mr Salisbury:** In another Jarvis deal that was signed earlier this year — a school bundle in the North of England — the local authority has taken a minority shareholding in the project company; therefore it will also benefit from that. The intention is to try and make it operate more as a partnership so that the local authority is there as an investor sitting alongside the private sector.

489. **The Chairperson:** Are there better value for money approaches to financing deals, especially given the difference between the public and private sector borrowing target rates?

490. **Mr Salisbury:** There are alternatives that have different benefits. We financed a prison in the Irish Republic on a finance lease. Therefore, having got through the procurement and building of the prison, the private sector was contracted to deliver on time, to an agreed cost and it had to absorb any overrun in costs. The contract then flips over to a finance lease whereby the Government pays directly, irrespective of performance, over the 30-year term, but with the option to re-pay early if it wanted to. It therefore benefits from the strength of its covenant in the pricing of that, so that is an alternative model.

491. There is a slightly different approach in Scotland from that of the Treasury in Westminster. There are a number of deals there where we receive a payment direct from the local authority. However in England, all the unitary payment would normally be at risk for performance deductions. If there are performance deductions, the local authority would go directly to the contractor, but it cannot interrupt the flow of money to us. Therefore we can provide a cheaper funding package because we are effectively taking a local government authority covenant. That locks in once the construction period has finished.

492. **Ms Lewsley:** The point was raised that if something happens in the PFI project and extra moneys are sought through the contractor, for whatever reason, the contractor is only worried about the bricks and mortar — they do not care about the services being delivered. That means that if there are cutbacks somewhere, the services will suffer, particularly in education. In our case the education boards will cut the service provided in the school to meet the contractor's needs.

493. **Mr Wall:** The key is to make sure that when crafting the contract for the concession there are rewards and penalties for good and bad performance — that occurs frequently. The most recent example of that in a UK context is the proposal for the London Underground. There are rewards and penalties in that scheme, depending on the quality of the contractor's performance. The key is to make sure that you tie in the project company so that the flow of dividends are impacted if it does not deliver a good performance, and there may be an upside if they exceed a high performance level.

494. **The Chairperson:** Our whole infrastructure deficit means that a non-profit company could raise bonds. Do you have any opinions on that?

495. **Mr Wall:** That is an appropriate model for the right situation, but it is not for everyone. A recent example of that in the UK, with which we have been involved, is the PPP approach to air traffic control — the Government have sold a 46% stake to a consortium of airlines. Those airlines have a non-profit approach. You might deem that right for the air traffic control infrastructure as you do not want people driving out every last penny of costs in that situation because there are safety implications. There are some sectors or sub-sectors where that approach makes sense. There are others that will not attract the interest of the private sector if there is no profit attached. In that case I say horses for courses.

496. **Mr Leslie:** How much capacity is there? We are at an early stage in this process and, theoretically, a huge amount of public procurement and building could end up being done in this way — you might find your market shrinking and that market growing. I do not know whether your industry has thought about that. Do you have any feelings about what might be a prudent level of division between public sector and private sector payment? Do you see any constraints?

497. **Mr Salisbury:** I have not heard of a cap being put on the market.

498. **Mr Leslie:** There is no cap — I wanted to know whether you had thought about that.

499. **Mr Salisbury:** There is no shortage of demand for PFI assets from banks, and overseas banks are keen to invest in UK infrastructure through PFI. The investor base is widening to include insurance and pension companies that also see this as an attractive asset. I am unaware of any analysis that has been done to assess the capacity of the market.

500. **Mr Wall:** The market is liquid for debt providers, and as long as the banking sector is in reasonably good health, there will be strong demand for infrastructure assets. There is a growing private equity appetite for these sorts of PFI and PPP deals.

501. On the contractor side some of the big Spanish construction companies are bidding for UK and some of the Southern Irish PPP and PFI projects. There is a strong appetite in the market for provision from the private sector, whether it is equity debt or building skills.

502. **Ms Lewsley:** You spoke about organisations such as Spanish construction companies. I am concerned about the skills shortage. There has been no investment in Northern Ireland for over 30 years and all of a sudden it could take off. The reality is that, even if we had the amount of money that we would like in the capital fund for education, we could not build everything at the same time because there would not be enough skilled people available to do that. At present we do not have enough electricians and proper tradesmen because they are all working in Dublin because PFI has gone through the roof there. Therefore, my worry is that when PFI and PPP take off in Northern Ireland where will the skilled labour come from? The contractors may be keen to come in but where will they get the workforce from, and what quality will that workforce be? Do you see that as a problem?

503. **Mr Salisbury:** We see that as a problem from time to time. We are more acutely aware of the shortages and the pressures that are put on the professional firms — the financial advisors, the lawyers and even the bankers. There are some shortages but they tend to be in professions where people can adapt relatively quickly if there is a real demand.

504. **Mr Wall:** It comes back to a point that we spoke about earlier; we must make sure that the Government decides what the priority projects are — whichever sector they may be in — so that the market

is not flooded. Banks have the same interest as the Government in the quality of construction because their debts will not be repaid if there is a problem. It is a fair point to make.

505. **The Chairperson:** Thank you for your presentation. We will come back to you if we have any more questions.

MINUTES OF EVIDENCE

Thursday 17 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Ms Lewsley
Mr Weir

Witnesses:
Mr N Rose) Business Services
Mr R McGlynn) Association

506. **The Chairperson:** Good afternoon gentlemen, you are very welcome. If you could make a short presentation, we will then ask questions.

507. **Mr Rose:** I am Norman Rose, Director General of the Business Services Assocation, which represents 20 of the largest outsourcing contractors in Europe. We put a little note at the beginning of the evidence to show that last year in the United Kingdom the members turned over £15 billion and employed 500,000 people in both hard and soft services, through technical IT services. We cover the whole business-to-business managed services sprectum.

508. **Mr McGlynn:** I am Roger McGlynn. I am a Director of WS Atkins Investments Limited, the investment arm of WS Atkins, which is a large multi-discipline consultancy and services company. It started off as a civil and structural engineering company, and has developed through outsourcing in the United Kingdom into a service provider, and more recently an investor in private finance initiatives (PFI). We have nine projects beyond financial close, where we are equity partners. On those projects, besides providing equity, we are generally the hard financial management services provider. Very often the company employs about 12,000 people in total in design.

509. **Mr Rose:** You have chosen an exceedingly good day, according to what the Prime Minister said yesterday. I could not help but read the Financial Times with joy this morning. I thought it was terribly appropriate to what we are doing.

510. PFI, as you know as well as any of us, is about the acquisition of services, including the provision for major asset. So far, not surprisingly, there has been a major focus on the procurement of the asset. Apart from some prisons, it is only now that we are beginning to see the focus on the service to be provided over the next 25 years or so. Since the asset has to be built first it is inevitable that the primary focus has been on that.

511. In our view the success of any PFI project can be judged solely by the service provision to users and the asset provision for the providers of that service. We strongly believe that PFI will succeed, as will PPPs as an extension to that — I know there is a debate as to what the difference is between PFI and PPP.

512. **Mr B Bell:** We do not know the difference.

513. **Mr Rose:** Nor do we, we have that debate every time my group of experts meet in the office. I think it is bigger, and if you drop off the building of the provision of a new asset, you tend to get the PPP, where the public and the private sector can work together. That is not necessarily or solely through the services being provided by the private sector — it is possible to work a hybrid on that. These initiatives will succeed because they have the potential to draw together the best of the public and the private sectors for the benefit of local people, and as public authorities and private companies that has to be our aim. They provide the appropriate mechanism to contain costs and increase quality.

514. Finally, as we have seen today these initiatives fulfil the Government's objectives to upgrade infrastructure which otherwise might not be afforded and bring together the best of both sectors. Mr McGlynn will give you one or two pointers on the more detailed issues to help you in focussing the discussion.

515. **Mr McGlynn:** You may have many questions but as a lead-in we are great supporters of PFI and are active participants in it. There are a number of wider issues on which there is continuing debate. The essential ingredients to success include the careful preparation of projects before they are brought to the market. A clear specification of what the client wants from the project is required, and it is important that work goes into that issue at the right level so that we, the bidders, know exactly what we are trying to provide and then we can develop that together. Tied up with that is the question of affordability and the careful preparation of public sector comparators. We have seen many projects that get part-way through the process and then an affordability issue arises. There is a mismatch between the client's requirements, which he is developing through the process, and the PFI credit that has already been agreed.

516. A continuing issue for both public and private sector is the transaction costs on these projects because they are long-term partnerships — 25 to 30 years — with fairly complex contractural structures, particularly for things like hospitals funded privately. There is no match presently between the complexity of the structure of those documents and the size of the deal. The same structure of contracts has to be in force for both small and large deals. This is an issue that is being addressed by the moves towards standardisation of contracts — that is the way forward. The more

standardisation of contracts across sectors we can get, the more efficient the transaction process is going to be.

517. I do not know what stage you are at in thinking about clients and projects you may wish to procure in Northern Ireland. It is imperative for the project to be delivered that there is a clearly identified champion and client who wants to see the project through. With some of the agencies here it is difficult to know who the client is because there are so many sub-agencies involved.

518. There has been a proliferation in the number of stages in the procurement process. There are now pre-qualification; preliminary invitation to submit proposals; clarifications; detailed submissions and proposals; further clarifications; best and final offers, and sometimes a stage beyond that. All of this takes place before a preferred bidder can be named. The process is costing the public and private sectors a lot of money. However, the standardisation of contracts and approaches should start to reduce that period. As regards risk, the rule has to be that it should stay with the party best able to manage it. There is always a debate about that between the sectors.

519. **Mr B Bell:** Which side would be best suited to manage the risks?

520. **Mr McGlynn:** Some risks rightly stay in the public sector. The majority, especially those involving delivery and performance would go to the private sector.

521. The other issue with respect to the future of PFIs and PPPs is the extension of services that can be brought in. In the health sector there has been a very rigid divide between clinical and non-clinical services. The public sector could take more responsibility for clinical support services — not related to critical care, obviously — such as IT and equipment procurement. To date, those have been omitted from several deals because they proved too difficult.

522. **Mr Leslie:** You advocate something that we have not seen elsewhere. Rather than design, finance, build and operate only, we should design, build, deliver and operate, and the finance could come from the market at the keenest price. Are you suggesting that Government should be the finance provider as a separate function? Are you saying that finance could be input at the point at which it is needed, quite separately from the time when the contract was negotiated?

523. **Mr Rose:** If Government want to keep finance out of the public sector borrowing requirement, then it cannot come via the public sector. Nowadays with the reduction in interest rates, and the ability of the financial markets to understand what is happening, the rates we can get are much keener than they were before.

524. Throughout the project, service delivery is the thread that makes or breaks a PPP — because it is all about delivering a service. While within the consortium there will almost always be a construction company and a financier, nonetheless the lead ought to be taken by the service provider who will have a long term commitment to make the project a success for the client and the users. Public authorities ought to be ensuring that the service provider takes such a lead.

525. Since the paper was written in 1997 matters have moved on a lot. Service companies are equal partners in quite a number of major consortia, and in one or two consortia they are the leading partners. That provides a greater opportunity for taking service necessities into account. In some early schemes a construction company and its architects designed the building. You could not pass two trolleys in the corridor or turn the trolley into the ward because the people concerned had not thought of that practical aspect.

526. **Mr McGlynn:** It is more concerned with recognising that those contracts are about long-term service provision and, therefore, that should rightly be where the lead is in the projects. The enlightened consortia operating in the market now work in an integrated way, with service providers being part of the design team to ensure that those problems — the practical problems of maintenance — are all taken into account.

527. The public sector — the European Investment Bank, for example — is involved in funding deals where they can provide slightly cheaper funds with limits on the percentage of the senior debt that they will provide. There is a role for some public sector funding but, as Mr Rose said, for major funding, where the imperative is to keep those off the public sector borrowing requirement, the funds will come from the private sector. In limited recourse financing, those who provide funds are taking some risk. That is one of the features of PFI.

528. **Mr Weir:** That bears out some of the other evidence that we have heard about the need for standardisation of contracts. There is still some degree of frustration with the Government at the speed with which they are adapting. To what extent is the Government learning the lessons — how quickly they are moving toward standardisation of contracts? Do you have concerns in certain areas of Government, particularly local government, about the lack of expertise in the deals? Is that acting as a hindrance with the tendering processes, which are perhaps made more expensive and lengthened unnecessarily because of that lack of expertise?

529. **Mr McGlynn:** Yes, but it varies quite a lot from one authority to another.

530. **Mr Weir:** You get a mixture in that regard.

531. **Mr McGlynn:** The most advanced sectors are those such as highways, where there has been a formal standard contract in operation, and the procurement is from a central government agency. Prisons have operated a standard contract for some time, and are relatively sophisticated procurement clients. On the highway side, deals go through quite quickly.

532. The Treasury task force did a great job producing the standard guidance, but that has not been universally adopted by Departments. Some Departments have taken that as a starting point rather than a benchmark of what the market would accept. That has led to some confusion. Some contracts from Departments have tried to be harder than the Treasury task force guidance has suggested. The value of standardisation has been slightly diluted.

533. In sectors such as education, they are working under a standard contract, but local authorities have up to now largely developed their own, or their advisers have advised them differently. Some projects have been quick; others have been slow. We have managed to close some projects with local authorities on schools in five months as a preferred bidder, and they have gone extremely well. Again, those are where the authorities were prepared to accept a contract that, at least in its basic format, had been used before rather than starting from scratch. Some of the other Departments, such as the Lord Chancellor's Department, for example, are only just starting to think about standard contracts. The NHS has a standard contract and is interpreting that very rigidly.

534. **Mr Weir:** The level of expertise is patchy — some areas are very efficient and have a lot of experience. In Northern Ireland there is a smaller pool of experience to draw from. It would presumably be very helpful, at devolved level, if there was a high degree of co-ordination between Government Departments in order to pool that expertise. If all Government Departments had the same high level of expertise it would make the job of the firms that work with you easier.

535. **Mr McGlynn:** It would be better for the public and private-sectors because the expertise that is built up in the public-sector would be rolled over from one deal to the next. If one local authority does one deal and then does not do another one for about 5 years the key person will probably have moved on. It is a steep learning curve, so you want to retain the lessons that have been learnt and the experience that has been gained.

536. **Ms Lewsley:** One of the issues that the last group of witnesses raised was the possibility of a skills shortage because of the number of PPPs and PFIs. In Northern Ireland there will sometimes be up to five at any one time because of the lack of investment in different sectors. Do you find that that is a problem? The trade unions are suggesting that there is a possibility of a two-tier workforce. How strong is the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) for staff who are transferred? If an employer downgrades a position and someone ends up being worse off, how do you deal with that?

537. **Mr McGlynn:** Those are two quite different questions. The skills shortage for executing the transaction is a difficulty here, and I am sure that it will be a problem in Northern Ireland too. If the procurement agencies can be more centralised it will help that problem because you will build up a cadre of people who have the right skills and experience.

538. My company has a lot of TUPE transferred employees. At least one third of our workforce have joined the company through TUPE transfers, through local authority outsourcing and PFI projects, and that has been very successful. The conditions of the transferred employees are protected to an extent by the TUPE legislation. We find that, because we have very clear training programmes, we are giving those people more opportunities than they would have had in the public-sector.

539. **Ms Lewsley:** What about the two thirds of your workforce who do not have TUPE protection — what are their conditions like?

540. **Mr McGlynn:** The other two thirds had already joined our company or were not transferred through TUPE. We are enlightened employers and it is not in our interest to lose people. W.S Atkins Investments Ltd is a company whose only resource is people, and we do everything possible to maintain our workforce. It is not in our interest to make work conditions unattractive because we are in a competitive market to keep people.

541. **The Chairperson:** People are contracted out from the public-sector to the private-sector. There has been a particular problem in schools and hospitals. In the past people have had bad experiences with the transfer from the public to the private-sector. In some cases transfers were not offered, and there was no part-time employment. A number of contractors can be involved in one project.

542. **Mr Rose:** I accept that criticism. When the Labour Party came to power in 1997, the then Parliamentary Under-Secretary of State for Defence, John Spellar, set up a working party on TUPE. The trade unions, the Ministry of Defence and the private sector got together and agreed a code of practice, which has stood the test of time, without one single problem in the Ministry ever since. It says that TUPE will apply in every contract.

543. As for staff transferring across, the code of practice also says that the past record on TUPE issues of every contractor and subcontractor will be examined before the contract is let. We welcome that, because we are plagued with cowboys in this sector as much as

anyone. We do not want them to win bids because then the good enlightened companies are tarred with the same brush, and you in the public sector get a feeling that we are there simply to reduce costs and not treat staff properly.

544. What Mr McGlynn said applies right across the BSA — staff are our only asset. We may have the most wonderful processes, the greatest managerial expertise and the most high-blown thought you can imagine, but if we do not have staff who are committed to us, who are happy to work and who are keen to work, then we can never provide quality services. One of the statements to which every new BSA member signs up is a commitment to quality, part of which relates to the way in which staff are treated and developed.

545. We have found that when we take over public sector staff, there are normally four or five different sets of terms and conditions, depending on how each person has come to the job. We will develop staff. The companies I represent have a policy of staff development and multi-skilling, both in the public sector contract and in moving them out into private sector contracts, where they can often develop much further than they could just within one public sector area.

546. The general experience is that those people who are willing to get involved with the private sector will earn more than before, once they come off TUPE terms and conditions. We can bring different incentives to the table, which we cannot do under protected terms and conditions.

547. When we take staff on subsequently within the contract, they are taken on with market force terms and conditions. TUPE means protected terms and conditions. These will very rarely be less, and there may be things, like public sector pensions, which are different. We cannot replicate the local government pension scheme, the NHS superannuation scheme or the Principal Civil Service Pension Scheme, but in general we give the best package that we can, because we want to get the best staff on board to do a quality job.

548. **The Chairperson:** Given the lessons learned from previous contracts, what would you change? Are there any particular features that you would like to alter?

549. **Mr Rose:** We would like to look at the procurement process. From the beginning, the procurement process, which has to be carried out under the public procurement directives, has often been an impediment. People like the Highways Agency and the Prison Service, because they are centralised agencies, have got it down to quite a fine art, and it can be quick. However, in other areas of the public sector, such as defence and local government, it can take years to get through. We would like to see that process streamlined because it is in everybody's interest, both in the public and private sector.

550. We would like to see far more expertise and training within the public sector in both procurement and project management. On Tuesday I was at a Ministry of Defence industry conference at Abbey Wood. The head of the procurement development group said that the prime aim of the Defence Procurement Agency is to become an agency staffed with project managers, as opposed to technical specialists.

551. The problem has been that in the past, project management and procurement have been sidings into which staff went for a time, from which in general they might never ever come back, and it was not seen as part of a career progression. That is something that I would not like to see again, and certainly in the Northern Ireland situation where you are coming at it much more lately. I would like to see that written in; so that getting a career in procurement and project management would be a major part of one's career development in the public sector.

552. **Mr McGlynn:** I support that. One of the things that we look for in choosing projects in which to invest our time and money is a champion — some one who really wants it to happen. The man who really wants to see this happen has to be an identifiable individual, or a small number of people. We look for a very clear, well worked-out output specification of what the client wants, not something that is going evolve once the bidding process starts. That just adds time.

553. Also, we look for standardisation of contracts and approach, which will help along the way. Any other changes to the details of the process or the deals done differ from one deal to another, anyway.

554. **Ms Lewsley:** We have had seven or eight presentations today, and we have only seen one woman. What is the gender balance in this area?

555. **Mr McGlynn:** Women notice these things. On the investment side, our team at Atkins is mainly male. Probably about 20% would be professional women. Quite a number of our legal advisors are women, and they have very powerful positions. Overall, the proportion might be 25%. Looking at the industry, I do not suppose that building contractors employ too many women.

556. **Mr Rose:** We always use the best person for the job. At middle management level, it is probably nearer 50-50 these days. There is a different perspective at the top of the company than there was 10 years ago.

557. **Mr McGlynn:** We have a much higher proportion of women in design and facilities management. I do not think that we are untypical, compared to other industries.

558. **Mr B Bell:** You said that you represented a huge group. Would the Northern Ireland market be big enough to sustain this type of thing?

559. As Ms Lewsley said, we are here today because for 30 years, under direct rule, there has been no investment. We have a block grant from Westminster that is sufficient to keep the country running, but there has been no investment in infrastructure, be it roads, railways, water services or anything like that. The same goes for health, education and a lot more.

560. We are being forced in to this, and we are at the initial stages. Unlike the rest of the United Kingdom or the Republic of Ireland, we are being forced to look at this because we need to raise the extra finances to deal with the deficit. What are your thoughts? You mentioned roads and prisons. We are in the market for roads, but we are closing down our prisons.

561. **Mr Rose:** The BSA member companies will go wherever there is business. It has a long history of doing business with the private sector, in particular, in Northern Ireland and also with some of the public sector. They operate in the whole of the UK. Wales is not much different to Northern Ireland; it is a bit bigger and is probably further down the PPP route — not in a voluntary way to start with, but it is now moving more quickly. They will set up subsidiary companies in any viable market where it can add value to the public and private sector.

562. The contacts in Northern Ireland are of a size that BSA members are happy to take on board. Their interest is that the services that you receive are the best that you can receive. Therefore the local citizen receives the best service that he or she is entitled to for the council tax and the national taxes that he or she pays. From that point of view, if half a dozen contracts start up now, we would be interested in talking to the Committee about them. However, if you want BSA members to become involved, you must talk to us early in the process. Do not come to us after the Official Journal of the European Communities (OJEC) notice goes out, because by then there may be things that we would suggest that you should look at differently and there may be options that we could raise with you. If we are to work in partnership the sooner that we can get together and talk with you, within the bounds of public propriety and with no undue influence under the directives, the better. Please speak with us early; it will give us a much better chance.

563. **The Chairperson:** There is under investment because the British Government did not provide adequate funding in the North over the years, and the Committee is trying to rectify that now.

564. **Mr B Bell:** I am certainly not in disagreement with that.

565. **Mr McGlynn:** The drivers were much the same here when we started — look at the state of our hospitals and schools.

566. **The Chairperson:** The rebalance of services is one issue in the East/West situation. All of the PFI projects are centred on Belfast and we are trying to get them out to the rural areas.

567. Thank you for your presentation and for taking our questions. We will come back to you if there are more issues that we want to raise. If the contracts happen we would hope to meet with you again in the future.

MINUTES OF EVIDENCE

Thursday 10 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr Close
Mr Maskey
Mr Weir

Witnesses:

Mr A Bill	)
Mr R Horner	) Confederation
Miss A McIntyre	) of British
Mr N Smyth	) Industry (CBI)
Mr N Wilson	)

568. **The Chairperson:** Welcome to the Committee. Mr Smyth, would you like to introduce the panel and make your presentation.

569. **Mr Smyth:** We welcome the opportunity to give evidence to the Committee. Our delegation consists of Nigel Wilson, who is chairman of Sx3 and managing director of Viridian Capital; Amanda McIntyre, head of Modernising Government CBI; Andrew Bill, director of John Graham (Dromore) Ltd; and Robin Horner from IBI Corporate Finance. I propose to give a short presentation and I have circulated a few bullet points summarising the submission.

570. We welcome the Committee's inquiry into public-private partnerships (PPPs) and private finance initiatives (PFIs). I will cover the benefits of PPP and PFI from a business perspective. I will look at some of their key success factors and some of their constraints and limitations, as well as at social factors to examine alternative options for addressing the infrastructure deficit in Northern Ireland, about which we are increasingly concerned.

571. The benefits of PPPs and PFIs are significant. That approach can play a part of the solution but it is not a panacea. However, when used on appropriate projects it will be a useful contribution to addressing the infrastructure deficit in Northern Ireland. Existing procurement has not delivered historically, and we believe that it will not deliver in the future.

572. There are four key areas in which PPP and PFI can benefit us: they will give us better value for money (VFM), and we have highlighted some of the details of that in our written submission; they will guarantee high quality service provision, which should not be under-estimated; they will provide better Government planning; and, from a business perspective, they will help to develop a competitive business sector.

573. In the last few years a number of indigenous companies have emerged as players in that field, and there is potential for those companies to go on and export the skills and capabilities they have developed.

574. PFI/PPPs encourage a more service-driven approach to investment decisions. We have highlighted the spin-off benefits in the paper and have given some examples relating to the education sector, in which school management is able to focus on providing education. Broader benefits are felt in the catering, cleaning and maintenance sector and there are additional significant benefits for the community. Many jobs can be created locally through better use of school buildings.

575. High-level political will and senior management commitment in the public sector are vital to pursue that route. It is important that for there to be a broader and more widespread understanding of the benefits and opportunities offered. It is essential that we select the right projects; PFI/PPPs will not necessarily be suitable for all projects, and we realise that. The skills base is important for both the public and the private sectors. I will return to that issue.

576. We need a sustainable "deal flow". Companies are investing a great deal of time and effort in that issue. They need to be confident that there will be continuity and that those skills will be effectively used.

577. If we look at best practice, it is important to have departmental preparation as that significantly reduces tendering costs. That is important for small and medium-sized enterprises (SMEs). It is also important that we allocate risks where they can be best managed.

578. We feel that the biggest constraint has been a broad attitudinal one. The public sector has been reluctant to encourage and promote change and to pursue the route of PPPs and PFI. We have identified one or two technical constraints in the legal and structural areas.

579. There is a good opportunity to develop new businesses. If you had asked us three or four years ago were we concerned about whether there was a constraint on the supply side, we might have had some concerns over facilities management. However, in recent years we have seen a strong growth in development of capability in Northern Irish companies in that area.

580. Skills are a major concern so it is critical that they are retained and developed in the public sector. We have identified particular areas — project management skills, contract negotiation, risk assessment and financial appraisal. Our experience would indicate that a small number of individuals have been relied on too much in the past, and as they have moved on, the process of taking forward PFIs has been undermined.

581. The Committee showed an interest in the social factors. Workforce issues is a key area — it is critical that we take account of those matters and manage staff

effectively. Experience has shown that opportunities exist to improve working conditions and staff morale. That is partly why the private sector believes it can improve the performance in many of those areas — by increasing staff motivation. We have concerns about incorporating broader social goals, and we feel that in relation to PFI and PPP they could be counterproductive and jeopardise VFM.

582. A range of options is available to address the infrastructure deficit. Many of those share common characteristics, are of a strategic nature, involve risk sharing and provide operational freedom to the private sector. In the Water Service and the hospitals we have seen some use of partnering arrangements being encouraged, as is the sharing of benefits between the private and public sectors when the cost comes in below budget. There may also be potential to amend existing contract conditions, which may help to accelerate the build programme. We realise that that is not sustainable. However, as part of the process to accelerate the programme, we believe that could be looked at.

583. It is vital that there be a champion in the Executive. Some of our members would argue that a number of champions are required to drive PPPs forward in Northern Ireland. We need leadership, direction and commitment. That has been our concern in the past where there has been a much higher level of commitment in Great Britain and, more recently, in the Republic of Ireland.

584. We need to ensure that we are using and developing expensive skills. It is vital that we improve departmental preparation. In recent years we have seen increased use of guidelines and templates, which we have encouraged. That helps to reduce costs in many cases when we see a higher level of standardisation.

585. That is not to say that everything we see happening in Great Britain or elsewhere should be replicated in Northern Ireland, but we should certainly be learning from the experience. PFI/PPPs are well established. We have nine to 10 years under our belt and it is a proven method of procurement.

586. We need effective co-ordination in efforts to improve performance in the public sector. The last thing we want to see is PFI addressed in isolation from other initiatives to improve performance, whether that be e-Government, best value or other VFM areas. It is critical that we develop and improve communications with the private sector. That has to form part of an overall procurement strategy that we are very keen to see the Assembly develop. Our submission suggests that we need a mini version of the Office of Government Commerce that we have in Great Britain.

587. In conclusion, PPPs and PFI are well established, and well tried and tested. We can learn from the early mistakes that were made in certain areas, but there is evidence that they are working effectively at the moment. When used appropriately, they can provide better VFM and a superior quality of service than existing provision.

588. While we have been making progress in recent years, particularly in education, we are concerned that Northern Ireland is lagging behind, which is reflected in the lack of "deal flow".

589. PPPs and PFIs are a key part of a solution that needs leadership and political commitment. We need to identify and choose the right projects, and we need the right skills to ensure that we are prepared for that.

590. **The Chairperson:** Thank you for your presentation.

591. **Mr Leslie:** How far do you think that could be taken? One reaction that we have had at departmental level is that there are capacity constraints in the Northern Ireland business sector. You say that that all depends on the certainty of "deal flow". Only then can you build capacity and incur the risk that that involves. To what extent can that continue? The deficit in water and sewage is about £3 billion over 20 years; in transport it is currently probably £200 million, and it gets worse. Not all of that could necessarily be fixed by PPPs. Opinions vary on how much of it could be fixed by going down that route. How much do you think could be fixed? Looking at those figures, without even mentioning schools or hospitals, and taking a 20-year view, how far do you think that could extend?

592. **Mr Smyth:** We can go much further than we have been going. If we look at experiences of water and sewage services in Scotland, they have gone significantly down that route. We have not assessed how much procurement could go down the PFI route. However, it would have to be a reasonably significant percentage.

593. Experience in education, with the various pathfinder projects, has indicated that some extremely successful projects are in operation, and we hope to see those develop. Therefore, a reasonably significant proportion of procurement in a number of areas — you talked about transport, water and sewage, and health and education — would be the way forward.

594. **Mr Horner:** PFI should not be seen as a solution to all the infrastructure deficit problems in Northern Ireland, rather it should be seen as a focus for improving that deficit. You specifically raised water and sewage as examples from across the water. Scotland is the only area in the UK, other than Northern Ireland, that is not privatised. In the last five years it has completed 11 PFI projects in water, sewage and waste management, with a capital value of £650 million of investment. Northern Ireland, in the same period, has completed one project with a capital value of between £10 million and £15 million — that is quite a significant difference.

There is scope for PFI to play its part in properly managing to reduce that infrastructure deficit.

595. The Minister of Education has just announced three bundled schools in the education programme that have a combined value of about £70 million. That is £70 million of additional capital expenditure that probably would not have been incurred through the conventional procurement route. Therefore, PFI can play a role in reducing that deficit across all sectors.

596. The first point raised was about capacity constraints. In all of the PFI projects established here, the main players and the principal sub-contractors are Northern Ireland companies. They have demonstrated their ability to play their part in the overall process. The great weakness from the private sector's perspective is that all the major projects carried out in Northern Ireland were initiated in 1996-97. No new projects — with the exception, perhaps, of the oncology project at Belfast City Hospital — have come onboard since. There has been a hiatus in the "deal flow" and the great danger facing Northern Ireland companies is that those that have built up that skill base could well lose it.

597. **Mr Bill:** John Graham (Dromore) Ltd has formed a partnership with McGinnis Construction and Farrans (Construction) Ltd to address educational projects. To date, we have successfully secured four of the six education pathfinder projects. The three main parties in our supply chain are from Northern Ireland, therefore we do not see any capacity difficulty. In fact, there is considerable frustration in the private sector at the moment that deals are not coming forward more quickly.

598. **Ms McIntyre:** In the long term our ideas about good practice in PPP will evolve. As ideas on how to do those deals develop we are seeing tweaking of the PFI model. What is good about PFI or PPP is that we are establishing some basic principles. For example, need is looked at on a decent scale. It is not just about a school catering issue or a school building falling down — it is about trying to put the issues together and solve the whole problem as a package. It is about trying to get better value for money by gluing that package together.

599. By trying to solve the problem over a long time, you are trying to get whole-life VFM for that solution while trying to best manage the risks. There are advantages to injecting private sector capital into the solution. Those core principles will always remain, but the precise details of how it will be done will change over time. Therefore, it is not just a narrow PFI issue; it is about trying to think about what type of PPP will best incorporate those key characteristics.

600. **Mr Weir:** Thank you for your presentation. You indicated that there are no financial or capacity constraints. Rather the opposite applies because companies are frustrated because there is not the volume. You believe that incorporating social goals into matters can be counterproductive and jeopardise VFM. With regard to constraints and areas applicable to PPP, the Treasury insists that consideration be given to PPP for any major project. What areas does CBI feel are unsuitable for PPP?

601. **Ms McIntyre:** One needs to look at some of the key characteristics of any project. If the risks of a project are political rather than operational PFI may not be suitable. One also needs to look at market capacity because as that grows the scope for doing the deals also grows.

602. PFI prisons in Great Britain may be used as an example. Ten or 15 years ago one might have thought that the risks in the prison sector were largely political and that there was not any private sector capacity to deliver prison services. Today's market is completely different. We have built up private sector capacity to deliver the services — a new industry has grown to deliver those custodial services. More mature debate is had about the risks involved. Some of the risks are still political and not taken on by the private sector, so the private sector does not take on demand-risk in the prison market. However, it takes on many operational risks.

603. One needs to ask what is doable now, and recognise that much more may be achievable in the future.

604. **Mr Weir:** You mentioned, and your submission identified, the technical constraints of business tenancy law. You thought that that restricted the development of PPP. In what way is it restrictive and how would you like to see it changed?

605. **Mr Horner:** I am not a lawyer, unlike some people around the table. The key issue is that during a PFI contract the public sector is giving the private sector operator an opportunity to use a Government asset. In normal PFI projects across the water that is done through a lease, because business tenancy legislation is different in Great Britain to that in Northern Ireland.

606. A private sector operator in Northern Ireland who is given a lease may not have to return the asset to the Government at the end of the project agreement 25 years later, because the private sector operator has rights under business tenancy legislation. In all projects in which CBI has been involved in Northern Ireland to date — particularly those that relate to the use of the land — the Government have had to issue a licence to the private sector operator. That has caused initial difficulties in relation to the private sector operator's ability to claim capital allowances on the capital expenditure it has invested in during the project. To date, we have been able to get around that, but it has caused a degree of difficulty that could be erased if that legislation was changed and brought into line with the rest of the UK.

607. **Mr Weir:** You have identified various areas in which you would like to see improvements in how the

Government handle PPP. Has the CBI identified any other lessons about PPP?

608. **Mr Horner:** It is taking too long for projects to be completed. The three-year gestation period from initiation to completion is too long. Enough precedent has been set — examples in Great Britain, Northern Ireland and in other places can be used to shorten the whole process. However, that process can only be shortened if the public sector has sufficient will, expertise and skills to take that project from beginning to end. The CBI is concerned that an insufficient skill base exists in the public sector, and that those skills that have been created in certain Departments have been lost because their people have moved elsewhere. Those are some of our key concerns.

609. **Mr Bill:** Pre-planning is another key area. That should be done in partnership with the private sector to identify suitable projects. There have been a few false starts, which do not help encourage private sector involvement.

610. **Mr Close:** Why is the private sector better equipped to deal with risk? As much of what we are discussing is about spreading and taking risk, why is the private sector any better at that?

611. **Ms McIntyre:** The private sector is only better at managing the risks that are in its remit — not every risk will be better handled by the private sector. I have talked before about political and demand risks being better left with the public sector. Managing operational risk, design risk and construction risk is bread and butter for the private sector. That is its core business. It does that every day by developing techniques to handle those issues well. The public sector cannot do everything. The injection of private capital puts pressure on the private sector to operate those risks well.

612. **Mr Horner:** A school is one example of what we are talking about. We do not suggest at all that the private sector should provide for teaching in a school. Specific issues such as tiles falling off the roof, the cleaning not being up to standard, contract specifications et cetera should be left to the private sector. Those issues should not be left to the school, the teachers or the headmaster to manage. Teaching is the key strength of teachers. By creating a partnership between the private and public sector, key issues such as the building of schools, maintenance, cleaning, catering et cetera is then passed to the private sector because it has built up expertise in those areas over many years.

613. **Mr Close:** Is that because the private sector is in a better position to exploit labour?

614. **Mr Horner:** No. Mr Bill can talk specifically about how the public sector workforce can be integrated into the private sector. Teaching is not The bread and butter of the private sector is not teaching, but building schools, or operating and maintaining them.

615. **Mr Close:** Going back some years, hospitals are the classic example of where the private sector has been involved in public sector facilities. Undoubtedly, service provision in hospitals has been done at a lower cost, and labour has been carrying that lower cost. That is indisputable.

616. **Mr Bill:** That is not my personal experience. I currently work at the North West Institute of Further and Higher Education in Derry, and we have recently transferred 70 employees from the public sector onto our books. We have guaranteed that there will be no compulsory redundancies and that the employees will enjoy the same terms and conditions. We have trained the staff and the morale in the college has increased. Those are our experiences.

617. **Mr Close:** Does nobody have any experience of what happens in hospitals?.

618. **Mr Bill:** Everyone is aware, from the press, of what you are referring to, but we do not have that personal experience ourselves.

619. **Mr Weir:** Have things moved on?

620. **Mr Bill:** Yes.

621. **Ms McIntyre:** The private sector is not only better able to manage certain risks, but, because of the way that deals are constructed, the contract is influential in holding the private sector to account. You get paid on results. If the facility is not clean or the kids are not fed you do not get paid. The contract ensures that risks are allocated to where they are best managed and that there is no fudge.

622. Things have moved on. For example, our experience of compulsory competitive tendering in local authorities and hospitals in England was, at worst, that you had “bargain basement shopping” at the expense of workers’s terms and conditions. The CBI has been at the forefront of a whole range of changes that have tried to ensure that we get better quality services and a better deal for staff.

623. An advantage of PFI and PPP is that it provides a much better framework for securing better quality services and a better deal for staff. That is not only because the deals are long term, but also because there is more political interest in making sure that they are right. The planning happens at the forefront. We talk about the importance of staff transferring with job security. We are having mature debate on how to take account of workforce issues in contracting. We recognise that you get what you pay for.

624. The margins of blue-collar services are very low. If you squeeze the prices down as low as you can you get bad quality service and a bad deal for staff.

Equally, if you have a long-term approach that is about quality, you are motivating the contractor to make sure that he delivers that quality, because he does not get paid otherwise. The only way to get that quality is to have terms and conditions that recruit, retain and motivate the staff of the calibre needed to do the work.

625. **Mr Close:** When looking at an overall package, you are looking at the long term and the emphasis must be on value for money. In long-term situations when you look into the future, and even in our short-term experiences through compulsory competitive tendering with local authorities, you do not get the service, because it suffers. We have all seen it in local authorities in, for example, provision of recreation. Local authorities get it built, but the service is cut back on.

626. When you bring in the private sector, you do not get the same level of service as 15 or 20 years ago. It is not just there. That is because everyone is focused on VFM in the longer term. My main concern with PPP is that you are looking so far ahead that there is the huge risk in cutting corners, one of which is the provision of service.

627. **Mr Bill:** The service requirements in PFI contracts are so demanding that corners cannot be cut. There are extremely detailed volumes of services, from cleaning to maintenance, covering every aspect of infrastructure. They are extremely demanding, so that would not be the case.

628. VFM in those projects can be achieved by innovation at the front end of the scheme. In all the construction schemes we have been involved with, the public sector has suggested, for example, the refurbishment of the existing building. The public sector will get new campuses, schools and colleges because of our ideas. If you assess that over the whole-life cost of the project it is proven to be greater value for money.

629. **Mr Horner:** The fundamental difference between this and competitive tendering is that if you do meet the detailed output specifications for each of the real service provisions in the contract, the public sector does not pay for it. There is a reduction in the payment to the private sector because it has not met the service requirements. In that way, the service standards, which are important to the entire general public, are maintained.

630. **Mr Maskey:** Mr Horner dealt with one of the specific points that I wanted to make. I am somewhat encouraged by your presentation. You are looking at the wider principles that are needed to underpin this direction.

631. Over the years we have all experienced the serious decline of the service. I hope that we have moved on from that very negative experience of private sector involvement in public service provision.

632. You have given us quite a positive view of the impact on the local labour force; you have stressed that local capacity and local companies will be able to benefit and build. You have dealt well with that. I want to explore two other issues.

633. The first is probably an easy one. You spoke earlier of the need for political will, or a champion, to drive this forward. The Executive do have the power to get involved and embrace those projects. If the political will exists in the Executive to pursue that strategically, and if the legal matters are resolved, would the private sector be seriously encouraged to engage in PPP initiatives?

634. **Mr Smyth:** Yes, very much so.

635. **Mr Maskey:** You said that social factors could possibly be a constraint on private sector involvement. Can you indicate how you view the issue of public sector comparators (PSC)?

636. New Targeting Social Need is a Government policy that is binding on the Executive — it has been built in to all the work that we do. We do not have all the templates just yet, but as we progress and as the Executive bed in, New TSN principles must underpin all our work. That imperative must also flow into investment, either through PPP initiatives or any of the other work we do. Your presentation suggested that the impact of those things may be negative. Nevertheless, they must be catered for because they are Government policies.

637. **Mr Smyth:** We accept that they are Government policies. We just wanted to highlight the risk of jeopardising VFM. On the social front we want to develop our abilities so as to put employment into as many indigenous companies as possible. Where we envisage bundling we should perhaps ensure that we do not go too far by bundling everything and making them enormous, as that would attract a lot of the multinationals. To date, the evidence indicates that indigenous companies are doing very well, both in terms of leading contractors and on the sub-supply side. If they are getting involved many local jobs will be created by those projects. People are not going to travel long distances in a number of those areas so there are opportunities for local labour. However, if you start inserting contractual conditions, there is a danger of increasing the risks. The private sector will have to judge those risks, and they will bid up costs on the back of that. Therefore, we need to be careful in that regard.

638. **Mr Horner:** The Belfast Institute of Further and Higher Education (BIFHE) project is a specific example of a PFI project that can improve social needs. That project was won by the Northwin Consortium and the initial conventional procurement solution was a mixture of new build and refurbishment of the old Millfield campus. Through innovation by the Northwin Consortium, the PFI solution has brought about a completely new building for the Millfield campus, work

on which has already started. A socially-deprived area that is probably well known to you, Mr Maskey, will have a whole new frontage. That exemplifies the benefits. Students will have access to state-of-the-art facilities that are more helpful for their third-level education; more students will be encouraged to come to that facility, and overall economic benefits for the area will improve.

639. **The Chairperson:** How much have the needs of the service users in the local community been taken into account when designing and putting forward those type of projects? Again that comes down to VFM against the issues that have to be dealt with, like New TSN.

640. **Mr Bill:** At BIFHE we primarily address its principal needs, but we do give consideration to how the facility could be used for the public. We are involved in two schools projects and the intention is that community groups from outside can come in and use the facilities. The community will benefit from the projects.

641. **Mr Smyth:** The key driver is the service required from the procurer, and that is where the attention should be focused. However, the private sector can bring an innovative approach. We could have wider benefits, particularly to local communities, than we would with a conventional procurement route.

642. **Mr Leslie:** We dealt briefly with the law earlier. Are there any specific areas in which we need to change law to make projects more feasible? I am still slightly unclear. Some aspects of the Treasury rules in England have been changed and there is a certain lack of clarity as to how that has spread to Northern Ireland. Can you tell us more about business tenancy legislation or any other points you think are important?

643. **Mr Horner:** One of the more specific issues that may arise is in relation to the further education (FE) colleges. Having created effectively limited incorporated entities out of each of the 17 colleges in Northern Ireland, they will effectively be the contracting authority with the private sector. That has been an inhibiting factor in the growth of PFI across the FE colleges in Great Britain because of similar constraints. The banks have difficulty in considering or accepting the covenant of each of those colleges, as the money they get from Government depends on the number of pupils they attract. They are contracting with a limited entity as opposed to a Government Department, therefore many of the financial institutions will have difficulty in lending senior debt to the private sector operator.

644. **Mr Leslie:** What is needed to fix that?

645. **Mr Horner:** In that particular case they would need a Government covenant underpinning the FE covenant.

646. **Ms McIntyre:** That is a quite similar issue to those we have dealt with in Great Britain concerning local health authorities. The laws had to be strengthened to make it clear that the health trust has the power to enter into the deal so the banks can be comfortable that it is within the NHS trust's power to pay the bills long term.

647. **The Chairperson:** Someone mentioned that PFI or PPP are well established, with proven methods. We have found little evidence of long-term schemes that have been fully implemented. We are still dealing with the short term, therefore we are guessing how the 30 years will pan out. From the Government's point of view, where all of their finances are tied up in PFI, how does that affect its successful conclusion?

648. **Ms McIntyre:** It is fair to say that PFI is still in its infancy. We are at least sure that it is trying to put into practice some sound principles that will be true forever — you are trying to get VFM and allocate the risks where they can be best managed. It puts you on a decent footing.

649. The point was made that PFI may tie up budgets. If you build a hospital conventionally, you will still have operational budgets for the staff and the service contracts. Therefore, you make a long-term commitment when you decide to build a hospital, even if you are building it conventionally. The beauty of PFI is that it puts discipline into the building exercise, particularly to ensure, for example, that the buildings are maintained. It is more honest about the implications of improving the infrastructure. We are relaxed about public finances. PFIs do not unduly constrain room for manoeuvre or tie up a huge chunk of public finance.

650. **The Chairperson:** How enthusiastic is the financial sector to invest in those projects?

651. **Mr Horner:** The Northern Ireland financial sector has supported all the projects that had the right covenant that have been undertaken heretofore. All got some project finance, and many have project finance experience. The two leading banks in the UK with PFI projects are the Royal Bank of Scotland, which has the Ulster Bank subsidiary in Northern Ireland, and the Bank of Scotland, which has been active in the market through its Northern Ireland subsidiary, Equity Bank. My own bank, Bank of Ireland, has enhanced its PFI capability in Belfast, Dublin and London. The market is maturing. You are right to say that no project has gone through the 20- to 25-year cycle. The market is mature so far as lending in the UK is concerned, and all the banks in Northern Ireland have played their part.

652. **Mr Close:** Will you get value added tax (VAT) back once BIFHE project is completed? How will VAT be treated under PPP? The rate of VAT is 17.5% on the bill, which reduces the potential savings.

653. **Mr Horner:** VAT is money that you spend and money that you get back.

654. **Mr Smyth:** Companies recover VAT. However, domestic consumers cannot recover VAT, and that

would have more of an impact on them than on a commercial enterprise. A commercial enterprise can recover VAT if they have to pay it.

655. **Mr Close:** Yes, but VAT is zero on new build. Is that correct?

656. **Mr Bill:** That is correct from an individual's point of view, but as Mr Smyth said, BIFHE, for example, is commercially completely VAT neutral. Commerce recovers.

657. **Mr Close:** The Government are paying for a service. What is their point of view on the matter? Buildings are not the only matters to which the VAT issue applies. VAT is incorporated into an overall service over a projected time, with which there may be problems.

658. **Mr Horner:** The payment mechanism with the public sector is all pre-VAT. The private sector will incur VAT on some of its expenditure, but reclaims that from Customs and Excise. Private sector expenditure is therefore VAT neutral, and the cost to the public sector is all pre-VAT.

659. **Mr Close:** What impact does resource accounting have on the balance sheet?

660. **Ms McIntyre:** Resource accounting should help with transparency when comparing a conventionally procured deal against a PFI deal. That should be helpful in ensuring that the focus of any contract is on VFM, not just about trying to get deals off the Government's balance sheet. Emphasis should be on VFM. We have talked about value for money a couple of times. That is about cost and quality issues — it is not about getting the lowest price.

661. Some of the past problems that we have spoken about have not been caused by a value-for-money mentality but by a lowest-price mentality. In theory, we are home and dry now because we have got the policy right — everyone talks about value for money. However, in practice, some public sector bodies still need to be won over to the VFM approach instead of the lowest-price approach.

662. **Mr Close:** That is linked to the fact that we do not know what the outcome of the PPP projects will be after 25 years. To an extent we are living on a wing and a prayer. Mr Horner spoke about a "panacea" — PPP is not a panacea, but there seems to be a view emerging that everybody has been waiting for years for this great new invention called PPP to arrive to solve all ills. We must keep our feet firmly on the ground and recognise that value for money does not necessarily mean the cheapest option. We should leave matters such as risk transfer to the experts — let them do what they are good at — but we must not get carried away. We need to redefine the term "value for money".

663. **Ms McIntyre:** It is important to have a good clientship and public sector officials who are really good at procurement and contract management. Our submission pressed the point very hard that we need to raise skills levels to ensure that the people who have the skills stay in the posts long enough to learn the job. That will be the key to getting value for money.

664. **The Chairperson:** Thank you for the presentation and for taking the questions.

MINUTES OF EVIDENCE

Tuesday 29 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr Close
Ms Lewsley
Mr Maskey
Mr Weir

Witnesses:
Mr Graham
Mr J Gillvray) Construction Employers Federation
Mr B Martin

665. **The Chairperson:** We will open the meeting with your presentation and then members will have some questions for you.

666. **Mr Armstrong:** I am John Armstrong, assistant director of the Construction Employers Federation. Thank you for the opportunity to make representations to the Committee today. I will start by introducing our representatives. On the extreme left is Mr J Gillvray, our vice-president and also the managing director of Farrans Construction. Immediately to my left is Mr Billy Martin, a past-president of the Federation and the managing director of H&J Martin. The leader of our delegation today is Michael Graham, managing director of Grahams of Dromore and a council member of the federation. Also present are my colleagues Nigel Lucas, deputy secretary, and Catriona O'Rourke of the Construction Employers Federation.

667. **Mr Graham:** We very much welcome the decision to hold an inquiry and are grateful for this opportunity to contribute. The Construction Employers Federation is concerned at the significant increase in infrastructure deficit in Northern Ireland, and feel that public-private partnerships (PPPs) and public finance initiatives (PFIs) have a key role to play. It is important that we find the most appropriate and cost-effective solutions to suit the scale and scope of projects in Northern Ireland. PPPs and PFIs are well-established methods of procuring public services, and number among possible solutions to our infrastructure problems. If used appropriately, PPPs have delivered and will deliver better value for money. It provides superior service performance to that of conventional capital procurement. It assists and helps with Government planning of future investment and helps develop those businesses in the delivery of a more competitive service.

668. It is important to point out that Northern Ireland is lagging behind in this respect. A lot of work has already been done in Great Britain and the Republic of Ireland through public-private partnerships. Although it is important to stress that PPP is only one key tool, the Office of Government Commerce in Great Britain has specifically named it as one of three main options — along with design and build, and prime contracting — which are particularly suited to renewal of the water, education, and health and transport sectors. Key success factors include selection of the right projects, namely those that are appropriate and of the right scale. Nevertheless, political commitment must exist to make it happen. Appropriate skills and good departmental preparation are necessary to make it happen at the requisite speed.

669. Let me sum up. It is vital for Northern Ireland to have a public procurement strategy and plan. We feel that that must be effectively co-ordinated, and we see great merit in having a dedicated support unit to help achieve this.

670. **The Chairperson:** Thank you for coming along and for your presentation. It gives another insight into this whole situation.

671. The stop-start approach has left companies unsure whether they are into PPP or not. Do you consider that there is a big enough base here to provide a continuous deal flow?

672. **Mr Graham:** There is a massive deficit in the spend for infrastructure. The deficit for roads is in the region of £2 billion; in water it is potentially £3 billion. If PPPs are properly administered we think there will be sufficient flow to make sure that it is not a stop/start process. Co-ordination and planning are very important, however.

673. **Mr Weir:** The trade unions have expressed concern that if there is a rapid increase in the amount of projects undertaken, local businesses will not be able to cope and it will lead to a lot of the contracts going outside Northern Ireland. How do you react to that assertion?

674. **Mr Graham:** I do not think that is the case at all; on the contrary, there is capacity in the industry here. We have all been involved in projects of this type before, and we have beaten quite significant competition from the mainland. The expertise is in Northern Ireland and can remain here, and we want to compete with the best — wherever they come from.

675. **Mr Gillvray:** I agree. That certainly has not been the case. It has been said many times in the past that we cannot do it, but local contractors have carried out work on the Odyssey, the cross-harbour Bridge and the Royal Victoria Hospital.

676. **Mr Weir:** Four or five years ago, a lot of projects were started. Fewer projects have been commissioned in the last year, so there is a danger that expertise may

be going to waste at the moment as there are too few current projects. You mentioned that there must be a fairly consistent flow of deals in order to sustain a flow of projects. Is there a danger that the expertise exists but is under-utilised?

677. **Mr Gillvray:** That is the case. The cancer unit at Belfast City Hospital is probably the only PFI project in the last two years. There has definitely been a gap. Even in the public sector, expertise which had clustered in the education department has now dissipated. Therefore, expertise on both sides must be marshalled. That is not happening.

678. **Mr Weir:** In your dealings with Government Departments do you detect different levels of enthusiasm for PPP?

679. **Mr Gillvray:** Yes. We even find a difference between individual users. For example, Peter Gallagher from the North West Institute of Further and Higher Education was a bit iffy at the start as to whether PPP would be useful; however, a PPP facility is now open there and he is an enthusiast. He can concentrate on teaching without having to worry about broken windows, catering or maintenance of the Institute, as he knows the building is going to be maintained for 25 years. In the past, one of the problems with the public sector was that, once the building was constructed, maintenance was either forgotten about or kept to a minimum.

680. **Mr Weir:** That is because maintenance was the first thing to be cut from the budget.

681. **Mr Leslie:** We have done a lot of work on the pros and cons of building schools and hospitals. Roads are more difficult. What initiatives should we be considering in order to harness the private sector and address those excessive traffic problems on key routes such as the West Link and the M2? What do you think about introducing tolls?

682. **Mr Graham:** In Great Britain, there have been differing experiences of the use of shadow tolls. In the Republic, I understand that both options of tolling of bridges and shadow tolling are being considered. It is important that a plan be put in place and that money be allocated where necessary. At the moment those criteria do not cohere, but when they do, it will simply be a matter of packaging projects attractively to allow the private sector more scope to offer innovative solutions and more value for money.

683. **Mr Leslie:** If a road is to be built then the private sector will build it, irrespective of whether it is financed through traditional procurement or PPP. The Government does not build its own roads — private contractors are brought in to do that. How do you think value can be added through PPP in a way that it is not through public procurement?

684. **Mr Gillvray:** That can be achieved mainly through maintenance of the road. There must be a maintenance sector. The design, build and structure of a road will be the same, regardless. Maintenance is generally carried out piecemeal.

685. However, a long piece of road is needed in order to make this work, as is happening in the South and in England. You cannot simply take a £1 million contract and decide that that is to be a part of PFI. That does not make sense. A mile of road cannot be maintained for 25 years, whereas fairly large chunks of road can.

686. **Mr Leslie:** Are you going to build it differently if you are responsible for maintenance?

687. **Mr Graham:** No. However, the private sector will get paid for maintaining it, and will only get paid if the service is being provided. In other words, if repairs have to be done and a lane is closed, there is a mechanism in the contract whereby the private sector carries the risk. Equally, it is important to mention that the recent National Audit Office report entitled 'Modernising Construction' indicated that of major projects procured under traditional methods, 73% were over-budget and 70% were late. If the private sector delivers late under PFI, it carries the risk. The private sector loses money because the facility is not available. In other words there is a much greater incentive to deliver on time, and within budget.

688. **Mr Gillvray:** There may also be differences in carrying out the contract. Obviously, greater capital cost at the start may lead to lower maintenance later on. That tends not to happen at the moment. The attitude at present and the maintenance done tend to be limited by the amount of money available, with the result that things are not done properly.

689. One obvious example is the Westlink, which now needs to be upgraded. If a bit more money had been spent to put another lane on it when it was first built, the problems we have with it today would not have arisen. Tillysburn is the same. We do not need lights at Tillysburn. We could have had a roundabout, but we did not have the money. There are similar examples all around the Province. By planning and doing it properly, you can get a better solution.

690. **Ms Lewsley:** I worry that if we were to go down a more permanent route of PPP and PFI, we would not have the workforce to facilitate a huge number of contracts at any one time. A huge skill shortage seems inevitable.

691. When we met the Major Contractors' Group in London, we learned that it was already finding a skills shortage on PPP and PFIs. How can we be proactive if further down the line we will be searching for skills?

692. **Mr Graham:** We recognise your concern. However, if there was a plan in place with a steady

flow of projects, the industry would be able to gear up and make provision for the training of young people. I sit on the Construction Industry Training Board (CITB). We are aware that the recent increase in activity in construction has encouraged more young people to come into the industry. I do not think that skills shortages will arise.

693. Construction companies and individuals in the industry can make better long-term plans if they know that there is a plan in place from central Government which shows a continuity of business. This will be much easier for our business than the stop-start climate that we have been used to over the years.

694. **Ms Lewsley:** Allow me to turn to the issue of the transfer of workers from one sector to the other; the transfer of undertakings of public employees (TUPE). I am concerned that women, and part-timers in particular, could end up with worse pay and working conditions if there is not some type of guarantee for them.

695. **Mr Graham:** It is important to stress that PPP and PFI models are based on value for money, not on lowest cost. Value for money is only going to be delivered by those who provide the best service over the whole life of a project. To do that you have to make sure the conditions are such that you can attract, retain and motivate the right people. It is silly to ignore 50% of the population. The future of a private sector business is based on the service it delivers. If it is not delivering, that business will run into serious problems.

696. **Mr Gillvray:** We worry about the other side of the process. Things are held up by statutory processes, planning, and human rights legislation; essentially by people being able to object to things being built. In fact, rather than this huge flow that you are expecting, I worry that we will not get anything built at all because it has to go through so many processes. Again, the Westlink is a prime example. Work cannot start until about 2004 and it will not be finished until 2007. That process started three or four years ago, so it has taken nearly 10 years to get a road built.

697. **Ms Lewsley:** Does that not come down to a lack of consultation with people? Decisions were being imposed, and the people that lived in those communities were not even consulted. Our inquiry also highlighted instances of poor communication between the workforce and the employers. In one case, cuts were made, which could have been made more appropriately if the contractor or developer had spoken to the workforce.

698. **Mr Gillvray:** We are all for communication and we all want a better Northern Ireland.

699. **Mr Close:** One key element of PFIs and PPPs is the transfer of risk. It strikes me that in drawing up the contracts etc, that really becomes a myth, because the risk still lies with the public sector. For example, if a private-sector firm is in the middle of a contract and cannot comply with its terms, the firm can put it to the public-sector partner that enforcement will ruin the firm and leave its partner high and dry. Where is the risk in that?

700. In your submission you said that financial advisers are rarely willing to take risks. It is very difficult to sell something and to convince the buyer that that is the best way to go. However, these contracts are so tight that the passing of risk is really an illusion. Can you comment on that?

701. **Mr Graham:** There are different types of risk. There is risk during the construction process where, under traditional procurement, things are normally late and cost more. The private sector takes on board that risk during the construction period. Once the facility is constructed the risks are relatively small. The deals are structured in such a way that they have to be financed over the entire term. Significant risks are taken by the private sector.

702. **Mr Gillvray:** There is a balance, and the idea is to find out who can take that risk. You could almost turn it round the other way and ask what risk the public sector is taking. They want a facility and we are providing it — where is the risk in that? It is a partnership working together. It is not the same as normal procurement, where there is a price up front and a year’s maintenance and that is the end of it. We are now entering into something where we are going to work with the public sector for 25 years; it is a private-public partnership. There are risks on both sides. We are taking the risk that we are able to provide the service at the price. You are taking the risk of getting value for money, and making sure that you do.

703. **Mr Close:** We are also taking a risk in that we have not seen a project run for the full 25 years. There is no example of this in operation where value for money has been clearly proven. Any exercises that we have seen are over a 10- or 15-year period. I have not seen any exercises that clearly demonstrate value for money at the end of 25 years, because there are none. You ask me where the public sector is taking a risk. It is quite demonstrable: we have not seen the fulfilment of any 25-year contract that has been able to demonstrate value for money.

704. **Mr Gillvray:** If you look at schools that were built in the sixties and seventies, and the state that they are in today, you cannot say that that is a public sector success. They have not been maintained. They have been put up and forgotten about. An amount of money goes in, teachers are paid first, then books et cetera, and eventually down the line there may be some money left for maintenance. That is not the way you or I want the schools to be run.

705. **Mr Close:** You are correct in that. However, money has not been available for maintenance. We are now moving into a situation where that money is written into the contract, and it is required to be available over a longer term. We would not find ourselves in this position if it had been managed properly in the first place. Unfortunately, for a host of reasons, that has not happened. I want to be satisfied that the appearance of risk movement is not an illusion, that it is real and that the public sector is not still carrying the risk.

706. **Mr Martin:** We feel that it is a risk for us. It is clearly defined in our contracts that we must maintain these buildings and we must deliver them on time. The penalties for non-completion are heavy. I have mainly been involved in buildings as opposed to roads, but the same thing goes both ways. Planning is important. PFI is only one way of procuring public services; it is not the only way. There is a slot for PFI.

707. Ms Lewsley made a good point about the shortage of people in the industry. There is a problem with getting engineers, bricklayers, joiners and plasterers into the industry, partly due to its cyclical nature. Colleges in the South of Ireland are full of engineers. The bricklaying apprentice schools are full because there is such buoyancy and continuity in the industry. Young people react to that by coming to work in the industry. There must be continuity with young people, employment, work and excitement. It is a matter of political leadership with a plan; if a special project team were founded, people could get on with it.

708. Look at what has happened at Laganside in Belfast. If that had not been concentrated on, there would be a derelict dockyard and a scrapyard. What has been achieved there with push and focus is terrific. With your leadership, PFI could play its part in redressing the public sector financial deficit.

709. **Mr Maskey:** In the Committee's experience, one of the arguments that has underpinned Government's reasons for using PPP or PFI in the past has been that the private sector can do things better than the public sector. However, when the Committee met with people in Dublin, Leeds and elsewhere, where the public sector has assembled people with greater expertise in negotiating contracts and so on, it saw that efficient and effective teams have been assembled in various public sector departments. That is obviously a good thing.

710. I presume that the introduction of PFI and PPP has forced the public sector to respond in a way that, perhaps, it did not in the past. I am trying to work it out in my own mind. It is the argument about whether the private sector can do things better. It is more to do with the culture of the public sector in the past, as opposed to the current demands, and how projects can be brought to fruition.

711. Is the private sector naturally better? I do not believe that it is. The public sector, if it faces the same demands and must maintain the same standards, must do the work better. Perhaps the public sector needs to attract a different kind of personnel, such as project managers and so on. It is a fair assumption that the public sector is assembling some expertise.

712. **Mr Graham:** It is important that the appropriate skills be available in the public sector. If they are not readily available, provision should be made for the development of teams, so that continuity can be ensured and whatever lessons are learnt in different areas can be shared. That is the point that I made earlier about having a dedicated support unit similar to those across the water. That is important because if the support unit is not in place the continuity will not be there, and things will take much longer.

713. It is not right to say that the private sector does it better. The structure of PPPs means that the private sector gets paid for service and delivery over 25 years. Equally, it only begins to get paid when the facility is there and available. Therefore, the focus in private sector companies is much sharper, because they are shareholders. They are much closer to the companies delivering. They are demanding to see the performance there. From that viewpoint, there is a commercial reality that focuses the mind on overcoming obstacles.

714. Through public-private partnerships, we hope to create better schools and hospitals and to help commerce and industry reach the ports faster. Private and public sectors cannot remain separate; they must work in partnership.

715. **Mr Gillvray:** There must be a change of attitude in the public sector. It runs "Northern Ireland Ltd," and it must look at what "Northern Ireland Ltd" needs by way of schools, hospitals and infrastructure. We must draw up plans for what must be done in the short and medium term and implement them, and that has not happened in the past. Lack of such forethought will leave us further and further behind. We have had 30 years of that attitude, and it is time for a change.

716. The public sector must consider what it wants and draw up a national plan such as the South has. Even if it does not achieve that, it will have gone a long way towards putting a good infrastructure in place. We do not have such a plan, but we do need one. People will be needed to drive the system, and if they are called project managers, so be it.

717. **The Chairperson:** Your submission says that where the preferred bidder has been identified, costs should be recoverable. Would that be the case if you were bidding for roads or contracts in the normal way? What is your justification for that?

718. **Mr Graham:** Costs should be recoverable if responsibility for a project's failure does not lie with the private sector.

719. **Mr Gillvray:** We usually have substantial legal and financial costs that are not found in a contract, so there is much more in the tendering and negotiating to a preferred bidder. We should get there as quickly as possible. If one party falls out with the other, one should approach someone else rather than keep the advisors and banks waiting, as these cost money. It is a very expensive process and its costs should be reduced.

720. **Mr Graham:** There are guidelines and templates that can be used to ensure that one gets to preferred bidder stage as quickly as possible.

721. **The Chairperson:** Trades unions are worried that in attempting to get PFI arrangements in place as quickly as possible, businesspeople may overlook workers' rights. Can the transfer of undertakings and the protection of workers be built into the contracts and be maintained in the long term?

722. **Mr Gillvray:** Yes, and that has not been a problem. It is fear. There have been many of them, and no compulsory redundancies have been built into the contract. That has not been allowed. Therefore, there is continuity of employment. If anything, the workers are better off as they have a better facility to maintain. They will have an involvement that they may not feel at present. That helps. If we talk to those involved, we will find that the fear recedes.

723. **The Chairperson:** How effective is risk-sharing? Why are risks not shared with the legal and financial organisations? They provide the money at some stage but do not seem to share the risks when the programmes are being put together.

724. **Mr Gillvray:** The legal and financial people want to say that it costs so many pounds an hour and that is it — you can either have us or not. Risk-sharing is not involved.

725. Risk-sharing in normal procurement involves building something and maintaining it for a year, but we are talking about something being maintained for 25 years. The public sector could say that you can construct the building, maintain it for five years and maintain payment over the five years. Thismeans that you can achieve more in the first two or three years than at present. I challenge the Roads Service, Water Service, hospitals and schools to produce projects that will take up twice the money that is currently available. That is not possible.

726. The statutory process means that there are too many obstacles. You need to speed the process up by planning more schemes. You do not have to say that it is all PFI or all conventional public projects. You can go for something in the middle, and you do not have to change any condition of contract — just the payment terms. When you build the construction you say that you will pay 50% of the money during construction and that you will give 10% each year over the next five years. The private sector will then maintain the works for five years.

727. **Mr Leslie:** You suggested that there should be a central unit that deals with that process. That has exercised our minds a lot. The Health Service is enormous in the UK and even in Europe. The Health Service has a central unit that helps those health trusts that are taking this route. The Health Service clearly has the scale to justify that unit, and the people there know about health problems and building hospitals and so forth. That approach is more difficult here because of the small number of hospitals that we have — and we will have fewer in the future.

728. We have been looking at whether there should be one unit in the Government that drives PFI and PPP projects. The snag with that is that individual expertise is required. If you are building a school, you need to know about building schools, and the same applies to hospitals and so on. The situation is completely different again when you take in the IT skills of the private sector. We do not know whether you could practically have an effective central unit — the answer is not leaping off the page. What are your views on that? How would we square those circles? There are advantages in getting the expertise in to one place, particularly if you look at the problem with scale. There is enough scale in Northern Ireland for one unit, albeit one that is multidisciplinary.

729. **Mr Graham:** You have highlighted a problem of which we are aware, but to which we have no ready answers. It is important that the central unit in some way facilitates those who want to use this route, and it is important that the expertise and experience of those who have been through the process is maintained and that things are done consistently. The danger is that one Department does things slightly differently from another. Departments are all learning at the same speed. One argument says that the central unit should act as a facilitator to map out the process, suggesting how that should be done, and also the disciplines that should be put in place. The health estates, for instance, have their team and Roads Service has its team, but there must be some way of co-ordinating efforts so that processes are not being carried out and repeated. We must ensure that we learn from best practice elsewhere.

730. **Mr Gillvray:** That would also help with the strategic plan that is trying to bring matters together. If that plan was implemented by a central unit, that would mean that matters are gathered together and will go forward as joined-up Government, and not as bits and pieces that may not have continuity. We do not need to

start from square one as we are so far behind what is happening in the Republic, England and Scotland.

731. That central unit should be able to go and get the information, as you have been doing in England, and start higher up the scale. This is state of the art at present, and we do not need to have legal fees going back to the start of this, having new conditions of contract and forgetting everything else. We can be quite a long way up the learning curve and benefit from coming late into the process. A central unit that would gather all that information together, rather than having people spread about, would help.

732. **The Chairperson:** Have you learned from any issues in the past, which you could use to the benefit of future contracts, whether in legislation, leases or any areas that you see as problematic?

733. **Mr Graham:** Rather than lessons learnt, it would be better to say that the lessons are reflected in some of the things that must be present to make a project successful. First, there has to be the political will and the senior management commitment within the public sector to say, “There is a deficit and we will do something about it”. PPP is one option, but we should recognise that things will have to be done differently than they were in the past, because the traditional ways are not going to match the deficit. The right projects must be selected, because not all projects are suitable for this approach. Our point is that PPP is one of the options. We have such a big deficit that we have to look at PPP seriously and use it as part of the plan to deal with the deficit.

734. It is important that public sector skills be developed. My colleagues and I have been involved in PFIs here, and there are some people who are a lot more adept than others and who have been able to progress matters significantly quicker. It is also important that we have expertise. We know that it exists here because some schemes are in development, and some have been constructed and are in operation. The continuity of projects is therefore important. It goes back to having a plan, because we do not want to develop skills and then have to lose them and end up back in a stop/start situation.

735. It is also vital to have good departmental preparation with clear objectives and outputs — specifying what the public sector wants to achieve from the facilities — so that, before they even go to a PFI, they are clear about what they want to get from it. Most importantly, the schemes that work do so because there is an open and objective attitude. They have a ‘can-do’ attitude to getting things delivered. If the attitude and will are there, then it will happen.

736. **Mr Gillvray:** We also have legal problems in that business tenancy here is not the same as in the rest of the United Kingdom. I cannot explain it to you, but from the lawyers’ viewpoint there is a problem. There is a problem with the strength of covenants for some of the further education colleges, as to whether they, as they stand on their own, are strong enough for a bank to lend money to. Those are things that we should be able to overcome.

737. **The Chairperson:** Thank you very much.

MINUTES OF EVIDENCE

Thursday 26 April 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Mr Hussey
Mr Maskey
Mr Weir

Witnesses:

Mr D Doyle	)	Department of Finance, Irish Republic
Mr G Hennessy	)	Construction Industry Federation
Mr P Keating	)	Irish Congress of Trade Unions
Mr R McCabe	)	Irish Business and Employers' Confederation

738. **The Chairperson:** You are all very welcome. If you will open by giving us a short introduction, we will then ask questions.

739. **Mr Keating:** I represent the Irish Congress of Trade Unions (ICTU) on the informal advisory committee. I am not an employee of the ICTU. I have a day job with IMPACT, which is primarily a public-sector union. I have responsibility for a number of issues there, but we can come back to those later if you wish.

740. Within the ICTU, assistant general secretary Joan Carmichael has overall responsibility for social and economic issues. Liam Berney, an industrial officer, has day-to-day responsibility for the wider public-private partnership (PPP) issue. I am the representative on the committee. A small working group, representative of various interests, deals with PPPs. That is how the issue is being managed.

741. Most of you will be familiar with the ICTU. The union has some 500,000 members south of the border and over 200,000 north of the border, spread over 63 unions. It is a large-scale organisation with members in every nook and cranny on the island. The ICTU does not see its role solely in terms of industrial relations. Particularly in the context of social partnership in the South, it has a role in social, economic and environmental issues, above and beyond the traditional role of trade unions. For that reason it is not confined to workers but also encompasses pensioners and former, potential and unemployed workers. Congress would like to think it is taking their interests on board.

742. We should view PPPs in the context of social partnerships, and the National Development Plan (NDP) in particular. As you are probably aware, we are now on the fifth three-year social partnership agreement since 1987. The agreements cover socio-economic issues, pay and taxation, and much as we should like to believe our members vote on the basis of the whole package when it comes to such agreements, there is a certain reality that pay rises and tax cuts are the primary deciders of outcomes.

743. At national level, trade unions, and the ICTU in particular, think it is essential that socio-economic dimensions be included in the overall framework. Most of the agreements are based on work done by the National Economic and Social Council, a body on which all the social partners are represented. It has traditionally provided the background and major proposals in the are of socio-economics. The last report, the forerunner of the present agreement, had a substantial section on the purpose of PPPs, focusing in particular on the need for us to agree a framework.

744. Another relevant issue is that social partnerships are developed on a national level. Work-place partnership is not as developed as we should like it to be, partly owing to its late arrival. It was provided for only in the second-last (1997) agreement, 'Partnership 2000', meaning that it is very much in its infancy. There is also a great deal of misunderstanding on both sides of the table about the concept of partnerships, what we wish to achieve through them, the reasons behind them and where traditional industrial relations will be left. While there is much confusion, where the idea has worked — and there are many good examples — it has worked very well, facilitating many important changes from the point of view of trade unions.

745. Currently our greatest difficulty is probably overcoming people's fear and distrust of those on the other side of the table. That is fairly standard in any set of relationships, but attempts to move away from the traditional adversarial approach to industrial relations towards a situation where certain parties engage themselves in work-place partnership is not an easy process. It involves confidence building and trust — issues with which I am sure you are familiar — and they cannot be achieved overnight. Their development has helped to bed things down.

746. The reality of PPPs from our point of view is that we are still in the early stages. As with any organisation, people look at other models. Many of our members have worked in Britain or Northern Ireland and are familiar with what happened with privatisation programmes under the Conservative Government. They greatly fear that PPPs are simply a new name for doing exactly the same thing — privatising and contracting out. A great deal of baggage must be dealt with, and none of us underestimates the amount of training and education which will be required to bring our constituents along with the process.

747. While members formally signed up for PPPs in the context of the Programme for Prosperity and Fairness,

when one talks to experienced trade-union officials one discovers that they do not have a full handle on the issue. That is not their fault but ours, for not putting them in that position. Information and understanding are essential to bring people along to ensure that the process is different to any similarly worded scheme they may have seen elsewhere.

748. **Mr McCabe:** I am the director of the PPP unit in the Irish Business and Employers' Confederation (IBEC). We are a national organisation representing employers and have some 8,000 members and a staff of about 130. Our headquarters are in Dublin and we have regional offices and also an office in Brussels.

749. Like many similar organisations, we operate via a structure of committees and have had a working group on PPPs for several years. The committee is made up of practitioners and professionals who have an interest in promoting the concept of PPPs. Specifically, we have representatives from the banks, the main consultancy companies, lawyers and one or two people from the contracting side. The Construction Industry Federation (CIF) represents most of the contractors.

750. The PPP committee has a number of roles. It is a social network and a forum to allow people to get to know each other. We are particularly interested in tracking the progress of the many PPP projects that are under way. We keep an eye on technical issues, particularly taxation and legislation.

751. Many technical issues need to be addressed and we will lobby on behalf of the professional and business community in those matters. That includes commercial rates and VAT. We will also lobby on delivery structures for PPPs. We are concerned about the management of the PPP process in the Republic and on how it is developed and delivered.

752. We also have a clear role as a stakeholder in the area of communications. The employers, as a group, and the business community have a strong interest in seeing an effective PPP process developed. We need to make sure that our own members, the people we represent, are on board. They need to understand that tolling, for example, must be introduced to finance projects. Everything is not always sweetness and light. We sometimes have to persuade our own members of the value of such things. As employers, we also have a role in the community at large. We see ourselves as having certain responsibilities in communicating PPP issues to our own members and the wider community.

753. From the inception of the current NDP, IBEC has been pushing for higher priority to be given to investment in infrastructure. Everyone is familiar with the infrastructure deficit in the Republic, particularly in roads, public transport, environmental services and waste management. PPPs play a central role in achieving delivery in those key areas and also in improving the quality of service. We have been pushing the infrastructure agenda for quite some time. We are signatories to the Programme for Prosperity and Fairness and are heavily committed to the overall social partnership process.

754. **Mr Hennessy:** I am the director of economic affairs for the Construction Industry Federation (CIF). PPPs are central to the interests of contractors and we are therefore keenly interested in the whole process. Our interest started around 1997 against a background of concerns about what would happen at the end of the 1994-99 NDP. In the expectation of falling EU resources, we were concerned about where the funding would come from for major infrastructure projects.

755. That was our starting point. We saw PPPs as part of the armoury of public sector clients, one of the options they had for delivering projects, particularly large-scale or complex projects, where we envisaged that consortia would be involved.

756. The NDP provided the bedrock of an investment programme and the framework for the roll-out of PPPs. The social partnership process in the Republic, involving the CIF, IBEC, the unions and the Government, allowed us to discuss PPPs within an inclusive framework. I mention that because our initial feedback, particularly from the UK, was that the roll-out of private finance initiatives (PFIs) brought a strong negative reaction from the construction industry, mainly because of the high costs involved in the bidding process. It even led to a number of companies going bust. We were anxious that that should not happen here, and I think that arrangements have been put in place to allow the concerns of all the social partners to be addressed, either under the NDP or in the PPP structures that have been set up.

757. The issue for the industry in relation to PPPs is the changing scale of projects. We are now talking about projects costing from £50 million to £150 million or more, whereas the bread-and-butter projects in the civil engineering sector of the industry would have been £10 million to £25 million projects. Civil engineering capacity has become a major issue, and the structural issues within the industry are a major concern for us as a representative organisation.

758. There are mixed views among contractors. There are those who see it as an opportunity, a way forward, but many contractors, particularly medium-sized contractors, see it as a threat to their traditional work base. One example is education, where a number of projects have been grouped together. Traditionally we would have had five projects of £5 million to £10 million each, but now we have one much larger project that attracted a totally different set of contractors and left other contractors out of their traditional markets.

759. As for the allocation of risk, the PPP process transfers a lot of risk from where it once sat under

traditional procurement methods to other methods. Risk largely falls on contractors, and that is an issue for the industry.

760. The cost of the tendering process is far higher than in traditional procurement, so standardisation of tendering procedures and contract documents becomes an issue. Perhaps those are technical points, but in the roll-out of PPP everybody should be working with the process. If it becomes an extremely expensive process for contractors, the numbers that are prepared to tender might be reduced, and there might be problems in the roll-out of programmes.

761. **Mr Weir:** Mr McCabe, you mentioned that you thought that there were problems with the delivery and management of the process. Can you expand on that?

762. **Mr McCabe:** We have achieved political buy-in and that is important. There is a strong commitment from the key Ministers — the Minister for Finance, the Minister for the Environment and Local Government, and the Minister for Public Enterprise — to the PPP process. Structures were put in place to deliver the PPP pilot programme about three years ago. The programme had quite modest ambitions. About £2 billion was envisaged for pilot PPPs which were recommended in a consultancy study carried out by Farrell Grant Sparks. The programmes were pathfinders; you can learn about the pitfalls of the process by actually doing it.

763. There have been developments since the NDP was published, especially in public transport, and the PPP programme has grown from a potential £2 billion to a potential £10 billion. However, the delivery and management structures are identical to those for the pilot programmes. The process needs to be moved up several gears.

764. We are interested in the type of structures that are in place in the United Kingdom. Its Treasury Taskforce did not work; they seemed to be too close to the Treasury. Partnerships UK has now been set up; it is independent and it is a PPP. It raises funds in the market and becomes actively involved in projects, although I am not suggesting that we should rush into the Partnerships UK model. I do not want to pre-empt things. We have made several suggestions but the Department of Finance has commissioned a study on PPP delivery structures this is almost complete from PricewaterhouseCoopers. Obviously I have not yet seen the report. More management resources in the public sector need to be devoted to the development negotiation of PPPs.

765. **Mr Weir:** The bulk of your firms' work would be in the Republic but presumably there are firms that go through the bidding process in the UK. This may be an unfair question, but if you compare the tendering processes in the Republic with those in the UK, what lessons do you think can be learned on either side?

766. **Mr McCabe:** Are you referring specifically to the tendering process?

767. **Mr Weir:** I used tendering processes as an example, but do you think that the PPP process has been utilised better in the UK or in the Republic for certain processes?

768. **Mr McCabe:** I do not have an in-depth knowledge of PFIs in the UK. They have had a much longer period of time in which to bed down the process, almost 20. We have only been involved for a few years and we are learning as we go along.

769. **Mr Hennessy:** The short answer is that we will learn from the UK experience. The essential difference is that in the UK it was Government policy to test all capital projects for PFI, but that is not the approach here. It is recognised here that PPPs have a role to play as part of the procurement process but that the bulk of projects will continue to be procured in the normal way and that there will be design-build projects. There is a more practical approach here that is more European than British in the way it uses private sector finance and facilities management skills to help to deliver a major scheme of infrastructure.

770. **Mr Leslie:** My question relates to how the problem was resolved to the satisfaction of the construction industry, although the construction industry sought the expansion of the programme. We have seen clear examples of high tendering costs and long timescales from invitation to tender to completion of contract.

771. What solutions have you proposed as to how those issues might be dealt with? Efforts have been made towards standardisation in the documentation and structure. However, that varies a lot and is not as simple as one might think. What thoughts do you have on how that might be approached?

772. **Mr Hennessy:** That is a key issue for the construction industry, which has been dealt with, first and foremost, through the National Social Partnership process. In the current programme there is a clear Government commitment to discuss the issue of tender bid costs with the industry.

773. There is also a commitment to find a solution to the costs problem, perhaps by way of a contribution to tender costs and addressing the standardisation both of tender procedures and contract document information. That process has just commenced and we have had one meeting. It is a priority and I note that it is an important issue for you as well. It is key to the successful roll-out of the PPP process.

774. **Mr McCabe:** We have learned from the UK experience. For example, the National Roads Authority, which is responsible for procuring PPPs, in the long term will have 10 road PPPs, with two currently in the

market. The authority has adopted the UK Highways Agency model as a form of contract.

775. Whether developed from the UK or developed internally, as time goes on much emphasis will be placed on the development of model forms and the standardisation of contracts. That can integrate efficiencies and save time, particularly at the negotiation stage. That will be a key issue in the overall management of the process.

776. **Mr B Bell:** In the mid-1980s I was chairman of the Northern Ireland Gas Employers Board. We formed what was then probably the first PPP on this island between the trade unions, the ICTU and the gas employers. We felt that it was essential to have co-operation between the unions and the employers.

777. Mr Keating talked about suspicions among his members. Is that currently a problem between the employers and the trade unions? In Northern Ireland we are about to embark on this process and we feel that if there are suspicions we need to learn some lessons.

778. **Mr Keating:** There are currently two different levels. I mentioned the National Social Partnership, which has been well developed over the past 15 years. There is not the same level of suspicion at national level of each other's motives because people work together and the information is available to all sides. Everything is out on the table and people can make their own value judgements on the motives, or otherwise, of where people are coming from. Therefore, there is not as much suspicion at national level as is involved at work-place partnership level.

779. However, when it comes down to the individual work place, there are problems because we do not have developed partnerships as much as we would like at the work place level. As a result, we still have the traditional suspicions of the industrial relations arena: the employer wants more profits, the workers want more pay, and if the employers are doing anything different, then it is simply another way of trying to screw the workers.

780. A practical example is Dublin Corporation's Ballymore Eustace water treatment plant. There are proposals to extend the existing plant using PPP. It has been discussed by the partnership committee of Dublin Corporation, and a number of angles have emerged. Issues have arisen about the transfer of undertakings. Who will be the employer? What is the difference between PPP and privatisation? What is the business case for it? The fact that water is involved, as distinct from a motorway, say, is an issue for many on the union side. The attitude is that no one outside the public sector should be allowed to take control of a vital commodity such as water. Issues of this kind are coming into the arena.

781. It is bubbling below the surface. The partnership group on Dublin Corporation has come to the view that it would prefer not to see a design-build-operate PPP. That includes management and the union side. The attitude is that if it cannot happen, for whatever reason, we must look at plan B. There is a great deal of discussion as to whether it is a good idea; there is genuine suspicion.

782. My own union has some involvement. One of our representatives worked for many years as a trade union official in the United Kingdom during the Thatcher era, and he comes complete with all the baggage. Suspicion is high on the list, and he is not alone in that respect.

783. That is where we must be clear — and why the framework is so important — about the purpose of PPP and where the circumstances might make it appropriate. We must deal with it on a pragmatic basis. Rather than say that everything is a PPP we should say that one project would be suitable and another not, securing discussions at the earliest stage.

784. It is a tough job to tread slowly and build the confidence of both sides, and the earlier people get the information, the better. In any political environment — as you will know — Ministers like to announce things fairly quickly. When a good idea emerges, the Minister announces it on the morning news or whatever to get any kudos going rather than waiting and thinking through the implications properly. That sort of thing gets the people's backs up on the ground, and they ask why they were not told and all the other things with which you are familiar.

785. **Mr McCabe:** There are actually three PPP projects under way in Dublin Corporation at the moment. One currently being built is the sewage treatment plant at Ringsend, which is a design-build-operate (DBO). There will be a consortium involved in operating it, and I believe it has been shortlisted. I am conscious that I am speaking on the record here, and I do not have all the details of the consortium, so let us skate over it by saying that the project is very close to completion. Neither the management of Dublin Corporation nor the unions appear to have a problem with its being operated as a PPP.

786. There is a proposal for a municipal waste incinerator on the same site — or an adjacent site — in Ringsend. So far there do not appear to be any problems with its being operated as a PPP. However, for reasons which I cannot fully appreciate, there is, as Mr Keating suggests, a substantial problem with Dublin Corporation operating a waterworks as a PPP. My feeling is that water is regarded as a traditional area of service delivery by the local authority. They are reluctant to cede control of a traditional area, whereas sewage is something that they —

787. **Mr Keating:** Dumped in Dublin Bay — literally.

788. **Mr McCabe:** He said it — not me.

789. That is where the fracture point arises. It is an issue largely to do with buying in. You are talking about stakeholders, their commitment to the process, and how inconsistencies can emerge very quickly in the same entity in relation to its attitudes, depending on the particular sphere you are addressing.

790. **The Chairperson:** With water, is there also a fear of the knock-on effects — that if you privatise one particular section you could end up with water charges for the ratepayer?

791. **Mr McCabe:** Yes, that could be part of it.

792. **Mr Keating:** That argument has come up at internal trade-union meetings. In most cases, we have been able to assure people that there is no connection and that Government policy is opposed to changes. A change in the law would be required before water charges could be imposed on domestic users. That can be done if Dublin Corporation is running the facility or if it is a private operator. It is neutral in that respect.

793. It becomes a political issue because, within the membership of trade unions and employers' bodies, there are people with their own political viewpoints on life. They are not always shy about finding venues and opportunities to express those views. Certain issues have emerged in the debate. Mr McCabe is right to say it comes down to what we have been doing over many centuries, not just years. The year 1200 was given as a good example — that is when Dublin Corporation started looking after water. It has not been a good manager of sewerage and does not have any great expertise in managing such a facility or an incinerator on a large scale. It was very much a case of "If we own it, we keep it".

794. **Mr Maskey:** Mr Keating mentioned Ministers and their good news stories; we have some Ministers now announcing the same stories three times.

795. Two issues caught my attention during the presentations. Mr Keating has dealt with one: the trade-union experience. I am thinking about the application of the Transfer of Undertakings (Protection of Employment) Regulations 1981. Can you elaborate on that? Some of the trade unions in the North are ideologically opposed to PPP — to some extent I agree with them — but by the same token they are dealing with it very pragmatically on a day-to-day basis, although it is very much in its infancy.

796. Earlier, Mr Hennessy mentioned the clustering effect for small companies. Obviously, in the North we have a fairly small economy, and small businesses are its backbone. I should be concerned if the clustering effect meant that you do small firms out of business and force them into larger consortia. Do you have any long-term projections? How would that affect local employees?

797. **Mr Hussey:** Mr McCabe more or less admitted that it is taking time to build up the expertise. Obviously, the Government are pushing ahead. How great is the danger of business from outside the island coming in, filling that void and freezing you out? As I understand it, the construction industry in the Republic is running at 99·9% of capacity, and it is still not able to fulfil all the projects available. Therefore companies from outside are coming in and taking that business. Can PPP progress at a speed which allows indigenous businesses to carry it through over a longer period, or are you content that it pushes forward at a pace which allows non-indigenous businesses to come in and take those contracts?

798. **Mr Hennessy:** From the macroeconomic perspective, because of the growth of the Irish economy in the last few years, there is an infrastructure deficit. We have bottlenecks in transport and the housing market. We must address those, for they are a national economic issue. The question of capacity in the construction industry must be dealt with in that overall context. We should like to see a stepping up of investment rather than an initial peak after which it might perhaps fall off. The NDP, as originally set out, had a peak in 2001-2002.

799. We want to maximise the capacity utilisation of the domestic construction contractor. The best way of doing so is by a mix of contracts by size and type. We see PPP as part of the arsenal of public-sector client bodies when deciding how to implement particular projects — not a philosophy which applies across public procurement.

800. There will be an impact on the scale of companies. Once you start rolling out PPPs, you can seriously impact on the traditional markets for family owned regional businesses, and that is what we see here. We have only had one example in the education sector, where five school projects from different parts of the country were grouped together. National contractors with foreign partners were on the bid lists for those jobs. The firms who would traditionally have got those jobs were not able to tender.

801. In the national development plan there are a number of very large and complex jobs where, regardless of what procurement route was going to be used, there would be very strong foreign contractor participation. LUAS is an example of a large-scale tunnelling project. There is also the treatment plant. We would normally expect major consortia to deliver those projects, with foreign contractors also involved. We want to see strong Irish contractor participation as part of the consortia and build up the expertise of our own firms.

802. The Government is supporting a major educational programme among contractors to give them more experience to develop co-operation and partnerships among Irish contractors. In the North there have been one or two PPP projects where two Northern Ireland contractors have come together only to be the least preferred bidder. That shows that the structure of the industry is changing.

803. **Mr McCabe:** A few weeks ago the preferred bidder for the education contract was announced. School principals have been complaining for years that, in addition to providing education, they have to arrange to fix the broken windows, cut the grass and so on. The PPP provides an opportunity where a private company is responsible for the “soft” services in schools. However, when the project was announced the headline in ‘The Irish Times’ and ‘The Irish Independent’ was “English contractor wins PPP”. The actual mini-revolution in education was completely ignored. The focus was on the fact that it was a foreign contractor, which is interesting. We can be very parochial in our view.

804. Interestingly enough, the same edition of ‘The Irish Times’ carried a story that the Irish Aviation Authority had led a consortium, which had successfully won the national air-traffic control contract for the UK. I believe that contract was worth around £1 billion, though I cannot name the exact figure. It is a huge contract, and an Irish agency lead the consortium.

805. I emphasise that we must be balanced in our view on the issue. You will have outside companies coming in. Jarvis plc, with huge expertise developed in the UK market, has the education contract. Our companies also have expertise. The PPP/PFI concept is phenomenal — it is not just a British Isles phenomenon; it is right across Europe and the world. There will be tremendous export opportunities for companies in the Republic and Northern Ireland as that process evolves, and as we develop the expertise. We must emphasise that. Tender costs will be reduced if we have more and greater involvement by outside contractors. I believe we must acknowledge that.

806. There is a difficulty in the local market since the construction industry does not have the capacity to deliver the range of projects contemplated. Therefore there is a need for greater foreign participation, and we welcome that. We should not focus on the negative aspects.

807. **Mr Leslie:** Mr Keating talked about public transport employees. A large cohort of public transport employees live in my constituency, so I have been on the receiving end of their concerns about the future of the sector. Northern Ireland just about got devolution in time to save part of its rail network. However, the concerns of people employed in the public transport sector reflect what you said about received wisdom and baggage. They were terrified that there would be privatisation and that their jobs would be threatened.

808. However, the reality is probably the opposite. What might save their jobs may be part-privatisation or some sort of joint package. The status quo will not do so. What tips do you have on how to convey that message?

809. **Mr Keating:** The capacity issue is a little masked in the Republic, for we are beyond capacity. In Dublin one will see large numbers of Northern Ireland and UK-registered vans on building sites, natural gas pipelines and so on. If there is an enhanced construction programme north of the border, some of those people will move back home, staying there and not coming down here during the week. That will create further problems on the island. There is no substitute for our having to find additional labour to deal with the projects and roll-out of the infrastructure.

810. Everyone familiar with the building industry would like to see a more balanced phased approach, but the infrastructure deficit is so great that there is a need to try and get the jobs completed as quickly as possible. That is one of the reasons why the trade unions have bought into PPP — it is a quicker way of delivery.

811. We must consider what will happen when all the projects draw to a close. Where will we end up? Most people do not think 10 or 15 years down the road. In the Programme for Prosperity and Fairness agreement the ordinary trade union member gives very little attention to the socio-economic or PPP aspects. There is a need for debate on the issue. It must be dealt with on a pragmatic basis to see if it is consistent with the values and standards we wish to see. For instance, what are the roles for the public service and the private sector? How can they work better together?

812. That is important for the ICTU in the context of the framework. Much of that detail is discussed to emphasise the differences between privatisation and PPP. It is important that people understand those differences. That will not happen unless they are engaged in the process and have to think about them.

813. Dublin Corporation was the first major project where that came on the table. As Mr McCabe said, there was no problem with the first two projects, but the third ran into difficulties for the reasons mentioned. Therefore that issue needs to be dealt with. Capacity is also a concern for the trade unions. External contractors must employ the same terms and conditions as local counterparts, and the agreements must be adhered to given the trade unions the CIF deals with. For obvious reasons that suits everyone. Those details are set out.

814. The trade unions were defending public transport from an ideological viewpoint — as is true of all public services. We defended it because it is the public service, not because it is the best way of delivering the service to the client or of delivering public transport or education.

815. We are doing it on ideological grounds and need to know the purpose for doing so and the best way of managing the situation. The difference between the public sector and private sector trade unions in relation to PPPs is interesting. Many of the public-sector trade unions are concerned about moving from public to private sector, while private-sector trade unions do not have that baggage. It varies from employer to employer and needs a totally different approach. One of the things we are looking for in the framework — and I do not believe it will be a problem — is that, if there were a transfer involved, minimum terms would apply. There has been much discussion when it comes to the transfer of undertakings. One issue which does not apply is that of pensions. Pensions will be a big issue for those in the public sector as they represent one of the reasons why some people have made a conscious choice to stay in it. A number of mechanisms have already been considered, one of which is the long-term secondment of staff. Another option is bringing the new PPP operator into the relevant public service pension scheme, something which has happened in the past.

816. Many of the discussions are at what I should describe as the emotional stage, where people are fighting ideological battles. There is the fear of the unknown — of the operator who will come in and change all the conditions. The more certainty that can be injected into the situation, the better. We must be able to say there is a norm applicable across the industry, whether it is a private or public operator. I know from Mr Liam Berney, who is dealing with the transport side, that it is down to arguments over detail in the legislation. For example, in one of the standard clauses which normally go into legislation where a body can procure rail services — such as a metro round Dublin — there is a doomsday situation where they could provide the system themselves if something went wrong. There are objections from the unions, and there is a fear that the procurers will set themselves up as an operator in competition to the existing state company. Such is the level of suspicion and concern.

817. No doubt a text can be found to appease all sides and sort out the problem, but unfortunately I do not have an off-the-shelf, easy solution.

818. **The Chairperson:** Perhaps we might return to the water issue. One of the things we discussed in London was that it was easy for PPPs where there was an income from a source which can pay off the contract. However, where there is no income, such as in the care of the Health Service where a mechanism can be seen for generating an income, is it a concern for trade unions?

819. **Mr Keating:** There is great concern, since in the two main areas there is going to be some form of charge, such as water charges or the equivalent, and that would send shock waves through the system. The other major issue will be the first line of PPPs in the new motorway structure. All those motorways will have tolls. We only have two toll bridges in Dublin, with no other tolling on public roads. We are now facing the prospect in the next few years of having six, seven or eight different major motorways with tolls — an unfamiliar environment. That is all right for the person travelling once or twice a week to Cork or Galway; they do not mind paying the extra couple of pounds. We now have a situation, particularly in the greater Dublin area where, because of housing and other infrastructure problems, people are living 40, 50 or 60 miles away and regularly have to travel by car to the city centre because there is no appropriate public transport. That will create mayhem unless alternative roads are kept in line. We have been discussing the possibility of ensuring that that road network be maintained to at least the same level as today. There is no argument or disagreement from the National Roads Authority on that.

820. Concerning the letters of comfort, where there are no direct charges on the consumer, there would have to be some sort of viable system from the staff's point of view. Those issues are part of the contract terms so as to be absolutely certain of the basis — whether they be shadow charges, picking up the tab as one goes along, or some other means.

821. The Aviation Authority, for example, operates an international system. Its costs are simply divided by the number of airlines and flights, and everyone receives a bill accordingly. Of course, that might not be appropriate for a school. There must be a means of ensuring that people in the education sector who do not pay charges are not levied in future and that the charges are not excessive but ensure viability and proper maintenance.

822. **Mr McCabe:** Whether a hospital is procured by traditional means or by PPP, the building will require maintenance and the service must be provided. It is a matter of efficiency. With a PPP there is competition at the outset in which people bid and put together a package intended to deliver the most efficient and cost-effective solution. That will be approved by the procurement authority. That immediately gives the procurement authority a great deal of certainty over a very long time about the likely cost of operating the facilities. The authority can see what sort of innovation has been introduced.

823. Most of those elements are missing in a traditional procurement — the contractor builds the asset and walks away, and the public sector is left with the job of actually operating and maintaining it in a very uncertain environment. I am not sure whether the charging for the service is really at issue here. Some appropriate services lend themselves to a charging mechanism; some services simply do not, and health care falls into the latter category.

824. **Mr Keating:** When there were cutbacks in the past — maintenance among them — central government tended to assign cutbacks to local authorities and to health agencies rather than cut back on the core budgets of Government Departments. I understand why many public sector workers might still be wary. Operators have lingering fears about how the state would fund their services if there were an economic downturn in the future. They fear the state might start penny-pinching their services so that those standing for an election did not suffer.

825. **The Chairperson:** We do not wish to be responsible for wrecking a partnership. Areas which have suffered disadvantage in the past — west of the Bann in the North and parts of the west of Ireland — might not be attractive to contractors or to public-private finance if they think the return might not be good.

826. How can you ensure that those who have been neglected in the past do not lose out and are not overcharged in the future?

827. **Mr Keating:** I do not feel it will prove a problem. PPP is only one of several mechanisms. The traditional routes still exist, and people will not accept this way of doing business unless they are happy with it. People can continue to use the traditional methods until their confidence in new ones has grown.

828. Environmental issues are involved, for people are concerned at how tolls are introduced and maintained on motorways. In the past, people have taken the state to the highest courts when appealing a decision on where a motorway was to be sited. A contractor may not wish to wait around for five or six years. These are questions relevant to infrastructure.

829. **The Chairperson:** Your information has been very valuable for our inquiry. I was interested to hear the trades unions' point of view. They have members in the North who wish to contribute to an inquiry, and we welcome that.

MINUTES OF EVIDENCE

Thursday 17 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Ms Lewsley
Mr Weir

Witnesses:
Mr T Barrett) European Investment Bank
Ms C Fisher

830. **The Chairperson:** You are very welcome. If you make your presentation the Committee will then ask you questions.

831. **Mr Barrett:** I am a director of the European Investment Bank (EIB), with responsibility for a number of countries in north-west Europe, including the United Kingdom. My colleague is Cheryl Fisher, who is one of our senior executives responsible for PPPs in this region.

832. I have given you a briefing paper and slides that I hope will at least set the PPPs in context. To some degree people find it difficult to envisage quite what PPP is about. It sounds good, but what exactly will it deliver and when? I will touch very briefly on some view graphs from the briefing paper to illustrate a very wide body of experience with PPPs throughout the European Community. In large measure that experience has been very satisfactory. The question of precisely what role PPPs should play in Northern Ireland will remain, but we can help you in part of your task by explaining why PPPs have been adopted in many different countries and in different circumstances, with what those countries see as beneficial effects.

833. The European Investment Bank is a European institution and is a very large lender within the European Union. Last year we lent approximately 35 billion Euro, of which 16% to 17% was to the United Kingdom. In recent years, not much has been lent to Northern Ireland because financial needs have been well looked after by EU structural funds and other UK mechanisms, and it has not been necessary. EIB, in many ways, comes in to complement structural funds. The other important aspect is that the Northern Ireland banking system is particularly liquid and strong. That affects the role of our institution, but it also creates possibilities for PPPs.

834. The slide marked ‘Single Market and European Monetary Union’ summarises some of the major trends that have been happening throughout the Union. The left-hand side of the graph shows the need for increased action by the EU and member states in favour of physical integration in peripheral regions. To implement the entire single market programme, notably the trans-European network programme (TENS), which started during the 1980s — the Thatcher Government’s early period in power — but still continues in all member states. There is enormous investment in developing networks in transport, communications and energy. The other side of the slide shows the complementary move towards economic and monetary union, which has lead to the establishment of larger financial markets, of which one of the effects has been increased competition between sources of finance and improved conditions for borrowers.

835. Though the UK is not currently a member of EMU arrangements, this topic is not irrelevant in the UK for the reason that the fiscal policies in many respects, notably the improvement of value for money (VFM) and restrictions on taxation and deficits which this Government follows, are similar to those followed by governments in the European Union. This has had the effect of changing the role of the public and private sectors, notably in the provision of public services and public infrastructure. There has been a switch between them throughout the Union. Examples are the commercialisation of state enterprises, increased deregulation and third party access to common infrastructure. One particular example in the UK was privatisation. The most recent development of that is public-private partnerships. The concept has been that the private sector brings a number of things into play that the public sector cannot, and there is a synergy and benefit to be gained by the public, as users of the services, in joining them.

836. It must also be said that the development of the single market and the economic and monetary union obviously changed the role of the financing community. This has become a much more important single force than previously, when it was compartmentalised. There is now much greater competition, and more diverse and competitive financial instruments are available to meet a variety of financing needs that could not be met previously. Part of the very significant success of PPPs has been the ability to tap into the financial markets to the benefit of public services.

837. I should emphasise that EIB speaks as a European institution, which by statutes is a ‘not-for-profit’ institution. Our key focus is not whether the private sector makes a profit or not — we count on their good sense and discipline to do so when they get involved, but on improving public services and on supporting the public authorities capabilities to implement their priority policies. We look at PPP proposals broadly by saying “does this improve the spread and level of investment — when it happens, how it happens, and

what it achieves?" and "do the public sector get better value for money?" EIB has invested and are willing to continue investing heavily in this area because we believe that generally is the case in the majority of proposals we have reviewed to date. This is the broader macro framework and is a key factor behind our views in guiding various member states.

838. Even though the United Kingdom gave a lead in the late eighties and early nineties — Norman Lamont formally started the PFI programme — other member states have been doing comparable things for long periods of time also, and it has developed momentum. It is interesting to hear the French remind us that the concept of PPPs started with Colbert, who started private sector concessions, and there is logic in that. The Scandinavians have been working on this concept for a number of years, and have used it on the Oresund Bridge and the Great Belt Bridge in Denmark. PPPs are not a fad concept — something that is simply fashionable at the moment. It is a method of procurement of public infrastructure and services that reflects different developments over time; it has deep roots in many countries and has stood the test of experience in a number of countries.

839. I will move on to the next slide, which shows infrastructure projects in the European Union. PPPs are a trend that is developing strongly in the EU. If you look the at many examples of how public sector infrastructure was procured, you see at the bottom right hand side of the graph (see handout) the Belgium ports, Spanish ports, Greek port terminal. et cetera: the public sector owned the infrastructure in its entirety. You will also see on the left-hand column that they were normally procured on a cost plus basis. Mostly user fees were not applied, though sometimes they had a small user fee complemented with Government subsidy, and sometimes they had a user fee. That was the traditional way that infrastructure was being procured in the EU. Over the last few years you can see from the slide a flourishing alternative development, where the private sector shares in the equity or the ownership responsibilities (middle column). The private sector also shares risk as a contractor — they bear the construction risk, overrun risks or the time risks. In some of these cases the users are the people who will pay for services at point of use. It is important to look at the significant number of such developments. One indication of that is when we look at the total PPP lending from the bank, with at least five countries in the community where the bank has lent more than £1 billion equivalent to PPPs. That is quite significant. The lending on PPPs in the United Kingdom alone is about £2 billion. Banks such as EIB are conservative institutions, and they do not get into such sectors if they do not consider that they are working.

840. You will already have heard the general arguments why PPPs work and what they deliver from the other witnesses you have called. One of the key points is that there is no single instrument that can meet all requirements. PPPs are an additional instrument. They widen the choice for the public sector when the public sector wants to achieve more within its limited resources. PPPs will not and cannot suit every case.

841. The next slide, which illustrates the motorway developments, is very interesting because it shows the variety of financing techniques available. Government is always asked what is the most effective technique in our circumstances, what technique will deliver what we want within our budgetary constraints. The other slides give answers to these questions from different countries and sectors. They show examples of roads in Wales, high-speed train lines in England and other countries, and energy in Italy. The Northern Ireland Electricity regulator is on record as saying that he thinks that much needs to be done in his sector — I do not think one needs to expand on that to this audience.

842. A further slide shows what the PFI and PPP projects in the United Kingdom the EIB has been involved in. You will recognise many of those as strategic, important and complex projects. The Skye bridge was a rather small but interesting affair. Other interesting projects are from the education and health sectors. Falkirk Schools in Scotland was the first set of grouped schools. The finance allowed Falkirk Schools to accelerate their investment and to deliver improved quality of schooling in that community. Under conventional Treasury rules it would have taken 20 or 30 years to make comparable investments.

843. Many of you will know the situation in Glasgow where the council decided that all secondary schools in the city had to be modernised and brought up to an acceptable standard as a matter of priority. I did not know the situation before but I am told that it was less than perfect. They put together a package of approximately £280 million and the programme has gone well. It is a significant test case in Scotland, and it will be interesting to see how it works out.

844. There are other projects such as Kirklees schools and the Dudley Hospitals — you will not lack examples of other hospitals and schools. The sophistication of the financial instruments being used at Dudley Hospitals is a full league above what it was 12 months ago. This illustrates my point, by using the PPP approach to financing public infrastructure one is able to tap into the new found structure characteristic of financial markets, which is quite beneficial.

845. You also see on this slide that there is a range of project costs and size. It is hoped that none of the projects in Northern Ireland will be as big as the Jubilee Line or the Eurotunnel. Hopefully you will have lesser problems to struggle with. Further slides illustrate the involvement

of banks and the evolution of PFI in the United Kingdom. I expect all that will be a familiar to you.

846. The final slide is about how to tap into financial markets, for example, when one is trying to lower the cost of transport infrastructure or assets that are being used for public services. It is a complex, sophisticated illustration, but it is a further application of how public and private come together — the public mission and objectives supported by the private sector using financial engineering.

847. The EIB has had an extensive experience of PPPs in the United Kingdom. All major markets of the EU to date have featured in our activities on PPPs. The level of involvement we have is considerable, and, to a large degree, we have had satisfactory results. There are always things that will not quite give you what you thought you were going to get, but there are no catastrophes that we are aware of or projects that we have had to revisit.

848. Looking forward to how we might play a PPP role in Northern Ireland, our general attitude would be that we could and would wish to play a role. We are already aware of projects that I am sure you also know a great deal about. For example, there was an educational project to introduce IT equipment throughout the entire secondary school sector in Northern Ireland, which was being looked at as a potential PPP project. There are undoubtedly projects like that which seem to be potentially suitable, and therefore the questions now are whether this is what you, as the public authorities of Northern Ireland, want to do and whether it can be done in sensible terms.

849. **Mr Leslie:** As you have identified, we are mostly operating at the smaller end of the scale. I was interested in a comment you made that the local bank assets were fairly liquid, which I suppose provides some encouragement. We have not looked very hard at the financing structures themselves. However, some of the comments that have been made imply that the focus is all on servicing debt, not repaying debt. To what extent are you expecting that? In reality, a project will get refinanced in due course. As long as the servicing is robust, are you likely to be comfortable with that or are you generally looking to repayment and then redeployment to other projects?

850. **Mr Barrett:** Our core approach is to look at each project on a stand-alone basis, being capable of fully repaying itself well within its economic life. To be frank, I am somewhat surprised by the perception that it might be sufficient to service the debt — the market simply could not work like that. The core focus is on repayment.

851. Perhaps another important point about refinancing comes from your question, because most projects have a construction period and an operation period. Many people think that it is sensible to provide finance to get through the construction period and then to refinance it, because the market takes prices of construction and operating risk differently. If you finance today for the entire life of the project, people’s vision will be clouded by the so-called high risk in the construction phase, and they may not give sufficient credit for what might be seen as the relatively low risk in the operation phase. If you do not refinance after completion of construction it is perhaps arguable that you would pay more than you should as the public sector. For that reason a number of projects have been brought forward with a type of two-phase approach — that is, finance the construction and then refinance the project later when the construction is completed.

852. We do not necessarily regard the issue as clear-cut. Generally, we have gone right through from construction to full life. In many cases at the outset we have agreed to provide post-construction re-financing. It is a question of instruments and fine judgement as to what is best for the public sector.

853. **Mr Leslie:** I suppose it is not appropriate for us to worry too much about how and why you lend money — as long as you do so. The asset is just a pile of bricks, and unless you can turn it over to someone else who wants a school — and there would be a limited market for that — it is not much use as an asset. Would you be looking at the quality of the revenue stream as the basis for the judgement required?

854. **Mr Barrett:** There is a dual basis for our decision. First we would determine if there is a good education project and if it is serving an educational purpose. As EIB is a not-for-profit institution, should the school fall back into our hands we would be even less interested than most bankers about alternative commercial uses for it. In the first instance our decision is really driven by establishing the priority educational needs. The second is to establish the capability for servicing the debt. The asset value is pretty marginal. It is there and, legally, it could form part of a financial security package. However, in essence one would expect that because the projects are needed, the public sector would have an interest in servicing that debt because those projects will serve a public purpose over a long period. EIB is more convinced by that type of logic rather than one that says this is a profitable opportunity.

855. **Ms Lewsley:** The Department of Finance and Personnel has mentioned the reluctance of some contractors to become involved in too many projects because of the risks involved. How can we encourage greater involvement by local and national firms? How enthusiastic is the financial sector to invest in Northern Ireland schemes? Do any special incentives need to be given to encourage greater involvement?

856. **Mr Barrett:** It would be interesting to reflect on which countries or regions within the EC you think are most similar to Northern Ireland in structure and in issues like this. I will comment on some of the countries in which some features had to be addressed, but I am not making a direct comparison.

857. Portugal had a completely domestic market, with small contractors and the type of profit margins that contractors in the UK are well accustomed to — pretty low. It was quite a serious problem because Portugal wanted to build its infrastructure and develop its construction industry simultaneously. A number of Portuguese companies have now grown quite well. They have managed to hold their own with international players who have come into the market and brought capacity, knowledge, skills and finance with them. Portuguese contractors did not disappear and I fully understand that no one would want to see that happen in any region in the EC. There has to be a way of encouraging the development of the local resource and helping it to grow. That has also been proven in Greece, which was another country with a relatively weak economic performance over a long period of time, but which is now doing particularly well.

858. When you look at Ireland you see similar questions being posed, and the Government has potentially taken the harder line by saying that they actively wish to bring in capacity skills because there is a shortage of capacity in industry there. This is the longer-term view, which is relevant for Government. In other member states we are seeing a certain evolution of contractors towards the establishment of what we would call “infrastructure utilities companies”. By virtue of winning a number of concessions they are actually starting a new business and strengthening their entire existing businesses. They are in a position where they are not just contractors at the whim of the market but they also have revenue-generating assets.

859. To see companies like that develop from national to international players is quite interesting. We have seen this with the Portuguese and Spanish, and had always seen it in the case of the Germans. You know full well that the French and Italians have also gone abroad in this particular area.

860. Experience of this type of work —of risk sharing and risk management — can be an opportunity for the construction industry itself. However, the construction industry by itself is not big enough, and it certainly does not have the appetite to provide all of the risk capital needed in such PPP projects. Other investors, both domestic and international, will come in, and potentially that is to the benefit of the regional economy — not the disbenefit — if it is reasonably handled.

861. **Mr Weir:** You have identified that in the various companies you are involved with there are slightly differing financial regimes. In particular, you have identified different attitudes towards the route in which PPP should apply. Looking at Treasury rules and guidelines in the United Kingdom do you have any recommendations for changes? Are they too restrictive, or are there areas that they are too loose? Allied to that, are there any areas to help facilitate PPP that requires legislation in the UK?

862. **Mr Barrett:** Our experience has made our reaction very pragmatic driven in a certain sense. We become involved in the early phase of these projects. People navigated by sight to some degree — what seemed the most sensible thing based on recent experience and what could you learn from others. We are almost in the third generation of how we handle these projects. In that 10-year period of navigating by sight they have probably gone through a constant process of improving, thinking, reflecting and learning — how you regulate and drive it.

863. Putting it again in a European context, at public sector level there is now an informal round table of Treasuries of the interested member states. Together with the UK Treasury they share their experiences. It is a very experience driven thing, and is really driven by the main objectives such as the value for money rather than any particular ideology. Experienced people in this area are very scarce. Do not tie them up for too long, or longer than you have to. Do not over-elaborate things, be simple. Try to standardise as much as you can. However, every time one tries to standardise somebody will make a good case why certain things cannot be standardised. There is a tremendous logic in allowing some flexibility in that, particularly in respect of the financial markets. You want to get the financial markets to compete, that is where a huge chunk of the cost of these projects is. If you think of the normal construction cost of a project, depending on the complexity and the length of construction, how much of that is your financing cost. Even during construction it could be up to 30% or 40% of that again. Over the life of the project it could be something quite considerable — a considerable multiple of that.

864. Getting the financial markets to compete and people to innovate is actually what the process is about. There has been a fairly similar development in most countries in many ways. There has been a common approach of having a central taskforce, for want of a better word, in most member states who drive the process in the public administration and seek to build up experienced groups in the major spending or procurement departments, and to share their experience.

865. Generally, the organisational process has been somewhat similar. Some countries, Portugal for example, have focused in on a number of huge projects. They really put their efforts into the projects that were normally of the multiples of hundreds of millions of

Euro type of category, and did not go for small projects in the initial phase. In the UK the split is that some 50% by value of all projects are less than about £25 million in value. The Italians have gone to both ends of the spectrum, the Greeks only to the big end. It is a question of resource; it requires experienced people, otherwise one must be very selective.

866. As with all new projects, it is necessary to build up credibility, because there are people who are uncertain whether it is worthwhile embarking on this kind of project. The public sector, when choosing, must focus its efforts, not diffuse them, and pick projects that are likely to succeed, rather than difficult ones where no solution can be found. Many things have guided the experience. The successes with the Dartford Bridge and the second Severn Bridge were key factors in the UK in building confidence in the idea of using the private sector for those projects. They were good, clean, demonstrable projects with obvious results. Likewise, the Tagus Bridge in Portugal and the Sparta airport in Greece were the flagship projects that really persuaded people that it was worthwhile.

867. **The Chairperson:** We lack infrastructure. European funds have certainly been beneficial, but additional money is needed. Are finance bonds a credible alternative to PFI?

868. **Mr Barrett:** Bonds are another important instrument. One example is the Channel Tunnel rail link. My answer is non-ideological rather than supportive of one or the other. Because of the market risks, it was impossible to estimate how many people would use the rail link. The construction, time and revenue risks were huge. Government left the construction risk and the time risk fully with the private sector, and shared the passenger risk. The Government's view was that, if they could not estimate their passengers, there was no point in asking the private sector to put funding together. So, they decided to provide a certain amount of guaranteed funding. John Prescott, while restructuring the project, lowered the cost by about £1 billion by guaranteeing that part of the debt, but a large part of the overall risk, lay with the private sector.

869. The same was done on the Danish project. The Government there decided not to allow the private sector to set the tariffs for the service, so they more or less dictated what the passengers and the tariffs would be. In those circumstances, it was better for the Government to guarantee funding and not leave that risk with the private sector. Other important risks were left with the private sector. In certain cases, the Government's role is to guarantee funding by issuing bonds. It is not a question of all, or one, or the other.

870. **The Chairperson:** How do shadow tolls operate?

871. **Mr Barret:** In this country, on major road projects — excluding bridges — the risks passed to the private sector have included construction risks and operating risks over the full life of the concession, but not the risk of putting a real toll on that would discourage passengers from travelling. There is a certain amount of traffic risk that lies with the private sector, and they have to estimate and finance it.

872. There is also a policy issue about payment at point of use, which is sensitive in many countries. Germany, which had a constitutional bar on such payments, recently amended its constitution to allow for payments at point of use. Other countries have chosen mixed systems. Portugal has some roads on shadow toll basis, others on a real toll basis. The Minister of Finance in Dublin has seemingly committed his Government to real tolls. While it can be argued which can give the better result, it does not nullify the transfer of risk.

873. You can, depending on the structure of the deal, get the private sector to base its repayments on an expectation of growth in the market. If that growth does not happen, the private sector will not be paid. The private sector takes the risk, even if it is not collected from your pocket or my pocket.

874. **Mr B Bell:** What are the banks' attitudes to that?

875. **Mr Barrett:** To be frank, having accepted both quite frequently, there is no simple argument either way. If you build a toll road where there are no alternatives in the vicinity, everybody must use it — real tolls are, therefore, not a problem. If you build a real toll road where there are 50 alternatives, how confident are you that people will use it?

876. **Mr B Bell:** We are talking about a bypass road that is quite close to a certain village. If you put a toll on that road, it may defeat the object of the exercise by forcing traffic through the village.

877. **Mr Barrett:** In those types of circumstance, arguing on general principles, you can argue that the public sector gets a better result if you pay a shadow toll, because everybody will use the bypass. The traffic risk is transferred to the private sector, but it is the Exchequer, rather than the individual user, that pays for it. It is very much a case by case argument. This emphasises the point that those civil or public servants, who are taking those decisions on a case by case basis, must have the requisite skills to make good decisions.

878. **The Chairperson:** Are there any examples where the toll is at an alternative location? That is, instead of building a new road and put a toll on it, an alternative stretch of road is chosen that people will use.

879. **Mr Barrett:** There are many examples of that. The Spanish situation is a useful example, because there is a constitutional obligation on the Spanish

Government that, if ever they construct a toll road, they must have an equivalent service available that is non-toll. Yet, many Spanish users decide that the convenience, comfort, speed and quality justify paying the toll.

880. **Mr B Bell:** Are the French in a similar position?

881. **Mr Barrett:** The French Government do not have the same constitutional obligation to provide alternatives. Obviously the European scene is rather complex, but one of the benefits of it is that many of the ideas that you think of will have been previously tested and you can find out the results.

882. **The Chairperson:** Thank you for your presentation and for answering our questions. It has been a useful part of our inquiry.

883. **Mr Barrett:** Please feel free to come back to us, if you wish.

European Investment Bank

Presentation to Northern Ireland Assembly Committee for Finance and Personnel

Pan-European Development of PPP's

Thomas C. Barrett
European Investment Bank

London, 17 May 2001.

European Investment Bank

European Investment Bank

The European Union's Financial Institution

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Kingdom of the Netherlands (AAA/Aaa)
Kingdom of Sweden (AAA/Aa1)

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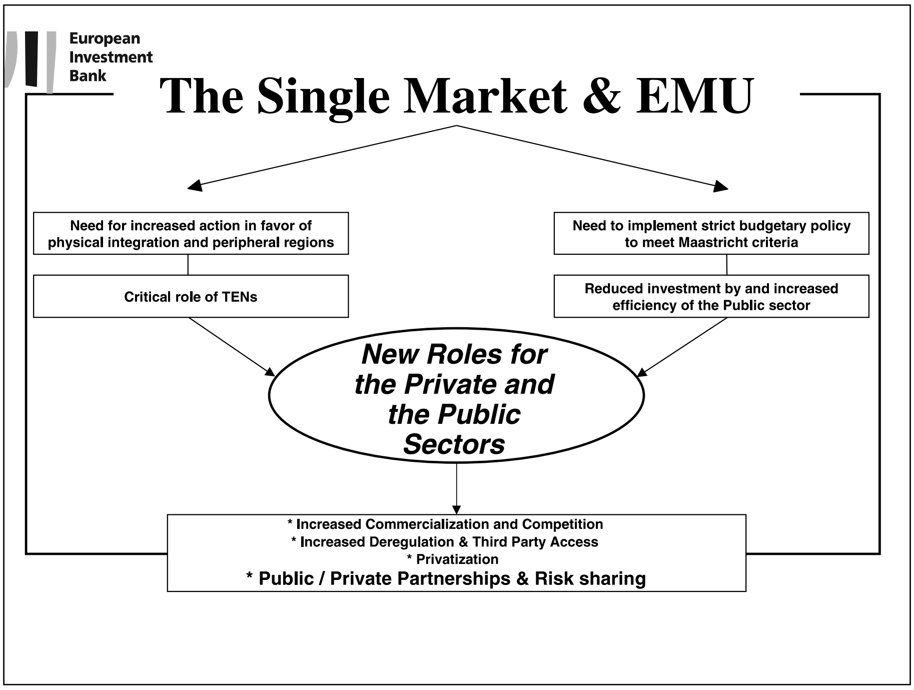
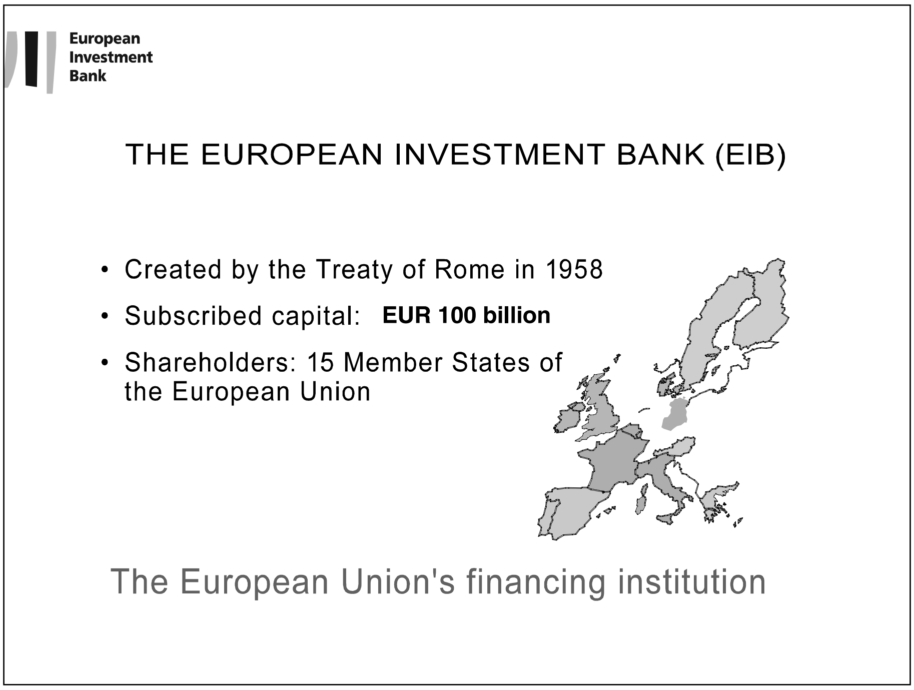

European Investment Bank
The Single Market & EMU
Need for increased action in favor of physical integration and peripheral regions
Need to implement strict budgetary policy to meet Maastricht criteria
Critical role of TENs
Reduced investment by and increased efficiency of the Public sector
New Roles for the Private and the Public Sectors
* Increased Commercialization and Competition
* Increased Deregulation & Third Party Access
* Privatization
* Public / Private Partnerships & Risk sharing


European Investment Bank
THE EUROPEAN INVESTMENT BANK (EIB)
• Created by the Treaty of Rome in 1958
• Subscribed capital: EUR 100 billion
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The European Union's financing institution

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INFRASTRUCTURE PROJECTS IN THE EU

		Private sector-owned	Mixed Public/Private	Public Sector
Fixed Price	User Fee	- Dublin Ring Road (IR) - Skye Bridge (UK) - Second Severn Bridge (UK) - ECT Port Terminal in Rotterd. (NL) - Tagus Bridge (PT) - IPP (Italy, UK, PT)		- Great Belt Link (DK) - Oresund (DK/SW)
Fixed Price	User Fee plus govt Fee/Subsidy	- West Coast Main Line - Thames 2000 (UK) - TOC Rail Franchises (UK) - Manchester Metrolink	- Rion Antirion Bridge (GR) - Spata Airport - CTRL (UK)	- The Greek ESSI Motorway
Fixed Price	No User Fee	- DBFO Roads (UK) - Wijkertunnel (NL)		
Cost Plus	User Fee	- Autopista Castedalenis (SP) - Eurotunnel (F/UK)	- Tunnel Valvidrera (E) - Most French Motorways - Most Italian Motorways - French Ports - Some Italian Ports - Some Portuguese Ports	- Belgian Ports - Spanish Ports - Greek Port Terminal - Irish Port Terminal - The Delta 2000 (NL)
Cost Plus	User Fee plus govt Fee/Subsidy		- TVA (IT)	- French Railways - German Railways - Danish Ports - The Greek PATHE Motorway
Cost Plus	No User Fee			- Most EU Motorways & national Route networks

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PPP Sectors Eligible for EIB Finance

Education
- Primary & Secondary Schools
- Universities and Centres for Further Education
- Technical Educational Centres

Health
- Primary Health Care
- Acute Health Care, e.g. Major Hospitals

Transport
- Roads & Bridges
- Rail infrastructure
- Rail Rolling Stock
- Airports and ATC
- Transport Telematics

Local Authorities
- Urban Redevelopment
- Waste Treatment
- Public Transport Authority Projects
- Local Roads

Environment
- Water Projects
- CDM, JI and IET

Energy
- Generation
- Transmission & Distribution
- CHP
- Renewables

Telecommunications and IT

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PUBLIC PRIVATE PARTNERSHIP (PPP)

Combining the advantages of the two sectors

- PPPs are an additional financial instrument to support capital investment in economic and social infrastructure.
- PPPs are valuable because
  - positive contribution in management, cost effectiveness, quality of service
  - complement scarce public funding
- PPPs offer a more flexible approach to
  - ownership
  - organisation
  - risk–sharing
  - regulation
- PPPs require appropriate control by Contract or Regulation to protect the public interest.

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Criteria for Public Private Partnerships

- Economically viable for the Public Sector
- Financially viable for the Private Sector
- Appropriate Risk & Reward Balance for Public & Private Sectors
- Public Sector : Value for Money

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Motorway Developments

With Tolls | **Private** → **Public** | **Toll Free**

- Private Concession Company:
- stand-alone B.O.T. concessions e.g. F. UK, ESP, IRL, GR
- HU, PL (?)

- Public Concession Company (or Authority):
- Toll Motorway Networks e.g. F, I, P, in part of ESP
- Complex stand-alone projects e.g. DK, SWE
- DARS (SLO), MB (HU)

- Private Concessions:
- UK, FIN "shadow tolls" DBFO

- Other off-budget Arrangements:
- German method (DBF)
- Dutch method (D&B and F)
- Belgian "Intercommunales"

- Public "Traditional" Financing:
- + "Vignette" : CH, CZ, SK
- Road Fund: L, NL, B, most CEECs
- Pure "traditional" method: D, UK, ESP autovias, I sud, DK etc.

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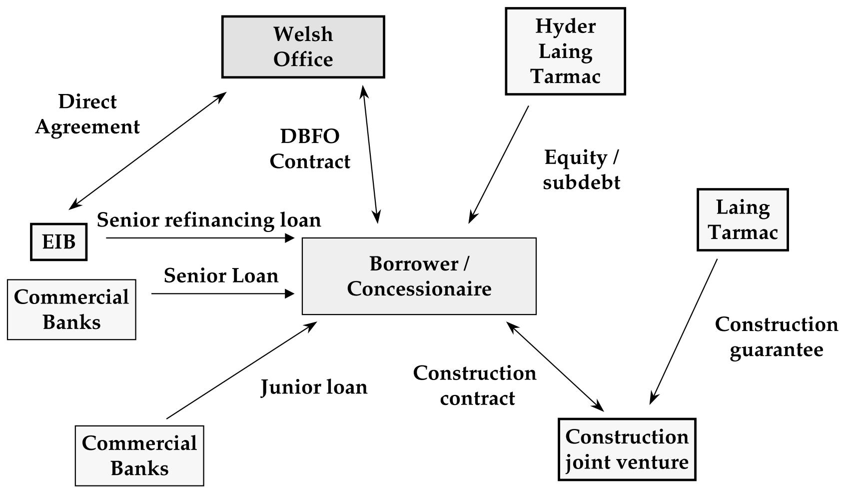
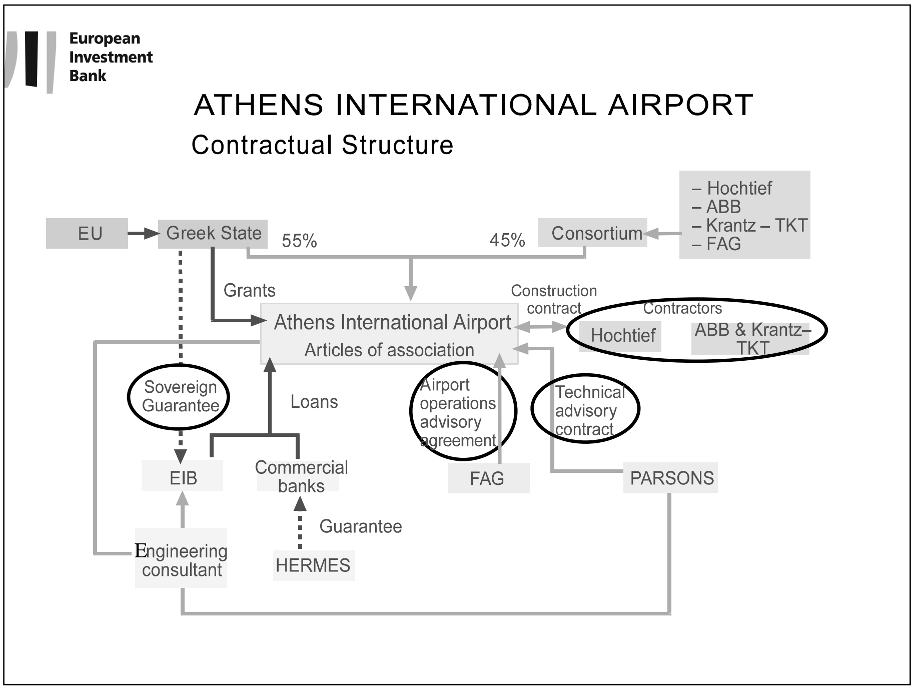
Welsh DBFO Road - A55 project

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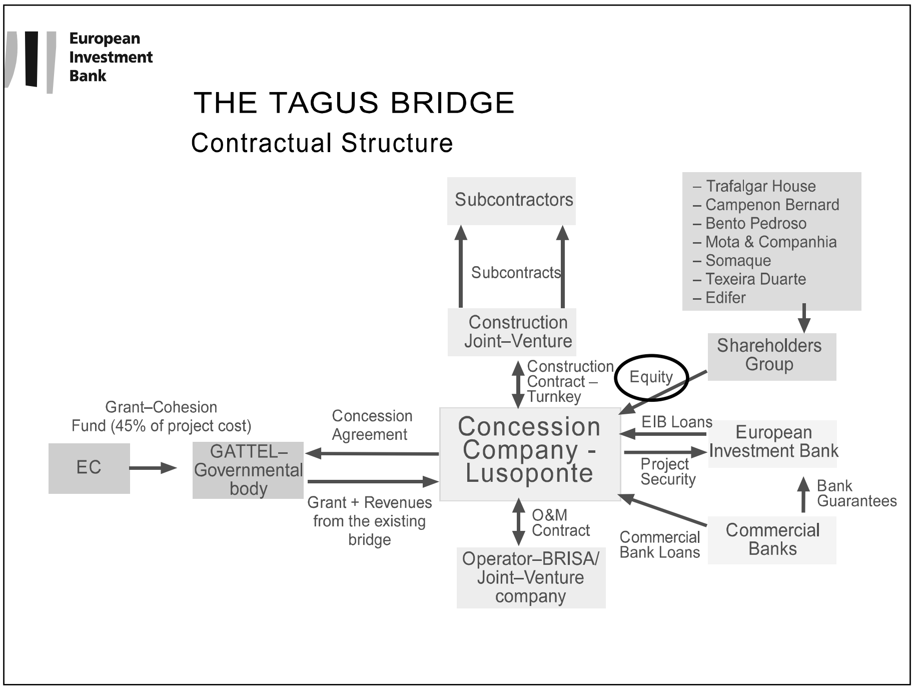
ATHENS INTERNATIONAL AIRPORT
Contractual Structure
– Hochtief
– ABB
– Krantz – TKT
– FAG
EU
Greek State
55%
45%
Consortium
Grants
Construction contract
Contractors
Athens International Airport
Articles of association
Hochtief
ABB & Krantz–TKT
Sovereign Guarantee
Loans
Airport operations advisory agreement
Technical advisory contract
EIB
Commercial banks
FAG
PARSONS
Guarantee
Engineering consultant
HERMES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THE TAGUS BRIDGE
Contractual Structure
Subcontractors
– Trafalgar House
– Campenon Bernard
– Bento Pedroso
– Mota & Companhia
– Somaque
– Texeira Duarte
– Edifer
Subcontracts
Construction Joint–Venture
Shareholders Group
Construction Contract – Turnkey
Equity
Grant–Cohesion Fund (45% of project cost)
Concession Agreement
EIB Loans
European Investment Bank
EC
GATTEL–Governmental body
Concession Company - Lusoponte
Project Security
Bank Guarantees
Grant + Revenues from the existing bridge
O&M Contract
Commercial Bank Loans
Commercial Banks
Operator–BRISA/ Joint–Venture company

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Danish Great Belt Link

Minimising Cost of Capital

Public Sector

- Great Belt Ltd., a publicly owned company, builds and operates the road and rail link.
- The Government controls cost of financing by guaranteeing loans raised by Great Belt Ltd.
- On completion, the rail link is transferred to the Danish State Railways against a usage charge.
- Remaining costs recovered from road users over a long period (+/- 30 years) through regulated tolls.

Private Sector bears the construction cost and time risk.

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Outline of Dutch High Speed Rail Project

- Links Amsterdam to Belgian Border via Schipol and Rotterdam
- Key extension of EU TENs Network linking Paris, Brussels, Amsterdam, Köln and London (PBKAL)
- Trains will run at 300 km/h (220 km/h for domestic services)
- Capital Cost - Civil HFL 6.0 billion
- Capital Cost - Systems HFL 1.5 billion
- Maintenance Cost / 15 years HFL 1.5 billion
- No new stations; redevelopment of old stations.

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Government Aims for Dutch High Speed Rail Project

- Create an efficient, safe reliable transport system
- Link the Netherlands to TENs
- Stimulate competition in the Rail Sector
- Create an attractive alternative to other forms of transport for short/medium distances
- Maximise economic benefit of project
- Whole life costing
- Ensure value for public sector money
- No dogma as to private sector involvement

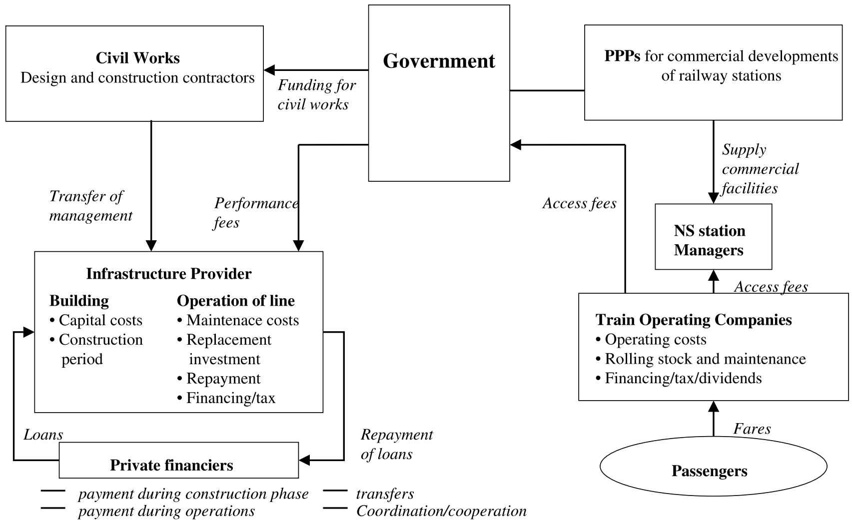
European Investment Bank

PPP Solution for Dutch High Speed Rail Project

- Infrastructure operations separated from Train operations
- Private Infrastructure Concessionaire responsible for financing operation of infrastructure and for procuring systems
- Concessionaire bears operations risks through availability commitments; maintenance, renewal and financing obligations
- Concessionaire bears “systems contract” procurement risks of cost overrun, design, technology, delay and commissioning risks
- A separate private sector concessionaire shares property redevelopment risks for stations

European Investment Bank

Dutch High Speed Rail Line



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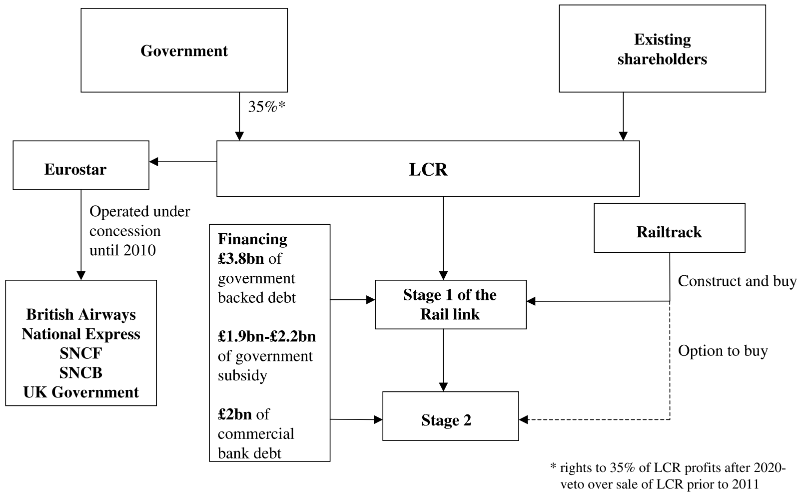
Summary: Dutch High Speed Line Project

- Private sector efficiencies and finance introduced for procurement and operations from outset and at risk throughout
- Build, design, finance and maintain contract
- No traffic risk for Concessionaire - state is source of availability payments
- Project handed back to state upon expiry of Concession

European Investment Bank

CTRL PPP - HOW THE DEAL WORKS



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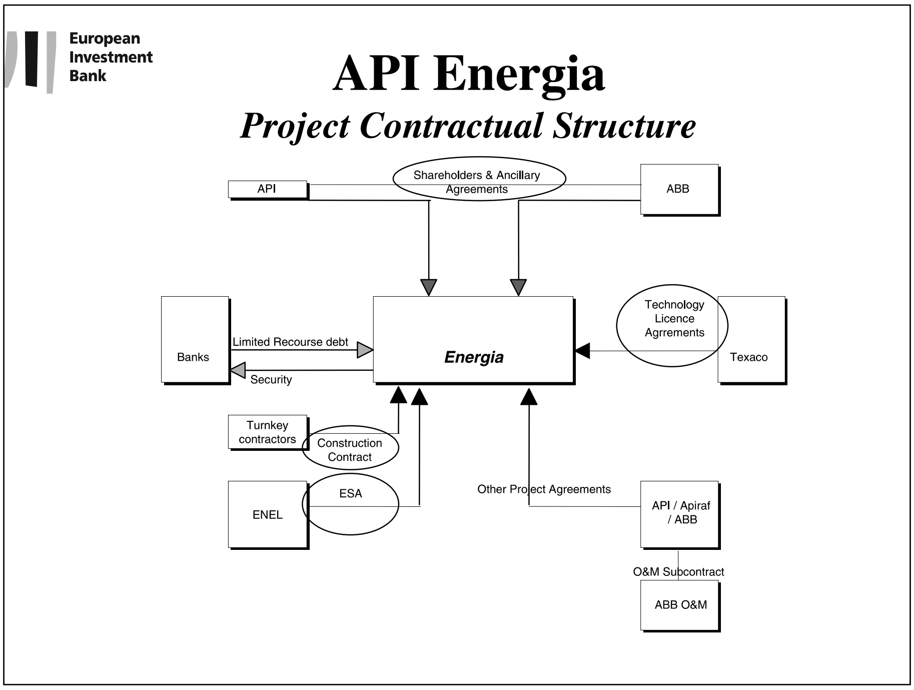
CTRL deal before and after restructuring - key points

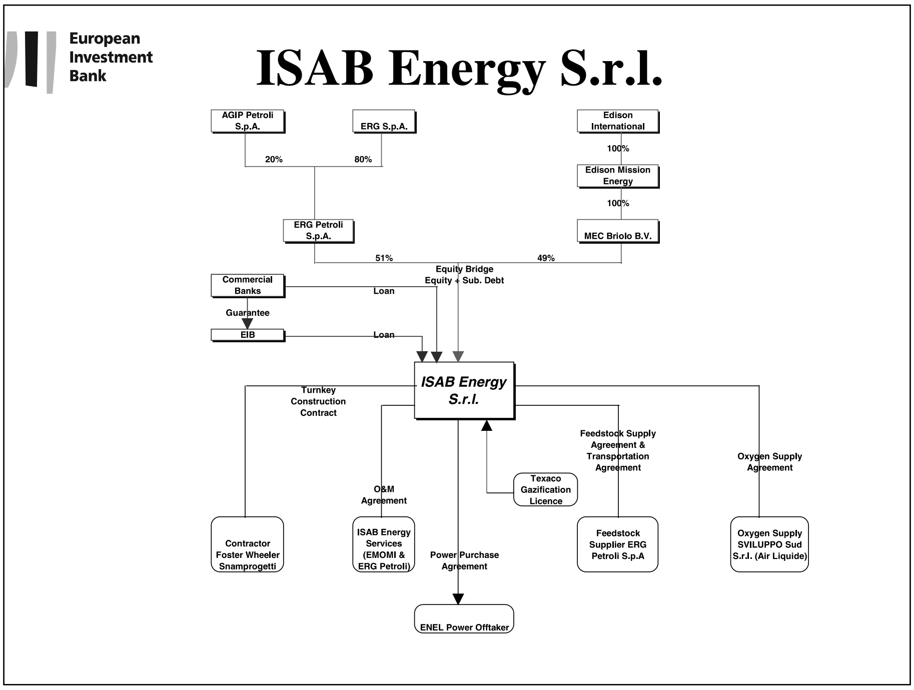
Before

- CTRL built in a single phase
- LCR raises finance for the link using Eurostar cashflow as security
- LCR builds, finances and operates CTRL and takes full construction risk
- LCR operates Eurostar and takes revenue risk
- Eurostar pays track access charges to LCR, owner of CTRL
- Government puts in £1.8bn subsidy
- 999 year concession
- No government ownership or financial compensation

After

- CTRL built in two phases
- LCR raises finance part backed by government guarantees (£3.8bn)
- Railtrack buys phase one and possibly phase two, takes construction risk and operates CTRL until 2086
- Eurostar pays track access charges to Railtrack for trains using CTRL
- Management of Eurostar contracted out to substantial entities which share revenue risk
- Government puts in £1.8bn subsidy and underwrites Eurostar access charges
- 90 year operating concession
- Government has 35% interest in LCR post 2020 and 5% in Eurostar management company


European Investment Bank
API Energia
Project Contractual Structure
API
Shareholders & Ancillary Agreements
ABB
Banks
Limited Recourse debt
Security
Energia
Technology Licence Agrrements
Texaco
Turnkey contractors
Construction Contract
ENEL
ESA
Other Project Agreements
API / Apiraf / ABB
O&M Subcontract
ABB O&M


European Investment Bank
ISAB Energy S.r.l.
AGIP Petroli S.p.A.
ERG S.p.A.
20%
80%
Edison International
100%
Edison Mission Energy
100%
ERG Petroli S.p.A.
MEC Briolo B.V.
51%
49%
Equity Bridge
Equity + Sub. Debt
Commercial Banks
Loan
Guarantee
EIB
Loan
ISAB Energy S.r.l.
Turnkey Construction Contract
O&M Agreement
Texaco Gazification Licence
Feedstock Supply Agreement & Transportation Agreement
Oxygen Supply Agreement
Contractor Foster Wheeler Snamprogetti
ISAB Energy Services (EMOMI & ERG Petroli)
Power Purchase Agreement
Feedstock Supplier ERG Petroli S.p.A
Oxygen Supply SVILUPPO Sud S.r.l. (Air Liquide)
ENEL Power Offtaker

European Investment Bank

EIB-UK PFI/PPP

Transport Projects financed

(GBP m)		Project Cost	EIB Loan	EIF Guarantee
Heavy Rail				
CTRL	- Phase 1	500	100	130
	- Phase 2	5,400	200	
Heathrow Express		440	125	
Eurotunnel (England/FR)		9,500	400	
Jubilee Line		2,100	100	
Bridges				
Skye Bridge (Scotland)		31	13	
Second Severn Crossing (England/Wales)		330	150	
Light Rail				
Manchester Metro	- Stage 1	140	15	
	- Stage 2	145	10	
DLR Extension	- Phase 1	530	100	
Roads				
DBFO Roads (England/Wales)				
A1-M1		287	90	22
A1 (M)		213	68	18
A 417/419		127	43	10
M6/M74 (Scotland)		246	87	
Welsh DBFRO Roads – A55		126	63	7
Schools and Hospitals				
Falkirk Schools		83	37	
Dudley Hospitals		170	70	
Glasgow Schools		278	105	
Kirklees Schools		58	25	

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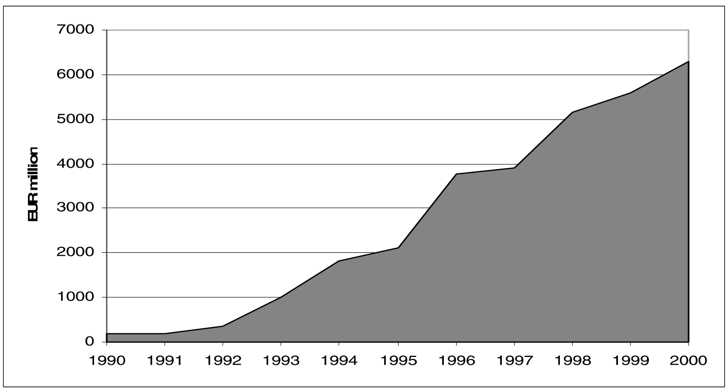
EIB & PPP: cumulative signatures



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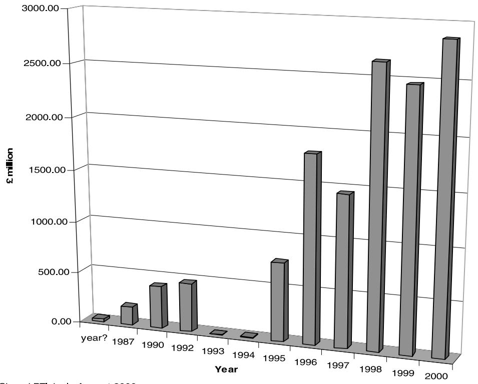
Evolution of the PFI (UK)



Figures taken from OGC list of Signed PFI deals August 2000

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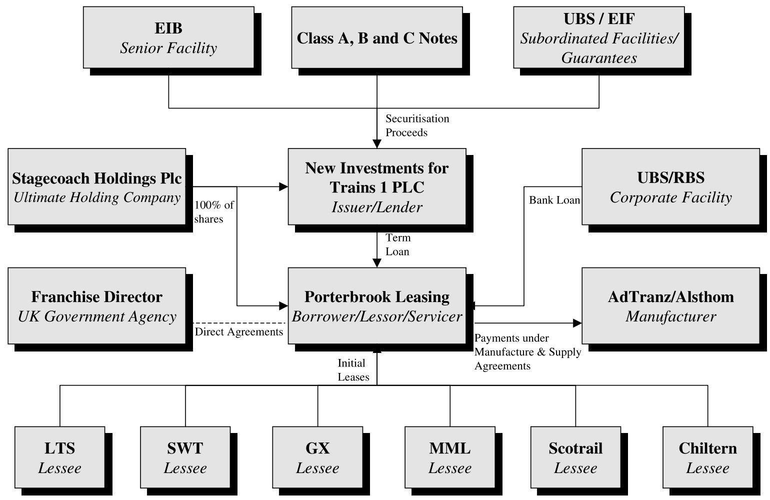
Porterbrook/NIFTI Transaction Structure



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PORTERBROOK / NIFTI

Class/rating	**Rating**	**Amount (GBPm)**	**Maturity**	**Spread: 3 month Libor (Bpts)**
Class A (EIB Facility)	Senior	110	May 2011	N/A
Class A notes	AA	61	Feb 2011	37.50
Class B notes	A	54	May 2011	75.00
Class C notes	BBB	25	May 2011	120.00
Subordinated facilities	BB	23	May 2011	N/A
Total securitisation		**273**		

MINUTES OF EVIDENCE

Thursday 17 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Ms Lewsley
Mr Weir

Witnesses:
Mr B Tallis)
Mr R Herzberg) Major Contractors Group
Mr I Lawson)

884. **The Chairperson:** Good afternoon. You are very welcome.

885. **Mr Tallis:** I am the director of the Major Contractors Group, the trade association for the 23 largest contractors in the UK.

886. **Mr Lawson:** I am the managing director of Kier Project Investments, a wholly-owned subsidiary of the Kier Group plc. Its role is to source potential private finance initiative (PFI) and public/private partnership (PPP) opportunities.

887. **Mr Herzberg:** I am the concessions director at Carillion plc. I manage our portfolio of signed PFI projects through the construction and operations phases.

888. **Mr Tallis:** Carillion plc and Kier Project Investments are representing the 23 companies because they are among the companies with the largest interests in PFI.

889. I do not want to say much, because we have already made a full submission. I will highlight three aspects of the PFI process that contractors have enjoyed, followed by three points that they find frustrating.

890. The first positive aspect has been an increase in the flow of projects. In the early days, the PFI initiative involved projects that would have been unable to go ahead without private funding. That happens less today, but it was the early experience, and certainly a very positive one for those in the contracting business.

891. The second positive point is that PFI has enabled businesses to expand into all sorts of areas, making links and alliances with other companies.

892. Thirdly, a very positive aspect for those who work in contracting and all areas of construction is the satisfaction of doing a better quality job for the public sector than had been possible in the past. There is a great deal of anecdotal evidence of, for example, better quality windows being installed in hospitals than in the past, because the same company would be responsible for their maintenance. The satisfaction of those doing the construction work should not be neglected, because it is part of the process.

893. The first frustrating element is that in spite of the large amount of experience which now exists, the bidding and tendering costs are still too high. At the end of the day, the client pays those costs; also, that process takes too long.

894. Secondly, we are still fighting to get genuine output specifications. We need to get the public sector to specify, for example, the level of patient throughput needed in a hospital or the number and age of pupils in a school. We want to avoid specifications of, for example, a classroom that is 3·7 m by 22 m.

895. Thirdly, we are still fighting against the "lowest cost" philosophy, as opposed to the "best value" philosophy. Most contractors like to do a good job. They like to feel that they have provided good value, both for themselves and for the people that they are working for.

896. **Mr Leslie:** Bidding and tendering costs cause just as much grief to the public sector as the private sector. Have you seen any improvement yet? There is a move towards creating standardised contracts for a proportion of projects. Secondly, what could the public sector do to try to achieve a quantum leap?

897. **Mr Herzberg:** While I recognise that the public sector is incurring significant costs at the early stage of a project, the at-risk bid costs which the private sector is incurring are dramatically heavier, particularly with regard to design. This is because the public sector will seldom, if ever, underwrite that sort of cost. The public sector's costs tend to be costs for lawyers and financial advisers, but the public sector expects the private sector to undertake the design work. Bid costs have improved moderately.

898. Some very good work has been carried out recently in the National Health Service. Progress was needed because a whole series of NHS trusts were doing their own thing, employing legal advisers, et cetera. Recently the NHS Executive made major improvements by introducing a standard legal template and an NHS protocol which lays down a particular format and level of requirement to be achieved at each stage of the bidding process. There has been an improvement in that there is clarity as to what is required in all the jobs. However, the requirements are still very significant.

899. **Mr Leslie:** We met with a local authority which had experience of wrestling with these problems. It concluded that it needed to spend more time drawing up the project specification before it invited any tenders. There were two motivations for this. First, this would address some of the issues that you have raised.

Secondly, the local authority wanted to improve competitiveness. Having invested time in drawing up the specification, it wanted to keep as many bidders as possible in the competition for as long as possible to ensure that it was getting the right deal. How would you react to those two points?

900. **Mr Herzberg:** As a taxpayer, competition is always a good thing. There will be much more competition among contractors if there is a very clear vision of what is required. It is enormously helpful if the public sector has developed the specification more fully and can identify a 400-bed hospital or 600-cell prison in some detail on a particular site. I would encourage the public sector to develop its vision as far as possible at the early stages to get more interest from contractors and more competition. However, there is a level at which the competition gets so excessive as to discourage contractors from competing. Carillion plc. would expect to participate with no more than six bidders on the long list, and four bidders on the short list. If we knew upfront that there were going to be more bidders, we would be put off.

901. **Mr Lawson:** I agree with Mr Herzberg. Another issue is that the public sector is taking longer to draw up its specifications, but it does not seem to be keeping up to pace with is how that affects affordability. In the case of NHS trusts and hospitals, contractors are at the beck and call of clinicians and others who expect to receive an "all-singing, all-dancing" hospital. They have a large say in what goes on, and if that process is not controlled properly there will be people who want a Rolls Royce, which prolongs the process, thus affecting the affordability of the project. Tight control mechanisms are needed otherwise we have to spend a lot of time and effort trying to lower the price. People's expectations can be high and it is difficult to backtrack in that respect.

902. **Ms Lewsley:** If there is only one bidder, rather than a maximum of six or four, how do we know that we are getting value for money?

903. **Mr Lawson:** We need to remember the processes and the communication that goes on with the parties at every stage. Under traditional methods of public sector construction, competing contractors are not allowed to know which companies are on the same tender list — the information is kept very closed and in-house. The benefit of PPP is that everybody is prepared to talk. It is a much more open forum.

904. The preferred route is to reduce the number of bidders from six, at the initial stage, to three. The three remaining bidders have a high level of input, particularly in the project design, and this constitutes a phenomenal cost at our risk. We then give a price certainty in regard to that particular design. When the number of bidders is reduced to two, there is a further period, known as the Best and Final Offer (BAFO) stage during which the contractor will be talking with the trust, the education department, or whoever. The remaining bidders are still in competition in terms of price and design, while at the same time the public sector is able to dictate even further what it is looking for. We are able to show the public sector what we intend to provide. During that process we can ensure that our price corresponds exactly to the public body's needs and that our design meets the output specifications, to a point where our bid is successful.

905. At that stage we have already quoted a price for doing the job based upon a specification and there are four financial models to go through. If the details need to be changed because, for example, an extra classroom or more operating theatres are needed, this will happen by negotiation. The competition exists throughout the process, until the very end.

906. **Ms Lewsley:** For over 30 years in Northern Ireland there has been no investment in our infrastructure. We are, therefore, planning to work with a number of sectors, not just roads, schools or hospitals. The issue for us is that contractors might be discouraged from getting involved in many of the projects because of the high risk. Do you think we will have a problem in attracting national and local firms in the future, including companies like your own? How enthusiastic is the financial sector to invest in Northern Ireland?

907. **Mr Lawson:** There is enthusiasm. I can only speak for Kier Project Investment, but we are very committed to PPP and PFI projects. When we consider projects we are seeking to add value to our own business. We would therefore ask ourselves whether we would be getting a good building contract and if we would be getting a facilities management contract for our own in-house facilities managers for the next 30 years.

908. Our problem is that we do not have a regional construction business in Northern Ireland, and we are not based over there on a facilities management basis. We would, therefore, have to consider the type and size of the project involved. If, for instance, the contract was for a large £200 million hospital project, our large building company would be able to resource it.

909. We might not be able to provide the same level of resources for facilities management, therefore we would have to outsource that. I do not know whether there are facilities managers in Northern Ireland who would be capable of carrying out that sort of work. We could source from the rest of the UK, but I do not know whether they would wish to do that. We would undoubtedly want to partner with a Northern Ireland contractor to work at the smaller-scale end of the market, including the construction of schools and infrastructure.

910. **Ms Lewsley:** Are skills shortages a problem, given that there are so many sectors, and two, three or

even four projects could be underway at the same time?

911. **Mr Lawson:** I would imagine that to be the case. We have a skills shortage in England, Scotland and Wales at the moment, and we are currently looking at a number of hospital bids, as Carillion and other major contractors are also doing. Carillion is one of the final three bidders for a project in Derby. We must consider that not only is a big hospital going to be built in Derby, two are to be constructed in Birmingham at virtually the same time. There are possible plans to build another hospital in Newcastle-upon-Tyne, and another is to be built in Leeds, so we must consider how these other projects will affect our resources. Design and innovation are very important in ensuring that the plan will suit the available resources. Therefore, skills shortage will be a factor.

912. **Ms Lewsley:** Do you tap into the education sector to try to counter the skills shortage?

913. **Mr Lawson:** Yes, companies such as Kier Projects Investment and Carillion plc are very keen to do that. The problem is that construction is not a sexy industry at the moment, unless you have a computer in front of you. However, in my view the situation will turn full circle. It is difficult to encourage kids in schools and others to pick up a trowel and go out into the muck and rain. Some do not want to do that when they can sit in a nice little warm office playing with a computer. We all have a part to play in changing that.

914. **Mr Herzberg:** It is likely that you will only encourage the big contractors to get involved in the largest jobs in Northern Ireland. Margins remain tight on the construction jobs throughout the UK at the moment — they are better on PFIs than on conventional construction projects, but they still remain very competitive. There is a lot of competition out there. Therefore, it follows that contractors will only be interested in jobs that can create a sufficient level of profit and a reasonable return, and those jobs have a minimum cost of anything from £50 million to possibly £100 million or more. The smaller deals are best done through conventional procurement methods, not through PPP.

915. **Mr Weir:** At one end of the scale, there is a concern that if too many deals come on stream suddenly, there will be a skills shortage. Interestingly, employers in Northern Ireland have raised with us a concern that despite the Government's initial enthusiasm for PPP projects in Northern Ireland in the mid-1990s, when many came on-stream, there have not been as many in recent years. They are concerned that if expertise is built up there might be no outlet for it. You said that one of the benefits of PPP is the increased flow of projects. Presumably, a fairly consistent flow of projects is important if everything is to operate at the maximum level of efficiency.

916. **Mr Tallis:** Many members have told me that one of the most attractive scenarios for them is that they might be able to see a steady flow of deals and, in particular, a standardisation of contracts. Mr Herzberg expressed Carillion's view that the size of projects is important, however I am sure that some contractors would be very interested in smaller jobs if they involved a high degree of repetition and standardisation, because this would allow them to roll the design team from job to job. That would be very efficient for the procurer.

917. **Mr Weir:** Presumably, if a firm were considering investing in a project in Northern Ireland, the attraction of several forthcoming projects would make it much more feasible to come here. The firm might not feel that it is worthwhile to come to Northern Ireland for one single project. You said, in response to Mr Leslie's point, that contracts are being standardised, particularly in the health sector. First, have other Departments or branches of Government been much slower to catch up on the idea of standardised contracts? Secondly, has the turnover time of each contract stage decreased in the last number of years?

918. **Mr Tallis:** Major Contractors Group met with the Department of Health, because we needed to find a more rational and efficient way of working through the transaction process. We worked together to produce the design development protocol for PFI hospitals so that at every stage of the bidding process each party will know exactly what it must provide. Specifications need to be given by one side, while the contractor must provide example drawings, with scale and room layouts. We identified that in the forward hospital programme one of the key constraints will be the lack of skilled managers and designers at the design and bidding stage, rather than the people who build the hospitals themselves.

919. We also said that by reducing the number of bidding contractors from six to three, and then to one, the capacity to bid for the next job is released more quickly; three of the design teams are not being tied up for an even longer time. Those general principles were agreed with the Department of Health.

920. We also talked to other Government agencies, and we have had initial conversations with the Highways Agency, because it is changing its procurement contracts. We are working with it to find a way to improve the transaction efficiency of road jobs, thus releasing the bidders more quickly for other work. That is one of the approaches you could adopt locally if you thought that it was viable.

921. **Mr Herzberg:** The length of time taken varies depending on the sector. Some Government Departments have a very efficient approach to UK public procurement,

particularly the Prison Service and the Highways Agency, which are excellent. They have a very centralised system of PPP procurement, and that is working extremely well.

922. Skills shortages on both sides of the table, particularly in the public sector, can still prolong the time it takes before a contract is signed. In the NHS, for example, a trust which has not taken part in a PPP transaction board will be helped a great deal by the NHS executive and the Office of Government Commerce. Nevertheless, the trust boards will have their own masters who will try to drive in their own views based on specific local circumstances. That will make the project different, and it will drag things out.

923. The other constraint is the ever-changing contract. One of the problems is that the Office of Government Commerce is still looking for what is referred to as "continuous improvement." It wants there to be continuous risk-transfer, and a bit more ratcheting of risk to the private sector each time. If they would just let that lie down for five minutes, contracts might get signed more quickly on the basis that each would be an exact replication of the previous one.

924. **The Chairperson:** What do you deem a small contract, and what is the minimum amount of money required for a contract to be feasible?

925. **Mr Lawson:** At Kier Project Investment, we would not look at a contract worth less than £10 million. That is on the basis that we would be responsible for the construction and facilities management — in other words, it would be entirely in-house.

926. **The Chairperson:** Would that involve bundling a number of schemes together?

927. **Mr Lawson:** No, a £10 million scheme would remain separate; it would not be bundled together with other schemes. At the moment, we are doing a job involving 12 schools which amounts to £13 million worth of work over a two-year period. I do not know whether you would regard that to be 12 different projects or one project bundled together. So that is a bundle with the minimum value for that type of order, provided that we get the added value of construction and facilities management contracts.

928. **The Chairperson:** Unions often have severe concerns about the transfer of undertakings when contracts are being drawn up, particularly when moving from private to public contracts. From a contractor's point of view, what is your opinion of this? How do you maintain the relationship between the contractors and the unions afterwards, and is this reflected in the contracts?

929. **Mr Lawson:** With the larger health schemes that we have been involved in, our facilities management provider has been a major subcontractor. A small number of providers in England can do that sort of work at the moment. They have built up a relationship with the unions and meet with them. A lot of meetings take place during the bidding process to satisfy both sides, because there needs to be a two-way relationship. During the bidding process, a lot of boxes are ticked, dependent upon how we are going to be dealing with the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE) issues and the meetings that take place.

930. **Ms Lewsley:** Technically, once you have taken on the workforce you could abandon them after a certain period.

931. **Mr Lawson:** Part of the workforce that we are taking on will voluntarily leave anyway. In general, we examine a job and work out how we must fund the number of people that we need to complete the project. In our experience, particularly in the health sector, this has not been an issue. We are operational in a hospital in Scotland, and there are no such issues at all. At the end of the day, they benefit from it.

932. **Mr Herzberg:** We have an in-house facilities management capability. Carillion Services Limited is probably the biggest provider to the health service, other than the health service itself. We have found that when members of staff join us, they see it as a good opportunity.

933. TUPE is the law. The law is such that those benefits, terms and conditions are maintained. We honour not just the letter of the law, but also the spirit of the law. Once employees have joined us, they enjoy considerable career opportunities, because we undertake facilities management across a series of trusts. Staff members are not limited to career opportunities within one trust, because we can give them the opportunity to move to more senior positions in a range of trusts. If we manage the situation properly, we will be moving people from trust to trust quite a lot. That is how we are able to drive savings out of the system and make it more efficient. If there is over-manning of one project, we can move people to another project.

934. Normally that would give those employees career opportunities, promotions and so on. We have been able to establish career ladders and identify career paths hitherto unknown to them as public employees in the health service. That has enabled us to not only sell it from a PR point of view, but to give employees a much higher morale in their jobs.

935. **Ms Lewsley:** What happens if you take on a project, decide that it is over-manned and try to downsize it by moving, for example, 10% or 5% of your workforce? What if an employee does not want to be transferred?

936. **Mr Herzberg:** Carillion will go through a consultation process with that employee. At the end of

the day, we have to comply with the law and we are obliged to make certain undertakings. In certain circumstances Carillion will, if necessary, make people redundant, but in the first instance it will go out of its way to offer those people opportunities elsewhere. If they do not accept any of those opportunities, Carillion will make sure that they receive what they are entitled to.

937. **Mr Lawson:** The sizes of some hospitals are being increased quite phenomenally therefore the number of people working in those hospitals needs to be increased. That is also happening in many other sectors. While there might be some natural falling away, we do need more people to work on the jobs. That has been the case in the job in Scotland where there is now a modern hospital. Previously the hospital was not as large therefore new staff had to be taken on.

938. **Ms Lewsley:** Is it not possible to employ staff on a part-time basis only, whereby their hours would be increased through overtime, rather than receiving the full-time salary and the terms and conditions that accompany such a position?

939. **Mr Lawson:** Different contractors are doing different things. I can only base my comments on what Kier Project Investment is doing with its partners. It must be remembered that Kier Project Investment is working with a hospital trust for the next 30 years, and we are responsible for this project. We have monthly meetings with the trust, and as soon as the trust sees that things are not going right, or that people have left because they are not being treated properly, the partnership breaks down. That is not what Kier Project Investment wants to achieve. The big facilities management providers that we are working with are very much of that attitude; they are looking at the project on a long-term basis.

940. **Ms Lewsley:** When the project becomes profit-driven, the service can be cut back. For example, if you have signed a contract you have to be paid, but if something goes wrong the service suffers; you will not be affected because you will be paid. The trust will cut funds from somewhere else to ensure that you are paid.

941. **Mr Lawson:** This is not necessarily the case; penalties and availability regimes will kick in against us. On a hospital job there are performance guidelines and availability regimes that have to be fulfilled. We must provide certain levels of quality in our service. We must also make sure that that service is open. The service that we are providing is looked at by the trust on a monthly basis as part of a complex system. If those qualities are not provided we get penalty points, and that works against us.

942. That affects the unitary charge and that knocks on against the facilities management provider who, for example, might have failed to provide the right number of people, the right facilities, or perhaps had not cleaned a room to the right standard. That is when we make a start to ensure that the facilities management provider has the right resources in place. That sort of problem reflects on us and it is reflected by the trusts — particularly, in our case, the health trusts — because they all talk to each other.

943. They also talk to the NHS executive, so when we bid for a new job the trust director concerned will speak to the trust director where we are already working. We are only as good as our reputation, so it is incumbent on all of us to keep that going.

944. **Mr Leslie:** In your written comments you state that in some of the early roads projects the public sector had a tendency to be prescriptive as to the materials used rather than specifying quality and durability. I find myself, by proxy, taking the same attitude. When looking at a hospital project, I asked someone from the health sector if anyone had responsibility for quality control. Then I realised that there was no reason to be concerned with that because I should not care less. However, I felt that, and I have nothing to do with building, so it is a natural instinct. That is your instinct if you have built a house. Is that understanding percolating through, or does it need to be given a big shove? It seems fundamental, and there is a big attitude point. People are probably concerning themselves with issues they do not understand which under this regime should not be their concern at all.

945. **Mr Herzberg:** It is percolating through very slowly. It varies from one Government Department to another, but your point is absolutely correct. The public sector should be buying a quality service, and it should not be interested in the materials for the building — the assets — as long as it gets a quality service which is value for money. That value for money needs to be optimised. That may be done by having an expensive building with low facilities management costs or a cheap building with high costs. Somewhere there is an optimum balance. If we are allowed complete freedom in our bid to achieve that optimum and present it, the public sector would get the ideal, best value for money quality service. I suggest you should look for that.

946. **Mr Lawson:** In addition, particularly on smaller projects, we are in it for equity. We have a long-term stake therefore for 30 years we will have equity in a particular business. That also applies in the larger projects. In addition, our in-house construction company and facilities management provider are doing the work. We are all one group, so it is also incumbent on them to ensure that in the best interests of the group everything is done properly. Your concerns arise when a contractor might be carrying out the work but decides he does not want equity in the scheme. The contractor will then be approaching the project on a short-term basis, and not for 30 years.

947. The same applies to facilities management. Many consortia with an equity investment will not do the work themselves but sub-contract that out and the facilities management. When choosing people to carry out the work, you will need to look very carefully at that to see who is investing in the project for 30 years.

948. **The Chairperson:** Those who are putting equity in have to scrutinise the contractor?

949. **Mr Lawson:** Absolutely right. If I head up a special purpose vehicle for a particular hospital, we put in the equity. A Kier company does the building works, and a Kier company does the financial management work, or there might be a financial management provider who also has equity in the pot. It is therefore in all our interests to make sure that that is done, and Carillion is of exactly the same attitude.

950. **Mr Herzberg:** A very important political point underlies what Mr Lawson has said, and that is that some trusts in the UK are trying to do PPP without facilities management as part of the project. I argue strongly that facilities management should be an integral part of the project, because that way it is possible to drive out the best value for money. That way enables you to dispense with the contractor who presents an up-front solution which is cheap but involves expensive long-term maintenance.

951. **The Chairperson:** So the quality of materials solves maintenance problems?

952. **Mr Herzberg:** Yes. That way you protect yourself against the unscrupulous contractor who does that sort of thing. For that reason, in our business we tend to look with particular interest at projects where we can provide a comprehensive service, both as building contractor and as facilities management provider, so that the two can be integrated.

953. **Mr Leslie:** I am quite dubious about local authorities' taking an equity stake. That seems to be a hangover from what we were discussing earlier — a desire based on long habit to test the consistency of the mortar — and also an obsession with being able to see the books, to assure themselves of the size of the profit that you claim is there.

954. **Mr Lawson:** They should do that on day one, but after that they should not worry about it. They have got something that is there, however they do not look at the risk we take on. There is an upside and a downside. Kirklees Council in Scotland has taken an equity stake in a development of schools there.

955. **The Chairperson:** That completes our questions. Thank you very much for coming along and making your presentation.

956. **Mr Tallis:** Thank you very much for the opportunity. If you have any further detailed questions with which you want to follow up this session contact me and I will distribute them to the various companies.

MINUTES OF EVIDENCE

Thursday 26 April 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Mr Hussey
Mr Maskey
Mr Weir

Witnesses:

Mr D Gordon	)	Department of Education
Mr G Murray	)	and Science
Mr P O'Neill	)	Department of Finance
Mr M Treacy	)	Department of Public Enterprise

957. **The Chairperson:** Thank you for giving of your time. Please begin and questions will follow.

958. **Mr Murray:** The Department of Education and Science's interest in public-private partnerships (PPPs) is slightly different to private finance initiatives (PFIs) in the UK insofar as we were not driven by a need for private financing. We talked to school principals about their roles and we learned that in a poor school up to 60% of a principal's time could be spent on building-related issues. Principals should not be running school buildings and that was a key driver in encouraging the Department to look at PPPs.

959. We also wanted to examine new ideas for school design. By working on an output specification, we allowed people to come forward with such ideas. We wanted to see better use of school buildings outside school hours and that currently does not happen.

960. We also wanted to test value for money on schools over longer than just the lowest quotation for a building project. Those are the reasons we became involved in PPPs.

961. We approached certain schools to see if they would be interested in participating in the process. It was not a case of telling them to go into this process or they would not get their school any other way. Rather, it was a case of going into the process or they would get their school the other way. The five schools that are involved in the first bundle of projects opted for the project; none were unwilling to do it. They also wanted to find new ways of building schools.

962. We are currently tackling a bundle of five schools in different parts of the country as a single project, and the Cork School of Music is also an individual PPP project. We are at the stage of having a preferred bidder for the projects. We are not as far advanced as Northern Ireland; we have no finished product but we are close to signing a contract and starting our first site.

963. **Mr Treacy:** The only area in the Department of Public Enterprise on which PPP has had an impact is public transport. The state company, CIE, has responsibility for all public transport services. It has suffered from underinvestment over the years, which has led to a deterioration in services and a lack of public confidence. It is only in recent years that we have tried to address those problems in a serious way.

964. The issue is being approached from two angles: the amendments that are needed in the institutional framework; and the need to provide the infrastructure. I do not have any documentation for you, but if you would like me to send anything, please ask.

965. In August 2000 we published a document that sets out the broad approach on how we propose to change the institutional framework surrounding public transport. First, we propose to set up a transport regulator, initially for the Greater Dublin area with the eventual possibility of that being extended that to the rest of the country. Secondly, we propose to set to up a railway procurement agency which will be responsible for procuring all the necessary new rail infrastructure, principally through PPP.

966. On the infrastructure side there are two, possibly simultaneous, issues that affect transport. The National Development Plan (NDP) has proposals for projects that amount to just over £2 billion for the public transport area, of which £300 million will be PPPs. While the NDP plans were going ahead, the Dublin Transportation Office (DTO) was carrying out a study of Dublin's public transport needs from 2000 to 2016 and how the growth of the city will impact on those needs. The study also examined how to get people out of their cars and into public transport, something we must do. We are going from a "do nothing" situation to the maximum.

967. The DTO report cited two PPP-related issues: the need to develop a metro system and a light rail system for Dublin. The DTO costed the metro at around £5 billion and the light rail system at £1·3 billion to £1·4 billion. In 2000 the Government decided to develop the metro. Legislation has now been drawn up to establish a railway procurement agency, which we hope will go to the Oireachtas in May. We are at a much earlier stage than the education sector.

968. We have started to develop a policy within the Department of Public Enterprise for rail-based PPPs and have drafted a market consultation document that will go out in the next week or so. Our intention is to map out our views on PPPs and then ask the market and all interested parties to respond.

969. Our obvious priority is the metro. A system of such a size and cost raises the question of whether it

should be one contract or several phased subcontracts. In other words, should individual projects lead to the development of the entire system?

970. We are putting those options to the market in the hope that, first, it will inform our general policy on PPPs, and secondly, that it will help the new railway procurement agency when it goes to the market. If a decision is made to phase the metro, it is hoped that the first phase will go to the market by the end of 2001.

971. A similar approach is being taken with the light rail system. Construction has started on two light rail lines on a conventional procurement basis. The DTO's proposal is that they should be extended widely over a period of 10 years as PPPs. The light rail system is at an even earlier stage than the metro system, but the intention is that whatever approach is taken to the metro should follow for PPPs. That is our current position.

972. **Mr O'Neill:** Unfortunately, Gerry Murphy was unable to attend this meeting, and I am here instead to talk about roads. The NDP identified Ireland's infrastructure deficit. The National Roads Authority reports to the Department of the Environment and Local Government and it has sole responsibility for the national primary road network in Ireland, a small percentage of the total road network which carries the majority of traffic. The main reason PPP has been adopted is that it will deliver the infrastructure extremely quickly. A number of projects are already under way, and two of them will be shortlisted next week: the Kilcock to Kinnegad motorway and the Waterford river crossing. A third project, a second westlink bridge for the C-ring (M50) in Dublin, will start construction in June.

973. The Minister's view is that there are two distinct differences between our procurement methods and those in the UK. First, we will leave the original route; a motorway or dual carriageway will be built, but users can choose the original parallel route. Secondly, people will be asked to contribute a hard toll for the use of the motorway or dual carriageway. Those two differences are significant, but otherwise there is no real difference between procurement mechanisms here and those in the UK.

974. **Mr Hussey:** Thank you very much for your presentations, which were brief and to the point.

975. We have already heard about the schools' grouping project. Mr Kearns mentioned newspaper headlines `— 'English firm's contract' or whatever. It seems that because of the size of the project and its geographical diversity, local contractors found themselves unable to compete for contracts where normally they could have done so. I declare a personal interest, coming from the west of the Province. I am sure that there is also an east/west division in the Republic, and that Donegal would constantly claim disadvantage. How do you feel about local people's access to infrastructural projects, thereby extending the benefit to local areas? Did it enter into your considerations?

976. **Mr Murray:** It did. The idea of "bundling" the schools came about from talking to practitioners. The issue for PPP is not construction but the 25 years of maintenance and operation. Could a value-for-money 25-year maintenance and operation deal be struck on one school alone? The feedback was that it could not be done.

977. The Construction Industry Federation (CIF) was consulted. Jarvis Construction UK won the contract for the five schools, but Jarvis is not building them. The school in Tubbercurry is being built by a contractor in Sligo, the school in Clones is being built by a local contractor, and the same applies in Shannon. The Irish contracting authorities had to move from a position where previously they had been the main contractors and had run the show and that that would no longer be the case. And as it happens, the facilities management 25-year contract would have required them to think differently about what they were doing. Initially, the CIF was fully in favour of the process but it certainly cooled a little on the schools idea.

978. As a Department, our responsibility is to the schools. These schools had opted into the process, and it was our responsibility to support them. My understanding is that the CIF does not hold one particular view; different people are expressing different views. As far as I know, the contractor who built the school in Tubbercurry is not building another school down there.

979. **Mr Hussey:** Perhaps I should have declared an interest because I was formerly deputy head of a senior school. I appreciate the vision of building maintenance. You are talking about a business manager and an education manager, and the linking element is the business management of the school estate.

980. **Mr Murray:** Absolutely.

981. **Mr Maskey:** I read recently that fares could be increased in Dublin, so decreasing demand. Has financial flexibility been built into the system? The Government may well increase fares if the system has been built through PPP. Will fares be built into the contract?

982. **Mr Treacy:** Regulator powers are currently being examined. I do not think the issue of fares will be opened up in the short to medium term until the market settles down and the infrastructure is in place. It is currently controlled by central government. To cut to the chase, I think we will have to find means other than fares to finance it.

983. **Mr Maskey:** But there has been a suggestion from a consultant that fares may have to be increased in order to lower the demand for the system.

984. **Mr Treacy:** That was within CIE and Iarnród Éireann, and the suggestion came from a consultancy. Even the companies themselves will not get as far as submitting that to the Department of Finance.

985. **Mr O'Neill:** The westlink bridge is over-subscribed, with queues to and from the toll booths, and there has been no escalation of charges. If that had been an option, it might have been used. Future toll roads will be set and benchmarked on an acceptable and affordable level. Toll revenue is not calculated on the basis of what will pay off the capital and operating costs of the contract. Tolls make a contribution towards total costs, but by no means do they come near to paying them.

986. **Mr Weir:** There are indications that there will be increased efficiency in schools with facilities managers on site, and in the private sector, with the borrowing rates, it pays off. It was mentioned that 60% of a headmaster's time was spent on building maintenance. Factors like that are difficult to quantify. In assessing whether projects were suitable for PPP, was this built in?

987. **Mr Murray:** That figure came from the UK. We spoke to school principals here, who told us that that figure was too low, particularly if a school was 50 years old and in a bad state. We did not want a PPP process that duplicated the old system where the school principal chased after the operator to make sure he was doing his job.

988. We opted for what is essentially a self-certification system, whereby if everything in the school does not work, there are financial penalties. A school principal does not have to follow the operator with a clipboard in hand.

989. **Mr Weir:** A facilities manager will do the job more efficiently, which will be a gain to the public purse. Presumably there is a gain on the flip side, the time that a headmaster saves, but that is more difficult to quantify. How do you quantify that?

990. Whether or not a particular project gets the go ahead, you must assess if PPP is the best way forward. All factors must be evaluated. How do you evaluate those less quantifiable factors?

991. **Mr Murray:** The Department of Education and Science is trying to bring in a system of whole school evaluation, of school planning, and continuous improvement in education. However, when we approach schools on the issues of school planning or home/school evaluation, they respond by saying that, yes, they would like that, but they have more immediate problems.

992. **Mr Weir:** So they are busy firefighting.

993. **Mr Murray:** They are firefighting buildings when educational output should be their priority. We fought very hard against cost benefit analysis and public sector comparators. The issue was: what should a school principal be doing? Should they be looking after buildings? The answer is no. We have been involved with five school principals, but we are not searching out further PPP projects. We are currently tackling only one further project, the National Maritime College.

994. However, pressure is starting to build up from schools that have witnessed the process and teachers who want to teach and manage schools rather than manage buildings.

995. **Mr Weir:** So other schools want to be part of the next project?

996. **Mr Murray:** Yes. We took a conscious decision not to force anyone into the PPP process. However, the school principals who have been involved in the process have been addressing conferences, and people are approaching us saying they would like to be involved in the next phase.

997. **Mr Leslie:** If I pay my toll on the M50 around the west of Dublin, who gets the money?

998. **Mr O'Neill:** We are concerned about windfall gains. Up to a certain level the concessionaire receives the tolls in order to cover his costs and give him a normal profit. However, above a certain number of vehicles per day, that money is shared, in various stages, between the concessionaire and the National Roads Authority.

999. **Mr Leslie:** Who paid for building the roads?

1000. **Mr O'Neill:** The concessionaire paid.

1001. **Mr Leslie:** So is he servicing his costs from the first skim of the takings, and thereafter benefiting from a bonus pool?

1002. **Mr O'Neill:** Yes, the revenue is shared above a certain figure. The original traffic data supporting that project was very different compared to what it is today, which is why we are starting to build a second westlink bridge to cope with the volume of traffic.

1003. **Mr Murray:** I looked at this issue before we became involved in PPPs. The bridge opened in 1991 and 28,000 cars a day were needed to cover its costs. From 1991 to 1996 the figure fluctuated between 11,000 and 16,000 cars a day. The bridge is now used by around 60,000 cars, and the state receives 50% of the gross revenue over 30,000 cars a day. The state makes about IR £12,000 a day.

1004. In the PPP process, that was the only road in the Republic where money could be made from tolls. Other roads do not have the same volume of traffic. You have to control access to make money, and you can control access to the westlink toll bridge.

1005. **Mr Leslie:** I am trying to identify the nature of the partnership. Our interest is not whether you should do A or B; it is identifying the most appropriate structures. If you want to build a carriageway around part of Dublin, the Government can make a huge contribution towards facilitation, planning and land acquisition. That, I assume, is what the Government brought to the process and the contractor then built a road. What is the Government's take of the revenue? Were the facilities provided free of charge in order to get the project up and running?

1006. **Mr O'Neill:** Yes, the compulsory purchase orders and some of the planning were undertaken by the Government. The concessionaire was asked to design, build, finance and operate it for the concessionary period.

1007. **Mr Leslie:** Presumably the concessionaire does not own the land.

1008. **Mr O'Neill:** That asset will revert back to the state at the end of the concessionary period.

1009. **Mr Leslie:** How long is the concessionary period?

1010. **Mr O'Neill:** The concessionary period for the toll bridge is 25 years.

1011. **Mr Leslie:** Does that mean that the Government will own and operate the asset in 25 years' time? The contractor will have made his profit, so is he then out of it?

1012. **Mr O'Neill:** Yes, if that is what the Government want.

1013. **Mr Leslie:** It would then be up to the Government to maintain the bridge, but it will have 100% of the revenue stream with which to do that.

1014. **Mr O'Neill:** That is correct.

1015. **Mr Leslie:** How does the structure that we have just identified on roads relate to railways? Who brings what to the process, and who owns what?

1016. **Mr Treacy:** I will talk about that from two perspectives. Two light rail lines are currently under construction through conventional methods. For the first time in the state, the decision has been made that a private operator will operate those two lines. The competition to award the franchise is under way. The franchisee will be purely an operator and he would be given the infrastructure. It is similar to the toll bridge operation, but we are in a new market with light rail. We have indications and projections, but at this stage we do not know what the take up and the demand will be for those services in the short term. We will not ask the operator to bring any capital expenditure to the table. He will be purely an operator.

1017. We will agree financial terms with him whereby he receives an operating fee, similar to the windfall situation that Mr O'Neill described. If ridership is above a certain level, the revenue is shared between the operator and the state. That is relatively straightforward.

1018. When we come to the PPP situation, it will be significantly different. Precisely how different will develop over the period of our negotiations and discussions. Our starting position is that we will inject as much private sector finance into the building of the metro system as we possibly can. However, given the nature of public transport services, the revenue will not pay that and it never will. The likely situation is that we will give a concession for a period of, say, 30 years, and we will enhance the fare box with a subsidy of some sort. It is a similar situation to the land purchase issue.

1019. The railway procurement agency will procure the land, the developer will build the tracks on the land, and at the end of the concession period the land and the infrastructure will revert to state ownership.

1020. **Mr Leslie:** You are assuming that the fare box will not pay for the project, and therefore it has to be topped up. How do you deal with the danger that the operator has no particular incentive to maximise traffic because he is going to be topped up anyway?

1021. **Mr Treacy:** Our first operating contract states that if ridership is above an agreed figure, the profit will be shared. The operator will get something in the region of 30% of the excess revenue, and 70% goes to the state. If it goes above a certain higher figure, the operator receives a lesser sum. That takes care of the windfall, but it also gives the operator the incentive to move above the first ceiling.

1022. **Mr Leslie:** Mr Murray mentioned that on the westlink bridge 28,000 vehicles a day were required to break even. If that figure is not achieved, somebody is going to lose money, and prima facie it is the contractor. Who carries the risk that the project will never break even?

1023. **Mr O'Neill:** The concessionaire takes that risk.

1024. **Mr Leslie:** And his incentive is that he believes that he can get into bonus territory by bearing a risk?

1025. **Mr O'Neill:** That is correct.

1026. **The Chairperson:** There are no tolls in education. Who pays, or how does the system pay for itself? Is there a danger that at some stage charges will have to be imposed?

1027. **Mr Murray:** The risks in a school that are equivalent to usage on a toll bridge are performance and availability. We want a school there every day, that works every day, and where everything in it works. We relate the payment mechanism to performance and availability. If something is not working, the operator is given a certain amount of time to fix it. If it is not fixed in time, and perhaps a classroom is unavailable, it hits them in the pocket.

1028. **The Chairperson:** Is there a danger or a possibility — depending on which way you look at it — of the internal management and teaching of the school becoming part of the PPP?

1029. **Mr Murray:** No, we would not allow that. It came down to issues such as the school secretary, and we thought that the school secretary was a personal choice for a school principal, so we said no. We are prepared to agree to a caretaker, because he will be responsible for what the operator builds. That is as far as it goes and we will not be taking it beyond that.

1030. **Mr Hussey:** The creation of a new motorway network with existing routes running parallel is all very well on the eastern seaboard. I suspect that the phrase “top up” that we heard in relation to the rail transport system is going to come into it. However, with regard to equality of access for all citizens to the level of provision that can be provided by this new motorway infrastructure, how will you guarantee that people in the midlands or the west of the country will receive the same level of service?

1031. **Mr O’Neill:** That was one of our prime concerns. That is why we have the alternative route, so that the existing route will remain.

1032. **Mr Hussey:** What operator will come in on a route that is not economical? How will you get an operator to build a motorway where there is not the same volume of traffic as there is on the eastern seaboard?

1033. **Mr O’Neill:** We are compiling a significant amount of traffic data. From that data the banks and concessionaires will decide whether they want to put private sector money into that project. That is a calculated risk that they have to take. When they bid for the project they bid for a level of capital and revenue subvention. It is up to them to decide how much of that toll will come back to them.

1034. In the NDP the intention is to have a motorway/ dual carriageway standard network between all the major cities in Ireland. There will be two toll roads on each stretch between Dublin and Cork, Dublin and Limerick, and Dublin and Galway. The toll elements of the road will be so many kilometres long but the state will cover the intermediate parts. So the concessionaires are not providing a road from Dublin right through to Cork. They are providing two sections in the middle of that road but the entire network will be up to standard at that date. They will also receive the benefit of state investment.

1035. **Mr Hussey:** I am thinking of a particular route which I am sure the north-west regional cross-border group made the Department aware of. What about a route that goes through Northern Ireland to access another part of the Republic? Has there been any liaison with the Department for Regional Development in Northern Ireland with regard to completion of that route?

1036. **Mr O’Neill:** Yes, there has been liaison between the National Roads Authority and the Department for Regional Development on various cross-border projects.

1037. **Mr Hussey:** I am thinking of the road to Derry and beyond into Donegal.

1038. **Mr O’Neill:** At present the earliest route that we are looking at heads up towards Cavan, which is in that general direction. The National Roads Authority would have the specific details on any future potential projects.

1039. **Mr Hussey:** Is the Department of the Environment and Local Government looking at an internal solution for the Republic of Ireland?

1040. **Mr O’Neill:** At present that is our prime concern because we have such a major infrastructure deficit.

1041. **Mr Weir:** The Department is looking at various projects and each will involve a PPP element. In addition to the general wear and tear and maintenance, are there any new projects which do not involve PPP?

1042. **Mr O’Neill:** Yes, the links between the PPP projects are non-PPP projects.

1043. **Mr Weir:** Are there any rural sections, for example, that are not connected with PPP?

1044. **Mr O’Neill:** We have a very intensive roads programme. For instance, there will be a dual carriageway from Limerick to Newcastle West, going on to Kerry. It would not be logical to put a toll on that.

1045. **Mr Weir:** PPPs with tolls make sense as an efficient way of generating additional resources for roads.

1046. A complication could arise if you were not also investing in the other projects that could, perhaps, not be as economically viable as PPP projects. There is a danger that people who live in areas that are not economically viable for a PPP project could become second-class citizens. However, if other projects to service those areas are running alongside PPP projects — *[Interruption]*

1047. **Mr Murray:** The capital budget for education has trebled over the past five years and I think that the capital budget for national and non-national roads is the same.

1048. **Mr O’Neill:** It is another mechanism for procuring the infrastructure, but it is not the sole mechanism.

1049. **Mr Murray:** That is a fair point. When PPPs were first discussed the Department of Education and Science said that it would not accept them as a replacement; it is simply a different way of doing things. The Department could go to its capital budget and find that it has been reduced by the cost of the five schools or the Cork School of Music.

1050. **The Chairperson:** It must be additional.

1051. **Mr Murray:** Absolutely.

1052. **Mr Maskey:** You mentioned that the state will provide the links between the tolls. Is there not a disproportionate investment from the state in respect of private companies coming in and taking so much profit whereas the state, in real terms, has provided the means to get to the toll?

1053. **Mr O'Neill:** It is part of a full procurement package. The positioning of the tolls is being done equally on national primary roads. Is the investment disproportionate? Well, we must address the infrastructure deficit and the PPP procurement package is another mechanism for doing that. By making sure that the private companies do not receive any windfalls gains from the project, that they get their return from their investment as a normal profit and any additional income generated will come back to the state for reinvestment in additional roads projects.

1054. **The Chairperson:** One of the problems that we discussed earlier was how to reduce the time frame from the start of planning to delivery. Are there any mechanisms that need to be put in place to ensure that that happens? What problems have you encountered to date?

1055. **Mr Murray:** We learned a lot from our colleagues in the Department of Education for Northern Ireland (DENI) about its projects. One of the difficulties that the Department of Education and Science faced was that PPPs in education here were going nowhere if they were slow, because the schools had the option of taking the traditional route or the PPP route. Therefore, at the beginning — even when advisers were being appointed — our approach was rather than simply making appointments on the basis of capability and the lowest price, delivery time was the second most important criteria.

1056. In its projects the Department of Education and Science has managed to cut the time in half, from the notice in the European Community journal to preferred bidder. It has achieved that in a number of ways. The project agreement is the important document in a PPP because it covers what will happen over the next 25 years. When the Department was down to six bidders it gave each of them a draft of the document. UK practice was to wait until there was a preferred bidder and only put a document on the table at that stage. The Department of Education and Science put the document out six months before that and when it was down to three bidders, much of the legal work had already been done and that enabled the Department to cut down the time frame.

1057. From the Department's experience to date, the few skirmishes that it had were with lawyers for the financial institutions. The Department was in a good position in that it could tell the lawyers that it did not need their money and that affected their attitude to us. The lawyers could say that the financial institutions were insisting on A to Z, and the Department could respond by saying that it did not need the money, so unless A to P was removed, it was not interested.

1058. It worked for us in that situation. We have spent a great deal of time talking about issues that will never arise, and people said their reading was that the Department had an incentive to terminate the contract because it believed you could make money. We say we are in the education business, but that it can go on if you allow it, unless you say you are not prepared to discuss the matter any further. If the banks are the drivers, the financing can take a great deal of time.

1059. **Mr Gordon:** You must bring the schools along with you throughout the process. We found it useful to meet schools regularly as a separate group. They had to be up to date on every stage of the process because they had to sell it locally. The eventual preferred bidder visited every school, and that informed their proposals. Other bidders did not do that. The questions the final bidder asked and the information they elicited influenced their bid, so schools always felt they were part of the process.

1060. **Mr Murray:** In discussions the Department of Finance and our education group take decisions; we do not have to talk to anyone else about it. While I do have an argument about the centralisation of the education system in the Republic, which I think has many drawbacks, we can tackle a PPP project quickly because we do not have education and library boards. The Education Department owns many of the schools involved in the process, so if the operator has a contract with the Department or the Minister for Education and Science, it takes many risk issues away from the table. There are down sides in the education system about the amount of material coming into the Department, but it has helped us enormously in moving the PPP process on.

1061. **Mr Treacy:** All the advice given to us to date is that one should talk to the market before even starting the procurement process. That leads to a better and more robust procurement process and it cuts down on time. If the market understands what you are looking for before you announce it formally, you will get feedback, so that when your specification goes out it is tighter and aimed specifically at the market. We are at an early stage, but all the advice we have been given to date is that it will help the process, and one hopes the market consultation exercise we are about to start will help that along.

1062. **The Chairperson:** Some problems have obviously arisen or are envisaged in the different sectors. What have you come across?

1063. **Mr Murray:** One problem that stands out is how easy it will be for caretakers who have hitherto worked for the school to transfer to the operator. Some trade unions now want to be involved in the process.

At central government level there is a social partnership agreement in the Programme for Prosperity and Fairness on PPPs, which obviously involves the Irish Congress of Trade Unions (ICTU). However, if you take that down to the union representative in Dunmanway in County Cork, he will not be too concerned about what has been agreed centrally; you still have to sit down and work through the issues.

1064. Jim Livingstone from DENI spoke to our schools at the beginning of this process. I thought that he had frightened them a little about the amount of work they had to do, but in fact it helped them focus on the fact that it was not simply a case of a wonderful school being created while you did nothing. They had to think hard about the curriculum, school relationships and so forth.

1065. Having said all that, we are not experiencing the difficulties that I had anticipated. In getting a preferred bidder, we adhered to all the dates that we set out in June last year when we first advertised the project, and those in the private sector also adhered to their dates. From choosing the preferred bidder in March, we expect to sign the contract within three months, which is one year earlier than any others. Will we achieve our target? I cannot answer that now — I will be able to tell you in July.

1066. **The Chairperson:** Have you been lucky enough to have one individual bidder, or have you had a consortium? In London we heard about a consortium of bidders, where one member pulled out and the consortium had to be realigned.

1067. **Mr Murray:** A consortium of bidders involves a contractor, a facilities manager and a bank. If the bank decided to leave the process, we could cope with that, but it would be another matter if the other elements two pulled out. Jarvis Construction UK has the contract for five post-primary schools and the Cork School of Music. Jarvis deals with the facilities management, so there is no evident difficulty for us.

1068. The private sector is as keen as we are to sign a deal. Facilities management may be an issue in future projects. There may be a consortium in which facilities management is divorced from the contract.

1069. **The Chairperson:** Is there a danger of tying down your money in, for example, a school building project for the next 25 years, so that in the next 10 years you may not be able to pay off your debts and continue to build?

1070. **Mr Murray:** We considered design-build-finance-operate (DBFO). We looked carefully at taking out the private sector debt after a number of years, and I would not be surprised if that happened. The banks are also examining that. We are implementing a Government decision by testing PPPs. We have looked to the Department of Finance for comfort, to know that that money will be ring-fenced to pay off those projects. Currently, the annual repayments for the five projects represent approximately 4% to 5% of the capital budget of the Department of Finance, so it is not a large amount of money.

1071. **Mr Treacy:** The area of public transport is flexible, and the system we require in 25 years' time will be different from what we need today. Therefore, the Department of Public Enterprise looks for review clauses which state that every five years either side can review the project and look at how we are approaching it. Our advice from the UK is that there were difficulties when that did not happen.

1072. **The Chairperson:** In London we discovered that some contracts were equally balanced in design and planning, and commitments were given for the payment of money, but in many cases there was no delivery.

1073. **Mr Maskey:** If the repayment of the mortgage — or whatever you wish to call it — has to be made over 25 years, and the rate fluctuates, will other services in your Department have to be cut back to pay the loan? No matter who finances the project initially, the money still has to be paid back every month. Earlier, Mr Kearns mentioned that the differential between private and public sector borrowing is somewhere between 1% and 3%.

1074. **Mr Murray:** The figures on our projects are less than 1% on top of the Euro borrowing rate, which is currently about 5·5%. I would not call it a mortgage; we were not interested in one and said that the only way we would take private financing would be if the contractors took risks. They take design, construction, cost overruns, maintenance and operation risks for 25 years for less than 1%. We told the banks that if the only thing they could bring to the table was cash, we were not interested; we wanted more.

1075. **Mr Treacy:** The transport issue is different because if we do not secure private investment for the building of a metro, it will not happen. How we structure a financial deal will obviously be important, because we do not want a situation where all the Department's finances are soaked up. We are seeking means of finance other than private capital investment. We have been looking to Europe.

1076. **The Chairperson:** It is also different with us. The money market knows that infrastructure depends on money and that we have a block grant from the British Exchequer, whereas you control your own taxes.

1077. **Mr Hussey:** That is exactly the point I was coming to. In dealing with lawyers from banks and finance houses, you were in a position of being able to say "Bugger off — we will get somebody else." We cannot do that.

1078. **Mr Murray:** We shall not be too cruel to them, since Mr Treacy needs them.

1079. **Mr Maskey:** Were you able to identify any alternative means of raising finance?

1080. **Mr Treacy:** At the moment we are examining the possibility. In Copenhagen an old military airbase of more than 500 acres that was in state ownership was handed over to a state development company. The company will develop the site, and the revenue will pay for the construction of a metro system. We may pursue the development of land as part-payment towards infrastructure.

1081. **Mr Maskey:** You could sell it and put the money into anything you wanted.

1082. **Mr Treacy:** Yes. It is very hard to control, and the agency could become a property management company rather than a transport company. That is the inherent danger, but it is one of the possibilities. We would have to structure it and keep it tightly in line.

1083. **The Chairperson:** Recently a school was being built in Dungannon which involved the loss of playing fields to the contractor for the development of housing. There was a social aspect, because a badly needed facility was being lost to allow the contractor to get his money back more quickly via housing development. That is a difficulty. Have you had that type of experience?

1084. **Mr Murray:** No, but the issue arose with one or two schools. Fifteen-acre sites are generally provided for a post-primary school. This is quite generous and you could fit several pitches on the site. One bidder in Shannon said it would have helped if a portion of the site had been allowed for housing, thus enabling us to cut back on the cost of the project, but we said we were not interested. It was an education project; we were not in it for money.

1085. There is a broader issue here. The Department of Education and Science owns 400 properties at primary, post-primary and third level. We do not do a good job in managing that property; we should be looking at ideas, perhaps moving an old school up the road, because the land would be better used for housing, and we could get a free school elsewhere.

1086. As a Department we do not have the capacity to run a property management system; it is an area we need to look at, but we have not taken it on board in the projects under discussion because we thought it would complicate them.

1087. **The Chairperson:** Do you have a project covering such matters as using buildings outside school hours, especially during the summer holidays?

1088. **Mr Murray:** We have the standard school day, outside of which there are banks of hours when the school can use the building for other purposes. Outside school hours, the operator may generate third-party income, which is shared on a 50/50 basis with the school. The Department wants nothing from the arrangement. In that way, the school and the operator both have an incentive to work together to develop ideas.

1089. **The Chairperson:** Or it could be developed with the community.

1090. **Mr Murray:** The community can use the buildings gratis in those banks of hours that are set aside. It has happened with UK projects, with all-weather floodlit pitches and so forth. Some communities have warmed to such ideas and would love to see them. However, it is up to the operator to judge if it is a viable proposition. If it is indeed viable, we facilitate it as owners of the property, and the school and the operator can do such things; we have no difficulty with that.

1091. **The Chairperson:** More use is made of the school building.

1092. **Mr Hussey:** Is it correct to say we have a problem with offering land for sale, since it would be additional to the Barnett formula?

1093. **The Chairperson:** Yes. The Barnett formula from the British Exchequer is a block grant, but everything that comes back in is returned to the Exchequer.

1094. **Mr Murray:** That is also a constitutional provision here. Unless provided for by law, all revenue goes directly to the Exchequer. However, if it goes directly to a school, it is not going to the Exchequer.

1095. **Mr Gordon:** The Cork School of Music project included a separate property. The existing school building will be flattened and a new school built, but some distance from it a property belonging to the Cork Institute of Technology was put into the pot for the PPP project. It must be worth an additional £500,000.

1096. **Mr Murray:** The building is derelict and is perhaps not worth that. Our advisers have told us that a deal is more attractive if you have additional property. This property is of no use to the Cork Institute of Technology.

1097. **The Chairperson:** Of no value?

1098. **Mr Murray:** Absolutely none — that man knows. You are right that it is part of the process.

1099. **Mr O'Neill:** Perhaps I might talk about the process. The roads have been split into two phases, the first one consisting of four projects with the remainder in phase two. It was perceived to be a good idea to have two sets of consultants, and as it happens the same group has won both phases, which is advantageous to the project delivery in saving time because they are running several projects in parallel. They have developed the systems and the contracts, and it is simply a matter of iteration and fine-tuning to cut down on the large costs for the bidding consortia in future tenders. The same consultants are appointed throughout the entire phase I and phase II procurement process. It has been of great benefit to the process in saving procurement time to meet our infrastructure needs.

1100. Mr Kearns may have spoken to you this morning about structures. My role involves contact with Mr Treacy on the metro and LUAS, with Mr Murray on education, and I am also involved with roads; I cut across all the various projects.

1101. As Mr Murray said, a number of issues have already been addressed by the Education Department, and if they fit for LUAS, for example, it speeds up the process. Anything we learn from previous projects is fed back to the centre with the intention of standardising the position.

1102. **The Chairperson:** This is cross-departmental, joined-up government.

1103. **Mr O'Neill:** Yes.

1104. **Mr Leslie:** We spoke earlier about the problem of putting a bid together and about documentation, and we hear that there is a move towards standardising documentation. I suppose that has been driven by experience. You did not know what you wanted at the start, and as you became more experienced, a tick-off list and a template emerged. I am interested in your comments on standardisation.

1105. **Mr Murray:** Many of us started off by looking at the Treasury Task Force documentation. We had some difficulty with it because of what we perceived as the power of the financial institutions. I will give you an example. We were new to this when we sat down with the financial institutions. A debt service reserve account is a feature of PPP, which sounds very grand. It means that if you have a £50 million project, the bank lends the operator £50 million. However, if there is a disagreement, the bank wants to ensure that six months' repayments are guaranteed. Therefore, the operator has to borrow an additional six months' repayments. When the operator deposits the six months' repayment money into the bank, it earns interest, which pays the borrowing interest. We asked the banks to explain their logic. The more we questioned issues such as this, the more people queried what was happening. They have had to go away and decide to do something different. We learned from the experience and I hope that that will lead to a better project.

1106. We learned a lot from Jim Livingstone from DENI and much of our early documentation on PPP came from DENI. We picked and chose, deciding to change this or that. As Pat O'Neill said, that becomes a document, which we then share with Maurice Treacy and others. We return it to Jim Livingstone and it becomes a template for people to test. It is a process that needs continuous improvement and refinement.

1107. **Mr Treacy:** The term "standardisation" may not be correct. Public transport projects will differ from roads projects, which will differ completely from schools projects. We are trying to put a framework together, and we all contribute to that, but the contracts may be very different. I would hate to think that just because something has been agreed as a standard contract we cannot move away from it to better suit the public transport or education sectors.

1108. **Mr Leslie:** Have you reached some degree of standardisation for schools?

1109. **Mr Murray:** The documentation used for the Cork School of Music is now being used for the National Maritime College, so that is standardisation. However, we also learn from the operators. They could look at a document and give us a price for a project, but they may advise us that by changing a particular clause, we could get better value for money. We have taken quite a few of their ideas on board. We might insert something into a clause and be unaware that it is causing difficulties for the operators. The difficulty becomes an actual cost to us. If both participants approach it fairly, we will learn from one another.

1110. **Mr O'Neill:** The perspective of the central unit is that certain issues such as force majeure will always be standard. We should standardise non-contentious issues in all contracts so that we do not have to pay additional moneys to lawyers to renegotiate straightforward clauses. Several areas have a generic base. In education, we have looked at compensation and termination, where a very different perspective is taken from the one taken on national roads where there is no compensation and termination.

1111. We must learn from these pilot projects. If we enter the pilot project phase and decide that everything should happen in a certain way, it will reduce our learning potential. We should develop in our own sectors, bring back our experience, establish a common ground, and then use that as guidance. That is the position that we should start from. If you want to deviate from that in a specialised area, such as LUAS, you must justify why you have moved from that position. If there is a justification, we should not tie our hands.

1112. **The Chairperson:** Thank you very much for the information — it has been a useful experience for us. I would like to thank Eamonn Kearns and the staff for their time and for organising today's meetings. It has been beneficial and I hope we will learn and develop from it.

MINUTES OF EVIDENCE

Thursday 26 April 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr B Bell
Mr Hussey
Mr Maskey
Mr Weir

Witnesses:

Mr D Doyle	)
Ms S Price	) Department of
Mr E Kearns	) Finance (Irish Republic)
Mr C Lavery	)

1113. **The Chairperson:** I should like to thank Mr Kearns and Ms Price for getting the arrangements for today's meeting in place and for the co-operation there has been between the different Departments.

1114. **Mr Kearns:** Thank you, Chairman. We look forward to a good session. I shall introduce the members of the Central Public-Private Partnership (PPP) Policy Unit. Colm Lavery is a policy specialist who has been with the unit since it began two years ago.

1115. Sonja Price is a private-sector lawyer on secondment with the unit for two years. While we like to think that the Civil Service has the all the expertise it needs, very often it does not. Our unit is, in fact, a form of public-private partnership itself.

1116. We shall begin by giving you an overview of the Republic's policy on public-private partnerships. Sonja will then take up a number of legal issues which we hope will be of particular interest, both here and in Northern Ireland. We shall be happy to take questions.

1117. **Mr Kearns:** Perhaps I might begin by stating what we mean by public-private partnerships. PPPs are arrangements between the public and private sectors with shared objectives to deliver infrastructure and quality public-service projects. It is intended that PPPs will do that by linking the design and construction of projects with their finance, operation and long-term maintenance. For us, a very important part of developing the PPP programme is the commitment of government at the highest level. The Irish Government have frequently expressed a strong commitment to the development of PPPs.

1118. That is not the whole story. Right across the spectrum in Dáil Éireann there is a strong acceptance of a PPP programme as part of a national infrastructure development plan. However, that is not the full story either. You are all familiar with the social partnership models we have developed over the last decade or more. We implement social partnership arrangements at the macro-economic level by rolling programmes. The latest programme is called the Programme for Prosperity and Fairness. The social partners in that programme have all reaffirmed a commitment on their part to the development of PPPs through representative organisations such as the Irish Business and Employers' Confederation (IBEC), the Irish Congress of Trade Unions (ICTU) and the Construction Industry Federation (CIF). It is part of our job in the Central Policy Unit to work with those social partners.

1119. One of the reasons we are confident about the PPP programme is that there is such a strong background of partnership between public service and the private sector. We even have examples of infrastructure projects which have been developed in Dublin as public-private partnerships. The city is split in two by the River Liffey. On the east and west sides we have two bridges — the Eastlink bridge and the Westlink bridge. Both of those are toll bridges, and you have to pay to cross them in a car. They were designed, built and are operated by the private sector, which charges users for the facility. Those are good examples of functioning projects developed as forms of public-private partnership.

1120. While the pilot programme we are developing is treated as a new policy initiative — because it formalises the way in which we approach the issue of PPPs — we have good practical examples of where that kind of approach works.

1121. One thing we should like to emphasise is the context within which PPPs have been developed. The Irish economy has grown exponentially over the last decade. We have had the highest rates of growth, output and employment in the European Union — I believe in the Organisation for Economic Co-operation and Development (OECD) area — since the mid 1990s. We have had significant increases in commerce and, therefore, in the use of the economic infrastructure. The very rapid growth has put huge pressure on our economic infrastructure, particularly in the case of transportation. We are at, or close to, capacity right across the economic infrastructure in the areas of roads, rail and urban transit.

1122. Secondly, we all share the "green" image of the island as an environmentally clean area. That is becoming less true for us. We are finding it increasingly difficult to ensure that we meet the standards set in European Union directives on environmental quality for air, water and so on. Therefore we must have a significant programme of investment in environmental infrastructure, for example, in water supply and treatment, sludge processing and waste management to meet even the basic standards which we set ourselves in the context of the EU.

1123. The Government and the PPP unit believe that PPPs can make a significant contribution to accelerating the delivery of those key economic infrastructure objectives. The benefits we are looking for from PPPs come down to the acceleration of the delivery of the overall programme set out in the National Development Plan (NDP), and also the improved delivery of individual projects.

1124. One of the ways we believe the public-private partnership approach can help us to achieve such accelerated delivery is through risk transfer. By that we mean the allocation of risks to the parties best able to identify and manage those risks in the development of projects and the delivery of quality services. We are not talking about the risk-loading of the private sector or about trying to have the private sector carry unreasonable burdens of risk in developing projects. In the PPP programme we wish to try and achieve a form of optimal risk transfer where necessarily, the public authorities continue to bear a project risk in many of the projects which would be retained by the public authorities, for example, planning.

1125. There are risks that are most amenable to more effective and efficient delivery by the private sector. Part of the PPP concept is that in private-sector firms there is a capacity for innovation, technological know-how, financial competencies and managerial expertise, which, working with the public sector, we can maximise by bringing it to bear on the acceleration of infrastructure project delivery.

1126. I should not be a Department of Finance person, of course, if I did not emphasise the importance of value for money. We see public-private partnerships as being able to deliver better value for money on many of the projects that we are bringing forward under the NDP.

1127. I shall very briefly say something about the NDP, for that is the context in which we are developing the PPP approach. In the NDP, our PPPs are focused on "design, build, finance and operate" PPPs. There are other types of PPPs — it is a broad spectrum — but the DBFO projects are very much a priority for the NDP, and they are focused very much on the economic infrastructure programme. The NDP, as you may know, covers social as well as economic infrastructure. The PPP approach will be focused initially on the latter.

1128. We have an indicative target within the NDP for privately financed public-private partnerships of V2·35 billion over the period between now and 2006. Within that, V1·27 billion is targeted on the national roads. Any of you who travelled here by road will know that the road system is sub-optimal. That is a charitable way of describing it. It is simply not up to the quality which we believe is needed to maintain competitiveness. About 90% of all freight in the Republic is carried on the roads. When you realise that we have only a very small proportion of the national routes at even the level of a dual carriageway, let alone a motorway, you will appreciate how important the road development will be in maintaining competitiveness over the long run.

1129. We have in excess of V120 million in public-private partnerships concerning the water supply. We have a very rapidly growing population, mainly concentrated in urban areas, so pressure on water supply is also a very significant policy issue for us. We have also targeted a number of projects in suburban rail, on-street light rail — and eventually the planned metro for Dublin — as public-private partnerships. We believe that the PPP approach will assist us in meeting some of the mass transit problems we have, particularly in the greater Dublin area, where we do not have a fully functioning integrated public transport system.

1130. The V2·35 billion private finance target is not the whole story. We also plan to develop "design, build and operate" types of PPPs, which will not have private financing. Some of those will be in the waste water area. Part of the reason is that we are still in receipt of some European Union structural funds on waste water facilities — cohesion funds — so we plan to develop public-private partnerships on a DBO basis using the resources from the EU structural funds.

1131. We are also looking at Northern Ireland and other European countries to see what other sectors we can push the PPP programme into. The health field is one of those areas, and the Minister for Health and Children has said he wants us to work with his Department in developing the scope for public-private partnerships. The justice area is also included in that, and we have seen in the UK how the building of prisons and police stations has been developed very successfully by means of public-private partnerships, giving good value for money.

1132. I should mention the criteria we use for choosing the projects for public-private partnerships. The PPP target is only about 10% of the total economic infrastructure programme, so we are selective. There are two key criteria, the first being that the project has a high priority at national level. As you know, at local level the project is inevitably the priority, but we wish to ensure that priority projects for economic infrastructure through PPP are national-level priorities. Those are roads, mass transit, water services and waste management. The second criterion is long-term value for money. We can achieve long-term value for money by effective risk allocation, which is critical to a good public-private partnership. Life-cycle costing is also important, and we do not have a good record in it for publicly procured assets. By taking a public-private partnership approach we can improve the total life-cycle costing of projects and therefore there will be better value for money over the whole life of a project.

1133. Payments or user charges will incentivise value for money in a PPP approach. Therefore on the roads programme the Government has decided that all the roads PPPs will be procured using a "real tolls" approach. The next PPPs in the roads area, which will be a bridge in Waterford city, an estuary crossing in Limerick and a stretch of motorway on the N4 to Galway, will be "real-tolled". There is naturally a debate locally about the tolling issue, but the Government policy is that "real tolls" will be used. Again, that will incentivise value for money in delivery of the project and the use of the asset.

1134. Finally, we shall consider the issue of competition. We are confident that PPPs can help to deliver competition in the Irish market. As part of the NDP strategy we have tried to raise awareness of the business opportunities available in the Republic under the plan. We sought to raise awareness in Northern Ireland among construction firms and also in Scotland, England and Wales, the rest of the European Union and farther afield.

1135. The payback for us is in the number of overseas firms which make a commitment of resources to bid for projects over the full duration of the NDP. The Irish construction sector is at — or close to — capacity. It has doubled output over the last 10 years and is also not as experienced in delivering high-cost, large-scale infrastructure projects. The projects we are offering to the market under PPPs are bigger than previously.

1136. We can tell you about road, rail, the metro for Dublin projects, but we shall leave it to you to ask us questions.

1137. **Mr Bell:** You painted a rosy picture and identified all the advantages — what are some of the disadvantages? Wearing another hat I am Chairman of the Public Accounts Committee in the North and am very interested in value for money. Do you see any difference in approach in the United Kingdom and Northern Ireland — which is of course part of the United Kingdom — to that in the Republic?

1138. **Mr Kearns:** Taking that part of the question first, the overall context in which we are developing PPP is rather different from the development of the PFI in the United Kingdom in the 1990s. There are a number of reasons for that. Our public finances are in a relatively healthy position, because we have a very significant Exchequer surplus — and have had for the last few years. In the early 1990s when the PFI was brought forward in the UK, there was a significant budget problem with substantial deficits on the current account. Therefore the PFI approach was seen to some extent as a means of procuring assets from the balance sheet by using private finance, and you are more familiar with that than I. That will not be a driver for the PPP approach in the Republic.

1139. Secondly, in the UK in the early 1990s — a hangover from the late 80s recession — the construction sector was in a downturn. The PFI approach was lobbied for by the UK Construction Confederation as a means of increasing contract opportunities for construction firms. Here we have a contrast, for our construction-sector activity is almost at capacity, and we are anxious to bring in construction, civil engineering and design firms from the UK and other European countries.

1140. The third difference is that we have tried to develop PPP by means of a constant dialogue, so we have established structures which bring in, for example, IBEC, the ICTU and the CIF. We are negotiating with them a framework for PPP, which will be an agreed basis for developing the procedure in the long run. There was some opposition to the PFI approach in the TUC and some of the local authorities in the UK in the early 1990s, but you would be more familiar with the exact details.

1141. **Mr Bell:** You have really hit the point. We now have a devolved Government in Northern Ireland, and we have discovered that for 30 years there has been neglect and lack of investment in the infrastructure. We are almost being forced into the PPP to address that problem — that may be the difference. You are doing it from a position of strength; we are being forced into it because we have a block grant of £9 billion from the British Exchequer, and that is not enough. That is enough to run the country, but not to address the problems of infrastructure and neglect of the last 30 years.

1142. **Mr Maskey:** Eamonn was talking about life-cycle costing. Do you borrow money regardless of the project? We are now being told that the cost for the Government to borrow money over the long term — 20 to 30 years or whatever the case may be — is cheaper than for the private sector. I presume that is what you mean by life-cycle costing. What would the projection be you if you started off as intended? Over a 25-year cycle, have the British Government more money now than using public-sector borrowing?

1143. **Mr Kearns:** The discussion as to whether it would be less expensive for the Exchequer to borrow to fund our entire infrastructure programme — given the surpluses on the public finances we could probably do it — was taken into account when the Government decided to develop the PPP approach.

1144. When you look at experiences in the UK, where there are similar projects in roads and some other economic infrastructure projects, the total financial cost of the projects tends to be about one third of the total project cost. The differential between the Exchequer borrowing cost and private-sector borrowing cost has narrowed over the last five years from about three percentage points down to about one. The additional cost of borrowing for private-sector consortia bidding for large-scale infrastructure projects has been reduced.

1145. The second way in which we can reduce the financial costs of PPP projects is by making them much bigger. Banks and financial institutions tell us that there is a threshold for financing major PPP projects above which it becomes far more economic to finance them. The reasons are obvious — it is less expensive for banks to borrow above than below a V50 million threshold. That is partly the reason why we are focusing on large-scale economic infrastructure projects and not the smaller-scale projects.

1146. We can have better cost-effectiveness and value for money for the Exchequer over the long run by using PPPs to link the design and construction of infrastructure projects with the long-term delivery of the service and maintenance of the asset. We have been developing infrastructure using EU structural funds and domestic Exchequer resources for around 20 years. We have had some great successes, but the focus has been on the low-cost delivery of infrastructure. We have been less successful in looking at long-term operation and maintenance.

1147. In building and design there has perhaps been inadequate attention paid to what the operation costs will be, what wear and tear will mean to the asset and what the long-term replacement and refurbishment costs will be. By matching responsibility for designing and building to the long-term operation and maintenance, the Exchequer can get better value for money. If you have responsibility for running an asset over 25 years, you will make sure that the quality of the design and building match your expectations — the refurbishment, maintenance and delivery of the service should be to an adequate specification in the long run.

1148. **Mr Maskey:** If you translate that into, for example, health or education — sectors which do not make money — how do you work 25 years ahead? The Department will have a budget which must then be ring-fenced to pay the design, building and delivery of service. In 20 years, the Department will still have to make that mortgage repayment. Are you not hostage to the private sector's borrowing rate at the time? Does that impact on the service that has to be delivered in order to make a profit?

1149. **Mr Kearns:** Those are serious questions to which, candidly, I do not have all the answers. One reason why we have adopted a pilot-project approach is that, with sectors such as health and water services, different problems arise from with roads, for example. Different problems also arise when we go down the road of mass transit, particularly in the Dublin area, with its procurement of a metro by means of a PPP. I should like to say that I have all the answers in that regard. Some of my colleagues might want to contribute on the issue.

1150. By developing the pilot-project approach, we are not saying that we shall develop the projects, stop to examine them, and move forward. Perhaps we should be calling them pathfinder projects rather than pilot projects, for we hope to learn by doing. We hope to learn from comparable projects in the UK and the North, in particular in the education sector in Northern Ireland which has enough similarities with what we want to do. I appreciate your point that, looking in 25 years at the quality of the services you wish to deliver, there is a judgement to be made.

1151. **Mr Maskey:** I asked that question because we have seen services being cut back badly in the Health Service over the last few years. Experience to date has shown auxiliary services being badly slashed.

1152. **Mr Weir:** To some extent you have touched on the points I wished to raise. A few things struck me about the overall picture you present. First is the fact that one of the Department of Finance's key criteria was the high priority that the project happen at national level. You said that there is, for example, a certain threshold for borrowing requirements. Obviously the programme is geared more towards large-scale projects rather than small local schemes. In addition to the borrowing requirements, are there any other areas which might necessitate an economy of scale and a certain threshold which must be overcome?

1153. **Mr Kearns:** That is a good point. Yes, of course, the project must have a number of attributes; it must be attractive for the private sector to bid for the projects — in other words it must have characteristics such as bankability. If the private sector is going to bid for the projects it must be confident that the financial institutions will be willing to put forward the financing in areas such as senior debt or equity. There will, preferably, be an equity element in the projects. If the projects do not have those characteristics, they certainly do not become good PPPs. It is something of a cliché, but a saying in the unit is that there is no good PPP if there is not a good project. In other words, the Central PPP Unit does not want a PPP approach to enable the delivery of a project which does not have strong characteristics per se.

1154. **Mr Weir:** I was interested to note the principal areas in which there had been investment in PPP. In the UK there tends almost to be a scattergun approach to health, education and justice issues, along with some of the infrastructure. It struck me, particularly with the devolved institutions, that the bulk of the main areas the Central PPP Unit would be looking at would fall into the remit of our Department for Regional Development, which deals with transport issues and the Water Service. Two questions arise from that. First, you identified that the Central PPP Unit is looking at pathfinder projects for areas such as health and justice. Are there particular sectors which you believe inherently do not lend themselves to PPPs for public investment? Secondly, could you outline what sort of monitoring procedures the Central PPP Unit has to evaluate whether particular sectors of the economy or public investment are appropriate to PPP when it is conducting the pathfinder projects?

1155. **Mr Kearns:** I mentioned that the objective is to try to widen the potential scope for PPPs in health and justice. As of now the Central PPP Unit does not have a pathfinder project in either area. The unit feels that there are no sectors of the economy which it would exclude from a potential PPP approach. However, it might find limitations in PPP in areas where the Government is taking an alternative approach, for example, in the energy sector, where the Electricity Supply Board holds a state monopoly on electricity generation. The Government has a policy of developing privatised electricity generation, something the Central PPP Unit would differentiate from the PPP approach, since privatisation is an effective asset transfer to the private sector.

1156. We do not, however, wish to rule out any potential sector for the PPP approach. If we can demonstrate through the pilot project programme that PPPs can deliver an accelerated programme of infrastructure quickly, and if PPPs can demonstrate value for money, it would stimulate a great deal of thinking “outside the box” compared with the traditional means of procurement.

1157. In relation to monetary procedures, I referred briefly to the framework for public-private partnerships which we are negotiating with the social partners under the Programme for Prosperity and Fairness. The framework is intended to provide a basis on which the different stakeholders in a public-private partnership can work in an area of common understanding in respect of the core principles of PPP and the objectives we wish to achieve. We have established a series of structures intended to govern the roll-out of the PPP programme. They begin with the Cabinet Subcommittee on infrastructure and public-private partnerships. That is chaired at the highest level by the Taoiseach, and it includes the Minister of Finance, the Minister of the Environment and Local Government, the Attorney General, the Minister of Justice, Equality and Law Reform and the Minister of Enterprise, Trade and Employment. It meets once a month and addresses issues in relation to the projects. Where monitoring questions arise in respect of high-level policy, they are addressed very quickly by the Cabinet Subcommittee. I attend with a number of other civil servants, who make up a cross-departmental team which takes in all the priority areas under the NDP. We can discuss with the Government at the highest level where monitoring issues need to be raised. For example, in the UK, after a number of early PFI projects an issue was identified regarding the vires of the statutory authority of the procuring bodies, with questions being raised. Ms Price can perhaps fill in the details of the response made in the UK. When we looked at the issue in consultation with the Attorney-General, it was felt that there was also a potential difficulty in the Republic. We were able to bring proposals through very quickly to develop a statutory response to that kind of issue, which you may well come across in Northern Ireland.

1158. **Ms Price:** Under domestic law there is no legal impediment to PPPs, but the central unit decided to bring forward a PPP Bill to address the issue of vires or the legal capacity of state authorities to enter into PPPs. International experience has shown us that investors in PPP projects require a high degree of certainty in that regard and, as you are probably aware, a state authority only has the power to do whatever it is empowered to do under statute. Since it is considered that overseas consortia will be participating in Ireland in delivering the NDP and public-private partnerships, and that they will be conscious of that issue, we felt it was important to bring forward the PPP Bill. It will provide certainty to the market, and will give local authorities the power to enter into joint ventures and to form companies for the purpose of entering into PPPs. The Bill is currently at the drafting stage, and we are hoping that it will be published shortly.

1159. You will probably be aware of the UK legislation, the Local Government (Contracts) Act, 1997. Legislation was also brought in in the health sector. The legal regime here in Ireland is very similar to that in the UK in relation to state authorities. Legislation has been brought forward in the UK because there had been a number of high-profile cases where local authorities had been held to act outside their powers. There is no legal impediment per se here in Ireland. For reasons of due diligence, we brought forward this PPP Bill to provide certainty and ensure that legal firms did not spend huge amounts of time and money checking out the legislation. It is a very short piece of enabling legislation.

1160. **Mr Kearns:** Picking up on another aspect of the monitoring of the project, and returning to a point that Mr Bell made about monitoring problems, our job is to lead, drive and co-ordinate.

1161. **Mr B Bell:** I support PPP.

1162. **Mr Kearns:** Someone described us as cheerleaders for PPP. I do not want to overdo it, but difficulties can arise when public-sector employees are required to transfer to a private-sector consortium for delivering the service.

1163. The European Union directive on the transfer of undertakings and the protection of employees covers Northern Ireland and the Republic. However, the local and industrial relations machinery varies from place to place, from industry to industry and from sector to sector. Undoubtedly, questions will have to be dealt with. We have worked with social partners in the context of the informal advisory group, and issues that arise from projects can be dealt with at a policy level, for example, staff transfers from public authorities to private-sector bodies. The local industrial relations questions will have to be dealt with by the appropriate sectoral industrial relations machinery. However, we hope that the advisory group can provide a high-level policy response on issues for which it is required.

1164. **The Chairperson:** Mr Bell's main concern is that, when we move into new relations and he may be running the system, to ensure that it is protected in the long term.

1165. **Mr B Bell:** That could be true. The Northern Ireland Housing Executive currently controls housing, and the policy is that people have the legal right to buy their own houses at a discount. The Housing Executive is not building any houses; they are being built by the housing associations, which are regarded as housing corporations and can borrow money from the private sector. The Housing Executive now controls all houses, although they are being built by the housing associations. Northern Ireland Housing Executive tenants can buy their houses at a discount as of right, but problems are arising because of the private-sector input into the housing associations. The private sector is saying, "Hold on. We have invested money, so you cannot give that discount to our tenants. If you do, you will have to find another way to compensate us." I am involved in housing, and that is one small matter I have come up against.

1166. **Mr Hussey:** You mentioned that economy of scale is necessary in projects. Have you had any experience with grouping of projects to establish that economy of scale? The "design, build and operate" agenda is correct, but you are looking at an operation over a long period. In that time, requirements are bound to change. You may have established a contract with the private sector over 25 years, but European legislation may dictate that the requirements of the service you are delivering must change. How is that flexibility built into the overall project to allow a change of remit?

1167. The population on this part of the island is the same as that in our part in that, if you suddenly have to start paying for something for which you have not been paying, there is a public response.

1168. There is a proposal to introduce tolling on the Toome bypass. However, that might not benefit the public if, rather than use the toll road, motorists continue to use the roads through the village. How do you counteract that? Much of the infrastructure deficit is in areas of social need — need which must be targeted — and that raises the question of equality. The equality of service provision must be at the same cost to people in other parts of the region. Have you come across that? If so, how do you deal with it?

1169. **Mr Kearns:** We have learnt much from the UK experience, and we have had very good relations with the Treasury taskforce and its successors in the Office of Government Commerce and with Partnerships UK. They have helped us deal with those long-standing issues, for no contract has yet been closed on our pilot projects. We are still at the early stages, whereas the UK's projects are in operation.

1170. The economies of scale must still be developed to our advantage. By that I mean that we are offering far bigger projects to the private sector than under conventional procurement. We shall need overseas expertise in delivering them. The broadening of the Irish market in technological know-how and expertise will outstrip what is available domestically. We are confident that it will bring benefits for Irish construction and engineering.

1171. Portugal had an inwardly focused, relatively small construction sector until the early 1990s. It developed a public-private partnership approach and now Portuguese companies undertake joint ventures with overseas firms on very large projects. Portugal now competes for projects in other European countries.

1172. **Mr Hussey:** I understand, but I should like to know if you have experience of trying to group smaller projects together to establish a major project.

1173. **Mr Kearns:** Very little, except in the education sector. One of our pilot projects has grouped five post-primary schools together and offered the "design, build and operate" option — not teaching, but the facilities management of that group of five schools for a 25-year concession.

1174. We have got as far as preferred bidder on that. The successful bidder is Jarvis Projects Ltd, which is a United Kingdom firm with very strong facilities management capacity. We have much to learn from grouping smaller projects into a bigger package which can be offered to the market.

1175. The initial reaction was sceptical in respect of the group of schools, for they are spread widely over the country. There are two in County Cork, one in Shannon, one in Sligo and one in Monaghan. The geographical dispersal of schools being offered under a single contract raises questions. However, the milestones for the project are being met so far, and we expect to see a good solid delivery of the construction phase. It is something we should look to in other sectors, for example, health, where individual projects may not reach the threshold for viability in a financial package. Where it is feasible, we shall try to group individual projects into a single package which we can offer to the market. Up to now, however, we are limited to education.

1176. **Mr Maskey:** Can you clarify the concessionary period? Ms Price mentioned the PPP Bill as enabling legislation. I know this is a different jurisdiction. However, with regard to the constitutional rights of the people of the Twenty-six Counties, does the PPP Bill deal with rights for services such as education and health, or is it purely a piece of technical and financial enabling legislation?

1177. **Ms Price:** The state authorities are listed in it, so it would be technical.

1178. **Mr Kearns:** It is enabling. It is in anticipation of a potential issue arising and will also provide a sound statutory basis to allow public authorities to enter joint ventures with the private sector where a doubt may arise in respect of the statutory authority for public service.

1179. **Mr Maskey:** If I am in receipt of a service such as that provided by a school, and it is not delivering for my children, can I use PPP in the Twenty-Six Counties under my constitutional rights? I know that new human rights legislation is also being introduced here.

1180. **Mr Kearns:** Our procedure in the education sector is that the teaching services will not be included as part of the package for schools. That will be retained in the existing remit. Although Irish second-level education is something of a public-private partnership in that education services provided by trusts and religious institutions are in partnership with the public sector. Similarly, at present health services per se will not be delivered under PPP schemes. I am thinking of assets and management facilities as opposed to medical service delivery.

1181. In the United Kingdom private-sector firms are now participating in the delivery of prison services. At present our approach is to concentrate on the delivery of assets rather than the provision of public services. Therefore entitlement to those public services will not be changed. We do not see PPPs changing the concept of the universality of service access and quality of service delivery.

1182. **The Chairperson:** Would the enabling Bill give an overriding authority where a local council or authority did not want to engage in PPP?

1183. **Mr Kearns:** This legislation will not give that.

1184. **The Chairperson:** I am thinking of waste management, where the Minister has now given a direction to the county manager to overrule the elected district councillors. If there were resistance to PPP in some area, would that enabling legislation deal with it?

1185. **Mr Kearns:** No, for the legislation is to enable local authorities, health boards and other public bodies to work at developing PPPs on a sound statutory basis. It does not change the authority of the Minister in respect of the powers and functions of the local authority.

1186. **Ms Price:** On the question on the DBOs, you mentioned two areas — variations and legislative change — and asked how they were dealt with over a long period. Variations are dealt with under the contract, basically by way of the payment mechanism. For example, in the health sector there would be developments in machinery and so on and that is dealt with in the contract. Similarly, a change in the law would also be dealt with in a contractual manner. It would depend on the type of change in the law and on whether legislation applied to all PPPs in that particular sector, in which case it would be the contractor's risk. However, if it is legislation which the Irish Government brings in just for incinerators, for example — there is only one in Ireland — that would be seen as specific or discriminatory. In that case it would be dealt with in the payment mechanism as a contracting authority risk.

1187. **Mr Kearns:** There is also a difficult tolling issue. You appreciate that the projects targeted for public-private partnership in the roads area are all new build, not upgrading or refurbishing existing routes. The Government's policy position in respect of existing roads infrastructure is that there will be no tolling of the existing stock of roads and river crossings. The existing routes will remain available.

1188. **Mr Hussey:** The point is that the proposed infrastructure is intended to overcome a problem. If, as a result of the charging, the problem still exists, how do you balance between public benefit and charging?

1189. **Mr Kearns:** I mentioned how important the roads infrastructure is to business in Ireland. You will find there is prioritisation of improvement in access and journey times. The benefits which will arise from having the improved infrastructure available are likely to ensure usage over the long run. Having said that, we have something to go on. When the two Liffey crossings in Dublin were put forward there was some scepticism about whether people would continue to use the longer routes over existing bridges, but the costs of congestion is such that people use the toll bridges.

1190. What is going to be important is the tolling regime. In the planning legislation brought through the Oireachtas last year, the responsibility for establishing the tolling regime was vested in the National Roads Authority. They look to develop appropriate tolling charges and needs to ensure best value in usage of the structure, and the avoidance of diversion through existing towns and villages — to stop clogging them up, but, at the same time, achieving the kind of social objectives you mentioned.

1191. The other question raised in that context was the equality issue. That is important, and there is no question that it is a priority. I shall return to the approach we have taken in consultation with stakeholders over our priority infrastructure projects.

1192. We hope to be able to create a framework within which those issues of equality are dealt with by encouraging a dialogue with the social partners. That is not going to be easy. For example, in the Waterford area at the moment there is a local newspaper and radio debate on the question of the toll bridge, which has been brought forward as a PPP. Such issues will be teased out time and again as individual projects are brought forward. As part of overall policy, we wish to try to ensure that equality issues are dealt with effectively and that there is universal access to public services. That will not be easy, but it is a policy priority for us.

1193. **The Chairperson:** Perhaps you would like to continue with your presentation, as you were interrupted.

1194. **Mr Kearns:** I should like to mention some of the projects, since you may wish to look at some of them as we develop them. There are two projects in the education sector — I mentioned the bundle of five schools. We might look at alternative means of bundling at a national level in the choice of schools. That is at the preferred bidder stage now. Jarvis Projects Ltd of the UK won a parallel contract to rebuild the Cork School of Music. We believe it is the first contract for a school of music ever to be procured by means of a PPP. You might ask whether that is part of our priority economic infrastructure. It is because we treat education as an economic priority as part of our NDP.

1195. In the area of roads, the one to look at is the Waterford bypass and bridge. That is due for shortlisting in the next week or so. We have had a very good response — a large number of overseas firms are in joint ventures with Irish firms to bid for the contract.

1196. To return to the issue of tolls, it might be easier to toll a river crossing. People might find it more acceptable to pay £1 to cross a bridge — there might be a different reaction when people have to choose a section of motorway. A section of the N4 from Kilcock to Kinnegad has been chosen which is a single carriageway road from Kilcock all the way to the west of Ireland. A section between Kilcock and Kinnegad will be tolled and will be completed to motorway standard. The choice of that part of the project is quite deliberate, for we wish to ensure we find out as much as we can about the effects of delivering road infrastructure in that way. There will be variations between estuary crossings, river crossings and sections of motorway.

1197. Later in the year there will be the Limerick estuary crossing and part of the Limerick bypass. That will complete a circular route around Limerick City. There are some examples in the UK of tolled estuary crossings, such as the Skye and Severn bridges, the second of which is, interestingly, tolled only in one direction. The usage and diversion rates are at acceptable levels after initial difficulties. There will be a buying-in period for all those projects.

1198. The waste management area will be crucial for PPPs. A thermal treatment plant in Ringsend is being brought forward as a PPP — we do not call them incinerators. So far, that plan is proceeding happily. Much will depend on the development of the regional waste management strategies, and, as the Chairperson rightly said, the Minister of the Environment and Local Government is introducing new legislation to change the locus of responsibility for approving the regional waste management plans.

1199. We have two early PPP water supply projects. There is one in Ballymore Eustace which is the biggest water supply facility serving the greater Dublin area, and one in Clareville in Co Limerick.

1200. There are two interesting projects in the pipeline in other parts of the education sector. We have an obligation to build a national maritime college, and we are developing proposals for a PPP approach for one in Cork Harbour.

1201. Finally, there is a proposal to consolidate the campus for the largest third-level education institution in the Dublin area, the Dublin Institute of Technology. There are three universities in Dublin — Trinity College Dublin, University College Dublin and Dublin City University — but the Dublin Institute of Technology is the biggest single third-level education institution. It is spread over nine campuses and, I believe, 27 different buildings around the city. The proposal is to consolidate the campus on publicly owned land on the north side of the city by means of a PPP.

1202. Those are projects which we shall be developing and bringing forward over the next year or so, and we have much to learn from them. If there are any aspects of the projects you find of interest and wish to probe a little more, our door is always open.

1203. **Mr Leslie:** I have quite a large conceptual question. Measuring value for money is a tricky business. It is relatively straightforward to measure it in cash terms, but that is not looking at the whole picture. I wonder what mechanism has evolved to evaluate risk transfer, inconvenience, another person's having the hassle? Those are quite arbitrary judgements. What progress you have made in deciding how to price those things.

1204. **Mr Kearns:** I mentioned that, for us, there is no good PPP if the project is not good in itself. The initial preliminary business case will be of major significance in determining whether an individual project becomes a PPP. As part of that, the development by the public authority of a public-sector comparator to test the costs of developing by traditional conventional procurement means will also be important. We are encouraging public authorities to acquire specialist expertise by means of consultancies and advisors to assist them with the development of good public-sector comparators for individual projects.

1205. The risk matrix will vary according to sector and individual project. Getting the risk matrix right and ensuring effective optimal risk allocation in individual projects will be hugely influential. I should like Ms Price to tell you more about that, as how we develop that in the individual contracts will be of significance.

1206. **Ms Price:** One of the first things done before a contract is drafted is the preparation of a risk matrix. Contracting authorities will have legal, financial and technical advisors, and their job, especially for the financial and technical advisors, is to put together the risk matrix.

1207. There are well-established risks over a number of areas. There are design, construction, operation and financial risk. There are usually about 80 to 90 different risks, some obvious, such as planning risk, and some sector-specific, for example, with waste water, the risk of not getting a foreshore licence.

1208. It is quite a simple exercise when you see it written out, but it is very complex to explain. There are a number of columns — one dealing with the risk of the contracting authority, the other with the operator's risk. Basically you work out whether the risk is more manageable for the contracting authority or for the contractor. Then the financial and technical analysts price those risks.

1209. **Mr Leslie:** It seems that you can quite reasonably be in a position where, in pure cash terms, it might be cheaper to do it in the conventional way. You then have to aim off for the other factors. If the difference is £10 million, how do you evaluate those other factors to arrive at a figure of £11 million, which justifies your concluding that you proceed by PPP?

1210. **Mr Kearns:** To some extent, we expect the private consortium bidding for the projects, and their financial backers, to undertake due diligence to examine the kind of risks that the public sector will be offering to transfer to the private sector. That they will put a price on it — the risk and costing — is one of the advantages we get from using a PPP approach. Under conventional procurement it was not always feasible to cost individual risks for project development, and that brings us back into total life-cycle costing.

1211. This afternoon you will hear from Gerry Murray, who is the PPP manager in the education area, Maurice Treacy, who has responsibility for public enterprise and transport PPPs, and Pat O'Neill, who is a project specialist in the PPP unit. They deal with risk issues on actual projects and may be able to give you more practical examples than we can by talking in a more general sense. We have the overall policy responsibility, but we do not procure individual projects in our unit. The issues you raise are hugely important. It may be that the people available to you in the afternoon may be able to give you more penetrating insight into individual risks and how the risk evaluation and risk costing will be made, with concrete examples.

1212. **Mr Maskey:** I want to tease out elements of Mr Leslie and Mr Hussey's comments regarding the transfer of risk. We have imperatives, which include equality legislation and targeting social need, so what are the alternatives in the Twenty-Six Counties? I realise this is probably a political argument with the Celtic Tiger and how it affects some urban areas in particular. When you talk about best value when policing contracts, can you build in social requirements, like building in a certain area or placing something in that region?

1213. **Mr Kearns:** That issue was raised here in the context of the National Economic and Social Council's comments on public-private partnerships, and you are absolutely correct — it is a crucial issue. It is very difficult to deal with that as a general policy issue because of the variations across the individual sectors. It does not mean the same thing in education as it does in the area of roads. Within the framework we have negotiated with the social partners under Programme for Prosperity and Fairness, the need to ensure that the users of services and people at local level — local communities — are able to receive quality public services under public-private partnerships. Therefore, social need, priority and equality issues are effectively dealt with. I do not believe we can put them together as a template, other than developing the framework under the Programme for Prosperity and Fairness in which individual projects can be worked through. It is a complex issue which tends to be quite sector-specific.

1214. **Mr Leslie:** Perhaps I might probe something I may not have heard correctly. When you were talking about DBO schemes, you said they would not be done by PPP. Are you saying that projects being carried out on a DBO basis would simply be private-sector?

1215. **Mr Kearns:** No, we include DBOs as part of our definition of PPPs.

1216. **Mr Leslie:** Have you gone down the route of having the Government as a stakeholder? Having worked in south-east Asia for a fairly long period, I am very familiar with the normal approach of its Governments. They enabled and facilitated, awarded franchises and actively participated in the profit. Some allegedly impossible engineering jobs turned out to be feasible on that basis. Have you to any extent taken the path of enabling something to happen, afterwards simply holding a stake and letting things run their course?

1217. **Mr Kearns:** We have not yet developed a DBO programme to the extent where we might be faced by such a policy issue, but a permanent transfer of assets is not our intention under any of the PPPs. I do not want our DBO approach to water treatment, for example, to appear a cliché, but it is very much about partnership, with outputs specified by public authorities signed up to and delivered by a private consortium over the concession period. There is clarity about public authorities' policies and what we expect from the private-sector participant. Perhaps that is not a wholly satisfactory answer. The best DBO example we have is perhaps the Dublin Bay water-treatment facility. The outputs we desire have been specified in the contract with the successful consortium.

1218. **Mr Hussey:** Where do you establish your public-sector comparator?

1219. **Mr Kearns:** At the point where the choice among bids for the project is to be made; generally we do not try to create a template for it. The answer is probably not completely satisfactory, for we are still at an early stage of DBOs. There is still some work to do teasing out the details.

1220. **Mr Leslie:** I shall attempt to answer my own question by suggesting it is a matter of "horses for courses". In certain projects it becomes apparent that the most useful thing the Government can do is facilitate. Perhaps the private sector requires Government stakeholders because it wants to share. The difference is where you share a burden rather than having to carry it all, and the same goes for the private sector. If you have a joint interest, you need a revenue stream to justify what you have done in the first place. It is probably a virtuous circle. Have you set out to achieve that outcome? I believe the answer is that you have not, though I suspect it may emerge over time; it may occur to us that it is the right way to go.

1221. **Ms Price:** At the moment the main sector which lends itself to DBO is waste water, and 100 such projects have been identified. A hundred wastewater projects have been identified which might be developed through PPP — they are being assessed for feasibility at the moment. In such areas there is obviously no way we should simply want to hand it over to the private sector and let it run with it. As Mr Kearns mentioned, it is a partnership approach. In a sector as important as that, the public sector has a very important role in regulating and ensuring that performance specification is maintained throughout the term of the contract.

1222. **The Chairperson:** One thing we found in talking to people in London was the length of time that some of those projects take to get up and running. You have a different mechanism here with regards to time span and delivery.

1223. **Mr Kearns:** We introduced an innovative approach in trying to shorten the time between shortlisting and selection of the preferred bidder. In education projects, for example, we gave contract documentation to the shortlisted consortia on a non-competitive basis, which allowed them to sign off on elements of the contract which then became fixed. Rather than having late stages of the contract negotiations leading to the unravelling of elements which have been agreed early on, we tried to block off those elements which had been agreed and were not contentious. It worked in the education contract, but that is not to say it will work in every contract or in every area.

1224. I mentioned at the beginning that the criterion for us, in driving the PPP process, is delivery. If you talk to our Minister, any of the other Ministers, or the Taoiseach, they will tell you the same thing. The PPP approach is valuable for them in that it accelerates the delivery of the overall programme in the projects. Part of our approach is to work with the procuring authority and the individual PPP units in the sectors to assist them in shortening that process.

1225. In some PFI contracts in the United Kingdom you have had periods of two or three years between nomination of a shortlist and selection of preferred bidder. In some contracts which we have seen, the banks came in at a late stage and unpicked elements of the contracts which had been signed off between the consortia and the procuring authority. That also leads to very significant increased costs for those bidding for projects and delays the delivery of the desired asset of the public service, so there are no winners in that. It is certainly part of our priority to try to shorten that process. So far we have done reasonably, but much more needs to be done in the sectors.

1226. **The Chairperson:** Thank you very much for the presentation. You have certainly answered a great many of our questions during the course of the day. Thank you very much for your help and co-operation.

MINUTES OF EVIDENCE

Tuesday 22 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr Close
Ms Lewsley
Mr Weir

Witnesses:

Mr J McCusker	) Northern Ireland Public
Mr J Corey	) Service Alliance (NIPSA)

1227. **The Chairperson:** Good afternoon and welcome back to the Committee.

1228. **Mr McCusker:** We are delighted to be back. I am Jim McCusker, the general secretary of the Northern Ireland Public Service Alliance (NIPSA). My colleague is John Corey, who is the deputy general secretary. We have 38,000 members in Northern Ireland, 20,000 of whom are in the Civil Service and 18,000 in other public bodies, such as district councils, education and library boards, health boards and trusts, and the Northern Ireland Housing Executive.

1229. Our approach to private finance initiatives (PFI) is based on the experience of our colleagues in Britain and, to some extent, our own experience. The first major heading that we have is the state of public finances. The argument often advanced — and it seems to be advanced here — for public-private partnerships (PPP) is that it is the only resource that might be available to finance the deficits in public infrastructure underfunding.

1230. That argument is invalid when the state of UK public finances, in particular, is examined. In the most recent financial year, as we said in our paper, the UK Government provided £7·4 billion for investment in public infrastructure. An estimated £3 billion of that has been spent. In addition, there was a surplus in the last financial year of around £20 billion. The state of public finances is much improved. Other indications are that the national debt is well under control, which certainly provides the scope for borrowing, if necessary, without risking the financial viability of the public finances. The state of the public finances does not, therefore, justify looking at PPPs as a principal way of financing public infrastructure projects.

1231. The problem for regions like Northern Ireland is to ensure that we get our fair share of UK public resources, which is another argument in itself. We have highlighted other areas, such as whether PPP and PFI projects provide value for money — the jury is out on that. It is difficult to make an accurate evaluation of it.

1232. A difficulty that we, and others, have encountered is the lack of openness in the system. We are told that the figures are commercial in confidence, and that they cannot be subjected to a great deal of scrutiny. Other noteworthy factors are that the public sector can borrow more cheaply and the way in which public borrowing is organised in the United Kingdom, with the public sector borrowing requirement. It is not subject to the same definition that is used more frequently elsewhere in the European Union, that is general government financial deficit. There is also scope there.

1233. Another point of concern is the lack of competition for public service contracts. We have examples of that. For example, the Classroom 2000 project involved a number of interested parties that boiled down to very few and eventually collapsed. We are going through a similar experience in electronic libraries. The Social Security project, although largely driven from the United Kingdom, had a number of entrants and is now down to one competitor. That area certainly concerns us. There is the question of a level playing field between the public and private sectors. We pointed out that the public sector is subject to a number of quite strenuous — and properly so — equality requirements. These do not necessarily transfer when the responsibility is transferred to the private sector.

1234. The risk transfer is another issue highlighted in our document. A quote from the private sector essentially says that if you really want the risk to transfer you are going to have to pay for it. The private sector will not accept the risk unless it gets a correspondingly higher price for it.

1235. Regarding the length of contracts, it was said earlier in other evidence that perhaps in 10 years' time you could make a better assessment. It is still difficult to say whether you could make a final assessment, because some of these projects are for 20 to 25 years. It is not possible to make a final judgement until they have run their full course. Sometimes the estimated savings are inside the margins of error of the estimating process. It is certainly questionable whether the numbers that have been claimed were inside the margins of error. One example is in the evidence of the hospital in Gravesend, where the savings certainly declined very rapidly afterwards.

1236. We also pointed out the French experience in our submission, which in many ways has been a bit longer than ours. The French certainly look at things from a much less ideological point of view, and seem to question the extent to which this can provide the opportunity for public financing. The public route will cost the taxpayer less in the long run.

1237. Why do these projects always have to be design, finance and build, but also operate? You can get some of the benefits when the private sector designs, finances and builds without having to operate. In the operate area you can get meaningful public sector comparators, which would show how the public sector could compare with what the private sector is doing. When these are all lumped together, however, it is very difficult to distinguish the various elements, and to make a proper comparison between them.

1238. We are also concerned about the possible export of work from Northern Ireland. We were concerned at the possible privatisation of the Water Service. It was clear that some firms from England and possibly further afield were interested. They would do their billing operations outside Northern Ireland, and that work would be lost to Northern Ireland.

1239. The final point here on the level playing field area is the protection for staff. I think we came in at the end of a debate on that. The Transfer of Undertaking (Protection of Employment) Regulations 1981(TUPE) provide protection on the day of transfer, but it is highly debatable what protection it provides down the road. There is certainly no guarantee of it, particularly when employers seek to rationalise terms and conditions of service.

1240. Our last point is about democratic control. If functions are hived off to the private sector, the in-house expertise is lost. This means that it does not reside in the public sector, and therefore local politicians — whether councillors or in the Assembly — do not have the same degree of direct control over the functions, and they have not got the expertise to assess whether the function has been performed adequately.

1241. **Mr Corey:** There is a tendency to think of PPP and PFI as just buildings — about providing roads, bridges or buildings. A big area untracked in PFI is the information technology area, which is not as easily seen. Mr McCusker referred to two projects in the education sector. One project was called ‘Classroom 2000’, which collapsed in December. Undisclosed sums of public money were spent on that. I am also directly involved in the electronic libraries project. The potential costs of that project have not been disclosed to us. However, the difference between these projects and traditional projects is the shorter time span that is involved. Technology has a short shelf life, and there are big issues such as costs that warrant investigation and examination.

1242. **Mr Close:** I share your concerns on value for money, a level playing field and democratic control. I also take the point about the smaller contracts that have been referred to by Mr Corey. However, we face a huge deficit in the public estate with non-investment for 30 years. We have to try to put that right. Mr McCusker mentioned that our share of public finances could be an argument for another day, but that is at the coalface of where we are now. Something needs to be done about our share of the Barnett formula, but are these things going to be done in time? Can we get those problems resolved to enable us to get the public estate and to enable the need for vital investment to take place sooner rather than later?

1243. We also have to bear in mind the current argument with England and the devolved regions about whether our share should be less. There is also the old bugbear about Treasury rules on borrowing, et cetera. I can see an inexorable push towards PPP with people saying that there is no alternative, and I have problems with that. How do you get around that fundamental problem and put forward the necessary arguments to combat that at Treasury and other levels?

1244. **Mr McCusker:** I am very conscious of the dilemma. Barnett has not been totally bad over the years, but the other downside to it is the restriction on the opportunity to borrow. It should be possible to do something with the Treasury on that. I read in some literature recently that one of the elements of the European Charter of Local Self-Government is the right of access to the national capital markets for borrowing. That is in the context of local government, but a regional Government such as the Executive and the Assembly does not have the right to have access to the market. The old Stormont Parliament used to float stock on the capital market, and I do not see why we cannot look at that again. We also mentioned the example of a company limited by guarantee, which can float bonds, being considered for the London Underground. Some people said that we should be looking at that, and it will be interesting to see just how far that goes in London. If it is a model for there, why should it not be a model for Northern Ireland?

1245. **Mr Close:** Would scale not be a factor? There are only 1·5 million people in Northern Ireland.

1246. **Mr McCusker:** If the principle is conceded for London, why should it be denied to Northern Ireland, Scotland or wherever? It seems strange that the only way to borrow effectively is through the private sector. The Government in Northern Ireland is not allowed to borrow. The Treasury’s so-called golden rule is to borrow for investment purposes. The infrastructure projects are certainly an investment in the future and have a life of 20 years or more. Perhaps we can put more emphasis on that, although I appreciate that the wider Barnett argument will go on for some years.

1247. **Mr Weir:** First, there is a strong argument, as you have indicated, that public finances are in a healthier state and that Government is not fully utilising them. The two solutions are either being given more public finances or having freer opportunity to borrow, which can be argued for at devolved level. However, the devolved institution cannot deliver that because it is essentially in the hands of the Treasury.

1248. Regarding the bond position, which may be part of the solution, are you confident that the revenue streams are sufficient to generate enough money to be able to deal with the infrastructure problems? For example, one complication in comparing it with the London Underground is that the amount raised here in the revenue stream through fares or congestion charges would not be anywhere near, even comparatively, what is raised in the London Underground. Although we are not looking at the same level of investment, I want you to deal with that issue.

1249. Secondly I want to ask you about design, finance and build, particularly in education. When we received evidence from representatives of the Republic, they said that a key incentive of a PPP was that an outside company looked after facilities management, maintenance and repairs. This freed up the staff and the headmaster to concentrate more on teaching — it was not just about the financial aspect. It was a big plus to enable the education sector to focus more on education. Can you comment on that?

1250. **Mr McCusker:** I do not know the answer about financing future borrowing. However, the new system of accrual accounting should separate revenue and capital expenditure more clearly. It will enable you to make a better judgement about future opportunities. Much of that is lumped together under the present system. It is impossible, certainly for somebody outside the system, to distinguish between capital and revenue money. Better reorganisation of finances would allow you to judge how much you could afford to borrow in the future.

1251. On the second point, you pay for that service. The public service is not currently organised to provide that service, nor is it encouraged to do so. That relates to Mr Leslie's point about the culture, which he put to the people from UNISON. Over the years, accommodation has been a "Cinderella" in the public services — it is not the "sexy" bit with nurses and doctors, and it tends to be treated as such. It is not normally a policy issue. People involved in that, the architectural profession, who provide the service, will tell you that they are not allowed to run it as a business. If a school has a maintenance problem, you need to be in a position to send somebody out to deal with it.

1252. The concept of the direct labour organisations, which some local authorities developed in Britain over the last few years, certainly came close to providing the sort of service that was comparable to the private sector. That returns to what is the best way to organise the public sector to provide that sort of service. It is certainly not geared up and we would further say that they are not encouraged to provide the sort of service that the facilities management people provide in the private sector.

1253. **Ms Lewsley:** You mentioned in your submission about the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE) and employer/employee relationships. That is an area I would be concerned about because of the two-tier system, and I am worried about the issue of women and part-time workers. It was suggested that they could become partners without transferring or that the in-house service should stay in-house — what is your feeling on that? If you were faced with working with PPP projects, what improvements or modifications to the procedure would you propose to ensure that PPP meets its aims?

1254. **Mr McCusker:** One of the primary areas we touched upon was facility management. You cannot make a judgement about whether you are receiving a better service if it is all lumped into design, build finance. There is an argument for separating that out so that comparisons can be made between the in-house service and the private sector.

1255. It depends on the type of public-private partnership. Government do not build their own buildings, and obviously there is always some form of PPP in the wide sense of the term. What concerns us is the situation where not only are facilities management being provided but also the resource itself is given out to the private sector and you then pay rent to get it back. We do not find that situation easy to work with, but it is possible to work with it in the context of fair competition on facilities management.

1256. **Mr Corey:** You are hinting at the TUPE provision and the application of that. We would have a strong view that TUPE is nothing more than a basic safety net — it does not go beyond that. If staff move from the public sector to a private sector company, after TUPE transfer has taken place it is within the scope of the new employer to seek to alter the terms and conditions of employment. You can have arguments about that, but we do not see TUPE affording any longer term protection for staff.

1257. It depends on the type of PFI project. In the electronic libraries project, for example, we wished to explore the scope for public library staff to move to the private sector company on secondment for a period, which could be months or a few years, if that was necessary to allow the project to operate. The staff did not lose their status as a public library service employees, which is important to them. In that case we did not find either the management side of the education and library board or the private sector company receptive to the idea. They preferred that it was a clean break, where we saw the secondment proposal as feasible. We would be looking for more flexibility in terms of how staff might be treated and what options staff might receive.

1258. If you take a public servant that has worked in the public service for perhaps 30 years, they do not relish the idea of working for a private sector company at the latter stages of their career. It is not an attractive prospect for them and they have deep concerns about it. Therefore, we believe there is a need for greater flexibility in that area, and this is one of the issues that we have to grapple with.

1259. **Mr Leslie:** You mentioned the potential loss of expertise from the public sector, and that will be the case if all procurement was done through these partnerships. You heard me asking UNISON whether there was any merit in some competition on the same jobs — for example, you could do it through the PPP or public procurement route — and whether this was improving the ways jobs were being done by the public sector. Do you think there are some benefits there?

1260. **Mr McCusker:** The benefit would come from giving the public services the opportunity to organise themselves differently. A lot of this will centre on the question of facilities management. If the public sector was better organised, or allowed to compete in the same way as the private sector in providing facilities management, there could be considerable benefits.

1261. It is not all about accommodation, but a lot of it seems to be. Accommodation has been a "Cinderella" area in the public services. If you were going to say that it would be operated as a business — and allowed to operate in the same way as it would in the private sector — there will not be the same constraints about only doing work for your own public authority. Then it is possible to change the mindset and to have an organisation, which can compete more effectively and, possibly, at less cost overall than the present arrangements, which are very compartmentalised.

1262. **Mr Leslie:** Is there not a risk, if you go down the PFI route to design, build and finance, but not to maintain, you will have to maintain the building, and if it has not been built right the burden falls on the person who is maintaining it. You may have some contractual recourse to the person who built it, but that is a wearisome process. Whereas, if you decide that you are going to have the whole job done by the private sector, including maintenance, you do not care how it is built, because they have to maintain it. It is up to them to decide what construction risk they want to take, because they have the burden of maintaining it to a predetermined standard for whatever the lifespan of the building is deemed to be.

1263. **Mr McCusker:** The problem is that facilities management often means more than just maintaining the building.

1264. **Mr Leslie:** I am talking specifically about maintaining the building, because you have said here design, build and finance only — not maintain. I am focusing on maintaining.

1265. **Mr McCusker:** Facilities management also means that the contractor provides all the support services. In schools the caretaking facility and internal office services are often done that way, which is not necessarily going to be done more cheaply by the private contractor. I accept that there could be an argument, but this goes back to ensuring that the specification is such that there is no loophole for the contractor to get away with providing a lesser standard of service. On the other hand if the maintenance is going to be done by the public sector then the contract must ensure that the building is completed to an effective standard.

1266. I can think of examples — not so much in accommodation, but in the IT field — where services were contracted out, and there was an inadequate specification. Things thought to be covered by the contract were not, and the contractor was able to get his arm in. It was discovered that some obvious things had not been included in the contract, and this has happened in the Northern Ireland Civil Service.

1267. **The Chairperson:** Thank you very much gentlemen.

MINUTES OF EVIDENCE

Tuesday 22 May 2001

Members present:
Mr Molloy (Chairperson)
Mr Leslie (Deputy Chairperson)
Mr Close
Ms Lewsley
Mr Weir

Witnesses:

Ms P McKeown	)
Mr T Mahaffey	) Unison
Mr J Swallow	)
Ms N Conlon	)

1268. **The Chairperson:** You are very welcome. Perhaps you would like to introduce the team.

1269. **Ms McKeown:** Thank you for the opportunity to come back. We appreciate the problems you had last week. Everybody representing Unison is involved either in the main policy side and negotiations or in the direct impact on staff and services. I am Patricia McKeown, and with me are Nuala Conlon, Thomas Mehaffey and Jonathan Swallow.

1270. We have already made a submission to you, and last week we were able to take you through it. I will not labour that but reprise it. We sent the Committee an initial submission on the inquiry, and we have appended some of our main Unison information on public finance, value for money, contract design and cost cutting issues to that. We went through that submission in detail last week, and we made comments on the terms of reference of the inquiry.

1271. Additionally, we included work from Prof Allison Pollock in our appendices. I know that you have taken that forward. We also gave a further submission on affordability, accountability and the two-tier workforce. We will not go through those in detail.

1272. I am pleased that our colleague Jonathan Swallow is with us. He has been working closely with us on PFI for a number of years. He is also well versed in the impact of PFI on the UK as a whole, and not just exclusively on Northern Ireland.

1273. **Mr Swallow:** There are three key issues in the discussion. The first is the principle of private finance; the second is the ability, if that happens, for in-house workforces to stay in-house; and the third is the rights and protection that should be afforded to transferred employees.

1274. We have never been opposed to innovative ways of financing services. I discovered a few years ago that most of the councils in Northern Ireland bought bin wagons out of revenue. They did not capitalise on or lease those, although they should have. That was not good financial management, and I made that clear to them.

1275. Our submission focuses on succeeding generations and rigidity. In some of the models the danger is that we go through storm and stress to build a new hospital, facility or school that may not be needed in 20 years. In the work I do with the NHS, hospitals are being built under PFI that reflect the assumption that you go in, have your operation and then spend three weeks with visitors bringing you grapes. The new design of hospitals is nothing like that — you are in and out again in three days into community facilities. I look at PFI hospitals that I call “cathedrals in the desert”. The contract has no model for changing the use of those hospitals as the NHS involves them in new technology.

1276. Schools in 10 years will be different sorts of institutions. They will be more linked to community needs, life-long learning and web technologies. We will probably build them in the wrong place, and, as Liverpool has recently discovered, it is disastrous to think about building PFI schools in a city that is depopulating. We have to be careful about rigidity and about not anticipating change. You can anticipate change in a contract for services, but there are difficulties when building something that must last.

1277. The second issue is affordability and the high levels of ongoing debt and revenue payments that have to be sustained. A lot of public clients to whom I talk say that that can crowd out other matters. For example, in the 11-plus consultation paper it was said that one option was to change 280 schools to 190. I immediately subtracted four, Wellington College, Balmoral High School, St Genevive’s High Secondary Intermediate Girls’ School, and Drumglass High School. Nothing can be done about them as they are under a 25-year PFI contract. That is a Northern Ireland model that shows how rigidity can get in the way.

1278. We must not make things rigid for future generations, and we must not get into such patterns of payment that we crowd out investment, particularly revenue spending, on other aspects of the service. We have always been concerned about that because of the dogmatic Treasury approach of using, for example, the six per cent discount rate to make calculations about affordability. If you change the rate, you get different results. Some of the projects that I have looked at are causing concern to the education and NHS authorities that built them. In schools in Glasgow and in hospital projects such as those in Carlisle, the number of beds or classrooms has been reduced to make a deal, and that has led to the loss of amenity.

1279. We know the NHS has been failing for many years under the unreasonable requirement of 90% or

95% bed occupancy, which has lead to people waiting on trolleys. Users of the Health Service are saying "If it is bad now, what is going to happen when the new hospital in Norwich takes 20% of the beds out?". The answers are not forthcoming.

1280. There is a very strong campaign in Kidderminster, where it appears that an independent doctor is going to win the election because of anger in the community about losing their facilities to centralisation in Worcester under a PFI model that could not be changed. The decision-making process must take account of succeeding generations, avoid rigidity and be much more imaginative in how it gets value for money.

1281. For that reason it is important that the Assembly examine models that are being developed elsewhere. Some political parties in Scotland have floated the idea of an investment trust for Scotland designed to lend to the public sector at quite low rates of interest, and they are attempting to structure that outside the public sector borrowing requirement (PSBR). We wish them well but think they will have problems. However, that is an innovative suggestion.

1282. There has been debate in London on bond financing the Tube. Bond financing would be a much more intelligent way of financing the Tube than the PFI proposals that are causing great concern to everybody who uses the Tube — it is terrible now, and the idea of a Railtrack situation frightens people. I encourage the Committee to look at innovative financing and not being trapped into thinking "We cannot afford it, so it has to be PFI.". That does not work as a model.

1283. Regarding the second key issue, I have been working for a number of years — and in my previous capacity with the Association of Direct Labour Organisations — on ways in which in-house staff can become partners without transferring their employment if PFI/PPP goes ahead. That was reinforced by the recent Treasury notes that identified in-house participation as a matter to be evaluated on a case-by-case basis rather than rigidly.

1284. In the case of the Belfast Education and Library Board's PFIs, the board and we as a union wanted to be flexible in our relationship with the contractor, and the contractor was sending us the same signals. Regrettably, the Department of Education's advice was that the services had been procured in a particular way and so things could not be changed. We have seen a similar situation in England with the three-month strike over the Dudley Hospital. It is a source of agony to the hospital and to us as a union, but we cannot get out of the situation.

1285. Structures are now in place to enable you to avoid the damage caused in England, where it was assumed that staff had to transfer as part of the issue. That can happen through the exclusion of services — as in Stoke-on-Trent, where 100 schools are going through PFI but school meals are not part of the deal —through partnership working or through forms of sub-contracting. It is feasible for in-house staff to be partners, to remain employees of the board or the NHS. That should be encouraged because you must understand how scared our members are after the histories of crude privatisation, particularly in the NHS the 1980s and 1990s.

1286. Thirdly, with regard to staff transfer, our concern is that the architecture for protecting people is severely deficient in Northern Ireland. Across the water, we have the new deal for local authorities on pension scheme admissibility by which private providers can join a local authority pension scheme and people can stay in that scheme. That is critical, given that the Confederation of British Industry's (CBI) studies show that people who change pension schemes lose money at the end of their working lives. We obviously want that to extend to the rest of the United Kingdom, to the public sector or elsewhere. It took enormous effort by the Minister, who hit the Inland Revenue with a handbag, to get a deal with local government in England, and it is a start.

1287. Beyond that, we still do not have the Department of Trade and Industry's consideration of the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE). The CBI and the Trades Union Congress are jointly saying that TUPE should apply for the life of contracts and for succeeding contracts. So it is not only a trade union perspective; it is an industry perspective too. If staff transfer, that will also be a crucial piece of the architecture. We are saying that they should not, but, equally, we have to protect our members whatever circumstances arise.

1288. Fourthly, we are very concerned by what we see as a conflict of laws, particularly in education in Northern Ireland. The Education Act 1993 prohibits the consideration of what it calls non-commercial matters other than fair employment. In other words, it prohibits consideration of equality. At the same time, the board is bound under section 75 of the Northern Ireland Act 1998 to do an equality assessment when going through the procurement process. That is a "mission impossible". If a quality assessment is to be done properly in all elements of the public-sector here, including education, it is fundamental that you recommend the amendment or repeal of the Education Act 1993, which was a competitive tendering and contracting (CTC) measure.

1289. The fifth issue is linked to equality assessment. Our view of the legislation is that procurement is a function of a public body and it is essential that public bodies entering PFI do a full impact assessment at all relevant stages. We would like that to be linked to something such as the 4Ps guidance to local authorities in England, which is brilliant in terms of disclosure of information and consultation. That would reflect the Treasury approach as the guidance states

> "it is not a question of what should not be revealed. It is a question of when everything should be revealed."

1290. The Treasury has put an emphasis on transparency in this process, so we wish to be present to represent our members at the outline stage of the business case and at the final stage of the business case. We want to exercise the right in the Treasury guidance and the 4Ps model to make detailed comment on any companies applying to tender. We wish to be able to meet any company that is shortlisted in a negotiated procedure, and we wish our recommendations to be heard. The issue is transferring rights — those rights are elsewhere.

1291. We hope that the Committee clearly understands our concerns about the principle and application of PFI, and that if PFI were to happen, it would strongly urge public bodies to look very hard at in-house options early. Looking at those options late is of no good to anybody, and such options should be sorted out before an invitation is made to negotiate. The Committee should also back existing employees in continuing to deliver the services that they have delivered down many difficult years and often in very difficult circumstances.

1292. **Ms Lewsley:** This inquiry is proof that we are taking the matter seriously. Some of my colleagues have done more on the investigating side than I have. The impact that PFIs would have on employees concerns me, and I am particularly interested in the issues of women and part-time workers. To an extent you have answered my questions because you spoke about some of the safeguards that we can put in place and about how early we should become in involved.

1293. I was in Scotland with the Education Committee, and one of the schools there was a PFI initiative. That school has so much more now than it had, and it was impressive to see that in action. I asked the Glasgow Board of Education about its employees. It had transferred 4,000 employees, and none had asked to return to the board. Some of the contractors whom we spoke to last week said that they offered better opportunities for flexible working hours, training and promotion. They are going to be very positive, but are there pitfalls that you can identify?

1294. **Mr Swallow:** Did you speak to the staff representatives?

1295. **Ms Lewsley:** No.

1296. **Mr Swallow:** I spoke to 30 caretakers from Glasgow a few years ago, and they had genuine fears. If the usage of a school declines, their hours can be lost. It is very hard to get a transfer. Where else could they put people? The company's business is schools; they have no other business in the area.

1297. The trade-union movement welcomes the fact that the CBI and its better companies are discussing workforce rights. The problem is still that TUPE is not standing up to financial pressures, so changes are being introduced. The creation of a two-tier workforce where there is unequal pay within an organisation is fundamental to Unison's concerns. That brings its own tensions and makes our members, who have transferred on public terms and conditions, feel very vulnerable. "If they went, look what we could do," are words they hear.

1298. Ultimately Glasgow was faced with a very dogmatic Government approach — now superseded — which said it might not deliver those services in-house. There could have been great potential in that, and we should examine it. A number of builders are starting to say "We are good at building, but not necessarily at management." They are also discovering that they are in consortia to deliver these projects and that consortia can fall out quite seriously.

1299. **Mr Weir:** I know the issue was touched on last week, but perhaps I might raise it again since we are now on the record. You rely on Allison Pollock's report questioning the findings of 17% efficiency savings. Is it Unison's position that, while exaggerated, PPP leads to some degree of efficiency savings, or do you believe there is no evidence at all to support that?

1300. **Mr Swallow:** Technically, efficiency savings can be a messy area. Efficiency savings, if measured in labour input, may have occurred. However, in many cases the public premises I walked round before the advent of PFI were already a disgrace, despite the best efforts of the staff. We are already noticing a serious recruitment and retention problem in Northern Ireland with low-paid women workers, since they are quite rightly going off to work for Tesco and Sainsburys.

1301. If you look at the current Dudley incident, you will see that staff were actually failed on the cleanliness of the hospital, since there were not enough people to clean it in the first place. If a contractor prepares a proposal based on that low level of quality — which is no one's fault — we can have efficiency savings, but we will not have solved the quality problem.

1302. **Ms McKeown:** We touched on this last week. Northern Ireland's public sector was pushed through a rigid process of competitive tendering or market testing, and contracts are delivered for less money than previously. However, we cannot get real attention paid to conditions, equal treatment of staff, quality of service and the public's view of what is being delivered. It is within your scope to go to a number of hospitals today where you will find the workforce totally destabilised.

1303. A minority of people left may still be covered by TUPE in some way, though there have been changes. The majority is now casual with considerably inferior pay and conditions. A significant block, up to

40% of the workforce in some cases, consists of students coming in to clean hospitals or cook for the elderly; that is a fact. A number of trusts are in discussion with us at the moment about how those services might properly be returned to an in-house group to get the standards up.

1304. I contrast that with the efficiency savings we could make in our support-services partnership with the Royal Hospitals Trust. We pushed up standards of service delivery, pay, conditions and training for employees while being flexible on service delivery, consequently making savings for the employer. Those savings were long-term; they will benefit as the years go by.

1305. **Mr Swallow:** And significantly greater than anything achieved through a tendering exercise.

1306. **Ms McKeown:** Very much so.

1307. **Ms Conlon:** Perhaps I might add my experience of talking to cleaners and canteen workers in schools. Some schools over the last few years have brought in private contractors for cleaning. The Belfast Education and Library Board has just started a new cleaning service, Bel Clean, and some schools now using private contractors are expressing an interest in going back to the board. They have not saved the money they were meant to, while standards of cleaning in schools have not been what was promised. The Belfast Education and Library Board is saying that.

1308. **Mr Close:** I think "standards down – savings questionable" sums up my experience of PFIs and PPPs over the past years. Is it possible to quote any example of satisfaction with the conditions, services, and efficiencies resulting from PPPs and PFIs?

1309. **Mr Swallow:** I will be blunt. All seemed well the day after the transfer in the North West Institute — the deal appeared to say that our members would be protected during the lifetime of the contract; that there would be no redundancy for at least seven years; that the client was clearly satisfied with the delivery; and that we were not losing members. Six months later, as the deal collapses into the dust through no fault of our members, our eyebrows are raised about the promises given and not delivered by the private finance provider.

1310. **Mr Leslie:** We could knock this on the head if we had a couple of private sector operations that were demonstrably better than the alternatives. The question is how we achieve that. What must we do to get the best performance out of PPPs in the public sector?

1311. I accept the problem of underinvestment. I will take Coleraine Hospital as an example. The £55 million investment has been raised and now we have a hospital. In a year's time we may say that it all works very well. However, I have this horrid suspicion that it will not and that we will be asking ourselves why this is the case. Can you point to anything that we could be managing better to achieve a better result?

1312. **Mr Swallow:** In the English, Scottish and Welsh Administrations, Ministers had one overriding concern, particularly during the first two years of this Government with its tight expenditure limits, and that was that there should be no overspending. PFI seemed very attractive. There was no overspending because all risk lay with the builder. What they missed is the range of new approaches coming out of partnering and the likes of the Latham report that showed that the public sector can relate far better to builders in matters such as cost and quality.

1313. For example, Rotherham Council is now a partner with an innovative builder in the building of three schools. I do not think there was even a price with the tender. It is about the ability to be a partner within a known range of costs. Head teachers are reporting much more satisfaction and much more ownership of the process.

1314. We must not assume that we can only control budgets if we use PFI. That is what is in the Ministers' heads in England and Scotland. There are new ways of building projects on a partnering basis that can be much more effective. We can make decisions without the fear of losing control of the budget. This is where we have to start from. We should not use PFI just because it is the only way of controlling the money. Nobody has looked at the long-term outcomes of the various methods of building in terms of user quality.

1315. Everyone has been saying that if we need a building we should use this method because there will be no overspending. Most of the PFI contracts are extremely weak on specifying outcomes and quality. It is like entering into a pre-nuptial agreement without knowing how to divorce.

1316. **Mr Leslie:** It would be much easier for us to do this inquiry in 10 years' time when there will be 10-15 years' of experience to look at. Unfortunately, we are not in that position. Is the start of competition from an alternative way of doing things providing a valuable stimulus to procurement in the public sector, and is that serving a useful purpose?

1317. **Ms McKeown:** The criticism of the public sector 20 or 15 years ago was its rigidity. It was extremely difficult to change anything. It did not need to be opened up to the marketplace for a start to be made on addressing the standards of service delivery or the treatment of people who work in the public sector. The public service can deliver better and higher standards in a different way if it listens to the public, finds out from the users what their needs are and makes whatever changes are necessary to meet those needs. It should listen to the people who deliver the services. That may sound ludicrous, but the vast majority of people delivering services, particularly in health and education, are not listened to.

1318. In the innovative projects that we have been involved in during the last five years, 80% plus of the new ideas came from the people who were at the front line of service delivery. For the first time they could say how we could do things better, save money and be more cost effective, and that was a remarkable experience. There has been a lack of awareness that public servants delivering services do not have that say. Attention has not been paid to keeping up to date with skills, training and the innovation that comes with that, but there are new processes in place now.

1319. There has also been rigidity in the boundaries of the public sector. One of the examples that Mr Swallow impressed us with was the refuse-cleaning contract in England that is linked with community care. People collecting bins for designated elderly people do some community care as part of the refuse collection service. We should be thinking about expanding those concepts in a much more imaginative way. The Programme for Government refers to commitments to new cross-departmental, cross-sectoral, holistic ways of looking at how the business is delivered. That is the right way.

1320. If the rigidity is lifted and the mindsets changed, the public sector can outperform the private sector. In any sphere of service delivery over the last 20 to 30 years where we have membership, we have outperformed those who have come along and privatised. The problems with those who have privatised lies in equality, a two-tier system and poor standards of service. Those in the public sector who have contracts have difficulty ending them, because the standards required in the first place were not written in. That is another instance of the public sector's not getting the homework right.

1321. **The Chairperson:** Unfortunately we have to end here. Thank you all for coming.

APPENDIX 6

RECORDS OF INFORMAL BRIEFING SESSIONS

Category	Individual / Organisation
CG	Department of Education
CG	Department of Further & Higher Education Training & Employment
CG	Department of Health Social Services & Public Safety
CG	Department for Regional Development
GBCG	House of Commons Treasury Committee
GBCG	Department of Health Private Finance Unit
GBLG	London Underground
GBLG	Commissioner of Transport for London
GBLG	Leeds City Council
L	L'Estrange and Brett
NDPB	Calderdale & Huddersfield NHS Trust
NDPB	Leeds Community Mental Health Services NHS Trust
PS	Catalyst Healthcare
PS	PricewaterhouseCoopers
U	Northern Ireland Public Service Alliance
U	UNISON

RECORD OF AN INFORMAL BRIEFING ON PPP BY THE DEPARTMENT OF HIGHER AND FURTHER EDUCATION, TRAINING AND EMPLOYMENT AND THE DEPARTMENT OF EDUCATION

Thursday 10 May 2001
in Parliament Buildings, Stormont

Present:

Mr Francie Molloy (Chairman)
Mr James Leslie (Deputy Chairman)
Mr Seamus Close
Mr Peter Weir
Dr R Davison (DHFETE)
Mr V Dukelow (DHFETE)
Mr D Young (DHFETE)
Dr J Livingstone (DE)
Mr N Mc Cormick (DE)

Members of the Committee for Finance and Personnel were given an informal briefing by officials of the Department of Education and officials of the Department of Higher and Further Education, Training and Employment on each Department's experience of PPP/PFI. The Department of Education (DE) told the members that it had become involved in Public Private Partnerships (PPP) in 1995 when it began to explore the way forward with Private Finance Initiatives (PFI) because of limited capital available to the Department. It had established pathfinder projects, which at that time included two further education colleges that were now the responsibility of the Department of Higher and Further Education, Training and Employment. One of the schools had been completed and was operational and three more had signed contract and nearing completion. Another eight schools had been put into the programme, which in total amounted to an estimated £110m capital investment. The members were told that the Department had a £500m backlog of major capital works that would take a number of years using conventional capital investment and it viewed PPP as an additional opportunity to try to tackle that backlog.

The DE told the members that it was keen to encourage one element of PPP that had the potential to reduce the school management team's time on time managing the building and facilities and so that it could be released to carry out core education functions. That was possible by transferring the design and operation risk to the private sector.

The Department's officials told the members that it was trying to develop its resources to create a PPP support unit for the promotion and undertaking of PPP projects in the educational estate which had developed skills in procurement and contract management. It aimed to provide the right size of PPP programme to address the education needs in the context of the capacity of the market. The Department was moving from pathfinder projects which involved individual schools to bundling projects and the eight schools in the current programme were in three bundles. Those reflected the Department's sectoral approach to education at present and related to individual education boards and trustees rather being projects that spanned boards. The contracts would belong to the boards and trustees who had originated the projects.

Members were told that DE saw PPP as a complementary programme to conventional capital investment and that it was more appropriate to post-primary education but not for everything in that sector. The Department's funding strategy was a mix of PPP and conventional funding.

The Department of Higher and Further Education, Training and Employment (DHFETE) told the members that on formation of the new Department it had two pathfinder projects for PPP in further education colleges i.e the North West Institute and the Belfast Institute. The former had been completed in February 2001 and building work on the latter was underway. These projects involved a capital investment of around £30m. Since then it had taken on two further major PPP deals for Springvale campus with a Departmental capital contribution of £40m and a joint project between Omagh College and East Tyrone College in Dungannon with a value of £30m. DFHETE also inherited an Information Technology (IT) package from the Training and Employment Agency on its formation. That PPP involved outsourcing all the Department's IT technical expertise to ICL. The drivers for the Department's involvement were also a backlog in the amount of capital works required and the objective of looking for alternative ways of funding those works. The Department also proposed to use a mix of conventional funding and PPP for future investment in the infrastructure for further and higher education.

In response to a member's question the Departmental officials told the members that assurances rather than guarantees were provided by the Departments to autonomous educational authorities. Treasury rules do not allow Government Departments to offer a guarantee to banks. With the agreement of Treasury assurances were given to contracting authorities that funds to pay the bill would be available. Experience had shown that bank credit committees had accepted those letters, although some had preferred direct assurances from the Department which had been steadfastly refused. One reason for doing this was that Departments were transferring risks and by going over the heads of the contracting authorities to give those assurances Departments would essentially be taking those risks back.

In reply to a further question the Departments told the members that a good size of a bundle is around £30m although discussions with the private sector during pathfinder projects had found that the minimum was around £5m to £10m. To achieve a reasonable bundle it would be theoretically ideal to bundle the best packages wherever they were but when the disaggregated schools system in Northern Ireland involved Irish – medium, maintained, controlled, voluntary grammar and integrated schools, it was difficult to bring those varied and autonomous authorities together in one contract. That subject had been broached in consultation with the school authorities and although concerns about the complexity of such an arrangement or contract were expressed, no outright objection was made to bringing different school authorities together as strategic partners in one procurement project. Members were told that the time frame for projects was 18 months to procure and 18 months to build and that compared favourably with conventional schemes.

The Department of Education told the members that a primary factor in determining the PPP prospect of projects was educational need and how the scheme fitted into the whole capital programme. From there on it was an issue of getting the right combinations to achieve the right bundle. A project in the primary school sector might average a capital investment of £1m and therefore 10 similar projects were required to achieve a minimum bundle, whereas, in the larger post primary sector the bundle required fewer schools. Discussion and agreement with the school authorities was then employed to agree the way forward. Surplus land was not a primary driver for determining a PPP and experience had shown that inclusion of surplus lands in negotiations was a complex area because of fluctuating land values.

The Department told the members that the pathfinder schemes in Drumglass and Wellington College had been an amalgamation of five schools into two new schools and that there had been surplus land. The Department's building handbook determined the accommodation needed for teaching and also included playing fields and environmental space and that the remaining land was calculated as surplus. The Department assured members that both schools had secured the minimum standards set out in the handbook. The surplus land was factored into the deals and the potential for profit reduced the partners' need to raise bank debt. The profits made by the private sector partners paid for the building of the school and greatly reduced the annual payments by the education authority. Competition was created by the three preferred bidders and in the case of Wellington College a claw back arrangement was put in place to ensure that the Belfast Education and Library Board and the Department received additional income if the private sector made additional money above a certain threshold on the development of housing on the site.

The members were told that every school in Northern Ireland has a long term enrolment (LTE) figure determined in negotiation between the Department of Education and the relevant school authority. The LTE is based on research into demographics and that was critical to the success of PPP contracts. If the Department did not get the LTE right it could find itself in a situation where an enrolment might fall for example from 1000 pupils to 700 and it would have to maintain the higher level of payment. Volume risk had not been transferred to the private sector because of the Department's role in enrolment policy, if that happened banks would conceivably want a seat on boards of governors. As part of its PPP deals the Department sought third party revenue because it was known that a typical school lies dormant for 75% of the year. The private sector was encouraged to find alternative uses for the properties during that period and the income is shared with the schools. This was of benefit to a school where the enrolment had dropped because the increased revenue could be used to offset any paper losses. The school designs allowed use of public areas by local communities rather than using classrooms.

In response to a member's question the members were told that general insurance liability and security for buildings lay with the private sector operator but that school authorities also retained certain public liabilities on insurance commitments.

The briefing concluded after members were told that Departments shared experience of IT projects and there were joint ventures between the Training and Employment Agency and the Social Security Agency (Department for Social Development).

RECORD OF AN INFORMAL BRIEFING ON PPP BY THE DEPARTMENT OF HEALTH, SOCIAL SERVICES AND PUBLIC SAFETY TO MEMBERS OF THE COMMITTEE FOR FINANCE AND PERSONNEL

Thursday, 10 May 2001
in Parliament Buildings, Stormont.

Present: Mr F Molloy (Chairman)
Mr J Leslie (D/Chairman)
Mr A Maskey
Mr P Weir
Mr J McGrath (DHSSPS)
Mr J Cole (DHSSPS)
Mr R Scott (DHSSPS)

Officials from the Department of Health, Social Services and Public Safety made a short presentation to members of the Committee on Public Private Partnerships (PPP), including Private Finance Initiatives (PFI). It was noted that the Minister of Health, Social Services and Public Safety had made a written submission to the Committee setting out the opportunities for PPP/PFI but also mentioned the limitations on dealing with the resourcing difficulties in relation to capital expenditure. The Department perceived PPP as a component of the overall capital procurement process and while D/HSSPS did not have a specific PPP/PFI programme, these approaches may have the potential to meet some of the capital pressures on the Department.

The Department had an estate with a replacement value of £2b ranging from hospitals to a diverse spectrum of community facilities. Much of the stock was quite old (pre-1960s) and there was a backlog in basic maintenance, etc. This was estimated at around £200m. There were also problems due to ageing equipment and this reduced efficiency.

There was public expectation that the health service required modernisation to bring it up to current standards in terms of IT development (e.g. imaging).

There were a range of pressures now beginning to be experienced by the Department, one of these being the second phase of the development of the Royal Victoria Hospital, Belfast which was estimated at £60m. Major investment was also needed at Altnagelvin Hospital, Londonderry and the Ulster Hospital, Belfast (£90m). Other pressures were arising in residential child care, part of which was being tackled through the use of Executive Programme Funds. There was a need for a new maternity hospital at £15m and major investment would be needed for the Ambulance Service. Looking beyond the major strategic developments, the Trusts and Boards at local level had an investment deficit estimated at £600m - £700m. In recent years the Department's capital budget has been in the region of £50m - £55m. This had resulted in the development of a rigorous testing process to enable projects to be properly prioritised.

The rigorous controls operated by the Department had enabled major schemes (e.g. the new £50m Causeway Hospital) to be completed on budget and on schedule.

PPP/PFI schemes had been used to provide new facilities within the Health Service including renal units at the City Hospital and at Antrim Hospital, imaging equipment, energy schemes and ICT (Link Lab Schemes). Schemes under consideration included the Cancer Centre at the BCH, an Imaging Centre at the RVH and a Services Centre at Altnagelvin Hospital. However, the outcomes of these explorations had yet to be determined.

The Department had gained some insights from its experience with PPP/PFI. The investment in the health sector tended to be extremely complex with buildings incorporating very specialised units and equipment. These posed a major challenge to the private sector. The investments needed were also very significant (ie £30m - £40m) and the Department had concerns about whether the private sector would have an interest in addressing such schemes. There were also fewer opportunities in the health sector in Northern Ireland for greenfield site developments which tended to be less complex in their nature. The Department had identified major issues in meeting the revenue implications of PPP/PFI schemes that tended to substitute a revenue bill for a capital bill. This meant that the long term affordability of PFI schemes had become a third test beyond VFM and transfer of risk, i.e. the scheme may give good value but may not be acceptable from the point of view of meeting the revenue bill. The Department also was not convinced that the private sector could out-perform the public sector in terms of running these large projects. The Department also had concerns about the design quality of hospital schemes undertaken in Great Britain. This was based on a report carried out by the Commission for Architecture in the Environment that raised criticisms about the quality of build, standards of build and in the sizing of some of the projects reviewed.

Committee members asked about the Department's assertion that the health sector lent itself less well to PPP/PFI than other parts of the public sector. In view of the investment need already identified how did the Department see this being tackled other than by PPP/PFI? The Department suggested that, one way or another, some means must be found to provide greater financial resources. Referring to the projected Cancer Centre scheme, the Department noted that, as a £50m project, a PPP approach might require an annual revenue premium of over £5m annually for a 25 year period. These were the choices that had to be made. The Department's view to date was that it had insufficient headroom in revenue terms to take projects forward on this basis. A further problem that might be specific to the health service was the lack of opportunities to generate external revenue e.g by using the facility for other purposes outside working hours, thereby reducing the cost to the public sector.

The Committee members asked about the extent to which the Department had sought to examine the experience of other health authorities in GB in using PPP/PFI for major capital projects. The Department noted that, in the early development phase of PPP/PFI, the NHS had been considered as a pioneer in the techniques. The Department had fostered close linkages with the NHS in monitoring their experience. Part of the thinking was to develop guideline documents to take on board the lessons learned as a result of experience, both good and bad, with the early PPP/PFI schemes. For example, in those early projects there was a lot of money wasted by employing lawyers to draw up extremely complex contracts. This has been tackled by the use of standardised contracts which were applicable across a wide range of schemes. However, the problem was not intrinsically one of knowing how to do PPP/PFI, but rather how to develop ways to enable the private sector to introduce innovations which genuinely provide the benefits that justify this kind of approach. There were opportunities where schemes involved the provision of equipment in which there was a high consumables element which, therefore, could be used to offset the capital costs. But the problem of creating additional income generation for the standard acute hospital still required to be solved.

In GB, the decision to use greenfield sites had created opportunities for the private sector, however, these opportunities were not so readily available on existing sites in Northern Ireland. One aspect of the HPSS finances that might not have been sufficiently stressed was the fact that around 75% of the annual budget related to staff costs, the majority of whom were clinical staff who were excluded from any PFI deal. The scope to achieve revenue savings remained a small part of the overall departmental finances. The fact that many of the support services (catering, cleaning, etc) were already contracted out meant there was little scope for further savings by the private sector over those being achieved by the public sector.

The Committee members asked how the application of New Targeting Social Need (New TSN) to the Department's policies would effect the implementation of PPP/PFI. The Department proposed that New TSN would be used to help determine whether a new facility was needed and where it should be located. Once those decisions had been made and tested under New TSN, the actual process of providing the facility would be undertaken using the most efficient means, whether by PPP/PFI or more conventional approaches.

Returning to the comparative costs, members asked for more detail on the £50m capital costs versus £5m per year over 20 years comparison. The Department explained that whilst the revenue approach looked much less attractive at first glance it did include two equipment replacement cycles and also all of the maintenance costs for the 20 year period. These projections were all taken into account when the business case was prepared and this demonstrated that the viability of PPP had to be tested on a project by project basis.

Members asked whether the introduction of Resource Accounting would have any impact on the implementation of PPP/PFI projects. The Department felt that the introduction of Resource Account Budgeting would make the task of comparing costs under the PPP/PFI and traditional approaches easier but would not actually overcome the difficulty of creating the necessary revenue budget over a long period into the future.

The Department was asked whether it was true that the capital costs versus revenue stream arguments really were a matter of how the annual budget was treated and if greater efficiencies were possible with the PPP/PFI approach then those should be pursued. The Department's concern was that high priority projects could sufficiently impoverish the Department's annual capital budget so that there would simply be no resources left to finance other necessary capital schemes. There would, therefore, remain considerable pressures in terms of maintenance etc, which PPP/PFI might not be suitable as a solution, but which would suffer because of the money tied up in the PPP/PFI programme. This point was particularly relevant to the HPSS owing to the large number of small facilities that go to make up the bulk of the estate. It was vital to retain a budget for normal capital procurement as there will be little prospect of a PPP/PFI solution to finance this type of facility.

Members referred to a visit they had made to a mental health facility in the North of England where they had noted that there was little in the way of additional finance income for the private sector above the interest repayments on the facility itself. The Department was asked what they saw as being the financial options available to it in taking these types of schemes forward.. The Department acknowledged that they were examining and reassessing the HPSS estate with a view to disposing of any assets that were not required. These disposals would provide greater assets for re-investment. Trusts were also being encouraged to investigate ways of linking with commercial interests on a partnership basis to broaden the use to which health service facilities were put in overall terms. Such schemes may also generate greater income for the health service. The provision of private sector residential nursing home care was a good example of how the private sector would finance facilities, which were then provided to the health service for a set fee.

The Department concluded by re-affirming its primary concern that large additional demands on its revenue budget flowing from PFI schemes could not be allowed to put the other clinical developments at risk.

RECORD OF AN INFORMAL BRIEFING ON PPP BY THE DEPARTMENT OF REGIONAL DEVELOPMENT TO MEMBERS OF THE COMMITTEE FOR FINANCE AND PERSONNEL

Thursday 10 May 2001
in Parliament Buildings, Stormont.

Present:
Mr F Molloy (Chairman)
Mr J Leslie (D/Chairman)
Mr A Attwood
Mr A Maskey
Mr P Weir
Mr R Spence (Permanent Secretary, DRD)
Mr J McGibbon (DRD)
Mr D Carson (DRD)
Mr S Carson (DRD)
Mr S Creagh (DRD)
Mr G Frasier (DRD)

Officials from the Department of Regional Development made a short presentation to members of the Committee on Public Private Partnerships (PPP), including Private Finance Initiatives (PFI). It focused on four issues. First, it noted that the Department faced a problem of massive funding needs in areas such as roads, transport and water services. Second, it was considered unrealistic that these needs could be met solely through public expenditure. Third, the solution must involve a considerable input from the private sector and more so than has been the case in the past. Fourth, the Department believed that the solutions of the past in terms of privatisation and PPP/PFI, in the forms developed to date, were unlikely by themselves to provide a sufficient answer. What was needed was a focus on new approaches.

Expanding on the first of these points (the scale of the funding deficit) it was noted that the Water Service needed to spend £3b over the next 20 years and £2b would be needed for roads and public transport over the next 10 years. This meant, in round terms, that DRD would need an extra £3b over the next 10 years. This money would be needed for a number of essential services. These included, maintaining the existing road system to a proper standard, up-grading the strategic road network, providing a modern "European standard" public transport system, replacing obsolete water and sewerage facilities and, finally, meeting European Union standards for drinking water and waste water.

There were three reasons why these large sums had to be faced. First, the privatisation of water and sewerage in Great Britain had ensured that the necessary funding had been obtained there. Similarly, in GB public transport had also been privatised creating considerable investment by the private sector. Generally, much more had been invested by the Government in roads and public transport there than had been invested in Northern Ireland. For example, the major investments announced recently by the Secretary of State for Transport were not applicable to Northern Ireland.

The second question related to the extent to which it was realistic to assume the funding gap could be addressed through re-adjustments within the Northern Ireland public expenditure block.

A further question related to whether it would be practicable to obtain an increase in the size of the block grant in order to meet these funding needs. However, the Department thought it unlikely that a re-adjustment of the Barnett Formula could, by itself, meet these funding requirements particularly where services like water and sewerage were not included in Barnett (since they were privatised in England and Wales). The overall conclusion was that a solution to these problems would require the involvement of the private sector to a greater extent than in the past. Options included the privatisation of services such as water and public transport, however, there appeared to be little public support for such measures.

The Department's experiences of PPP/PFI indicated that PPP might have a part to play in addressing the £3b/10 year funding gap. However, all options for funding public service improvements would be considered. The Minister for Regional Development had spoken about this recently when he raised the idea of a "not-for-profit" company financed by bonds over a 30 year period to create the finances needed to address the investment deficit mentioned earlier. Any investment would be guided by the Department's Regional Development Strategy.

Members acknowledged the point about exploring the possibility of a not-for-profit company as an example of an innovative approach by the Department and asked what other ideas the Department had for addressing its very considerable investment deficit. In particular, how did the Department envisage creating the revenue to pay for PPP/PFI style projects over the projected 20-30 year life span. Regarding the "not for profit" company proposal, the Department noted that this approach had been successfully operated in North America in a range of projects, for example Vancouver International Airport, albeit in a different administrative and funding structure. If carefully constructed, the bond issue approach might work. The Department noted that an approach based entirely on PPP/PFI projects would quickly take up the Department's existing resources for revenue requirements.

In answer to a question on public concern about privatisation of public utilities such as the Water Service the Department considered that a not-for-profit company such as a regional development trust might have a higher degree of public acceptability. The need to ensure a proper level of public acceptability when considering such matters was a matter that had been stressed by the Minister.

The Department concluded by explaining that PFI had been a learning experience for all concerned and that lessons had been learnt. For example, there was the need for in-house expertise, difficulties caused by the small size of early projects and the need to ensure appropriate enabling powers and legislation were in place. Legislation was, in fact, now being drafted by the Department to address a legal obstacle to the use of PFI in public transport.

RECORD OF AN INFORMAL BRIEFING ON PPP BY THE HOUSE OF COMMONS TREASURY COMMITTEE TO MEMBERS OF THE COMMITTEE FOR FINANCE AND PERSONNEL

Wednesday 14 February 2001
in the House of Commons, Westminster.

Present:
Mr F Molloy (Chairman)
Mr J Leslie (D/Chairman)
Mr A Maskey
Mr P Weir
Mr D Hussey
Mr Giles Radice MP (Chairman, House of Commons Treasury Committee)
Mr J Cousins MP

Mr Radice referred to the Fourth Report of the Treasury Committee which dealt with the Private Finance Initiative. The report made a number of recommendations:-

- that Value For Money should be the main justification for PFI;
- that PFI projects should combine capital and service requirements in cases where the risks are primarily commercial;
- that the transfer of risk is optimised and that the private partners should be required to accept those risks;
- that the outputs required from a project should be clearly established in order to clarify the trade-off between competitors and due length and cost of negotiations;
- Departments should be required to evaluate PFI projects following implementation;
- employees transferred between employers as a result of PFI projects should be protected;
- care should be taken to reduce the likelihood of a conflict of interest in the involvement of Partnerships UK.

Mr Cousins drew attention to the hospitals project in North East (Newcastle). This had involved a reconfiguration of hospital services in the region with over £100m identified as the total value of the project. It was necessary for 16-20 health authorities to sign up to the scheme.

Referring to their report the Treasury Committee had sought evidence from a wide range of individuals and bodies which were active in the area of PFI. These included the government departments, the building industry representative bodies, the CBI and TUC. Attention was also paid to the academic research and other work undertaken by, inter alia, the Audit Office.

Mr Radice said there was a need for evidence to justify the VFM outputs. Problems were arising in respect of the parameters for carrying out the calculations, eg the Treasury discount rate of 6% and questions over its applicability. A small change in this rate would make a considerable difference to the outcome of any comparison.

The visiting delegation asked whether conclusions had been reached about whether some sections of the public service were particularly suited to a PFI approach. Mr Radice confirmed his Committee believed that where both capital and running costs are incorporated into a project it is important to ensure that the contractor does not focus on one at the expense of the other. Regarding hospital projects, the Treasury Committee were concerned that difficulties tended to arise because the clinical aspect of the service remained in the public sector while the support services were privatised. Getting these relationships right was absolutely crucial.

Members asked about the evaluation of PFI projects. The Treasury Committee's view was that while the NAO evaluated the large projects, it was considered that the Government should require all projects to undergo evaluation. In response to a question about whether quality of service provision and social inclusion should be core issues for consideration in PFI projects, Mr Radice said that there was a need to compare the alternative approaches on all fronts. An example related to the future of facilities management. Better information was needed to enable decisions to be taken on the provision of "hard facilities management" (ie the maintenance of structures, heating systems etc) as compared to "soft facilities management" (ie cleaning services, catering etc). Care needed to be taken to protect against damage to the level of the service and this had to be an integral part of the way in which the project is constructed.

The problems associated with measuring the benefit accruing from a project were discussed. Mr Radice pointed to the tendency to move away from individual projects covering, say, individual schools to projects that are based upon a regional or board-wide approach.

Members asked about the pitfalls that the Treasury Committee had identified and what further work the Treasury Committee planned to do on PFI matters. Mr Radice indicated that further work was needed on the question of how to evaluate and monitor PFI projects following implementation. It was essential to clearly identify the causes of mistakes or problems encountered that prevented the project from fulfilling its objectives. It was agreed that the NAO/NIAO should be asked about their view on this issue. It would also be helpful to know what structures may be emerging among the client groups with PFI and also among the contractors' consortia. Mr Radice suggested that there should be a Northern Ireland branch of Partnerships UK established. This would help to ensure an appropriate level of expertise within the public sector so reducing the likelihood of expensive errors being made. Steps need to be taken to ensure that such expertise is retained and established.

Mr Radice suggested that the state of current practice should be established, it what projects have been concluded, are new trends developing, are projects being concluded effectively (ie what is being added to the section capital provision – estimated at 10% for GB).

Members asked about contract compliance, ie how to ensure that targets (objectives) are met. Mr Radice suggested that penalty clauses needed to be both carefully constructed and strictly enforced. A focus on outcomes was needed in the work of structuring the project. These had to be specific, ie a reduction in hospital waiting lists, extra beds, miles of new roads, etc. Penalty clauses must actually work.

Members expressed concern about the long time scales for those projects and that finance was tied up for up to 30 years. Mr Radice agreed but pointed towards the capability of ensuring that maintenance was included as an integral element of a capital project so ensuring that the asset retained its full value. The move towards resource accounting would greatly assist this approach.

RECORD OF AN INFORMAL BRIEFING ON PPP BY THE PRIVATE FINANCE UNIT OF THE DEPARTMENT OF HEALTH

Thursday 3 May 2001
in Quarry House, Leeds.

Present:

Mr Francie Molloy (Chairman)
Mr James Leslie (Deputy Chairman)
Mr Derek Hussey
Mr Alex Maskey
Mrs Susan Stockley (Dept of Health Private Finance Unit)
Mr John Guest (Dept of Health Private Finance Unit)
Mr Paul Townsend (Dept of Health Private Finance Unit)
Mr Peter Cockett (Dept of Health Private Finance Unit)
Ms Susan Peak (Dept of Health Private Finance Unit)
Mr J Clyne (Dept of Health Private Finance Unit)

The members of the Committee for Finance and Personnel received an informal briefing from the Private Finance Unit (PFU) of the Department of Health on the use of PPP in the NHS. The PFU told the members that the available public capital in the National Health Service (NHS) was inevitably constrained and that the Private Finance Initiative (PFI) could significantly increase the overall level of investment in the NHS. Members were also told that PFI investment in the NHS was expected to be £790m out of a capital total of £3.12b. It was expected the balance would shift more towards PFI given the major building programme being undertaken by the NHS and the initial approval of a large number of major PFI schemes by the Secretary of State.

In response to a member's question the PFU described how Treasury was concerned by the amount of health Trusts' budgets being tied up in contracts for the provision of infrastructure – this was referred to by Treasury as "silting up". PFU believed that Treasury had set a trigger point in 2001/02 for the Department of Health of 2% of its revenue settlement. In the case of England, this is 2% of around £40 -£47b. The PFU would take stock when that limit was reached and re-examine its plans. PFI deals included the cost of services such as portering which Trusts would normally meet, therefore the NHS only calculate the 2% as the cost of the facility itself.

The members were told that the NHS had its own tight guidelines for constructing public sector comparators (PSCs), which were based on Treasury guidelines. Technical notes and the "Green Book" issued by Treasury ensured that unrealistic and excessive construction periods were not included. The PFU carried out benchmarking to ensure that risks were appropriately assessed. The PSCs are checked regionally and by an economist attached to PFU. Treasury also approve larger schemes.

The PFU told the members that although Government could borrow more cheaper than the private sector the benefits of PFI were that appropriate risks were transferred to the private sector and private sector expertise could manage the projects better. In response to a question on the prioritisation of projects based on health need the PFU explained that in the early days of PFI it had been left to each health Trust to develop projects individually. Projects were now prioritised by the Department of Health and presented to the market in a structured way. The supply of projects to the market needs to be managed to ensure there is the capacity to deliver deals and the competition necessary to ensure value for money deals.

The members were told that monitoring arrangements would focus on operational benefits from PFI but because the schemes were so new it would take some years to be able to do that. The lessons that had been learned by the NHS were largely in terms of procurement and one painful lesson was the high cost of legal advice which had drawn adverse publicity. Standardisation of contracts had now reduced those costs. Work was continuing on standardisation of payment mechanisms that would lead to a further reduction in costs.

The PFU told the members that before PFI six or seven years ago, Trusts did not have the maintenance funds for hospitals and there was no capital available to fund the building programme the NHS had. During the 1980s in any given year there would have been four or five major projects approved. Since PFI, six or seven years ago the NHS has approved 64 major schemes which are now at various stages, from procurement to completion. The NHS has the largest investment plan it has ever had in terms of numbers of schemes. Also PFI generally produces larger schemes because private sector capital is not constrained in the same way as public funds. PFI enables the NHS to build complete new hospitals. With public funding, schemes have to be split into phases built over a number of years.

Members were told that decisions on prioritisation of projects began with health authorities. The Department of Health has a Capital Prioritisation Advisory Group which recently completed an exercise on behalf of the Secretary of State (SoS). The SoS wanted a whole health economy approach to get away from focusing on the district general hospital development. He wanted to be satisfied that services were being provided out in the communities so that a local health service was also provided. The SoS was concerned that people in rural communities were becoming disenfranchised from health care because developments were concentrated on the larger schemes. The models which had brought successes in the larger acute services were gradually being used in smaller schemes such as mental health and community health provision with a capital value of between £2m and £20m. There would be difficulties with economy of scale in the smallest schemes because the front-end costs of legal and accountancy advice could make the schemes uneconomic for Trusts. Additionally, the small margins did not make them attractive to the private sector. However, the standardisation of contracts and payment mechanisms and the bundling of the smallest schemes under the NHS LIFT project which operates in primary care would address those issues.

The PFU explained that smaller GB contractors are being attracted for the smaller Trust units and a number of construction firms from other European countries were involved in some of the larger schemes. The European Investment Bank were the funders of a NHS project in Dudley.

In response to a member's question as to whether Northern Ireland should set up a centralised team to standardise and manage a range of projects covering several Departments the PFU said that in developing a centralised team it was necessary to recognise the range of expertise that was needed. The Department of Health's unit had chosen to second legal and financial experts from the private sector to provide continuity of expertise. The PFU was also looking at ways of encouraging project managers to move from one project to another or to be consulted by others. Forums were held to go over particular items of concern for NHS managers involved in PFI. The NHS is a leading user of PFI because of its large number of building projects. It had developed the principles laid down by Treasury (such as regarding the contract terms) to suit the issues which are relevant to PFI schemes in health. The PFU concluded its briefing by explaining that it was not able to comment on how PFI expertise had developed in other Government Departments.

The Private Finance Unit provided the members with the following additional briefing notes relating to their experience with PFI to date:

Benefits of PFI

- Finance schemes over contract life (revenue) rather than up front capital cost - in other words not constrained by amount of immediate public capital available
- Lack of availability of public capital means that publicly funded schemes are often in phased developments whereas PFI schemes are in one complete package.
- Delivery of major acute and non-acute hospital schemes.
- Delivery of medium sized community and mental health facilities
- Delivery of other types of PFI schemes e.g. heat and power plants, staff residences.
- Delivery ahead of schedule e.g. Carlisle - several months early
- Ability to innovate - faster delivery compared with the public sector comparator e.g. Bishop Auckland and Worcester.
- Site rationalisation e.g. Dudley (but there would be the same benefit with a publicly funded build)
- Transfer risk of construction cost and time overruns and design faults to private sector e.g. on Guys a publicly funded scheme the capital costs increase four fold prior to completion.

(Note that this can be an issue with PFI - where the capital cost as outlined at the SOC stage needs re-approval due to changes in functional content etc. However once the contract is signed any construction cost overruns are a private sector risk.)

- Genuine risk transfer through the contract.
- Service side tends to be where VFM achieved - more efficient use of resources
- No hospital, no fee i.e. only pay when operational - only pay for services you receive
- More disciplined planning process
- Frees up health professionals to do what they do best – provide health service rather than manage facilities

- Incentives to build good quality facilities and maintain the hospital and provide services to meet specified standards through the payment mechanism.

Key factors for the successful application of PFI

- Prioritisation of schemes on basis of health service need rather than at the whim of the market. If there are too many schemes the market cherry picks the ones it wants. The result is poor VFM for the NHS especially complex schemes.
- Effective project management arrangements - project owner (CE), project board, project director and project team
- Functional content agreed at outset with clinicians - if not clear on scheme - capital costs could escalate and may need variations later on
- Comprehensive market sounding exercise to determine the best time to go to the market, the likely bidders, necessary level of competition and how they think the scheme will be shaped. This would cover scope of soft services. If there are too many schemes the market will cherry pick the ones it wants and this will result in poor VFM for the NHS. Also it is unlikely consortia can handle more than 2 schemes at once which are at different stages of procurement.
- The timing of OJECs may need to be managed centrally once market intelligence has been gleaned to ensure that there is sufficient real competition to achieve VFM. OJECs may need to be scheduled depending on the supplier market and how far the Trust has progressed the scheme.
- Market soundings can take a number of forms but for bigger schemes they may take the form of a day event in which contractors, FM providers, banks etc are invited to the Trust and presented with the key features of the scheme proposed, there may be an opportunity to ask questions and discuss the scheme and they may be qiven a questionnaire to take away to complete on areas where the Trust would like to seek their views
- Define the affordability ceiling at an early stage - SOC - must be affordable over contract life - develop shadow tariffs and define affordability ceiling
- Competition in selection process is the main way of achieving VFM - VFM is achieved through keeping the competitive process going as long as feasible - however once there is a preferred bidder the key is to minimise the points of principle and not to re-open any issues thereby limiting any changes from the firm price with the preferred bidder
- Commissioner support of strategy and costs from outset and commissioner on board all the way through
- Strict time-tabling - slippage increases costs - monitoring of milestones
- Standardisation of documents e.g. the contract, payment mechanism.
- Guidance to Trusts on selection and preparation of schemes, PFI procurement process, technical and commercial issues e.g. design protocol, accounting etc.
- Service element tends to be where VFM is achieved.
- Sizeable projects benefit from economies of scale (even with standardisation costs are high e.g. advisors).
- Stakeholders fully represented in scheme development e.g. staff, local authority, CHCs
- Follow best practice in selection of advisors - otherwise waste of time and money.

RECORD OF AN INFORMAL BRIEFING ON PPP BY SENIOR MANAGERS OF LONDON UNDERGROUND TO MEMBERS OF THE COMMITTEE FOR FINANCE AND PERSONNEL

Thursday 15 February 2001
in London.

Present: Mr F Molloy (Chairman)
Mr J Leslie (D/Chairman)
Mr A Maskey
Mr P Weir
Mr J Smith (Director of Contract Services – London Underground)
Mr A Foulds (London Underground)
Mr A Mitchell (London Underground)
Mr P Chislett (London Underground)

Jon Smith noted that the primary objective of the major PPP projects being developed by LUL was to privatise the maintenance of the rail network while ensuring that the operation of the Underground system remained within the public sector under the control of the mayor. The proposal would ensure that the major investment needed to upgrade the standard of the rail network would be obtained and that the network would be obtained and that the network would then be properly maintained over a 30-year period.

Presentations were then made by both Alex Foulds in respect of the 3 major PPP projects and Peter Chislett in respect of smaller PFI projects.

The 3 PPP Projects

The Underground rail network had been divided into 3 separate sections for the purpose of constructing the PPP projects. The reason given for the decision to create 3 projects as opposed to 1 or 2 much larger projects was the desire to be able to measure the performance of one consortia group in delivering their objectives against the others.

The basic features of each of the 3 projects were essentially similar. Each was a service contract, 2 had 2 consortiums competing for the contract while the third had 3 consortiums in competition. The selection criteria included minimum technical requirements such as safety, management, structure and price. The principle concerns from the clients' viewpoint related to the ability of the consortia members to gel as a management team and, in effect, act as a single entity. It was noted that should a partner be sold or absorbed into a new organisation, the resulting partner would retain all the responsibilities of the original company. LUL had ensured that all TUPIE issues were addressed in the formulation of the projects and its management would retain a presence (ie be represented) on the management boards of the private sector consortium partners.

The Committee had identified a number of areas on which comment would be helpful.

(1) Crucial Factors

These included, early definition of the risks to be transferred, clear English in setting out the requirements of the contract, adherence to PUK guidelines.

(2) Lessons Learnt

Shadow running of the contracts deemed to be essential in revealing deficiencies/weaknesses in the contract conditions, the need to carefully plan the transfer from the project development team to the contract management team, establishing a data room for use by both LUL and the consortia partners, the need to develop access to both internal and external advisers, ensure that the specialist advisors are properly controlled and that they have no residual role when the contract is signed (to avoid any conflict of interest).

The PFI Projects

Peter Chislett confirmed that 5 PFI projects had been created and were now fully operational. Their total value was £3·5B. Effectively LUL was buying a service in the following areas:

(1) the provision and maintenance of a fully computerised ticketing service;

(2) a rail network communication system;

(3) the provision of electrical power to the Underground;

(4) new accommodation for the Transport Police;

(5) extending the rail line to Terminal 5 at Heathrow.

It was suggested that these projects were suited to PFI because they were discrete and well suited to independent operation. It was also noted that private sector operation in, say, the ticketing system would invest in and make use of possible advertising opportunities whereas it would be unseemly to invest public money in such a way.

Each of the contracts had a finite life span, eg 17 years for the ticketing system, 20 years for the communications system and 30 years for the power generation contract. After the expiry of that period, ownership of the asset would return to LUL which would then have the option of extending or re-letting the contract or embarking on a completely new contract/project.

As with PPP the main concerns related to achieving accuracy and clarity in the preparation of the contract. It was essential to avoid caveats being introduced and to avoid arguments over lack of clarity in the documentation of an established contract. It was also essential to ensure sufficient competition among the contractors to ensure that better value is to be realised. The transfer of risk must be carefully managed to ensure that appropriate risk is carried by whoever is best equipped to manage it. Finally, it is essential that performance is capable of being measured in a meaningful way and that there is no opportunity for the contractors to claim for extras.

Mr Chislett proposed that care should be taken in selecting projects for PFI that would be attractive to the private sector (ie would be capable of being managed so as to produce a profit). For example, IT projects had a history of going badly (and expensively) wrong and were, therefore, unattractive to the private sector

RECORD OF AN INFORMAL BRIEFING ON PPP BY THE COMMISSIONER OF TRANSPORT FOR LONDON TO MEMBERS OF THE COMMITTEE FOR FINANCE AND PERSONNEL

Thursday 15 February 2001
in London.

Present: Mr F Molloy (Chairman)
Mr J Leslie (D/Chairman)
Mr A Maskey
Mr P Weir
Mr Bob Kylie (Commissioner of Transport for London)

The Committee's representatives met with Bob Kylie on the afternoon of Thursday, 15 February. The understanding is that Mr Kylie will assume responsibility for the London Underground when the 3 major PPP contracts have been let.

We expressed grave misgivings about the way in which the future maintenance of the underground rail network was being handled. In particular Mr Kylie suggested that the current arrangements were impossibly complex and that they would be unlikely to work smoothly in a real-world context. He raised the question of ownership being shared between the various partners, eg the infrastructure (tunnels/lines) and rolling stock will be owned by the consortia and the operation of the rail service will be owned by LUL. He was deeply concerned that the London Underground was a public asset and that these arrangements would seriously damage that concept.

Mr Kylie was also concerned that the Underground system was being separated into 3 separate components with all of the conflicts and co-ordination/co-operation difficulties that were inherent in this. There was also the likelihood that the practical realities of ensuring that the trains continued to run (and on time) would be likely to create an adversarial relationship between LUL and the consortia – when what was needed above all was co-operation.

Mr Kylie noted that there were strong arguments in favour of PFIs and PPPs (he felt that they are one and the same). They were suitable for projects which were discrete and where the risks were clearly identified and suitable for transfer to the contractor. Above all the project must be of manageable proportions. He disagreed with any notion that a lower (viability) limit of £50m applied to such projects. Another key issue was the question of evaluation and performance measurement. This was an inescapable requirement but he had reservations about how meaningful evaluation could be achieved in a project that had a life span of 30 years. Clearly, there was an assumption that such a project could only begin to be fairly evaluated late in its life span and this was not an acceptable way to proceed.

The Commissioner stressed the need for a comprehensive assessment of the asset before any detailed work on contracts is undertaken. It is not possible to assess the risks until the true state of the asset is known. It was also suggested that rather than look towards buying in private sector contractual or consultancy assistance when dealing with a prospective project, the possibility of recruiting a suitably experienced and competent management team should be considered. While acknowledging that the best managers for running essentially commercial organisations may lie in the private sector, there is nothing to prevent these managers from being recruited into an in-house management team. This concept diminishes the argument that expensive PPP contract set-up costs will inevitably be off set by private sector efficiencies.

Members asked how the Commissioner would approach the need to refurbish the LUL infrastructure. Mr Kylie noted that around £100m had been spent on consultancy fees and other similar costs to date without a single contract having been set. He suggested that time and money could still be saved in the long run if the viability of the 3 PPP projects was to be reassessed and any changes made that were deemed essential. In the light of the 30-year contract period such a reassessment would be a small price to pay for getting it right.

When asked about the NAO view about the efficiency savings to be achieved through the PPPs, Mr Kylie concluded that these were an indictment of the quality of the present LUL management. Such efficiency savings were not the sole preserve of the PPP approach. In addition it was suggested that the best forward cost projections could only be deemed accurate for, say, 7½ years. After that it was not possible to predict costings with any degree of accuracy. Predictions over the 30-year period of these contracts were, therefore, meaningless.

The Commissioner also suggested that ticket revenues should be sufficient to act as collateral to cover the interest payments on new plant over, say, a 7-10 year period. Similarly, a Government pledge (bond) could be made to cover, say, £250m - £300m. This would secure around £7B and would also enable the work to be completed in a 7-year period.

Mr Kylie concluded by suggesting that complexity and very long-term projects should be avoided when considering PFI/PPP. Such approaches were viable for discrete stand-alone areas of the public service where the risks were obvious and straightforward to quantify.

RECORD OF AN INFORMAL BRIEFING ON PPP BY LEEDS CITY COUNCIL PRIVATE FINANCE INITIATIVE TEAM TO MEMBERS TO THE COMMITTEE FOR FINANCE AND PERSONNEL

Wednesday 2 May 2001
in Leeds Civic Hall

Present: Mr F Molloy (Chairman)
Mr J Leslie (Deputy Chairman)
Mr D Hussey
Mr A Maskey
Mr David Outram (Project Co–ordinator)
Ms Philippa Toner (Project Manager)
Mr Paul Guest (School representative on project team)
Mr Fintan Bloomer (Finance)
Mr Derek Howell (Education Leeds – PFI client)

Leeds City Council Private Finance Initiative team briefed the Committee on their experience in developing PPP through a PFI deal to build the Cardinal Heenan High School. The deal was a pathfinder deal sponsored by the Catholic Diocese of Leeds with assistance from Leeds City Council and supported by the Department for Education and Employment (DfEE). The school was voluntary-aided and the payment arrangements required the formation of a trust fund at the insistence of the bank that financed the deal. That co-ordinated the funding streams from the DfEE, the diocese, the school and the council. The trust fund provided the guarantee for the bank. This arrangement was unique to voluntary-aided schools and future deals would involve a direct funding stream from the council to the special purpose vehicle company set up for each of the council's proposed future deals.

The council was planning a seven schools PFI deal which would have capital costs of £36m and involved a financial model to build the schools and their maintenance over a 27 year period. The council must ask DfEE for PFI credit approval which was normally 70% of the annual cost of a project. It must then meet the remaining cost from its normal annual budget and from the budget given to the school by DfEE. The council did not expect a shortfall.

Before the procurement stage of its seven schools project the council devised its public sector comparator which demonstrated that the cost of the council running the project is more expensive than the alternative of using the private sector. The council used financial and legal advisors to devise the comparator which looked at risks including construction and cost overruns, risk of inflation, maintenance etc. One new feature for the council was examination of future maintenance costs, previously any assessment of a new build scheme involved only construction costs. The comparator was then examined by external auditors to ensure that it was robust and the risks had been correctly addressed and allocated. If the external auditors had assessed that the project was a capital project it would not have proceeded.

The council was concerned that by using special purpose vehicles the objective of having assets at the end of their 27 year deals which were in the condition defined by the output specifications could be put at risk. The buildings were expected to have a 60 year life span and involved council ownership at the end of the 27 year deal with a nil residual value. These concerns existed because the special purpose vehicles were set up purely for particular projects and would probably be dissolved at the end of the 27 years. To deal with that problem the council's project included a review 5 years before their end of the contract to establish which buildings were not reaching the output specifications. If work needed to be carried out at that time "undercharge" payments could be withheld from the special purpose vehicles. Additionally, a contingency sum was built in to bring the buildings back up to standard.

Leeds Council selected the schools in their project on the basis that the fabric of the schools was so bad that they had to be replaced and the priorities were decided through their asset management plan. The council also used an educational criterion that the school should have a long life, that the population in the school's area had been assessed to ensure that in 25 years time the school will still be needed in its present location. The reason for replacement was to raise pupil achievement by improving the surroundings. No school had been chosen on its educational performance but the council must comply with Office for Standards in Education (OFSTED) recommendations to consider closure of schools that were performing badly. It was unlikely therefore that any such schools would be considered for PFI.

The council chose not to include the provision of information technology in their project but has included provision of the infrastructure. This was because it was considered that basic infrastructure provision was best handled by the private sector while the schools were considered best able to handle replacement IT kit as technology advances and changes.

The council had learned many lessons from their pathfinder deal in education and were keen to use their experience in a second deal and had deals planned in other fields including housing and waste management. The council was eager to keep its team together and wanted opportunities to utilise its knowledge. Leeds Council PFI team would like to see more guidance and mentoring from sponsoring government departments to authorities going into PFI for the first time. The team believed that there had been too much secrecy caused by concerns over commercial confidentiality and there was not enough opportunities to meet with and learn from others preparing similar deals. Development of standard contracts by the team and utilisation of expertise would lead to less dependence on external legal advice which cost £0.5m in the 7 schools project. It will not be possible to completely eliminate the cost of that external advice.

The PFI team emphasised that client side membership of the project team was very important and that full time secondment was needed. Preparation in the initial stages of the project to construct the contract documentation and output specifications was recommended and pressure to get to the procurement stage should be deflected until that preparation had been properly completed. In the long run this meant that the project could achieve the right scheme at the right price without having to catch up during the negotiation stage.

Monitoring mechanisms would be put in place at the schools in the project but contractors were also being asked to monitor themselves and to react to deficiencies. The project was influenced by Human Rights legislation and considerations of the project's impact were assessed on an ongoing basis. The PFI team recognised that there is a long term relationship between the City Council , the schools and the contractors and that a lot of faith has been placed in how things will work. An assessment of how that act of faith was will not be possible for about 5 years.

The Council's Finance Department established the value for money of the PFI deal by using the public sector comparator. That gave the Council a benchmark on which to make a decision on the viability of the project. The Council team explained that public sector was not available to the Council and that PFI enabled it to fund large projects. For example, the latest PFI project involved a need for £36m over a three or four year period while the basic credit approval set for schools was just over £3m. The team confirmed that the Council's policy on PFI was that PFI would not include provision of teaching services.

RECORD OF AN INFORMAL BRIEFING ON PPP BY REPRESENTATIVES OF L'ESTRANGE AND BRETT, SOLICITORS TO MEMBERS OF THE COMMITTEE FOR FINANCE AND PERSONNEL

Thursday 10 May 2001
in Parliament Buildings, Stormont

Present: Mr Francie Molloy (Chairman)
Mr James Leslie (Deputy Chairman)
Mr Alex Attwood
Mr Peter Weir
Mr Richard Gray (L'Estrange and Brett)
Mr Paul McBride (L'Estrange and Brett)
Mr Adrian Eakin (L'Estrange and Brett)

Representatives of L'Estrange and Brett, Solicitors met with members of the Committee on Thursday, 10 May 2001 in Parliament Buildings, Stormont to brief members on their firm's experience of Public Private Partnerships.

The representatives explained that L'Estrange and Brett had extensive experience of working on PPP/PFI projects in Northern Ireland and that its role was to facilitate the PPP process for its clients within the legal constraints. While the wider process political and economic decisions were not within their competency there was a need for political will and commitment to be demonstrated if the PPP process was to be carried forward successfully. PPP was not, however, the answer for all projects.

The representatives outlined a number of steps that could be taken to facilitate successful PPP. For example, the public sector needed to develop a strong PPP skills base as well as considering organisational and structural changes to assist the development of new skills. Practical steps should include the standardisation of contract documentation wherever possible. They recognised that there was considerable unease amongst public sector employees and stakeholders on the likely impact of PPP and regular consultation throughout the process was crucial. There were a number of contractual and practical protections starting to emerge from market practice that could alleviate those concerns.

With regard to legal constraints and problems there were four main legal issues encountered to date on projects that have adversely affected the length of time needed. These centred on contracting with public sector bodies and business tenancies.

Contracting could be a problem for the private sector when dealing with public authorities such as district councils that did not have extensive powers to contract. The issue of vires could then be questioned. The robustness of the payment covenant may also be challenged, resulting in the need for a letter of comfort from the sponsoring department. Examples given were statutory corporations such as higher education colleges and the trustees of a grant maintained school. While these would continue to be questioned they should be addressed at an early stage in the negotiations.

The representatives went on to explain that the Business Tenancies (Northern Ireland) Order 1996 did not allow for contracting out, it was mandatory legislation. The public sector was therefore reluctant to offer a leasehold interest in accommodation. The public authority would instead offer a licence to the private contractor to occupy that particular property. The problem that arose with that solution was that the Inland Revenue had indicated that a licence might be an insufficient interest to enable the licensee to claim capital allowances. This had led to uncertainties and has resulted in late price negotiations.

The problem was not as acute in England and Wales where the public and private sectors could simply contract out and agree that the licensee or tenant would not have security of tenure under the business tenancies legislation. The public sector could offer a lease without any difficulty. While that resolved the problem in England and Wales, Northern Ireland still has that difficulty.

The representatives explained that the second element of the problem with the Business Tenancies (NI) Order was claiming for compensation under the Criminal Damage Compensation Scheme. The Compensation Agency has indicated that a licence might not be a sufficient interest to claim compensation for criminal damage to property used in a PFI project. This has led to complex and time consuming negotiations on the contract documentation to ensure that the private and public sector partners were protected. The representatives suggested that clarification should be sought from the Compensation Agency that the type of licence offered in PFI transactions would be of sufficient interest to enable private sector contractors to claim compensation.

In response to a question on possible solutions to the problem, such as bringing Northern Ireland legislation into line with England and Wales, it was explained that when the Business Tenancies (NI) Order was introduced it was decided to retain the ability to refuse people the right to contract out. In England and Wales where they have the right to contract out this was seen as undermining the security of tenure principles of business tenancies. If amendment of the legislation was not a possibility then further guidance from the relevant Government Department or the Inland Revenue might resolve the problem.

A member asked for a recap of those particular aspects of the legislation that might need to be changed. It was explained that the business tenancies legislation was also creating problems, for example to people who are franchisees or on short leaseholds. One solution would be to have particular legislation that dealt with the problems encountered with PFI. The classic English structure was for the awarding authority to award a long lease on a facility to a bidder, for example 999 years. The bidder would then give back a sub-lease for the period of the contract. The danger for the authority was being able to recover the facility if the project terminated before the end of the contract. The difficulty with the Northern Ireland legislation was that it was framed in such a way that certainty of recovery did not exist because of the security of tenure given to business tenants. In England and Wales the two parties would agree within the lease document to contract out of the relevant Act. This removed the uncertainty. The representative understood that Scotland did not have any security of tenure and therefore did not have this problem.

One solution, short of amendment of the legislation, was that the legislation does provide for public authority exemption. This was designed to enable public authorities to recover public institutions such as schools but it was not geared to the needs of PFI. The Committee may want to consider if it is possible to strengthen that exemption to take into account PFI.

Another point that was clarified by the representatives was the problem of capital allowances. This was due to the tax guidance produced by the Inland Revenue. The tax legislation would allow a licensee to claim allowances but the guidance states that is not the case without recognising that in Northern Ireland a party was a licensee by necessity due to the Northern Ireland business tenancies legislation. The guidance is based on the position in Great Britain, which Northern Ireland has to follow. The issue of guidance specific to Northern Ireland could solve the problem. This might specify that where a party has a licence for certain properties capital allowances could be claimed in certain circumstances.

A question was asked on the lessons that could be learnt from their experience of PFI projects. The representatives explained that key skills such as project management, contract negotiation, risk assessment and risk appraisal were crucial to successful PPP implementation. Each Department considering PPP should have access to these skills through dedicated PPP teams. The establishment of a central team to co-ordinate PPP policy and act as a focus for advice should also be considered. It would be unfortunate if the knowledge gained by Departments such as Education was dissipated.

The Republic of Ireland had taken a slightly different approach to PPP. They have sought comments on the contractual structure much earlier in the negotiation process and before preferred bidders had been selected. Bidders were asked to set out their conditions early on in order to restrict room for re-negotiation of peripheral or generic issues after the preferred bidders were selected. They also asked the financial partners to commit themselves earlier in the process in an attempt to deliver faster results. The representatives considered that this was an issue that should be examined but expressed concern that such an approach might deter potential bidders if they felt that they would incur significant costs before the preferred bidder stage. They later emphasised that caution should be exercised. Any expectation that bidders would incur heavy financial costs in the opening stage of the bid process may in the long term deter many potential bidders from becoming involved in projects.

Other issues raised by the representatives were that standardised contracts, tailored for sector specific interests, would help to identify areas for negotiation and reduce the time required for negotiation. With regard to TUPE conditions and the danger of a two-tier workforce being created the representatives explained that TUPE did not include pensions rights of transferred staff. However, the Government's view was that the protection of the exiting pension rights of transferred public sector staff should be built into contracts as part of good practice.

The representatives were asked if they were aware of any monitoring of the TUPE arrangements. They explained that TUPE were essentially 'self-monitoring' in that staff were entitled to go a tribunal if they felt that their rights under TUPE had not been protected.

The scale of PFI projects in Northern Ireland and the degree of interest in PFI across departments was questioned. It was explained that while many potential projects were too small on their own PFI was a viable option if they were bundled together, such as in the case of Wellington College and Balmoral schools. However, anything that reduced complexity and bid costs would make projects more attractive to potential bidders. Based on the number of projects coming forward the representatives did not see any shortage of appetite or lack of interest in PFI projects in Northern Ireland. Standard contracts and guidance on the sharing of risks such as the impact of any changes in the law would help to instil trust between bidders and departments.

The meeting concluded with a question on the inclusion of publicly owned land in PFI projects. The representatives explained that the valuation of land could cause difficulties, however including land in a deal normally would make the deal more attractive. In terms of equality of opportunity and best value being obtained the representatives agreed that there could be situations in which the sale of land on the open market could free up money to undertake public sector building projects.

RECORD OF AN INFORMAL BRIEFING ON PPP BY CALDERDALE AND HUDDERSFIELD NHS TRUST, CATALYST HEALTHCARE AND THE PRIVATE FINANCE UNIT OF THE DEPARTMENT OF HEALTH'S NATIONAL HEALTH SERVICE EXECUTIVE

Wednesday 2 May 2001
in Halifax Infirmary, Halifax, Yorkshire

Present: Mr Francie Molloy (Chairman)
Mr James Leslie (Deputy Chairman)
Mr Derek Hussey
Mr Alex Maskey
Mrs Dawn Stephenson (Calderdale & Huddersfield Trust)
Mr Keith Seymour (Calderdale & Huddersfield Trust)
Mr James Lasseter (Catalyst Healthcare)
Mr Graham Johnson (Catalyst Healthcare)
Mr Peter Coates (Department of Health PFU)
Mr Tim Watkinson (Department of Health Regional Office)

Calderdale & Huddersfield Trust made a presentation to members of the Committee for Finance and Personnel on its involvement in a Public Private Partnership to build a new 614 bed hospital. The Trust had 3 sites providing 900 beds– 2 Victorian sites which were over 100 years old and a 1960s flat roof building which collectively had maintenance and life cycle replacement and Health and Safety fire work backlogs of £40m. The Trust has been waiting over 30 years for a new hospital and although it has had many successful business cases, public sector capital has not been available. Their project involved closing 2 of the hospitals and moving to a new build on the site of the third. The building and maintenance risks were transferred to the partners.

Besides the new build deal, the Trust also refurbished some administration blocks and transferred these to the consortium as part of the maintenance risk transfer. Additionally, the Trust invested £4m in dementia beds and rehabilitation and community support teams to reduce the bed requirement at the new hospital by making more care available in the community.

Private Finance Initiative (PFI) was seen as the best way of achieving the goal of a new hospital. The Trust took its time forming the shape of its contract and excluded and included different services as it made its way through the specification process. Nurses and doctors were involved in the design stages. The deal was also made flexible to allow variation of use of accommodation because the shape of health care will change in the future.

The Trust engaged the Catalyst consortium as its partner. The consortium is made up of Bovis – the builders, ISS Mediclean –the Support Service providers and Halifax plc and Bank of Scotland who financed the deal.

The PFI deal made by the Trust eliminated the cost of maintenance backlogs. Future maintenance costs are built into the contract and are the responsibility of the consortium. Performance in that area is part of the monitoring and payment/penalty mechanism. PFI does provide difficulties in the long run by reducing flexibility in the room for manoeuvre in the Trust's remaining resources as the Trust tries to find 1% efficiencies each year under public expenditure arrangements from non-contracted funds.

The Trust's deal involves partnership, trust and commitment and the private sector are in the deal for 30 years. One example of the difference between this deal and a traditional one is that the consortium was keen for the hospital to open on time because their availability payments were triggered when that happened.

When the Trust were trying to make their deal and raise the capital they considered bonds and traditional finance and decided on the latter due to restrictions on future plans. In 1997/98 when the Trust was trying to raise finance there were 30 or 40 groups trying to do the same and the Trust felt duty bound to comply with the banks' wishes in the matter or risk losing the deal. Since then the Private Finance Unit in the Department of Health had produced controls and limits on the number of Trusts approaching the market place at any given time. The unit also developed standard contracts to save time and effort by the Trusts. The Calderdale and Huddersfield Trust recommended that any Trust involved in a similar project should learn from previous projects so that effort was focused and maximised. The Trust also recommended high levels of communication with stakeholders including local groups, staff and unions.

The Trust's project was delayed by changes in prospective partners and Government in 1997 and those delays had caused increases in the capital cost. Difficulties were also encountered by personnel changes in the project team. The Trust employed advisers for legal, design, finance, services and insurance areas.

The Trust described in detail the considerations made before opting for PFI. The options considered were refurbishment, public sector capital and PFI. The heavy weighting of the Trust's Strategic Fit of more care in the community and flexibility in the use of accommodation swung towards the PFI option. In the financial appraisal the life of the contract, affordability and risk transfer were also accounted for.

A lot of care was taken on the transfer of risks and involved nurses, finance and operational staff. The Trust retained the provision of clinical services and certain equipment groups. The partner was responsible for support services and building. There was shared risk in volume changes, insurance and income risk. This exercise led to payment and performance, availability and volume measurement mechanisms. Performance is based on a 100% working hospital and reduced payments result where that is not reached by the service provider and depends on the criticality of the situation.

The service provider's contract can be terminated and replaced if a penalty system is invoked and consistently unfavourable. The penalty system is not meant to be punitive because the Trust does not wish to have a closed Accident and Emergency service, however, the contract does have a penalty based on the length of time taken to repair something. One problem with this is if the service provider decides to take the penalties because the cost of the repair is much greater than the penalties in the contract. Therefore, the Trust recommends escalators to double, treble etc the penalty to make the repair unavoidable for the service provider.

The Private Finance Unit (PFU) of the Department of Health told the members about standardisation of contracts, output specifications and payment mechanisms and guidance for the NHS. In this way Trusts can carry out the procurement process and sign financial closure to build a hospital of £125m to £150m within 2 years. The actual construction will generally take another 3 years. Under traditional public sector financing this process would take up to 15 years. The main risk of the traditional route is that public capital budgets become the first target for cuts and this constrains any project plans. By going to PFI Trusts can have an unfettered run through revenue.

PFU described the 3 stages of a PFI project as planning, procurement and construction. Experience has shown that there is investment in planning – becoming an informed purchaser, knowing what you want and addressing some of the detail – getting it right. Working up the business case and output specifications saves time and complexity in the procurement stage.

As part of the move to PFI, the PFU have established public sector comparator assessments which compare the original public sector solution to that offered by the PFI deal. Comparators show that in the PFI deals made so far, PFI is statistically cheaper or the same cost as publicly funded schemes over 60 years. The public sector comparator is based on Department of Health (DoH) guidance on the size of hospitals and £x cost per sq metre. The PFU team, DoH and NHS Estates and a quantity surveyor employed by the Trust examine the comparator to ensure that the number of beds and capital equipment is comparable in each option. Trusts use the details of the PSC as leverage in negotiations and use the PFU database for the same reasons.

PFU recognises that it must have a more sophisticated approach to marketing by managing the market on the basis of the whole of England. This leads to controlling the number of schemes going to tender at any one time to keep the market interested. The NHS approves schemes on a national basis through a monitoring committee called the Capital Prioritisation Advisory Group which assesses all schemes above £20m. It takes a volume of schemes the NHS believes the market can handle at any one point in time and monitors the number of schemes in the market place against the market's capacity to cope.

There has not been any PFI involvement in the provision of clinical services other than some separate small scale schemes in renal and scanning services. It is not current policy to include clinical services in PFI schemes.

RECORD OF AN INFORMAL BRIEFING ON PPP BY LEEDS COMMUNITY MENTAL HEALTH SERVICES TRUST, DEPARTMENT OF HEALTH PRIVATE FINANCE UNIT AND BRADFORD AND NORTHERN HOUSING ASSOCIATION

Thursday 3 May 2001
in Trust Headquarters, Meanwood, Leeds

Present:
Mr F Molloy (Chairman)
Mr J Leslie (Deputy Chairman)
Mr A Maskey
Mr S Large (Leeds Community MH Trust)
Mr R North (Leeds Community MH Trust)
Mrs S Watson (Leeds Community MH Trust)
Mrs S Stockley (Department Of Health PFU)
Mr B Turnbull (Bradford & Northern Housing Assoc)
Mrs P Partridge (Bradford & Northern Housing Assoc)

Members of the Committee for Finance and Personnel received an informal briefing from representatives from Leeds Community Mental Health Services Trust, Department Of Health Private Finance Unit and Bradford and Northern Housing on their experience of a PFI scheme for the provision of mental health services.

Leeds Community Mental Health Services Trust gave a presentation to the members on the background of the Trust and its services. The members were told that the Trust is part of the National Health Service and covers the geographical area of Leeds, which has a population of 750,000 people. The Trust has a budget of £100m and most of that comes from the local Health Authority in Leeds. Services provided by the Trust include a wide range of community and mental health services, including community physiotherapy, district nursing, health visiting and occupational therapy. In addition the Trust has a number of community and residential based learning disabilities and mental health services.

The members were told that services are provided from more than 100 premises in the city, some of which were very dilapidated and included 1950s and 1960s pre-fabricated buildings and Victorian age hospitals. Nine of those premises provided 700 in-patient beds, 650 of which were mental health beds.

Members were told that central to the scheme was the closure of the 19th century High Royds hospital (a Victorian institution) and the Roundhay wing of the St James's hospital which were completely inappropriate for modern mental health service delivery. In the early 1990s the Trust identified that it needed 18 separate capital schemes to re-provide these services. These schemes would mean decentralisation of services from one or two sites to several sites based in catchment areas for community based services. When that decision was made PFI did not exist and it was believed that it would take 10 years to gain traditional public funding for the scheme. Between 1995 and 1998 the Trust was able to build six of the 18 schemes it had identified through publicly funded schemes. Those schemes had received public approval during consultation in 1995. In 1996 the Department Of Health issued guidance on PFI to the effect that the choice of procurement route (between PFI and public funding) should be based on the fundamental criteria of value for money. Consequently the Trust had to re-think its strategy and examine the value for money of PFI as a means to procurement . It was decided that the Trust would not batch its remaining 12 schemes into one package but would initially place two of the schemes in a PFI deal. The remaining 10 schemes would form 1 PFI deal called "Omnibus". The members were told that the schemes included all non clinical support services.

The Trust told the members that initially the Department of Health Private Finance Unit had to concentrate on the bigger hospital schemes. The Leeds Community Mental Health Services NHS Trust were the first Trust to use PFI for such a large scale mental health scheme. For a number of reasons the scheme was novel and therefore its development took longer. The deal had taken five years from the initial consultation until it was signed in February 2000. The Trust recognised that in hindsight that the deal had taken longer than necessary due to an attempt to include some surplus NHS land.

The deal achieved was a 26 year contract with Bradford and Northern Housing Association to provide and operate the mental health facilities. At the end of the contract the Trust has the right to renew the contract with the same terms and conditions for a further 15 years and a further 10 years after that. The Trust also has the right to purchase the buildings from Bradford and Northern at their residual value. (The amount that the Trust pays during the contract reflects the fact that there is a residual value to the properties –i.e they pay less).

Bradford and Northern were responsible for the design, build and operation of the buildings in the scheme. One of the main risks transferred to B&N was the acquisition of land and planning permission for these new sites. The contract was drawn up in such a way as to ensure Bradford and Northern took these risks and had to find alternative sites within a certain timeframe if necessary. Usually the land is purchased and planning permission obtained prior to financial close. This and the fact that the scheme includes the sale of NHS owned sites to B&N made this a difficult scheme. For their part Bradford and Northern Housing Association have taken a different approach to their buildings by identifying possible other uses of the buildings such as residential, student or nursing home accommodation. This approach is more common with mental health schemes than large general hospitals.

For various reasons the surplus NHS land at High Royds hospital could not be included in the PFI scheme. This presented an affordability problem. Consequently, the Regional Office agreed to inject a bullet payment in lieu of the land. This enabled the Trust to get a cheaper scheme because financing costs are reduced. The Trust therefore put in place a structure that puts the bullet payment at risk if B&N fail to deliver on any of the facilities.

In response to a member's question about the limits of PFI use by the trust and flexibility in use of resources the members were told that although there were not many more large sites left in the trust which needed replacement there was still a massive need to improve the quality of the smaller community centres. As public capital was not available and these centres on their own were too small for PFI deals the trust may move forward in partnership with primary care trusts to package primary and community health care centres under the LIFT (currently being developed by PFU). In contrast to its current position of the Trust tying money up in maintenance and repair of 100-year-old buildings which have inappropriate facilities and which it cannot dispose of, the trust now has flexibility in the 26 year contract it has signed.

PFI is being extended to areas other than hospitals and larger buildings. The LIFT project will examine how to achieve affordable solutions by grouping General Practitioner premises for public private partnerships.

In response to a member's question Bradford and Northern described how much of its business was involved in PFI and how much further it could go, members were told that as a Housing Association it had been involved in private finance since the change to the Housing Act in 1988. B&N is not a special purpose vehicle and was financing the PFI scheme as a legal entity in its own right. This gave it access to finance without any major problems. The contract was financed by 100% debt and there was effectively no equity going into the deal. This was quite different from what the PFU had experienced in the health sector. At the equity was generally required to get an off balance sheet opinion. This is no longer the case. The association is a not for profit organisation. B&N did not encounter difficulties with funders because of its track record. B&N have signed up more PFI deals since its deal with Leeds Community Mental Health Services NHS Trust. The Association had reservations about the length of time taken to complete the deal because of the costs incurred. That would have a knock-on effect on deciding the number of substantial projects B&N could afford to be at risk on. Human resources were also stretched during this time.

The Association is regulated and although the capital cost of the Leeds Community Mental Health Trust deal is £47m and about 20% of B&N's business that did not present a problem to the Regulator. The Association had a turnover of £40m before PFI and is now worth some £250m.

Members were told that banks have a great appetite for PFI deals at present and regard housing associations as strong organisations backed up by Government. They were also told that the large international financial institutions have joined the big high street banks in PFI.

The members were told that the scheme involved considerable time and effort from the clinical services staff to make the partnership work. That involved training and joint preparation work to understand how the services working alongside them would operate and how monitoring would work. Those had been outweighed by the major benefits to the clinical staff being able to get involved in changes to design and better response times for maintenance issues.

The meeting concluded with members being told that both the trust and B&N considered that it was necessary for a trust manager who was experienced involved in operational management and delivery of clinical services to lead the project and be involved in negotiating the contract. The Department of Health had built up a bank of experience by forming a PFI unit and the staff there had developed standardised contracts and guidance and payment mechanisms which could be shared nationally. This had significantly reduced timescales and reduced but not removed the usage and costs of external advisers. The NHS recognised that it was hard to get managers involved in PFI because of the amount of time and effort it required. The PFU held forums where Trusts shared their experiences with others who have ongoing PFI schemes.

RECORD OF AN INFORMAL BRIEFING ON PPP BY PRICEWATERHOUSECOOPERS TO MEMBERS OF THE COMMITTEE FOR FINANCE AND PERSONNEL

Friday 11 May 2001
in Parliament Buildings, Stormont

Present: Mr Francie Molloy (Chairman)
Mr James Leslie (Deputy Chairman)
Mr Peter Weir
Mr Hugh Crossey (Partner)
Mr Nigel Middleton (Partner and Head of PPP)
Mr Colin Tenner (Director)

Representatives of PricewaterhouseCoopers (PwC) met with members of the Committee for Finance and Personnel on Friday 11 May 2001 to brief members on their firm's experience of Public Private Partnerships both locally and internationally.

PwC has been involved with the Treasury Taskforce developing Policy and Guidance on PPP. The company had also been involved in 17 of the 23 PPP transactions completed in Northern Ireland to date, 13 on the advisory side for the public sector and four on the bidder side.

PwC did not regard PPP as a universal panacea for addressing all aspects of the infrastructure deficit facing Northern Ireland. In addition, PwC consider that many of the issues associated with the delivery of PPP projects are not a reflection of the PPP process itself. Instead they are a function of the complex nature of the projects being undertaken and would still need to be addressed even under traditional procurement. Accordingly, PwC believe that in order to make a success of any project or procurement there must be:

- senior management commitment;
- stakeholder buy in; and
- the right skills and resources.

The experience of PwC in the Republic of Ireland was that a social partnership had been developed at a national level encompassing government, business interests and trade unions. This partnership is formally committed to the use of the PPP approach and may provide a useful model for Northern Ireland. Some work still needs to be done within the Republic of Ireland to secure commitment to the PPP approach at a local level.

In their submission to the Committee PwC had made a number of recommendations. These included making a Minister responsible for driving forward PPP and for developing the skills base in the public sector. PwC had recommended that the Minister should also ensure that a deal flow is established and that the momentum in relation to PPP is not lost (as it appears to have been at present).

PwC were asked about how roads could be delivered and paid for using PPP. PwC said that after initial investment by the private sector the payment options were broadly as follows:

- payment by road users (hard or real tolls);
- payment by government (shadow tolls or lane availability charges); and
- a combination of the above.

Real tolls were easier to introduce for significant new road schemes or networks (rather than existing roads) and where there was an absence of alternative routes or modes. However, in order to achieve this, a political and popular acceptance of tolling would be needed. Alternative sources of finance such as the European Investment Bank could be accessed to reduce the cost of private sector debt.

PwC were asked about their experience or knowledge of Not For Profit (NFP) companies and the use of bonds. PwC described profit as basically an additional cost and noted that profit was a feature of all PPP structures even those that claimed to be NFP. A good example of a NFP company in practice was Welsh Water. Bonds could be used to raise finance but they still involved interest and repayment and could have to be recognised on balance sheet. More fundamentally, however, PPPs are about securing better value for money and risk transfer, improving service quality, increasing competition and promoting accountability. They are not just about raising private finance. As such a bond arrangement is not likely to result in these benefits being realised.

PwC were asked about the readiness of the private sector and Government in Northern Ireland for an increase in PPP projects and if expertise in both sectors was being wasted or frustrated. The company said that building contractors in Northern Ireland were still active and where opportunities did not exist now these companies had looked to the Republic of Ireland and GB.

PwC said the key lessons that could be learned from the Republic of Ireland in relation to PPP were that: (a) political commitment was essential and had been enshrined in the Government's programme; (b) that a strong deal flow of some very big projects had been initiated concentrating in two or three core Departments; and (c) support from the social partners had been secured at a national level.

PwC noted that levels of enthusiasm for PPP varied within and across Departments and that where there was a deficit in the skill base it could be bridged through training and development so that the level of external support could be reduced.

PwC were asked how equality issues were addressed in PPP arrangements and if they led to two tier employment arrangements (i.e. different conditions for transferred public sector staff and private sector staff). PwC stated that recent PPP deals had learned from the past and issues like pensions where a gap existed had been bridged. The private sector and the public sector transferred employees had also learned that PPP projects could offer opportunities for upskilling and multi-skilling. For example, the Classroom 2000 project employees had been disappointed that their transfer had not gone ahead.

PwC also said that what happened in relation to staff would depend on the nature of each deal and its underlying objectives. In South Africa, for example, a PPP deal had been awarded that sought to maximise employment, although this came at a cost to Government. Alternatively, where efficiency is a key objective then this may lead to lower levels of employment, although this was usually now achieved by means of voluntary redundancies or natural wastage.

Discussion took place on general views of the PPP position in Europe and how it compared to Northern Ireland. PwC described how many countries had taken the decision to commence their PPP programmes in the utilities, transport and roads sectors with the award of concession contracts. In contrast the PPP projects undertaken within Northern Ireland had focused on the provision of social infrastructure such as education and health facilities. Some initial work had been undertaken in other sectors. For example, in December 1999 a report had been prepared for the Department of Regional Development looking at a wide range of PPP options for public transport. This report recommended the introduction of bus and rail concessions. Concessions could be for five to ten years and standards could be set and enforced locally, enhancing accountability.

In general PwC stated that the best PPP deals align interests so that efficiencies are shared and payment is performance driven. The mechanisms for payment should be transparent so that local representatives and communities can input into performance monitoring. Examples of good PPP projects can be found in the Scottish Water industry where responsibility for performance monitoring rests with the public sector and performance measurement is output let. These PPP deals involved the provision of infrastructure by the private sector and incentivised new investment. This contrasts with the Railtrack situation where there is a reduced incentive on the company to invest.

PwC were not aware of any major legislative difficulties in relation to the implementation of straight PFI or DBFO type transactions. However, PwC recognised that primary legislation would be needed to establish new structures and regulatory controls in sectors such as utilities and transport if other forms of PPP were to be undertaken (for example, concessions).

RECORD OF AN INFORMAL BRIEFING ON PPP BY NIPSA AND UNISON TO MEMBERS OF THE COMMITTEE FOR FINANCE AND PERSONNEL

Tuesday 15 May 2001
in Parliament Buildings, Stormont

Present:
Mr F Molloy (Chairman)
Mr J Leslie (Deputy Chairman)
Mr Peter Weir
Mr Jim Mc Cusker (NIPSA General Secretary)
Brian Campfield (Deputy Assistant Secretary)
Patricia Mc Keown (UNISON)
Thomas Mehaffey (UNISON)

NIPSA and UNISON representatives met with members of the Committee to brief members on their experience and views of Public Private Partnerships.

NIPSA referred to specific points made in its written submission to the Committee. It believed that the definition of the Public Sector Borrowing Requirement (PSBR) was out of step with the European Union and was inhibiting development. NIPSA believed that the Government should adopt the General Government Financial Deficit (GGFD) which is the European standard for measuring public sector borrowing. This would enhance the freedom to borrow for projects falling outside the GGFD. As payment for loans to finance projects was now calculated on an accruals basis the need for PFI was obviated. NIPSA also believed Regional Government should have access to capital and supported a revision of the Barnett Formula.

Addressing Value For Money (VFM) NIPSA called for more openness. NIPSA had found it difficult to comment on VFM because they had been refused information on the grounds that it was Commercial In Confidence. NIPSA also queried the shortlisting of prospective partners thereby reducing competition. It said that the Classroom 2000 and Electronic Libraries projects had failed because the short-listed prospective partners had withdrawn. During the Classroom 2000 project two of the prospective partners had withdrawn while the other two formed a consortium before also ultimately withdrawing. NIPSA said that years had been lost because the project had been handled in this way and by being overly reliant on a few companies it created a weak negotiating position for Departments if the objective of achieving a deal was pushed through. This basically meant that competition did not exist and therefore no assurance of achieving the best deal could be made. The Social Security Agency's prospective partners had also withdrawn leaving only one bidder.

NIPSA was concerned that the Public Sector Comparator did not establish a level playing field because the public sector must comply with human rights and equality issues under section 75 of the Northern Ireland Act while the private sector did not. NIPSA were also concerned with the degree of risk transferred.

NIPSA was also concerned with involvement of the private sector in providing public services using workforces outside Northern Ireland. NIPSA saw more and more use of IT enabling removal of jobs from Northern Ireland but in response to a question from a member it recognised use of IT was a double-edged sword. Evidence of this was recognised by the successes by the Social Security Agency and Child Support Agency in bringing jobs to Northern Ireland through relocated services. However, NIPSA had seen jobs removed through the Contributions Agency and pointed to Northern Ireland's share of centralised services in GB as an overall shortfall.

NIPSA pointed out that Transfer of Undertakings and Protection of Employment (TUPE) applies only on the day of transfer and it had its concerns for public sector workers if more were transferred into the private sector.

Transfer to the private sector produced a loss in democratic control for the provision of public services.

NIPSA recognised the social partnerships set up in the Republic of Ireland and said that there had not been much encouragement of this in Northern Ireland but it should be examined. It said that the comparisons were not the same as pay was a greater issue in the Republic than it was in Northern Ireland.

NIPSA said that it did not have particular problems with Not For Profit organisations using bonds to raise capital and said that this should be explored because public sector borrowing was still in Treasury's plans.

UNISON presented additional written material at the meeting – a document entitled "Public Services, Private Finance (Accountability, affordability and the two-tier workforce)". It also presented a press release by St Johns and Rosetta Residents Group regarding planning permission for the Northwin Consortium to build 400 dwellings on land owned by the Belfast Education and Library Board.

UNISON referred to its written submission which saw three fundamental flaws in the Inquiry's Terms of Reference (TOR). Firstly, it felt that the TOR should address succeeding generations and how PPPs may produce rigidity of contract. This could have an impact on the Government's ability to cater for changing public service requirements in the future. Secondly, it felt that equality issues were not properly addressed because of a lack of a specific reference. Finally, the term "customers" should be referred to as "service users" or "citizens" and "employees" and the impact of PPP on them should be specifically addressed.

UNISON referred to its experience of trying to establish terms and conditions for employees transferred to the private sector. It also discussed difficulties with services encountered following transfer of responsibility to the private sector. It held the view that PFI was not the route for investment in infrastructure and public services but it was not locking the door on innovative ways which provided VFM, accountability and affordability. UNISON wanted these issues addressed and clearly set out.

NIPSA concluded by saying that it recognised that the Civil Service had problems when it owns specialised buildings which had outlived their usefulness but the current system restricted what it could do about that. Public servants had no incentive to be creative about how they could maximise the value of public property. Public sector rules had got to be more flexible and one way would have been to allow reinvestment in Northern Ireland of capital acquired through property sales.

UNISON concluded by saying that it had not seen evidence in the public health or education sectors of greater efficiencies achieved by the private sector and said that Unions had a role to play but were not always given the chance. It would not rule out PPP if the rules are right and if greater transparency was produced.

Both unions requested formal evidence sessions.

APPENDIX 7

LIST OF MEMORANDA SUBMITTED TO THE COMMITTEE (UNPRINTED)

Category	Individual / Organisation
A	Gren Folwell
A	David Heald, University of Aberdeen
A	Des Mc Conaghy
CG	Office of the First Minister & Deputy First Minister
CG	Department of Agriculture
GBLG	London Underground
LG	Ballymena Borough Council
LG	Ballymoney Council
LG	Castlereagh Council
LG	Craigavon Council
LG	North Down Council
NDPB	Belfast Education & Library Board
NDPB	Greenpark HSS Trust
NDPB	Northern Ireland Ambulance Service HSS Trust
NDPB	Northern Ireland Water Council
NDPB	North & West Belfast HSS Trust
PS	Barclays Bank
rROI	Department of Finance
SDC	Chairperson Culture Arts & Leisure Committee
SDC	Chairperson Social Development Committee
U	National Association of Schoolmaster, Union of Women Teachers

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