MANAGEMENT PAPER

building for the future

the management of procurement under the private finance initiative

audit commission
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Introduction

Why has this paper been written?

1. Public Private Partnerships (PPPs) are a key element of the Government’s strategy for delivering high quality, modern public services. PPPs range from joint ventures to outsourcing and the sale of equity stakes in state-owned businesses, but the Government has particularly encouraged public sector bodies to procure assets and services through a form of PPP known as the Private Finance Initiative (PFI).

2. In September 1998, when the Audit Commission published *Taking the Initiative; A Framework for Purchasing under the Private Finance Initiative* there were no significant completed PFI schemes in the NHS or local government [Ref.1]. *Taking the Initiative* focused on the control framework required to protect public funds where organisations enter into substantial commitments for the procurement of services and the use of associated capital assets over several decades.

3. More than two years later, many local authorities and health bodies have extensive experience of the practical aspects of PFI deals. In England and Wales, health service contracts with a total capital value of £4.6 billion are at various stages of completion and six major hospital schemes were operational by the end of May 2001. In local government approximately 160 schemes are in procurement and the Government is committed over the next three years to supporting, through its credit approval mechanisms, local authority PFI deals valued in total at over £4 billion.

4. This paper draws out some useful lessons from schemes in health and local government that have reached contract closure, but neither endorses the PFI nor questions the fundamental assumptions underlying it. It is too early to say whether PFI contracts generally offer the public sector long-term value for money in terms of service delivery. A conclusion will only be possible when post-implementation reviews of operational contracts are carried out and the cost of services procured under the PFI is compared with similar PFI contracts, as well as those procured by other means.

5. The PFI is not an easy option. The procurement process is long and complex and requires a great deal of senior management time, which can have adverse effects on existing services. Schemes can generate significant opposition from staff and local people and may fail on the grounds of affordability or as a result of concerns about the value for money offered over the life of the contract. However, many public sector bodies have negotiated successful PFI deals and children are being educated and patients treated in new facilities designed, built, financed and operated by the private sector.

For whom has this paper been written?

6. *Taking the Initiative* was aimed at local authority councillors, chief officers and NHS board members, and considered the strategic and control issues that had to be addressed to ensure the proper control of a PFI procurement. This paper looks at the strategic aspects of PFI, but also considers the practical project management issues that are raised by this form of procurement. This paper is designed to be of use to hard-pressed PFI project managers who are probably in the middle of the most arduous and pressurised procurement process they have experienced in their working lives. The paper
should also be of use to prospective project managers, as well as to councillors, board members and chief officers who have ultimate responsibility for the successful conclusion of PFI deals.

How should this paper be used?

7. This paper is designed for organisations that are currently procuring assets and services under PFI, or who may be contemplating the use of this form of procurement. These are described as ‘purchasers’ or ‘clients’ or ‘commissioning bodies’ in the remainder of this paper. Those providing assets and services are referred to as ‘providers’ or ‘contractors’ or, in some cases, ‘consortia’. Key points raised in the paper are summarised at the end of each chapter and advice from experienced project managers and advisers is included at Appendix 3.

8. The PFI is only one of several possible methods of procuring assets and is often used following a strategic review of capital investment requirements and asset management planning. The Audit Commission has carried out a number of pieces of work on these issues: Just Capital: Local Authority Management of Capital Projects (1996), Rome Wasn’t Built in a Day: A Management Handbook on Getting Value for Money from Capital Programmes and Construction Projects (1997) and Hot Property: Getting the Best from Local Authority Assets (2000) (Refs 2, 3 and 4).

9. Readers wishing to know more about the mechanics of PFI should refer to guidance produced by the Department of the Environment, Transport and the Regions (DETR), the Department of Health (DoH), the former Treasury Taskforce (now Partnerships UK or PUK), the Office of Government Commerce (OGC) and the Public Private Partnerships Programme Ltd (4Ps).

10. The paper uses case studies drawn from actual schemes to illustrate good practice or key issues. These practices should not be taken as the recommended, or only, approaches to particular issues and are not in any way endorsed by the Audit Commission as being universally appropriate.

The research behind this paper

11. The project team visited ten completed schemes in the local government and health sectors within England and Wales, and one NHS scheme in the early stages of negotiation (Appendix 1). The purpose of these visits was to record the practical experiences of project managers in dealing with every aspect of the PFI and to collect comparative data where possible. Discussions also took place with external auditors, financial advisers, contractors and other key players, including DETR, the DoH, HM Treasury, the 4Ps, and Partnerships UK. The project team was guided by an Advisory Group for whose assistance the Audit Commission is grateful (Appendix 2). The Audit Commission would also like to thank those officers at the field sites who gave up their valuable time to pass on their considerable expertise to the project team. We are also grateful to Grant Thornton, PricewaterhouseCoopers and Abros for their assistance during the course of the review. Responsibility for the contents of this paper, however, rests solely with the Audit Commission.
The structure of this paper

12. Section 1 sets out the key features of the PFI, including the principles that underpin PFI contracts, the procurement process and the differences and similarities between the local government and health sectors in their approaches to PFI. Section 2 then considers how commitment to the project can be generated by strong leadership, motivated and skilful project staff, and the early involvement of stakeholders.

13. Section 3 reviews the specification of long-term service requirements and Section 4 considers how purchasers can demonstrate that PFI deals meet best value requirements. This is an issue that is applicable to both sectors, given that the NHS performance framework described in the NHS Plan (Ref. 5) and in the NHS Plan for Wales (Ref. 6) is consistent with the principles of best value.

14. Section 5 considers risk allocation and value for money, while Section 6 looks at the length of the contracting process and considers ways in which purchasers can maintain competitive pressures. The need for experience and expertise to be shared is considered in Section 7, while a short concluding section brings together the paper’s key messages.
15. The Government is committed to encouraging continuing collaboration between the public and private sectors, and the term Public Private Partnerships (PPP) is used to describe a range of practical relationships between the sectors that have varying degrees of formality and differing legal or commercial foundations. In its broadest sense, PPP encompasses voluntary agreements and understandings, service level agreements, outsourcing and the PFI.

**PFI fundamentals**

16. Traditionally, public sector bodies have procured new assets – for example, roads, schools, hospitals, vehicles and plant – separately from services. They have delivered the associated services either using their own workforce, or by ‘outsourcing’ or ‘contracting-out’. The latter has become more common over the last two decades as organisations have searched for ways to improve efficiency and make the best use of resources. The PFI offers a radically different approach to traditional procurement in that the purchase of major assets and associated services is accomplished within one long-term contract, under which the initial capital outlay is financed by the private sector [BOX A].

17. One of the key objectives of the PFI is to bring private sector management expertise, and the disciplines associated with private ownership and finance, into the provision of public services. If the PFI is to deliver value for money to the public sector, the higher costs of private finance and the level of returns demanded by private sector investors must be outweighed by lower design, construction, management and operating costs. PFI contracts seek to achieve this through the application of four fundamental principles [EXHIBIT 1]:

- **output specifications** – commissioning bodies should concentrate on specifying the outputs expected from a contract, not on how these outputs should be delivered;
• **appropriate risk allocation** – risks, such as demand, construction and financial risk, should be allocated to the party best able to manage them;

• **whole life performance** – there is an understanding that the commitment of the private sector should be long-term; and

• **performance-related rewards** – contract mechanisms should provide for commissioning bodies to make payments to providers that are based on results.

18. Because PFI contracts combine so many complex elements and commit bodies to paying for services over a long period of time, they represent a significant challenge to the negotiation and project management skills of the commissioning body. The focus on outputs rather than inputs gives bodies the opportunity to carry out fundamental reviews of the services to be provided from assets procured under the PFI. In addition, payment systems can be designed to ensure that there is a clear link between service quality and rewards. Above all, bodies must remember that they remain accountable for the quality of services provided by schemes procured through the PFI, and cannot delegate this responsibility to their private sector partners.

**The procurement process**

19. Local authorities and health bodies follow the negotiated tendering procedure allowed under European Union public procurement rules [EXHIBIT 2, overleaf].
20. The key feature of this form of procurement is the period of negotiation with the preferred partner prior to the closure of the contract. This stage allows both parties to finalise detailed aspects of the contract, but the process can be protracted and public bodies need to be aware of the impact of delays on the overall cost of procurement. This is considered in more detail in Section 7.

The scale of the PFI

21. In England there are 148 approved health service PFI schemes with an approximate capital value of £4.5 billion. At the end of May 2001, six major capital projects with a total capital value of £423 million were in operation and a further 17 schemes (with a total capital value of £1.6 billion) were under construction. In Wales, six NHS deals with a total capital value of £105 million had been signed by the same date. The total capital value of major, publicly-funded NHS schemes in England that were approved between May 1997 and May 2001 was only £172 million.

22. There are also approximately 150 approved local government PFI schemes in England. Information on the total capital value of these schemes is not collated by the relevant central government departments, but the spending review announced by the Government in August 2000 indicated that a total of £4 billion in additional PFI credits (see paragraph 31) would be made available to support local authority PFI schemes in England in the years 2001/2002 to 2003/2004. In Wales, there are 13 approved local government schemes with a capital value of £280 million.

23. While this represents a significant increase in resources, local authority capital investment from traditional sources in 2000/2001 alone was approximately £8 billion. The PFI is, therefore, not the dominant method of procurement in local government that it has become in the NHS. Nevertheless, local authorities are continuing to prepare innovative schemes for submission to the DETR and other sponsoring departments, and the availability of PFI credits on a large scale will act as a significant incentive for those authorities that have not considered procurement through the PFI.
Accounting for the PFI

24. The accounting treatment of PFI schemes is of critical importance to purchasers. The inclusion of PFI property assets on an NHS Trust’s balance sheet increases capital charges and thereby the level of income needed for the Trust to meet its financial targets. In England, the recognition of assets by a local authority means that it has to find capital resources to meet the costs of the PFI contract. In both sectors, PFI contracts may fail if assets have to be recognised by the purchaser.

25. The accounting treatment of PFI transactions has been the subject of extensive guidance in recent years. In September 1997 the Treasury issued interim accounting guidance pending the publication of guidance from the Accounting Standards Board (ASB). This was issued in the form of an Application Note to FRS 5 ‘Reporting the Substance of Transactions’ in September 1998 (Ref.7). It was followed in 1999 by publication of revised Treasury accounting guidance designed to ensure that the principles of Application Note F are consistently applied by relevant public sector bodies (Ref.8).

26. Treasury guidance is careful to emphasise that the objective of PFI procurement is to provide high quality public services that represent value for money for the taxpayer. The accounting treatment of a scheme should not be the key issue in deciding whether a project should go ahead or not and purchasers should not transfer risks to the operator to achieve a particular accounting result at the expense of achieving value for money.

27. In both sectors, the balance sheet treatment of assets, and the external auditor’s view on the reasonableness of the proposed accounting treatment, are also factors that are taken into account by Government departments in determining whether PFI schemes should be approved. Local authorities and health bodies should work closely from the outset with their financial advisers and external auditors to ensure that the accounting treatment of PFI contracts is consistent with the risks assumed by both parties to the contract, and that the risk allocation is consistent with the achievement of value for money. Risk allocation is considered further in Section 5, and the role of auditors discussed in more detail in Section 7.

Local government approval mechanisms

28. If English local authorities wish to receive revenue support for the cost of PFI deals, they must submit schemes to the relevant sponsoring government departments for approval. There are four main factors that authorities have to take into account when preparing their submissions:
- value for money;
- the requirements of the capital finance regulations;
- the Government’s national policy objectives; and
- the project assessment considerations of the Project Review Group (PRG).

29. Local authorities should subject PFI schemes to a rigorous value-for-money assessment in the context of a wider options appraisal. Although it is not mandatory in local government, authorities are expected to forecast the whole life costs and benefits of all realistic options and to prepare a public sector comparator (PSC). The options appraisal should be included in the Outline Business
Case (OBC), which can be prepared with the assistance of the 4Ps. Some schemes may be self-financing, and in these circumstances there is no requirement for the authority to submit the scheme for approval.

30. In cases where funding is sought, sponsoring departments scrutinise the OBC and supporting documentation and – if they are satisfied that the scheme offers value for money, is affordable and is consistent with national policy objectives – will refer it to the Project Review Group (PRG). The PRG is chaired by the Office for Government Commerce (OGC) and attended by representatives from the 4Ps. Projects endorsed by the PRG become eligible for revenue support.

31. Revenue support is provided by the allocation of notional credit approvals or notional supplementary credit approvals (PFI credits). These credits generate revenue support for the capital element of the unitary charge through the Standard Spending Assessment (SSA) mechanism in the same way as traditionally procured capital schemes. The revenue element of the unitary charge relating to payments for services has to be financed from existing resources.

32. Similar approval and financing mechanisms apply in Wales, although the accounting treatment of schemes is not relevant for capital financing purposes. The National Assembly for Wales has its own internal equivalent of the PRG and authorities must obtain approval for their provisional and final OBCs before proceeding to OJEC.

**NHS approval mechanisms**

33. Sponsors of NHS schemes have to follow many of the same processes and contractual stages as their counterparts in local government, but the mechanics of approval for proposed schemes differ. NHS schemes, for example, are not scrutinised by the PRG but the preparation of a PSC is mandatory, as is compliance with Treasury guidance on accounting for the PFI. NHS bodies are generally expected to meet the costs of PFI contracts from existing resources, although additional funds may be made available in some circumstances.

34. NHS bodies must make the strategic case for change and appraise their options. For schemes under £20 million in value, the OBC is submitted to the DoH Regional Office. For schemes over £20 million in value, a Strategic Outline Case (SOC) is submitted to the Capital Prioritisation Advisory Group (CPAG). Proposals for major schemes are prioritised nationally on the basis of health service need, and only prioritised schemes proceed to procurement. In Wales, the National Assembly is responsible for the approval of schemes with a capital value greater than £2 million and all bodies with schemes above the threshold have to produce a Strategic Outline Case.

35. Once the strategic case has been made, the next stage is to carry out an investment appraisal and so identify a preferred option for approval. The approval process is rigorous, and approval does not mean that the scheme will proceed to contract close. Progress on all approved schemes is monitored by the DoH and the National Assembly and significant concerns about value for money and/or affordability can lead to the withdrawal of support at any stage of the procurement process.
KEY FEATURES OF THE PRIVATE FINANCE INITIATIVE

KEY POINTS

● The PFI offers a radically different approach to the procurement of assets and associated services and represents a significant challenge to the project management skills of health service and local government purchasers.

● The PFI is firmly established in both the health service and local government – the combined value of schemes in procurement is approaching £10 billion.

● The purchaser remains accountable for the quality of services provided under the scheme – it cannot delegate this responsibility to its private sector partners.

● Accounting considerations are important, but they should not be allowed to distort or compromise the principle of achieving value for money.

● There are rigorous approval processes in the health and local government sectors to help to ensure that proposed PFI deals are consistent with national policy objectives and offer value for money to the public sector.
2. Commitment and leadership

Vision and purpose

36. Commitment is crucial to the success of PFI schemes. All potential purchasers should consider how they can best foster real commitment for the project by demonstrating a clear purpose and a vision of the desired outcomes from the scheme. The field visits demonstrated that PFI schemes in local government benefit from strong direction and firm commitment from elected members. While NHS bodies are, to varying degrees, directed by central government to prepare schemes that are consistent with the achievement of national policy objectives, local commitment and vision is also critical to the success of the PFI in the NHS [CASE STUDY 1].

37. Commitment comes from a strong and consistent view of the future shape of the services that the PFI scheme will help to deliver. As well as being crucial to the construction of output specifications, a clear purpose also helps authorities through the detailed and lengthy PFI procurement process.

CASE STUDY 1

Local vision and commitment

Essex County Council – A130 road development

The idea for a new road in Essex had been a long-term top priority of the County Council. As early as 1980, road network inadequacies were being seen as an obstacle to economic development in towns in the south of the county, mainly because of the poor links to the North Sea ports. The proposal to construct the new road received strong cross-party support and meant that the project manager could concentrate on the PFI procurement process in the knowledge that elected members – irrespective of their political party – were fully supportive of the scheme’s objectives.

Chepstow Community Hospital

Chepstow Community Hospital was designed with the stated objectives of Gwent Health Authority in mind – the major purchaser of the services provided by the trust that negotiated the deal:

‘The Gwent HA… envisages a network of neighbourhood health units (NHUs) of which Chepstow Community Hospital is the first. It sees these as being founded on “people centredness and resource effectiveness”. NHUs are to operate as a focal point for primary care, but should provide a range of more accessible diagnostic, therapeutic and treatment services previously only available in District General Hospitals. The Gwent HA has a vision to bring services closer to the people, where it is clinically and managerially safe to do so’.

Source: Audit Commission

Working with the private sector

38. PFI schemes may last for 30 years or more. Given the potential length of involvement, evidence of commitment is needed from both the purchaser and the contractor. The PFI is not just about commitment to a business relationship. A private sector consortium that is bidding to play a part in any local service will have a better chance of success if it has a clear understanding of the culture and practical politics of the purchasing body.
39. At the start of the process it is important that both sides work hard to understand each other and that they ascertain that there is scope for a constructive long-term partnership. Political leaders, board members and senior officers should be expected to make time to demonstrate their commitment to senior executives and decision-makers within bidding consortia.

Management structures

40. Project managers need to have delegated authority to make decisions as necessary – there has to be free movement of information between members and officers. In some projects delegation can be achieved relatively informally through agreements between those ultimately responsible for corporate direction (councillors, board members and senior officers) and those charged with implementing a PFI scheme (normally an officer-led project team).

41. In larger schemes, project boards are more likely to be used formally to direct the PFI procurement. The composition of these boards is critical because of their important role in bringing key stakeholders into the procurement process. Organisations must also carefully consider how project boards fit into existing decision-making structures and how they relate to the project group that is charged with delivering the PFI scheme [CASE STUDY 2].

42. Although commissioning authorities are generally aware of what is needed in a team to deliver a PFI scheme, internal inertia can prevent the right organisational and decision-making structures being developed to support effective PFI procurement. Failure to put the correct structures in place can have a significant impact on the procurement process and purchasers should be aware of the critical importance of this aspect of the PFI.

CASE STUDY 2

Management structures

Central Manchester Healthcare NHS Trust and Manchester Children’s Hospitals NHS Trust

This scheme involves the merger of the Manchester Children’s Hospital and the Manchester Royal Infirmary and the construction of one new hospital serving the health needs of all sectors of the community. The scheme has a capital value of £250 million and overall control of the project is vested in two project boards, each of which meets monthly:

• the Strategic Board is chaired by an officer from the Regional Office of the DoH, and includes board members and senior officers from the two trusts involved, as well as the health authority, primary care trust and the University; and

• the Project Board is chaired by the Central Manchester Healthcare Trust’s Chief Executive, supported by other senior officers from both Trusts. The Project Board determines the activities and the timetable of the Project Director, the Project Finance Director, the Project Manager and the rest of the team operating within the PFI Project Office.

Source: Audit Commission
Staff commitment

43. As well as gaining the necessary strategic and senior level support from political leaders and policy makers, PFI deals benefit from the early involvement of staff and trades unions. The interests of staff are particularly critical given the huge uncertainties generated by potential transfers to the private sector, and the threat of industrial action is a risk that organisations must manage if they are to succeed in delivering a workable PFI scheme. Staff are also a vital source of information for output specifications, and many of the schemes visited had developed imaginative ways of involving staff at every stage of the procurement process [CASE STUDY 3, overleaf].

Community involvement

44. The interests of the potential users of services that are procured under the PFI can be neglected, and there is often a tendency to adopt an insular, managerial approach to PFI. This is a natural reaction to the complexities of this form of procurement, but community involvement in proposed PFI schemes is becoming a critical issue as local opposition to some PFI deals has intensified. Local people care about the future shape of public services, and the provision of health services is a particularly emotive issue in many areas.

45. Purchasers have begun to recognise the importance of gaining the commitment of the local community to proposed PFI deals through consultation with local groups and the involvement of community representatives on steering groups and project boards. There are also some excellent examples of promotional literature that simply and clearly explain the benefits that the proposed schemes will bring to local communities (see opposite).

Project resources

46. Management quality and motivation are key determinants of a scheme’s success and, almost without exception, the schemes visited during the review benefited from high quality project managers. However, the evidence also shows that purchasers consistently underestimate the ‘client-side’ resources that are required to manage the procurement process. Attempts were made at one field visit site to share project management responsibilities between two officers, but in every other case the management burden was left with one person. In one instance the project manager commented that ‘the Trust had anticipated the client-side staffing problems – but had not resourced them’.
47. It is important, therefore, that purchasers undertake an appraisal of the strengths and weaknesses of their ‘client-side’ resources. They should ask themselves whether they have:

- strategic thinkers who are able to see the potential improvement in a service area and how this might be achieved with a privately operated scheme;
- a project manager with the skills, drive and commitment to convert that strategic vision into a practical PFI scheme;
- financial expertise to establish the business case and understand the costs of each of the components within the proposed scheme;
- legal support to deal with the details of the contract documentation;
- skilled negotiators who are competent to bring the scheme to a satisfactory conclusion; and
- contract managers to check that once the scheme is operational, it delivers services as intended.
48. It is likely that most authorities will require external help, but this will be influenced by the availability of in-house resources. Those preparing for the PFI should assess their own in-house skills objectively and honestly. It should not be assumed that because the purchaser is large it is adequately represented in each skill area. Nor should it be assumed that because a purchaser is small it will struggle.

CASE STUDY 3
Generating staff commitment

**Stoke City Council – Schools Refurbishment**
This refurbishment project affected all LEA schools as well as independent, voluntary-aided church schools. ‘Stakeholder days’ were arranged for governors, unions and head teachers and all schools were regularly updated through evening meetings and briefing pamphlets.

**Ceredigion County Council – Penweddig School**
The headteacher at the school helped to specify the school’s functional requirements, and was an active and influential member of the scheme’s Project Board during the commissioning process.

**Gwent Healthcare NHS Trust – Chepstow Community Hospital**
The Chepstow scheme involved the transfer of 43 staff to a private operator in order to demonstrate risk transfer and value for money. The Trust was wary because it had little experience of outsourcing prior to the PFI deal, and there was some trade union opposition to the transfer of staff. In the event, only two of the transferred staff left their employment in the twelve months after the hospital opened and all staff have benefited from a much improved working environment. One of the key features of this scheme – from an early stage – was the opportunity for staff to visit and look around the new hospital building. The project manager said:

‘As far as I know, pretty well everyone who will be working at the hospital has come around on more than one occasion to see it develop – from board members to nurses, cooks and porters.’

*Source: Audit Commission*
KEY POINTS

- Commitment is crucial to the success of PFI schemes in the health service and local government.

- Purchasers must have a strong vision of what they want from the scheme and must communicate that vision to key stakeholders.

- Politicians, board members and senior officers must work hard to foster a constructive, long-term partnership with the private sector provider.

- Project management structures must be appropriate to the needs of the purchaser and must fit into existing decision-making structures.

- The support of staff and trade unions is vital given the huge uncertainties that can be generated by PFI schemes.

- Purchasers must adopt an open approach to PFI schemes and encourage community involvement at every stage of the procurement process.

- The quality of the project manager is crucial to the success of PFI deals.

- Purchasers must be realistic about the resources required to complete PFI deals.

- Prospective purchasers should test their own ‘fitness’ by carrying out a full appraisal of client-side strengths and weaknesses.
3. Specifying long-term service requirements

49. Long-term planning of services and associated assets is difficult, but this is true irrespective of the method of procurement. All capital acquisitions raise questions about the strategic value of an asset – the specific issue with the PFI is that it also raises long-term questions about how the asset will be operated. Although public authorities have considerable experience of the procurement of assets such as buildings, hospitals and roads, they have less experience of committing themselves to long-term contracts for the provision of services associated with those assets.

Planning in a changing world

50. Most PFI deals currently under negotiation are expected to operate until 2031 at least. Inspection of just three demographic and social changes that have occurred over the last 30 years gives a first impression of the scale of the problem of dealing with potential changes in service needs for the next three decades. Since 1971:

- the UK population has increased by almost 7 per cent, from 55.9 million to 59.6 million in 2001;
- the very old – those over 85 – have tripled in number from approximately 400,000 in 1971 to 1.2 million in 2000; and
- the number of children living with a lone parent has almost tripled from 8 per cent to 21 per cent in 2000.

51. These changes are actually easier to predict than other events that change the way that services are delivered. The same three decades saw important developments in the organisation of local government and health services, with at least one reorganisation of local government in each decade. The National Health Service experienced major upheavals in the 1990s with the introduction of:

- community care;
- NHS Trusts;
- the internal market (subsequently dismantled); and
- the NHS Plan and the NHS Plan for Wales.

52. It is also particularly difficult to plan for the delivery of health and social services. Although it is expected that these services will have to work with and for an increasingly older population, and that their expectations for service quality are likely to increase, it is not known with any certainty:

- how health care will be shared between the NHS, the privately funded sector and local authority social services;
- what care will be handled in community and intermediate settings; and
- how responsibilities will be allocated between medically trained staff and others with a more general care qualification.

53. While events such as local government and health reorganisation can be seen as political choices, others, such as the development of new technology and the emergence of new diseases (as well as new cures), are less predictable. PFI schemes negotiated within the health service have to take on board these uncertainties.

54. For example, a hospital may be commissioned in 2001 or 2002 to support a trust’s objectives to perform 5,000 operations and 10,000 surgical diagnostic episodes per year. The PFI deal will probably involve operating theatres and diagnostic rooms being serviced and maintained by the contractor, who is likely to base costings (and
therefore charges) partly around the level of work done in the rooms.

55. If over the next 30 years surgical practices change as they have in the last 30 years – in 1971 there was practically no day surgery and very limited use of scanning and imaging technology – the commissioning trust needs the flexibility to re-negotiate fees with the contractor. If it cannot re-negotiate, it will be left operating a facility with outdated practices and methods – the reverse of the leading-edge thinking that the private sector is expected, through the PFI, to bring to the public sector.

56. In some areas of local government and the NHS, particularly in those functions dominated by information and communications technology (ICT), purchasers have been cautious in establishing PFI deals. The pace of change in the ICT industry is such that PFI contracts in this sector are typically limited to seven years.

**Contract review**

57. To allow for change, purchasers should specify that the design of assets allows for some operating flexibility and contracts should include clauses allowing purchaser-generated service changes. Contracts should also provide for any proposed increases in the unitary charge arising from service changes to be tested against prevailing market rates. Some contracts provide for the regular review of ‘soft’ services in addition to one-off changes and this is good practice to ensure that contracts offer good value for money.

58. PFI contracts must also be clear about how changes in service initiated by the contractor are dealt with. These changes may result in a better service being delivered within the same unitary charge, but in some cases the contractor will be able to deliver the same service more cheaply and a reduction in the unitary charge may be agreed. Purchasers should recognise the need for incentives to encourage contractors to innovate. They should also appreciate that it is generally counter-productive to insist that all benefits are taken by the purchaser under these circumstances.

59. Most of the schemes studied included some provision for the regular review of ‘soft’ facilities management services. For example, in the Leeds mental health scheme there is provision for annual renegotiations to achieve cost savings, and market testing of hotel services every five years, with potentially all gains going to the Trust. In this case the providing consortium makes comparisons with the cost of services delivered elsewhere but is only allowed to pass on cost savings; it cannot raise its unitary charge.

60. In the health sector, there is also a developing tendency, at the negotiation stage, for clients to specify possible growth scenarios and for bidders to say what the extended facility would cost to build and operate – a practice that could be applied in the future more generally to local authority schemes. In this way the commissioning authority writes into the PFI contract the right to require an expansion of facilities at a fixed and known cost, with the contractual agreement that any extended facility will be accommodated by the contracting consortium without both sides
having to go through a second, full negotiation process.

**Outputs, inputs and imagination**

61. Authorities that are commissioning through the PFI have to make their best attempts to accommodate future changes in demand. As the contract specification is the starting point for inviting tenders, it is important that it is written clearly and helpfully by the purchaser. Effort invested in establishing strong project foundations – within an inevitably uncertain environment – is likely to pay dividends later.

62. One of the key features of PFI schemes is that purchasers should concentrate primarily on what is wanted of a scheme rather than how it is to be operated. Care needs to be taken not to over-specify; it is important to keep the specification simple, and to expect the provider to work out how to make the scheme achieve its objectives.

63. Although all NHS PFI schemes feature output specifications, not all of the early NHS schemes fully adopted this approach – some trusts maintained significant influence on design and architectural issues. This was justified on the grounds that the private sector bidders had little experience of designing hospitals and were not always capable of coming up with workable design solutions to an output specification.

64. This may have been a rational response to the market conditions that existed five years ago, but the DoH was keen to ensure that subsequent schemes – frequently referred to as ‘second-wave’ – used output specifications. The danger in following an input-based approach to specification is that purchasers may be cautious and miss opportunities to explore new designs and working methods, which could, in turn, offer improved service delivery opportunities and/or lower operating costs. Over-specifying also makes it harder, when choosing between contractors, to distinguish those that can competently follow an established formula from those that can create more imaginative solutions. The intention of the PFI is to encourage the latter.
KEY POINTS

- Planning, and contracting for, the long-term provision of services is inevitably difficult – and in some sectors more difficult than others.

- Purchasers should produce output specifications and should not involve themselves in architectural design beyond stating that the design must be flexible.

- Any proposed increases in the unitary charge arising from purchaser-generated service changes should be tested against prevailing market rates.

- Contracts should be clear about how potential gains arising from contractor-generated service changes are to be shared.
4. PFI and performance management

65. Under the Local Government Act 1999 (Ref.9), best value authorities must comply with the general duty of best value and make arrangements to secure continuous improvement in the way that their functions are exercised, having regard to a combination of economy, efficiency and effectiveness. All authorities must carry out best value reviews of their functions over a five-year cycle and, in carrying out these reviews, they must:

- **challenge** the fundamental basis of service provision;
- **demonstrate** that the service is **competitive**;
- **consult** with the local community and ensure that their aspirations are reflected in future priorities and targets for service improvements; and
- **compare** service performance with the standards achieved by other organisations in the public, private, and voluntary sectors.

66. The statutory duty of best value is not applicable to the NHS, but the NHS Plan and the NHS Plan for Wales anticipate the development of a new system of health care that is much more patient-centred than the existing system (Refs 5 and 6). In meeting the considerable challenges of implementing these reforms, trust boards and NHS managers will have to adopt the principles of best value, even if it is not a statutory requirement. The messages contained in this section are therefore just as relevant to health bodies as to local authorities.

### Challenge

67. In meeting the challenge requirement, purchasers must ask fundamental questions about why a particular service is being provided and how it could be provided to a higher standard than is currently being achieved. In some areas purchasers have a statutory duty to deliver services, and the challenge lies in reviewing how continuous service improvements can be achieved over the medium to long term.

68. In carrying out an option appraisal, deciding that PFI represents a realistic option and embarking upon the PFI procurement process, purchasers have already challenged the fundamental basis of service provision. Furthermore, the use of output specifications forces purchasers to review desired service outcomes and challenges contractors to come up with innovative new ideas to deliver services.

### Competition

69. Purchasers must demonstrate that services are competitive, and they may do this by subjecting them to a competitive tendering exercise. PFI schemes follow the negotiated tendering procedure allowed under European Union public procurement rules. This provides for significant competition up to the selection of the preferred bidder, and authorities using the PFI to deliver services may justifiably claim at contract completion that they have followed the principle of competition.

70. In the longer term, best value purchasers need to demonstrate that the long-term service contracts negotiated under the PFI continue to be competitive when compared to similar contracts operated by other public or voluntary sector bodies, or by private sector companies operating in similar market-places. The evidence from the study sites is that the market-testing of services within PFI contracts is common, but one authority visited commented that
‘had BV been around sooner, the market-testing element of the contract would have been strengthened’.

Consultation

71. The need for local communities to be committed to PFI schemes has already been emphasised. Consultation plays a key role in fostering that commitment in the early stages of the procurement process. Prospective purchasers in the health and local government sectors may wish to refer to the Commission’s management paper Listen Up!: Effective Community Consultation (1999) (Ref. 10). It includes advice on how to conduct consultation exercises and ensure that the results are used to generate service improvement.

72. Consultation is also an important feature of ongoing service delivery, and provisions requiring contractors to consult with users have been built into some contracts. This is not the norm, however, and our field visits demonstrated that the general performance of existing local government PFI contracts in meeting the best value consultation requirement could best be described as ‘mixed’.

73. There are two options for organising consultation with service users: it can be done either by the contractor or by the purchaser. It makes sense, in some cases, for the contractor to take market soundings of customer satisfaction. A good example is the provision of school meals within a schools PFI contract, where a contractor might be expected to test, from time to time, pupil satisfaction with menus and to respond to the results by changing the service delivered to the customer.

74. In other cases, the purchaser may wish to carry out a consultation exercise with a wider scope than the services covered by a PFI contract. Under these circumstances, it would not be feasible for the contractor to carry out this exercise, but under both scenarios purchasers must ensure that the PFI contract gives them the flexibility to use the results of consultation to change the level of performance required of the contractor.

Continuous service improvement

75. The PFI has been introduced in the public sector partly on the grounds that the private sector has the project management skills to deliver capital projects on time and within budget, as well as the general management skills to operate long-term service contracts more economically, efficiently and effectively than their public sector counterparts.

76. At the very minimum, purchasers must ensure that PFI contract terms require contractors to deliver levels of performance that enable them to demonstrate compliance with relevant statutory performance indicators, targets and standards. Purchasers may also set local performance standards and measure continuous service improvement by referring to benchmarking data from comparative organisations. These requirements should also be included within PFI contracts.

77. Purchasers should also expect contractors to deliver measurable improvements in service quality over the life of a long-term PFI contract. They should be careful, however, to establish prior to closure of the contract that the costs of requiring contractors to bear risks associated with the achievement of rigorous performance targets are not likely to outweigh the benefits.
78. The evidence from the field visits is that some local authorities are including challenging performance targets in PFI contracts. For example, Stoke City Council requires the contractor for its schools PFI deal to improve school energy efficiency by 25 per cent over the life of the contract, and payment mechanisms are linked to the achievement of this target. Incentives like this should become a common feature of PFI contracts as best value authorities grapple with the need to reconcile long-term service contracts under the PFI with the principle of continuous service improvement.

79. Initiatives to incorporate service improvement in PFI contracts are not confined to local government. In the Chepstow Community Hospital scheme, the contracting consortium is required to benchmark domestic services every five years, and each year the consortium is required to produce a plan proposing how it intends to improve its service delivery in the following year. This is good contracting practice and all public sector organisations should seek to build targets for service improvement into PFI contracts.

80. If PFI contracts are to be compatible with the principles of best value, then purchasers need to ask themselves a number of key questions [BOX B]. If the answer to any of these questions is ‘we don’t know’, then any failure to take action to remedy these aspects of the contract could lead to significant problems in achieving the required standards of performance under best value. These issues should be considered as early as possible in the PFI procurement process, but purchasers who are concluding

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**BOX B**

**Continuous service improvement**

All best value purchasers need to ask themselves a number of key questions when considering whether prospective PFI contracts are likely to deliver continuous service improvements.

- How will the obligation to achieve continuous improvement be demonstrated over the life of the contract?
- How, if at all, will community concerns about standards of service be addressed?
- How will improvements to services, expected as a result of the new arrangements, be monitored?
- How will the council’s obligations for meeting relevant national performance indicators (NPIs) be met, given that the whole service is to be carried out by the PFI contractor in future?
- What local performance indicators and targets will be set for the contractor to meet over the life of the contract?
- What happens and who bears the costs (if any) if the council wishes to change those targets at a later stage in order to make them more challenging?
- What happens and who bears the costs (if any) if the Government revises any of the relevant national performance standards after the parties sign the contract?
- What happens and who bears the costs (if any) if the Government subsequently sets new NPIs that require a change in the method of service delivery within a particular time scale?

*Source: Public Private Partnerships Programme (4Ps)*
negotiations with a preferred bidder should also satisfy themselves that these fundamental questions can be answered to their satisfaction before proceeding to contract close.

Joint working

81. The PFI has a role to play in the procurement of facilities for the joint provision of health and social care. However, the experience of one joint scheme visited during the study suggests that it will remain a difficult option while the health and local authority bodies concerned remain separate entities, subject to separate approval mechanisms and legal frameworks and working within different planning horizons.

82. A development relevant to both the NHS and local government, as well as to those commissioning through the PFI, is the Health Act 1999 (Ref. 11). This has removed many of the legal obstacles to joint working through the use of:

- pooled budgeting, under which local authorities and health bodies put money into a single dedicated budget to fund a range of care services;
- lead commissioning, under which the local authority or the health authority/primary care group takes the lead in commissioning services on behalf of both bodies; and
- integrated provision, under which local authorities and health authorities merge their services in order to deliver a single package of care.

83. In rehabilitation medicine, and separately in services for the mentally ill, there are a number of initiatives to establish new single, multi-purpose legal bodies to commission and be responsible for local health and social care. In England, the NHS Plan proposes to build on the creation of primary care trusts to create ‘Care Trusts’ responsible for the commissioning and delivery of social care to older people and other client groups where there is local agreement that this model offers the best way to deliver better care services. Care Trusts will deliver social services under delegated authority from local social services authorities.

84. The development of Care Trusts should also ensure that PFI schemes are developed within an integrated planning framework that considers the health and social care needs of client groups across the whole of the local area. Until then, the opportunities for joint PFI schemes are likely to remain limited.
KEY POINTS

- Purchasers should not reject the PFI on the grounds that long-term service contracts are incompatible with the principles of best value.

- Purchasers must be able to demonstrate that PFI contracts remain competitive through the regular market-testing of services.

- Purchasers should ensure that contracts allow the results of consultation to be used to change the nature of service delivery and/or the level of performance required of the contractor.

- In negotiating PFI deals, best value purchasers must pay attention to their statutory duty to make arrangements to secure continuous improvement in the way in which their functions are exercised.

- Joint PFI schemes will remain a difficult option while the health and local authority bodies concerned remain separate entities, subject to separate project approval mechanisms and legal frameworks, and working within different planning horizons.

- The development of Care Trusts should help to remove some of the obstacles to the use of the PFI in the health and social care sectors.
5. Risk and value for money

85. The relationship between risk, value for money and affordability is one of the most complex and controversial areas of the PFI. In simple terms, the Outline Business Case (OBC) should identify all the risks associated with the project and how they are to be allocated between the purchaser and the providing consortium. Bids are then invited from the private sector to operate the scheme according to the suggested risk allocations. A Public Sector Comparator (PSC) is calculated, showing the cost of the scheme if it were to be created and managed wholly within the public sector, and based on the assumption that all the risks associated with the scheme are borne by the purchaser.

86. If the PSC is more expensive than the private sector bid, it is an indication that the PFI scheme will offer value for money, but the purchaser must still demonstrate that the scheme is affordable – that it has the resources to commission and pay for the scheme’s long-term operation. Because the client is typically committed by contract to make payments over 30 years, affordability is a crucial issue.

Risk allocation

87. All organisations face the risk that outcomes will differ from those planned. Risks arise as a result of uncertainty about the future, but also from inaccurate information about existing conditions, or as a result of the failure of systems designed to contain or control risk. All individuals and organisations deal with risks every day and while some, such as the risk of a train strike preventing a planned meeting, may have relatively minor implications, others can give rise to significant additional costs.

88. All projects in all sectors involve risks, but the introduction of the PFI has caused public sector bodies to focus on risk to an extent unknown under traditional methods of procurement. Risks should be borne by the party best able to control or manage them, but purchasers must also consider the need for appropriate risk transfer to the private sector.

89. There is generally little scope for purchasers to transfer to the private sector risks arising from changes in demand for the services provided from PFI assets. Risks linked to the design, construction and operation of PFI assets can more easily be allocated to the private sector, or shared between the purchaser and the private sector – often, but not necessarily, at an extra cost.

90. One feature of the sites visited was that the risk allocation did not alter much between the production of the OBC and contract close. Purchasing authorities stated their own requirements in terms of risk and outline affordability, and private sector contractors largely delivered proposals that matched, rather than sought to change, these requirements.

Risk reduction

91. The emphasis on risk in the PFI gives purchasers the opportunity to think creatively about how the cost of risk can be reduced. For example, a purchaser may impose a requirement on a provider that a lift is guaranteed to be operating for the entire working day, every day of the week. This creates a high operating risk for contractors, the cost of which will be passed on through the unitary charge. Purchasers could explore other possibilities with the contractor to reduce the potential cost of that operating risk. The contractor may be able to make other space
available, temporarily, in the case of a lift breakdown, effectively reducing the significance of the lift's reliability in the risk model and on the cost of the project. We found little evidence, however, that purchasers were taking these more creative approaches to risk reduction.

92. Treasury guidance states that purchasers should not transfer risks to the operator to get a particular accounting result if this arrangement delivers poorer value for money. In practice, however, there is not always a linear relationship between the levels of risks accepted by the contractor and the price attached to these in a contract. The strength of the link is likely to be influenced by the state of the market and the profitability of the whole contract.

93. Moreover, big contractors, using their own equity, do not have to convince financiers that the risks involved are reasonable and justifiable. If contractors really want to get involved, they are likely to be prepared to accept a package of risks, and clients may be surprised at the apparently low price attached to some risks by contractors, compared with their own estimates. The result is that risk transfers from the purchaser to the contractor do not necessarily mean significant extra costs and reduced value for money.

94. Quantified risks, and associated probabilities, could be used more often to find out whether certain risks allocated to the contractor should be re-assumed during negotiation. If the contractor were to be asked how much the price would be reduced if a risk was reallocated to the public sector, value for money could be improved. Incomplete use is currently made of risk models in exploring risks and their probabilities. Instead, risk models still tend to be used as 'necessary' number-crunching exercises to demonstrate whether the PFI scheme is better than the conventionally funded alternative.

95. While risk models can be used to assist skilled negotiators by showing general tendencies in the likely movement of price with risk, they cannot be relied on to generate a 'correct' answer. Given the nature of the market, and the approach adopted by individual companies, PFI negotiation around risk is rarely simple or predictable.

Value for money

96. The principal method used to demonstrate that a scheme will potentially deliver value for money is to compare the capital cost of the PFI deal with the PSC. The preparation of a PSC is usual practice in local government, and required practice in the NHS.

97. The PSC is based on the assumption that all aspects of a project are to be financed, controlled and managed by the public sector. It shows the cost profile of a project over a number of years (usually 30), and the financial and other returns for the same period. A discount rate is then applied to these expenditure and benefit streams to produce the project's 'net present value' (NPV) under conventional funding.

98. In its favour, the public sector traditionally enjoys lower borrowing costs than the private sector. On the other hand, the PFI is based on the assumption that the higher cost of private finance is more than outweighed by private sector providers being:

• better equipped with project management skills and therefore more capable of keeping to planned schedules;
99. Previous external reviews of the PFI have emphasised the difference in estimated value for money between conventional and PFI funding. A review, commissioned by the Treasury Taskforce and published jointly by the London School of Economics and Arthur Andersen in January 2000, analysed 29 public sector projects that used the PFI and calculated that the average predicted savings from using the PFI, compared with conventional procurement, was 17 per cent (Ref.12). The National Audit Office has separately suggested savings of around 20 per cent in the central government sector.

100. The Audit Commission’s own analysis of eight schemes in local government and the health service – where full data were available – suggested a narrower differential, at least for the smaller schemes. One schools refurbishment scheme, with a capital value of £130 million, showed predicted savings of 17 per cent, but the smaller schemes in the sample showed predicted savings ranging from 3 per cent to 5 per cent.

101. The extent to which predicted savings are actually delivered, or exceeded, will only be demonstrated over the longer term. In the short term, purchasers can only rely on the PSC to demonstrate value for money and, while the PFI can generate significant predicted savings, it is not guaranteed. Rather than constructing a PSC in the expectation that the PFI will be cheaper than the conventionally funded option, project planners should not be surprised to see the two calculations showing broadly the same results. In reality, the PSC is not only a valuable tool in demonstrating predicted value for money, but it can also be used as a ‘comfort check’ on the validity of the assumptions underlying the proposed scheme.

102. If the PSC is significantly higher than the capital cost of the PFI deal, particularly in the case of smaller schemes, it may mean that the PFI deal offers value for money. It may also mean that the public sector has not done its own calculations correctly, or, more likely, that the business case has been written in a way that is open to misinterpretation from the private sector bidders. If this is so, it is an early warning that negotiations may hit difficulties as the true nature of the scheme gradually becomes apparent.

103. Purchasers should also be prepared to use the PSC to analyse rigorously the components of the contractor’s bid, in an attempt to identify areas of profit that could help to inform a negotiation strategy. Where several bids are received, project planners should not concentrate on one comparison (private versus public), but should carry out as many comparisons as possible. Comparison of three or four schemes in detail will shed even more light on where there is most uncertainty and what the critical keys to the project’s success are. Making several comparisons will provide a better understanding for purchasers about exactly where their attention is likely to be most useful in promoting and assuring the overall success of the project.
KEY POINTS

- Purchasers should think creatively about risk reduction as well as risk allocation.

- In allocating risks, and negotiating contracts, purchasers should be aware that the relationship between price and risk is affected by the nature of the market and the approach adopted by individual companies.

- The PFI can offer significant predicted savings over conventional procurement, but purchasers should not be surprised to see predicted savings in the order of 3 to 5 per cent, particularly in the case of smaller schemes.

- Purchasers should compare several bids to obtain the best possible understanding of the assumptions that are critical to the affordability of individual schemes.
6. Competition and the contracting process

Time taken to close deals

104. A key feature of PFI schemes is that it takes a long time to negotiate deals to a successful conclusion, and almost always longer than the purchaser had originally expected. The Private Finance Unit of the DoH collects information on the time taken to move from the publication of OJEC contract notice to contract closure for major contracts subject to project approval by CPAG. In July 2000, the Department produced information on the time taken to conclude major ‘first wave’ hospital PFI deals in the NHS [EXHIBIT 3].

105. Many ‘first wave’ NHS schemes were subject to delays beyond the control of purchasers as a result of the review of the PFI announced by the Government in 1997 and the major review of health policy. The complexity of major hospital projects will always militate against the quick completion of PFI deals in the health sector. However, the evidence from second and third wave NHS schemes is that the time taken to reach contract closure has been reduced to approximately 30 months.

106. A different picture emerges from an analysis of data from 19 completed local government schemes [EXHIBIT 4, overleaf]. These data were collected from a sample of 13 schemes held on the 4Ps database and were combined with information collected during the field visits. Information was collected on the time spent between the publication of the OJEC notice and the selection of a preferred bidder, as well as the time taken to reach contract close after the preferred bidder has been selected.

107. PFI contracts are complex, but the process should get quicker as purchasers and contractors become more familiar with it. Contract standardisation should also help.
but the evidence suggests that bodies considering a PFI deal should do so in the expectation that the scheme is likely to take between 12 months and two years to move from OJEC to contract closure. As this is preceded by a period of investment appraisal and followed by a 12-month to two-year construction period, it is likely that purchasers will have to wait three to four years (at a minimum) before schemes are operational.

108. In five of the health and local government schemes visited during this project, the length of time spent in exclusive negotiation exceeded the time that had been spent selecting the preferred partner. This is not good procurement practice and purchasers should make every effort to complete the process in the shortest possible time while ensuring value for money.

109. This paper has already considered some of the factors that are critical to the success of PFI schemes. Discussions with project managers and financial advisers highlighted a number of other factors that have an influence over the time taken to conclude deals [BOX C].

110. Purchasers must also put a considerable amount of effort into choosing the right partner and establish robust channels of communication throughout the procurement process. The maintenance of competitive pressures may reduce the time it takes to close deals and purchasers should attempt to involve financiers at the earliest possible stage to avoid delays caused by the process of ‘due diligence’.

EXHIBIT 4

Time taken to complete PFI deals in local government

The average time taken to complete PFI deals for a sample of 19 completed local government schemes was 26 months. On average, authorities took 16 months to choose their preferred partner after OJEC and a further ten months to negotiate closure of the contract.

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Local Government PFI schemes

- OJEC to PP status
- PP to contract close

Source: 4Ps and Audit Commission

The average time taken to complete PFI deals for a sample of 19 completed local government schemes was 26 months. On average, authorities took 16 months to choose their preferred partner after OJEC and a further ten months to negotiate closure of the contract.

Source: 4Ps and Audit Commission
Choosing the right partner

111. Putting effort into choosing the right partner takes time, but it is the best way of ensuring that, once selected, the contractor will be able to move swiftly to contract closure. There is evidence that stability within the providing consortium has a strong influence on successful negotiation of PFI deals. Purchasers evaluating bids for PFI contracts should look very carefully at the structure of each bidding consortium and ask:

- is the consortium cohesive?
- have the various companies within the consortium worked together before? and
- will all companies within the consortium be committed to the same outcomes?

112. Purchasers should always be prepared to check each company’s previous record and find out why they are bidding together. Purchasers should be wary of becoming a consortium’s ‘guinea pig’ client, although this should be balanced against the need to bring new players into the market. Clients should in any case seek to test consortium cohesion; one way of doing this is to build in an expectation that there will be change during the contract, and to invite each consortium to discuss and explain its change management processes.

Communication

113. Our field visits highlighted examples of conflict within consortia, most commonly involving disagreements between facilities management contractors and consortium architects and builders. These conflicts resulted from communication problems and although they were in many cases easily resolved, they still resulted in delays in the completion of contracts.

114. It is rare for a consortium to channel communication through one person, even though it may have identified a contractor-side project leader. Public sector project managers are usually expected to

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BOX C

Reducing the time taken to close deals

If purchasers are to reduce the length of time taken to close PFI deals, they should:

- demonstrate a clear purpose and a strong vision of the desired outcomes from the scheme;
- translate that vision into a simple output specification and resist the temptation to make regular changes to that specification;
- get early commitment to the scheme from key stakeholders;
- set up a project management structure that allows for an appropriate level of delegation to key officers and is integrated with existing decision-making processes;
- agree a clear project plan, establish project milestones and monitor progress against the plan on a regular basis;
- agree the key contractual terms, including payment mechanisms and risk transfers, prior to issuing the invitation to negotiate, in order to force bidders to indicate their position early on in the negotiation process; and
- be clear about how they are going to evaluate bids.

Source: Audit Commission
work out who needs to be approached and then make sure that the message is passed on to other partners in the consortium. This puts an unnecessary burden on the project manager and, in selecting their preferred partner, purchasers should be prepared to state that they expect a simple communications protocol to be established as a condition of accepting a bid.

**Maintaining competitive pressure**

115. It may benefit purchasers to have two potential contractors involved in the tendering process for as long as possible, but discussions with contractors reveal that this is not a model they find attractive. Contractors like having time to settle outstanding legal and financing issues and to invest in setting up the structures needed to deliver the contract – confident in the knowledge that this investment will be recovered. They argue that purchasers who keep two contracting competitors in the ‘frame’ add unrecoverable costs to one of the two contractors. They also claim that if this is adopted widely, it will reduce the interest of the private sector in doing PFI deals and add to the costs of those deals that are done.

116. This argument has some validity for the more complex contracts where set-up costs may be considerable. However, purchasers should at least be aware of the benefits that may be gained from keeping more than one contractor involved in the process for as long as possible. It is possible to achieve this in practice when contractors want the work and are willing to invest time and money in trying to win the contract [CASE STUDY 4].

117. Two of the schemes visited had slow starts, but contract closure was achieved very quickly after the preferred partner was chosen, probably as a result of the maintenance of competitive pressures. Roads schemes and information technology schemes may be more amenable to sustained competition than other forms of PFI deals, but as a general rule no purchaser should plan to remain in

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**CASE STUDY 4**

**Maintaining competitive pressure**

**Essex County Council – Road Scheme**

Essex County Council took 31 months to move from OJEC publication in November 1996 to the selection of a preferred partner. This delay was in large part attributed to the general election in May 1997 and the Roads Review that soon followed. Despite this hiatus, the county council managed to retain the interest of two bidders throughout, and eventually selected its preferred partner in May 1999. It took just five months from this point to contract closure in October 1999.

**Countess of Chester NHS Trust – IT system**

The Trust produced several drafts of an Outline Business Case for an information technology scheme between January 1996 and August 1998, before it was given approval to advertise the project through OJEC. From this point on, progress was rapid and two potential suppliers were kept in the race until two days before the contract was signed, 16 months after publication of the OJEC notice.

*Source: Audit Commission*
exclusive negotiation with a preferred partner for more than nine months. For smaller and less complex schemes, the target times should be reduced to six months or less.

**Due diligence**

118. In the final stages of the procurement, the most common problem facing purchasers and providers alike is the 'due diligence' procedures carried out by financiers. These checks often pose serious questions about risk and other aspects of the contract that purchasers and providers think they have already resolved. Banks rarely use the time of their own staff until they have decided that they have enough of an interest in the scheme for it to be worthwhile for their own legal experts to go through the documentation in detail. This final step, more than any other, can be a trial of nerves and patience:

- in one scheme, the banks and financiers were involved soon after the project reached preferred partner status, but 'due diligence' had to wait until the very end of the process. The bank's lawyers still took several weeks over this, before they would confirm that they were prepared to lend;
- in another scheme, the preferred partner chose not to employ its own financial advisers and used the advisory service of a lending bank instead. On occasions towards the end of the negotiation, the bank overruled what the contractor had earlier agreed with the client on the grounds that the plan was not commercially acceptable; and
- in a third scheme, when the major lending bank entered, the client said 'it felt like negotiations were opened up on points already agreed. When the contractor was happy with an agreement that had been struck with the client, the bank raised objections'.

119. Negotiating skills are critical at this stage, if only to hold the ground that had previously been considered 'established'. However, purchasers must recognise that banks and other providers of finance have a duty to their own shareholders to ensure that funds are protected. Indeed, the scrutiny of PFI deals by external financiers is one of the key features of the PFI and one that brings an element of rigour to the evaluation of the financial viability of the scheme that may be missing in traditional procurement.

120. It is in the long-term interest of purchasers and providers that financiers are happy with the proposed deal. The simplest and best way of doing this is to strive to get bankers and financiers involved, if not at the very beginning, then in the early stages of negotiation with the preferred partner. This level of involvement will not always be achievable, but purchasers should be aware of the form that due diligence will take and should at least be prepared for delays prior to contract close.
KEY POINTS

- PFI schemes commonly take three to four years to become operational and purchasers should not regard the PFI as a ‘quick-fix’ solution to their investment needs.

- The length of time taken to close deals can be reduced, but only if purchasers have a clear vision of the desired outcomes from the scheme and maintain that vision throughout the procurement process.

- Purchasers should check the cohesiveness of the bidding consortia, and insist on a simple communications protocol being established as one of the conditions of accepting a bid.

- Purchasers should require bidding consortia to explain their change management processes prior to accepting a bid.

- Where possible, purchasers should maintain competitive pressures for as long as possible.

- Purchasers should ensure that that the preferred bidder’s financiers are ‘on board’ as early as is practically possible, but prepare for delays at the end of the negotiation stage as a result of due diligence.
7. Sharing experiences, external advice and audit

Sharing experiences

121. Comprehensive guidance on the PFI has been produced by the DoH and the DETR. The DoH in particular has committed significant resources to producing revised guidance on PFI which draws on the lessons learned from early NHS PFI schemes (Ref.13). It has also produced a model contract, which is mandatory for all schemes currently under negotiation, and has launched a model payment mechanism and an output specification.

122. In local government, the 4Ps has been working with the DETR and the Office of Government Commerce to produce a supplement to the Treasury Taskforce's General Guidance on the Standardisation of PFI Contracts (Ref.14). This supplement addresses issues that are unique to local government and will be a valuable source of reference to any local authority considering the PFI, or involved in a PFI procurement. The 4Ps has also taken the lead in promoting the sharing of legal advice and the production of standard guidance for authorities undertaking social housing PFI schemes and is an important source of expert advice and support to individual local authorities [BOX D]. The creation of Partnerships UK will also mean that authorities that are using its services will be able to benefit from the considerable project management experience accumulated by that body in its former role as the Treasury Taskforce.

123. Each of these efforts is designed to promote consistency and share hard-earned knowledge among public sector bodies to enable them to reduce the cost of procuring through the PFI. They are all valuable, but the experience of the site visits showed that there is no substitute for actual experience in managing a PFI deal. The depth and variety of the managerial talent both in local government and the health service was clear from the schemes visited. The challenge facing the public sector is to ensure that project management skills and PFI expertise are shared to the common benefit of all local authorities, health authorities and trusts undertaking this form of procurement.

124. There are some local initiatives that aim to do just this. For example, some local authorities have put arrangements in place to

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BOX D

The importance of sharing information and experience

‘The private sector has an incentive to keep intelligence to itself; there is no strong incentive to let other commercial operators into hard-earned commercial secrets. On the other hand, the public sector should be encouraged to share its understanding and experience rather than guard, parochially, its achievements and mistakes. The public sector, through internet technology as well as government departments, should provide guidance at the centre and make sure that everyone has access to it.’

(Peter Fanning, Chief Executive, 4Ps)

‘It might surprise some... that the construction industry would actually prefer to deal with a client who is educated enough to give them a hard time...an informed, confident client is actually easier to deal with than a nervous, inexperienced one’

(PFI Journal, Volume 5, Issue 1 Page 7).

Source: Audit Commission
share information, and there have also been ‘exchange secondments’ between local education authorities in Wales. In addition, both the Private Finance Unit of the DoH and PUK have experimented with the ‘bundling’ of schemes within sectors, and the DoH actively encourages purchasers to contact other health bodies undertaking PFI schemes with a view to sharing information. This could be done in a limited and immediate way – to pass information between PFI commissioners of separate schemes – and more generally and widely, through joint specification and the development of schemes between local authorities, and between local authorities and health bodies.

125. Despite the various efforts, the sharing of PFI expertise between parts of the public sector, and within the health and local government sectors, is not as common as it should be. Project managers are too often protective of their knowledge and expertise and unable to devote the time to help colleagues who are facing similar problems. This will always be a barrier to the sharing of information, but the demands of this form of procurement require a change of attitude, and purchasers should ensure that any requests for help from other bodies are looked at sympathetically. They should also consider whether the formal secondment of experienced project managers offers a viable way of spreading good practice and promoting value for money.

**External advice**

126. Without exception, the authorities visited during the project engaged external advisers (legal, financial and technical) to help to specify, justify and negotiate their PFI deals. At the field visit sites, the minimum cost of using external advisers was about £150,000, and in one scheme the cost exceeded £2 million. There were wide variations between the cost of external advisers expressed as a percentage of the annual unitary charge and, as a result, no clear relationship between the size of schemes visited and the total cost of external advice could be identified.

127. The DoH has also analysed the cost of external advice at 18 ‘first wave’ NHS hospital schemes with a capital value greater than £25 million [EXHIBIT 5].

128. Exhibit 5 shows the wide range of costs incurred by NHS trusts, but the relationship between the size of schemes and the cost of external advisers may be illustrated by plotting the capital cost of ‘first wave’ hospital schemes against the cost of advisers expressed as a percentage of the capital cost [EXHIBIT 6, overleaf].

129. It would be reasonable to hypothesise that there is a minimum level of advisers’ costs that all schemes have to bear regardless of their size and, as a result, the cost of external advice will be higher as a proportion of the capital cost in smaller schemes. Exhibit 6 tends to support this hypothesis, but some of the smaller schemes in this sample incurred costs in similar proportions to the larger schemes and it is likely that other variables, such as the complexity of the deal or the nature of the providing consortium, can have as much impact on the cost of external advice as the size of the contract.
More recent NHS schemes have benefited from revised guidance from the DoH, and the standard form of contract and evidence from the most advanced of the ‘second wave’ NHS schemes is that the costs of procurement have been reduced. Nevertheless, local authority and health purchasers should be aware of the potential costs of external advice and ensure that every effort is made to minimise these costs.

To guard against the possibility of excessive cost, purchasers should appoint their advisers through some form of competitive tendering. Purchasers must be clear about the proposed timetable for the project and the likely volume of work before tendering and should seek references from other clients before appointing firms. Whatever the final size of the bill, it has to be paid for by the purchaser and should be included within the affordability calculations. This, in itself, should create an incentive to minimise the cost of external advice.

Initiatives driving greater contract standardisation and those involving sharing advice across several similar schemes will help to reduce costs, but many purchasers continue to pay a premium for access to accumulated knowledge. In the future, they may need to use advisers in a more limited capacity to quality check their own in-house work and be prepared to use local firms with lower fee rates.

Despite the high cost of advice, the Audit Commission found purchasers to be generally happy with the quality of advice received. Good advice can gain purchasers long-term affordability benefits that more than outweigh the costs. One of the most valued skills that advisers bring to the process is the ability to negotiate with the contractor – an area where most public sector managers consider

### EXHIBIT 5

**The cost of external advice in major NHS hospital schemes**

The cost of external advisers in ‘first wave’ NHS hospital schemes, expressed as a percentage of the capital cost of each contract, ranged from 8.7 per cent to 2.4 per cent, and averaged 4.1 per cent.

<table>
<thead>
<tr>
<th>Percentage of capital contract cost</th>
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<tbody>
<tr>
<td>10%</td>
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</tbody>
</table>

**NHS PFI schemes**

Source: Department of Health

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**Minimising the cost of external advisers**

130. More recent NHS schemes have benefited from revised guidance from the DoH, and the standard form of contract and evidence from the most advanced of the ‘second wave’ NHS schemes is that the costs of procurement have been reduced. Nevertheless, local authority and
themselves to be well behind their private sector counterparts.

134. Purchasers must actively manage and control external advisers and use them as supporting technicians rather than project architects. To confirm this, project sponsors, as clients, should be prepared to meet with contractors without advisers present, on the understanding that the meeting is being held ‘without prejudice to negotiations’.

135. While it is important for commissioners to have the support of external advisers in some circumstances – particularly to help with negotiations – purchasers can underestimate in-house abilities. Guidance from the centre, and from those who have successfully negotiated their way through PFI deals, should help to remove some of the mystique surrounding the PFI. In turn, this should give more purchasers greater confidence in their own abilities, and enable certain tasks to be carried out in house in the future.

136. External advisers will continue to play an important role in PFI deals specified and negotiated over the coming decade. But it is also important that purchasers should not be over-reliant on the advice and support they buy in. As ‘commissioning authorities’, they will have to take over the management of the contract once the advisers have done their work and left. Therefore, their own staff must understand all the components of the contract. Over-reliance on external advisers can reduce a purchaser’s ability to do this effectively.

**External audit**

137. External auditors will generally review proposed PFI deals in fulfilment of their audit responsibilities under the Code of Audit Practice (Ref. 15). Project approval mechanisms in the NHS also require purchasers to obtain
written confirmation from their external auditor that their ‘initial view’ of the accounting treatment of the proposed scheme is reasonable. In local government, there is an expectation that an audit view will be included in an authority’s submission for support from the relevant government department.

138. The field visits indicated that purchasers had mixed views about the quality of external audit input, with some commenting that auditors offered constructive and timely support, while others expressed concern that auditors lacked consistency in their judgements over the application of FRS 5. As a judgement that a scheme is, on-balance, sheet can result in the failure of a PFI deal, it is imperative that external auditors are informed of potential PFI deals at an early stage, and that both parties maintain open channels of communication. Purchasers, and their advisers, should also keep auditors fully informed of all factors relating to the accounting treatment of schemes during the procurement process.

139. It is also essential that all parties are aware of the nature of their responsibilities in this critical area. The purchaser is responsible for reaching an ‘initial view’ on the accounting treatment of the proposed scheme on the basis of information provided by its external advisers. This is only a preliminary view and it may need to be updated if there are significant changes to the contract prior to contract close. If requested to do so, and if given sufficient time and opportunity, the external auditor will normally provide written comments for submission to the approval body at the relevant stage in the approval process.

140. The auditor is not giving an opinion at this stage on whether the proposed accounting treatment gives a ‘true and fair view’ or ‘presents fairly’ the financial consequences of the PFI deal under consideration. If the auditor confirms that he or she does not expect to challenge the initial view of the accounting treatment taken by the purchaser, this does not mean that the auditor has in any way fettered his or her discretion to examine the contract at any later stage in fulfilment of his or her statutory duties and responsibilities under the Code of Audit Practice (Ref 15). If this is understood by all parties at the outset, the chance of conflict and disappointment later in the process will be reduced.
KEY POINTS

- One of the key challenges facing the public sector is ensuring that project management skills and PFI expertise are shared to the common benefit of all bodies undertaking this form of procurement.

- The cost of external advice is considerable, although initiatives to promote the sharing of advice and guidance should reduce costs in the medium to long term.

- Purchasers must actively manage their external advisers and ensure that they are working to a clear specification within an agreed timetable for completion of the work.

- Purchasers need to make better use of their own in-house skills and restrict the use of external advisers to areas where these are clearly lacking.

- Purchasers should ensure that their external auditors are kept fully informed about PFI deals, and that both parties maintain open channels of communication throughout the contracting process.
8. Conclusion

141. Collaborative working between the public and private sectors is one of the key themes of the Government’s modernisation agenda, and the principles of public private partnerships and the PFI are now well established. This paper does not question the policy objectives of the PFI or the assumptions underlying it, but offers guidance, based on practical experience, of what to avoid and what to look for in delivering a successful PFI scheme. Many of the messages could also be applied to other forms of PPP.

142. This paper has drawn on the considerable expertise of project managers in the local government and health sectors, as well as external advisers. They were asked to give three or four ‘top tips’ for making a scheme successful, and these have been summarised in Appendix 3. While there are some variations, common themes are clear:

• have a clear and consistent vision of desired service outcomes;
• assemble a good project team and resource it properly;
• use professional advisers effectively; and
• use the accumulated knowledge and experience of other purchasers where possible.

143. Negotiating a PFI deal is one of the most demanding jobs that public sector project managers will ever have to undertake. To get stakeholders on-board and committed to the aims of the scheme, and to keep them focused on this regardless of the complications and distractions along the route, is the over-riding demand on project leaders. Purchasers must ensure that managers with the requisite skills are available to carry out this work.

144. A successful PFI deal can only be negotiated if all parties to the contract are able to reconcile conflicting objectives, while meeting their obligations to their own stakeholders. If approached in the right spirit and with the necessary support of key stakeholders, there is no reason why the PFI cannot deliver facilities and services that offer value for money to present and future generations.
## Appendix 1

### Field visit sites

<table>
<thead>
<tr>
<th>Name</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Manchester NHS Trust</td>
<td>Hospital centralisation</td>
</tr>
<tr>
<td>Ceredigion County Council</td>
<td>School</td>
</tr>
<tr>
<td>Countess of Chester NHS Trust</td>
<td>Patient care system</td>
</tr>
<tr>
<td>Dudley Priority Health NHS Trust and Dudley Metropolitan Borough Council</td>
<td>Health, library and social care centre</td>
</tr>
<tr>
<td>Essex County Council</td>
<td>Road scheme</td>
</tr>
<tr>
<td>Gwent Healthcare NHS Trust</td>
<td>Community hospital</td>
</tr>
<tr>
<td>Greater Manchester Fire Service</td>
<td>Fire station</td>
</tr>
<tr>
<td>Leeds Community and Mental Health Services Teaching NHS Trust</td>
<td>Units for mentally ill</td>
</tr>
<tr>
<td>Neath Port Talbot County Borough Council</td>
<td>Waste disposal</td>
</tr>
<tr>
<td>North Durham Healthcare NHS Trust</td>
<td>Acute hospital</td>
</tr>
<tr>
<td>Stoke City Council</td>
<td>Schools refurbishment</td>
</tr>
</tbody>
</table>
Appendix 2

Advisory group membership

Jeremy Colman
Peter Fanning
Frances Houston
Andrew Lloyd-Kendall
Peter Marsh
Amanda McIntyre
Laurie Pavelin
Mike Robinson
Tim Watkinson
Pam Williams
Mike Barnes
Greg McIntosh
Philip Blake
Chris Vanderweele

National Audit Office
Public Private Partnerships Programme (4Ps)
HM Treasury
Department of Health
Walsgrave Hospital NHS Trust
Confederation of British Industry
National Assembly for Wales
South Gloucestershire Council
District Audit
Department of the Environment, Transport and the Regions
Audit Commission
Audit Commission
Consultant
Consultant
Appendix 3

Good practice tips from experienced purchasers

**Ceredigion County Council – Penweddig School**

*Emlyn Watkin (Director of Finance)*

1. Build a good team.
2. Choose advisers well and be prepared to pay the proper price – good advice will win later affordability savings.
3. Keep everyone that needs to know informed and supportive.
4. Be prepared to negotiate and compromise – but retain your focus on what the project is intended to achieve.

**Gwent Healthcare NHS Trust – Chepstow Community Hospital**

*Chris Hopper (Capital Investment Manager) and Phil Lane (Associate Finance Director – Capital and Audit)*

1. Stick to simple principles – be sure about what you want to achieve – stand your ground, be confident in simplicity.
2. Make sure you are really committed to achievement – there will be times when you will want to ‘get out’.
3. Try to maintain continuity of your commissioning personnel.
Countess of Chester NHS Trust – Patient Care System

Keith Richardson (Director of Information Management & Technology)

1. Keep your eye on your ultimate goal/aim and do not be deterred.
2. Find out what others have done.
3. Insist on the freedom to go to whichever reference sites you choose.
4. Recognise the need for professional advice and procure competitively.
5. Maintain more than one horse in the race for as long as possible to avoid being pushed on price at the final hurdle.

North Durham Healthcare NHS Trust – Dryburn Hospital

Bill Headley (Project Director)

1. Set out a well-structured process where you can see all the stages. Set a timetable and then meet it.
2. Make sure you recognise where your strengths are – and do those things that only you can do.
3. Make sure the organisation is committed in terms of morale and resources.
4. Use advisers wisely.
Dudley Metropolitan Borough Council and Dudley Priority Health NHS Trust – Health, Library and Social Care Centre

Jon Tomlinson (Borough Council) and Julie Gunning (Trust)

1. Set up a project team with clearly identified and committed resources.
2. Make sure the team has the authority to make and take decisions.
3. Make sure you have a clear output specification and brief the contractors in depth about your business needs and the key success factors.
4. Control and specify the work undertaken by your advisers or costs could escalate.
5. Don’t underestimate the amount of time it takes.

Essex County Council – Road Scheme

Sean O’Donnell (Head of Finance, Environmental Services)

1. Organise a workshop involving both public and private sectors to scope the project and identify risks.
2. Free-up sufficient client-side time for the size of the job.
3. Provide delegated powers to identified individuals to negotiate and sign the contract.
Leeds Community and Mental Health Services Teaching NHS Trust – Units for Mentally Ill People

Simon Large (Planning Officer)

1. Make sure that people are given sufficient time to undertake the task.
2. Ensure that the organisation nurtures and supports its staff – through suitable training and contact with others (PFU, 4Ps).
3. Try to obtain as much comparative and benchmark data as possible.
4. Keep in mind the major purpose of the exercise – don't be distracted by peripheral issues.
5. Ensure that financiers are involved from the outset.

Stoke City Council – Schools Refurbishment

Mike Inman (Head of Premises and Client Services)

1. Don't be put off by the complexity of the PFI process – go for it.
2. Use in-house expertise as far as you possibly can.
3. Use the experience and expertise of those who have done this before.
4. Use standardised contracts where you can to reduce costs.
5. Set a realistic timetable and strive to achieve it – don't contemplate changing it unless you are forced to.
Greater Manchester Fire Service – Fire Station

Roger McLachrie – Estates and Building Manager

1. Be clear where you are, where you want to get to and the processes that you will have to follow to achieve your goals.

2. Make sure you have the motivation to succeed. Choose your project team wisely and measure performance on a regular basis.

3. Be careful about your choice of private sector partner – make sure you are compatible.
References


The Audit Commission has produced a number of studies covering related issues. The following may be of interest to readers of this paper:

**Taking the Initiative**

*Taking the Initiative: A Framework for Purchasing Under the Private Finance Initiative*

Written for councillors, chief officers and board members in local authorities and the NHS, this helpful management paper explains the key features and pitfalls of the PFI. It sets out a strategic framework for the procurement process up to the point of contract signature, and includes arrangements to ensure that the contract is properly managed. Illustrative case studies are included, together with a pullout checklist for action.

*Management Paper, 1998, 1862401195, £15*

**Just Capital**

*Just Capital: Local Authority Management of Capital Projects*

Councils in England and Wales spend about £7 billion a year on capital projects, more than half of which is accounted for by constructing and renovating buildings. *Just Capital* focuses on the management of building projects in the context of the new measures being taken by central government to reduce construction costs.

*National Report, 1996, 0118864351, £12*

**Hot Property**

*Hot Property: Getting the Best from Local Authority Assets*

Property assets have not always received the attention they deserve at senior levels within local authorities. *Hot Property* emphasises the contribution that sound asset management can make to improving frontline services. The report examines the difficulties that face authorities as they attempt to get the best from their valuable property resources and keep pace with user needs. It offers practical guidance to help councils to incorporate property into best value reviews and make services more accessible.

*National Report, 2000, 1862402205, £20*

**Uniform Approach**

*Uniform Approach: National Report and Good Practice Guide*

Targeted at fire authority and fire service decision-makers, *A Uniform Approach* will assist fire brigades in their best value reviews of procurement. The report looks at procurement as a strategic function, rather than simply a purchasing activity, and examines the relationship between procurement and service objectives. It examines how procurement decisions are made and compares brigades’ approaches to the research and development of new equipment and supplier management. The good practice guide is designed to ensure that procurement processes are managed effectively and that systems are streamlined and brought up to date. Case study material highlights examples of good practice and identifies a range of opportunities for improving efficiency and value for money. Although written specifically for the fire service, much of the guidance is transferable to other public services.

*National Report, 2001, 1862402604, £20*

*Good Practice Guide, 2001, 186240268X, £20*

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To order Audit Commission publications, please telephone 0800 502030, or write to Audit Commission Publications, PO Box 99, Wetherby LS23 7JA.
Public Private Partnerships (PPPs) are a key element of the Government’s strategy for delivering high-quality, modern public services. The Government has particularly encouraged public sector bodies to procure assets and services through a form of PPP known as the private finance initiative (PFI) and is committed to providing resources to support PFI deals in the health and local government sectors. Many organisations will have to face the challenges of this particular form of procurement over the next few years.

The PFI is not an easy option. The procurement process is long and complex, and requires a great deal of senior management time, which can have adverse effects on existing services. Nevertheless, many public sector bodies have negotiated successful PFI deals and this paper uses practical case studies and evidence from completed PFI contracts to highlight project management issues that are raised by this form of procurement.

This paper is designed to be of use to hard-pressed PFI project managers who are probably in the middle of the most arduous and pressurised procurement process that they have experienced in their working lives. The paper should also be of use to prospective project managers, as well as to councillors, board members and chief officers who have the ultimate responsibility for the successful conclusion of PFI deals.