PUBLIC SERVICES INTERNATIONAL RESEARCH UNIT (PSIRU)
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Nationalising Special Purpose Vehicles to end PFI: a discussion of the costs and benefits

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The authors would like to thank Professor David Hall for comments on an earlier draft. All data is based on that available at the time of writing and cited in good faith: we welcome comments and corrections.

"*Who shall doubt 'the secret hid*
Under Cheops' pyramid'
Was that the contractor did
Cheops out of several millions?
Or that Joseph's sudden rise
To Comptroller of Supplies
Was a fraud of monstrous size
On King Pharaoh's swart civilians?" Rudyard Kipling 'A General Summary'.

"I think the PFI has been a fraud on the people" (Howard Davies, RBS chairman, on Question Time, January 2018[1])

Abstract

The article's principal purpose is to provide an initial set of costings relating to the proposal to end PFIs in the UK through nationalising the Special Purpose Vehicles. The article uses book value to estimate that the cost of compensating the shareholders of the SPVs on HM Treasury database would be between £2.3bn and £2.5bn. It further analyse the potential savings to public authorities. The article proposes that service contracts are renegotiated so that the public authorities contract directly with the providers, not via the SPV. This secures significant annual savings from the elimination of operating profits, of £1.4bn, indicating that nationalisation will pay for itself within two years. Further the article proposes to honour all outstanding liabilities but to secure substantial refinancing through a new body in which ownership of the SPVs will be vested. Finally the article suggests that as service contracts are ended, either through break clauses or other reasons, the public authorities must bring provision 'in-house', ending outsourcing and also providing further savings from more rational and integrated provision. The approach has been developed on the basis of significant research into how PFIs operate and consideration of the range of alternative solutions to the PFI problem that have been put forward so far. These issues are also explained and developed in the article.

Section 1: Introduction – the extent, scope and nature of PFI projects in the UK

Introduction

The Private Finance Initiative (PFI) / Public Private Partnerships (PPPs) enlists private finance to rebuild and maintain Britain's public infrastructure. It has become an object of public hate and derision[2] and has crippled the public sector with high levels of debt, while instances of shoddy and unsafe construction methods and service provision are regular press items. Nevertheless governments across the globe continue to sign new PPPs. Solutions which will free the public sector from current and future PPPs are urgently needed.

In December 2015 a health campaign group suggested that a way to exit existing PFIs and to challenge the PFI / PPP model in general was to nationalise the Special Purpose Vehicles (SPVs), the companies set up which sign the contract with the public authority and implement the PFI. The proposal sprang from the group's research into the accounts of the SPVs that had signed contracts to rebuild the Royal London Hospital in London's east end and PFI contracts entered into by the South London Healthcare Trusts. This showed the myriad ways in which profits were extracted by the private sector from public assets, via the SPVs. Campaigners drew the conclusion that just as SPVs play the central role in the PFI / PPP model, SPVs must also be central to dismantling the model. In September 2017 the idea was referred to in a Labour Party briefing, prompting a rash of press and 'think tank' comment. This paper is intended to correct misapprehensions and to present initial and sober estimates both of likely costs, and also of the wide-ranging benefits. The paper aims to explain the PFI model and to demonstrate that it is possible through nationalisation to unpick its complex contractual structures.

The Private Finance Initiative in the UK: extent and operation

Background

The Private Finance Initiative – PFI - was introduced under John Major's Conservative government in the early 1990s, but its heyday was under the Labour governments of Tony Blair and Gordon Brown 1997-2010. In 2012 the Coalition government introduced a variant – PF2. (PF2 retains many of the features of the PFI model but the public sector takes a minority equity stake in the SPV, the tendering phase of the project is to be kept to an 18 month limit and so-called 'soft' services are removed from the project.) The total capital invested through PFI and PF2 contracts has been nearly £60bn, providing about 10% of the value of total capital spending in the UK since 1992.[3]

The PFI model became the 'only game in town' [4] for public authorities as governments sought to renew Britain's neglected infrastructure while staying within very tight fiscal rules. While balanced budgets and low levels of government debt have been consistent aims of both main political parties over the last 30-40 years, Gordon Brown's 'sustainable investment rule' introduced in 1998 limited public sector net debt to 40% of GDP. This is an even tighter limit than the Maastricht Treaty's 60% rule for gross public sector debt and has been criticised as completely arbitrary and itself against the public interest.[5] Even so, it is questionable whether the total impact of capital spending on PFI, had it been financed through government borrowing, would have breached even the lower limit. The effect of PFI turned capital outlays financed through government borrowing into current expenditure on the books of public authorities burdening these with debt which is ultimately shouldered by government.

Fiscal and Value for Money arguments (as detailed in the section 2) are weak and possibly spurious arguments for using private finance. A more realistic assumption may be that the use of PFI reflects the strength of lobbying by the financial institutions and construction and service provider firms through associations such as the PPP Forum.[6]

The extent of PFI projects

Information on the extent of PFIs and PF2 in the UK is mainly available in a dataset published by HM Treasury in December of each year – the last available one at the time of writing was published in March 2016. This lists 716 projects, of which 687 were operational and the rest were in construction as at March 2016. 615 of the total number of contracts were signed between May 1997 and May 2010; the period since the financial crisis has seen a marked decrease in the numbers signed – and at one point the PF2 programme was almost abandoned due to the lack of interest from private investors. The average length of contract is 27 years and most will have ended by the 2030s. Total repayments on the outstanding schemes in the dataset is £199bn according to the National Audit Office (NAO) which calculates that 40% of this is to pay for debt and interest payments (see figure 1).[7]

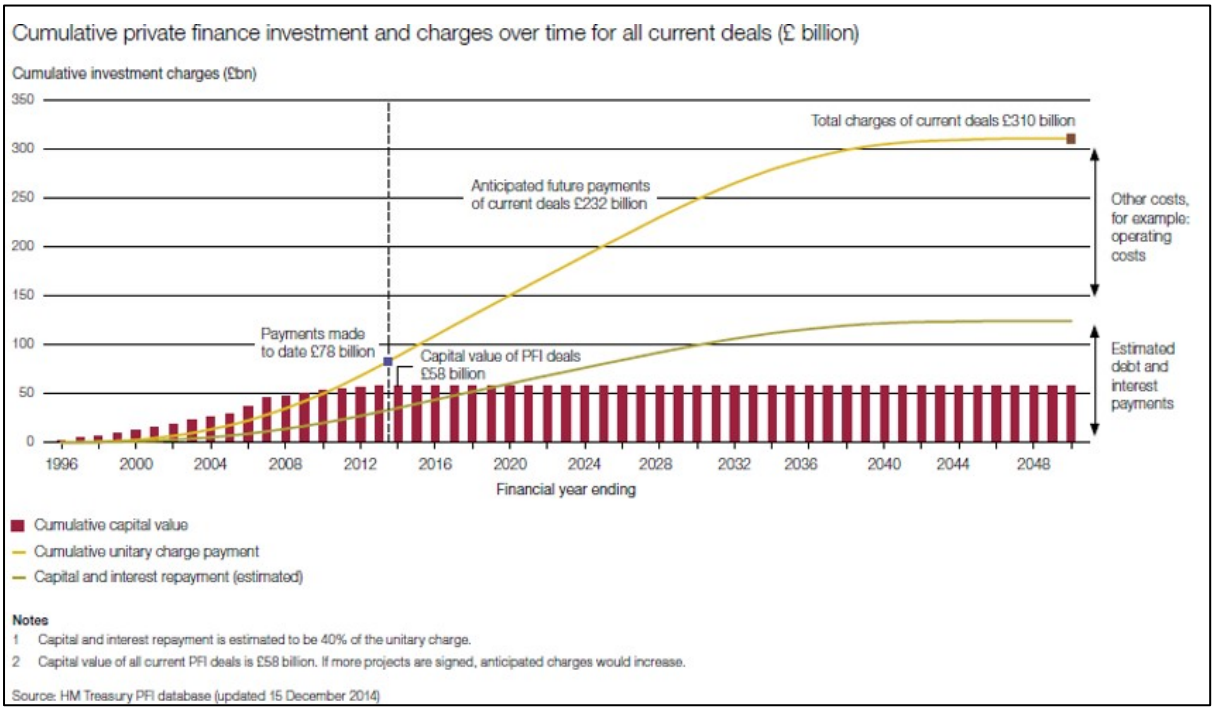

Figure 1: reproduced from National Audit Office (2015) *The Choice of Finance for Capital Investment* , p.24: HM Treasury. https://www.nao.org.uk/wp-content/uploads/2015/03/The-choice-of-finance-for-capital-investment.pdf

The Treasury data includes five PF2 projects and 15 LIFT projects - 'Local Infrastructure Finance Trusts' providing 'integrated' health care centres. The Departments of Health and Education together account for 36% by value of all PFI contracts (Appendix Table 1). The Ministry of Defence has signed two of the most expensive PFIs - Future Strategic Tanker Aircraft and the Allenby-Connaught project to renew service personnel housing with capital values of £2.7bn and £1.6bn respectively. PFI schemes entered into and paid for by hospital trusts and local authorities, (the latter covering schools, waste disposal, housing, social care, highway maintenance, street lighting, libraries and leisure facilities and offices) make up 60% by capital value of all PFI projects, meaning that, while total annual payments for PFI deals is less than 3% of departmental spending, it forms a much higher proportion for some departments (Appendix Table 2).

The Treasury dataset excludes PFI contracts which are not centrally supported by departments and devolved administrations and procured under the standard PFI and PF2 contract terms. Such PFIs include University PFI schemes for student accommodation and sports centres[8], local flood defence schemes and most of the 49 'LIFT' projects. The list includes PFIs sponsored by the Scottish department of the UK government but excludes a variant

on PFI promoted by the devolved Scottish government – the 'Non-profit Distributing' Model or NPD/Hub projects of which 47 are either operational or in construction.[9] Nor does Treasury data indicate the relatively high number of PFIs which have either had to be abandoned (16 projects), have been terminated (20 projects) or been 'bought out' and the contracts ended (11 projects), including the various London transport schemes such as the failed Metronet and Tube Lines for London Underground[10] (Appendix, Table 3).

The PFI contract

The PFI contract to rebuild or maintain a school, hospital etc is signed between the public sector body concerned and the Special Purpose Vehicle (SPV). The contract obliges the SPV to design, build, finance and operate (DBFO) the proposed facility: "The SPVs' only activities and income relate to their contracts with the [hospital] trusts. They are shell companies without employees and simply channel payments received from the trusts to its subcontractors, typically their sister companies".[11]

When a public sector authority advertises for tenders for a PFI project, private consortia of investors submit bids and a couple will be shortlisted. The consortium which wins the bid forms an SPV. All the equity in the SPV is held by the firms in the consortium that won the bid but over time equity shares have been sold on and today nine infrastructure funds have majority equity stakes in nearly half of all PFI projects in the UK. These are funds based offshore.[12] In certain sectors control of SPVs has been monopolised in a few firms. Veolia has 100% share ownership in nearly half the waste management PFIs. Five investment companies control nearly 50% by capital value of all PFI hospitals. Of the thirteen prison PFI contracts, Barclays (BEIF) has 100% ownership of five of the SPVs and G4S firms control another four.

The public sector body pays the SPV an annual 'unitary charge'. This has two elements the first of which is an 'availability charge' which is the cost of making the facility 'available' to the public and consists of payment of interest and capital on loans raised to pay for the facility, lifecycle costs and an allowance for profit to the SPV. The second is a service charge covering the cost of the contracts for maintenance – 'hard facilities management' (Hard FM) and servicing like cleaning – 'soft facilities management' (Soft FM). Payments for hard and soft FM represent on average about 60% of the total unitary charge.

The SPV raises the finance for the project from two sources. Bank loans or bonds provide 90% and is designated as 'senior debt' meaning it has first priority for repayment by the SPVs after operating costs have been met. Bank loans are based on a floating interest rate of LIBOR + a given percentage + an adjustment for inflation. The SPV uses interest and inflation rate 'swaps' to transform these into fixed rate, higher interest loans or bonds. The owners of the SPV provide about 10% of the finance: most of this is in the form of 'subordinate' or 'shareholder' debt and is effectively the 'risk capital' - being most exposed to risks in the project. The owners of the SPV are rewarded for risking their capital through the level of interest allowed on the subordinate debt, usually a fixed rate of between 10 and 15%. Ownership of shares entitles investors to dividends from the post-tax profits earned by the SPV[13]. The SPV's other role is to subcontract the design, build and operation of the project to private construction and service firms. PFI has been a major mechanism for outsourcing and privatisation of so-called 'ancillary' public sector services.

The SPV is therefore at the centre of an array of agreements and contracts (see figure 2 below): *"The centre of any PFI project is a concession contract within which the public sector specifies the outputs it requires from a public service facility, and the basis for payment for those outputs".*[14]

Being in such a pivotal position allows the SPV, and hence its shareholders effectively to capture an income stream derived from public assets. The SPV is the mechanism whereby public assets become the source to provide private profit - to banks, infrastructure funds, construction firms and private service providers.

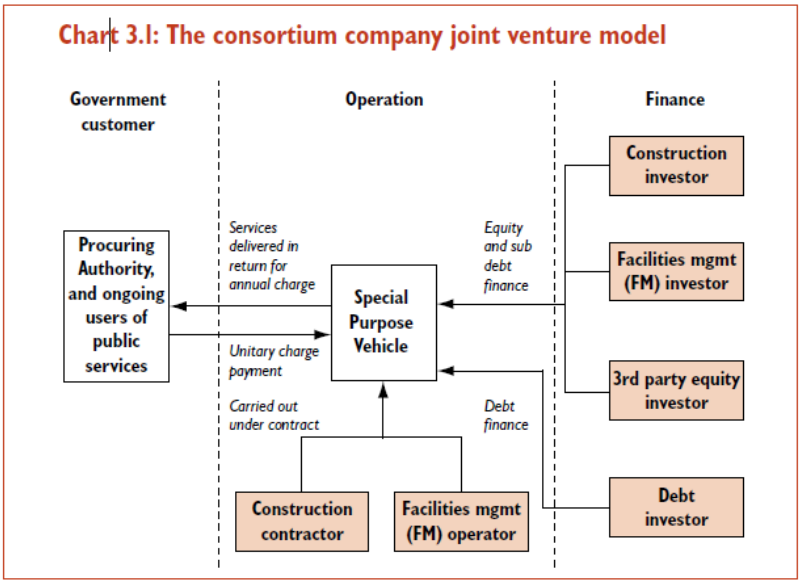

Figure 2 Reproduced from: HM Treasury (2003) *PFI: Meeting the Investment Challenge:* http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/media/F/7/PFI_604a.pdf

Section 2: The PFI model: public cost, private opportunity

Introduction

This section explains the PFI contact in more detail to argue that it rests on fundamentally flawed assumptions and methodology which allow myriad forms of wealth extraction from public assets while imposing costs on public authorities and the wider economy. The PFI/PPP model rest on a conceit: that the public benefits from transferring project risk to the private sector, which, it is assumed (there is no evidence to support the assumption) offers more efficient, effective and competitive delivery. In turn the private sector can reap profitable returns as compensation for its risk-taking, entrepreneurial flair: as a Treasury statement has it: 'Public Benefit, Private Opportunity'.[15] This section summarises evidence on the remuneration for risk to the private sector and the extent to which that risk is actually shouldered. Secondly it examines wealth extraction through the outsourcing of services. Finally it considers the wider costs imposed on society and the economy. Our analysis has relevance to other types of Public Private Partnerships (PPPs) including variants on PFI in the UK.[16]

The cost of private finance and private delivery

Overall the cost of private finance is estimated to have averaged 7-8% per annum compared with 3-4% for government borrowing over the period.[17]

Conventionally public bodies have financed public infrastructure either through central government grants or local authorities could borrow from the Public Works Loans Board (PLWB). Ultimately both mechanisms rely on government borrowing which is always the cheapest option due to the assumed low risk of default. The PWLB rate is slightly higher than the rate for Treasury gilts being 0.5% higher until 2010 when it was raised to 1% higher. By comparison the risk premium on private borrowing is higher still: for the senior debt, bank finance adds a premium to LIBOR (a rate usually slightly above the bank rate), of about 1.4%[18]. Senior debt financed by bonds similarly has a risk premium above a notionally 'risk free investment' ie Treasury bonds. A Treasury report states: *"A risk premium is therefore made explicit in the private sector cost of capital, and the level of return on capital is competitively determined according to the risks assessed in the project".*[19]

The use of interest rate and RPI swaps have further increased the rate of interest on senior debt. Such swaps replace fluctuating interest rates and RPI with a higher fixed rate of interest. They are fixed at rates, available at the moment of financial close, and written into the final terms of the contracts with the public authorities (NAO, 2015). Swaps have raised the cost of the senior debt still further and, according to the NAO, "*increased the inflexibility of PFIs making termination and renegotiation more difficult*" but "*public bodies had little option but to agree to PFI contracts that used interest rate swaps*".[20]

Part of the cost of finance is accounted for by the overall rate of return on investment allowed to the equity owners of the SPV. This is partly the rate of interest on the subordinate loan and partly dividends allowed on profits earned by the SPV: according to the NAO: *"In PFI, the project discount rate, or expected rate of return for the private sector, takes into account the costs associated with procuring private capital and also seeks to price the wider risks associated with lending to the project."* The expected rate of return to equity (interest rate on the subordinate loan + dividends) anticipated at the time contract were signed was on average 12-16%.

Public authorities have incurred additional transaction costs in securing and monitoring the contracts, including significant payments to external advisers. Fees to third party advisers, mainly from the Big Four accounted for 2.6% of the cost of PFI deals closed between 2004 and 2006. By 2011 they may have earned collectively £4bn advising on PFI deals.[21]. Ernst and Young was both 'midwife and undertaker' for London Underground's failed Metronet PPP, earning £50m advising that the project was robust and £900m for running Metronet's business during administration.[22] Public authorities may have secured assets, but these could have been secured through public borrowing. Otherwise the supposed benefits of private finance and provision have not been realised. There is little evidence of better quality build, or significant reduction in delays. Operational costs have not been reduced and there is evidence of poor levels of hygiene and cleanliness, for instance in hospitals.[23] This concurs with a variety of studies covering privatisation, outsourcing and PPPs across nations and sectors.[24]

'Competition' in tendering has also been a chimera: there are few companies with the resources to submit an initial bid and contracts are eventually signed under monopoly conditions with the single 'preferred bidder'. At this stage costs can rise, and the public authority will be under pressure to sign the contracts or risk being unable to proceed with capital projects. Competition in tenders for sub-contracts is also limited, for instance, the investor consortium commonly contract firms in the consortium to undertake construction and hard and soft FM.

Public authorities are faced with inflexible contracts – one of the effects of the use of interest rate swaps. Hence they could pay for a service which is no longer needed such as the example of Parklands High School in Liverpool which is standing empty but for which the council continues to pay £4m a year until the contact ends in 2027-8.[25] The public authority is also paying for the profits required by construction firms and service providers on the sub-contracts who usually expected an average profit of 6-12% (see section 5). The 'life-cycle costs' are an element included in the availability charge to cover equipment replacement needs over the lifetime of the contract. According to the NAO these were priced cautiously, and therefore have been an additional cost for public authorities.[26]

The risks remain with the public authorities. Outsourcing construction has created major costs for public authorities – risks which are becoming very plain such as school walls collapsing (Oxburgh Primary School, Edinburgh), or hospital wards being 'unavailable' due to fire safety breaches (multiple hospitals) or flammable cladding on tower blocks (Chalcotts estate). But they are risks which have not been and cannot generally be costed. PFI contracts have fragmented the delivery of public services, especially where so-called 'ancillary services', such as cleaning, are actually intrinsic to providing a safe service, as would be the case for instance in hospitals and prisons.

The failures of the Value for Money methodology and overcompensation for risk

Levels of risk and hence of compensation to private investors and lenders were estimated before a contract was signed through a 'Value for Money' (VfM) assessment with the bidder's price judged against a 'Public Sector Comparator'. According to Treasury guidance: "*The merits of using private finance should be assessed by considering whether the benefits of using private finance outweigh the additional cost of private finance above government borrowing*".[27] In a study of hospital PFIs, the PFI option was only judged to be better VfM once the so-called risks had been factored in and even then only by a very small margin.[28]

The VfM methodology, as the NAO agrees, was fundamentally flawed. Discount rates imposed by the Treasury made the costs of private finance appear lower: this was achieved through setting the rate too high and applying a fixed, flat rate discount across the whole time period.[29] Calculation of the risks being transferred were based on unwarranted 'optimism bias' which overestimated the superior efficiency and effectiveness of private provision

while underestimating the risks to the public sector such as the costs of being tied into long-term inflexible arrangements. For instance an overrun of 34% was assumed in the Business Case for the Norfolk and Norwich University Hospital, when at the time the average overrun for hospitals was 13%.[30] Rates of return for investors were guided not by assessment of risk but by 'hurdle rates' imposed by company boards for minimum returns on their investment: "*hurdle rates include investors' needs to recover their costs for bids they have not won. The hurdle rate, together with any cash flow requirements set by a projects' bankers established the minimum equity return that investors propose in their bids".*[31]

The existence of PFI credits for local government PFI projects skewed the validity of VfM analysis: according to a 2012 Treasury report, their existence "*provided a budgetary incentive to pursue PFI and, thereby, undermined a genuine appraisal of the optimal delivery route*".[32] Interest in the use of PFIs only gathered pace after local government rules were changed allowing local authorities that developed viable PFI schemes to 'top slice' overall funds available from central government before the distribution formula was applied.[33]

While the rates of return for the investor consortium were anticipated to be between 12 and 16% when the contract was signed, research has consistently established that realised returns have been well in excess of this**.** Vecchi et al, for instance, argue that the rate of return to equity, meaning the combined value of the share capital and shareholder loan, is on average 9% higher than that anticipated.[34] In particular VfM tests did not anticipate or make allowance for other developments which might have been anticipated. For instance, corporation tax rates have declined by over a third since many of the contracts were signed, giving windfall post-tax profits.[35] After the more risky construction period was over, SPVs sometimes refinanced the senior debt: a process which could increase the internal rate of return to investors to as much as 70%.[36] (Recommendations by the Public Accounts Committee established that refinancing gains should be shared with the public authority 50:50 and some projects have reported savings as a result). Finally a lively secondary market in SPV equity has developed with a total of shares to the value of £17.1bn being bought and sold between 1998 and 2016, and providing investors with 'exit returns' average rates of return reaching 29%.[37] One effect of equity sales has been to increase levels of concentration among the main PFI investors in one recent case only one bidder was left at the shortlisting stage. Equity sales have rendered the Value for Money assessments 'null and void', as they did not take account of the additional returns to capital from future sales of equity.

Government reports summarise the situation. A Public Accounts Committee report in 2010 found "no clear and explicit justification and evaluation for the use of PFI in terms of its value for money"[38].

Risks are actually avoided by investors and lenders

The SPV shareholders have ensured that the SPV, and their investment, are protected from many of the risks it faced.

The risk that unitary payments would be missed through default, or termination is mitigated by provisions in contracts with the public authorities imposing penalties in such cases. This has meant that unitary payments are effectively a ring-fenced item in the accounts of public bodies as any lapse risks incurring penalty payments. In the case of hospitals, unitary payments have been underwritten by government through a specific statutory guarantee. In 1997, *The National Health Service (Private Finance) Act* underwrote all unitary payments due under hospital PFI contracts. This was done explicitly to overcome the unwillingness of the financial sector to take

on the 'risks' of investment in hospitals[39]. Moreover PFI credits for local authorities, intended to induce them to sign PFI contracts,[40] have subsidised private profit by removing the majority of costs from local authorities and hence removing risk for investors. Over the last seven years alone 2010-217, £7.57bn PFI credits have been awarded for local authority PFI contracts which represents 10-12% of total unitary payments across sectors and across the UK, and between 17 and 19% across all sectors in England alone (Appendix, tables 1 and 2). Together with the emergency £1.5bn subsidy for PFI hospitals awarded in 2012, the total known subsidy for PFI contracts across local authority projects amounts to £9bn 2010-17.

The SPV's sub-contracts with Hard FM providers ensures that construction risks, including the cost overruns, delays and poor maintenance services for which the authority may charge the SPV, are passed on to the sub-contractors. The SPV investors are similarly insured against the financial difficulties of their sub-contractors. John Laing Infrastructure had nine SPVs in its portfolio where Carillion was the FM provider, representing 9.6% of JLIF's net asset value. It was able to declare on 16 January 2018 that "that the compulsory liquidation of Carillion should have no material impact on the Company".[41]

The use of the SPV as a type of company is itself is a form of insurance for investor companies against risks in the project. An SPV is a 'bankruptcy remote entity'. The primary reason for the investor consortium to set up an SPV is to protect its assets in the SPV even if it the parent company goes bankrupt. This bankruptcy remoteness also works the other way so that "any high-risk project can use the SPV to protect the mother company from great losses should the project fail".[42] Finally, some investors who are also construction companies or service providers, such as Interserve and Skanska, have transferred equity shares in SPVs to their pension funds in lieu of contributions affecting 71 PFI contracts. Interserve and Skanska have made the largest sales.[43] The investors could in fact be using their pensioners as a human shield, in case the risks do actually materialise.

Outsourcing

PFIs have been a driver for outsourcing and privatisation of service provision, and this element has provided the opportunity for considerable additional wealth extraction especially by the investor consortium.

The SPV acts as a conduit between the public authority and sub-contractors: the unitary charge is paid to the SPV which passes the relevant amounts to the various private contractors and lenders. However, monies are not simply 'passed through' the SPV: in the case of service charges significant gross profits are made on the difference between the payments for services made by the public sector body to the SPV - denoted as turnover in SPV accounts - and the payments made by the SPV to the service providers - denoted as 'cost of sales' in SPV accounts.[44] On SPV accounts the difference between the two is referred to as 'gross profits' and these can be very high: one analysis reports that gross profits represented over 30% of monies paid by the hospitals on their PFI contracts.[45] 'Operating profits' are shown after the deduction of administrative costs including project management, directors' and audit fees. Pre-tax profits are shown after the balance of interest received and interest paid and these average 8% of the money paid by the NHS to the SPVs operating the 125 PFI projects in the UK: for some hospitals pre-tax profits represent over 30%.[46]

Absolute figures for profits and dividends derived from the operations of SPVs are important indicators of the potential levels of profit that can be extracted from PFI contracts, and hence the potential for public gains from ending the contracts. Our estimates from a sample of 100 SPV annual reports and accounts for 2016 or 2017, identified annual operating profits of £204.7m or £1,431m per annum based on 699 SPVs, that is nearly 14% of the £10.4bn unitary payments paid to SPVs by public authorities in 2016-17. The same sample identified 55% of SPVs

paid annual shareholder dividends of £140.5m or £982.1m based on all 699 SPVs in either 2016 or 2017, that is 9% of unitary payments in 2016-17 (see section 5).

Profits and dividends, as we have seen, were allowed in contracts (although not at the levels actually realised). In addition SPVs have imposed excessive charges when public authorities require changes or repairs, even tiny ones such as a new key, which had not been specified in the contract. Examples in a 2008 NAO report were legion: the report estimated that public authorities had paid an additional £180m for such changes to PFI contractors in 2006. In one example the figure quoted by the contractor was nearly 1000% more than a local contractor could have done it for. [47]

Negative and positive externalities of private and public provision

Relatively neglected, and certainly not systematically addressed in government reports and academic research, are the costs to the wider economy that PFI has entailed. These are negative externalities - social costs not included in the estimates of 'Value for Money' which are based only on the gains and losses to the parties to the contract. Most of the services and buildings outsourced via PFI are 'public' or 'merit goods', that is private provision will not provide sufficient for public needs. Such services have a range of 'positive externalities' - social benefits not calculated in the contract between the immediate consumer and provider of the service. It is for this reason that historically government began to provide most aspects of the welfare state, as well as amenities such street lighting and a sewage system. As a method of procurement and delivery of these services, PFI creates negative externalities instead of the positive externalities that government investment should produce.

PFI has created specific and potential negative impacts on the public finances. For instance the NAO has reported that SPVs collectively hold about £4bn in surplus cash, retained in the SPV in order to ensure that they can meet their loan obligations. Not only is this public money being used to earn additional interest for the SPV, but were such cash surpluses held by public bodies they may be used to reduce the need for short term government borrowing. As the NAO states: "*These companies are not in public ownership, so there is little, if any, scope to achieve efficiency savings from centralised management of working capital, for example via the Government Banking Service".*[48] Public finances are also damaged when returns to investors find their way to tax havens. The five largest listed offshore infrastructure funds made a total profit of £2.9bn in the five-year period 2011-2017. They paid a total of £13.5m taxes or a tax rate of 0.47%, when the £21.2m of tax credits is included. The five funds collectively paid zero corporate tax in the offshore territories where they have been registered for six years. Two of those funds published accounts to include 2017 and jointly paid no tax in the seventh year. This represents a potential loss of over £600m in UK tax revenue had these companies been registered in the UK. (This is based on UK corporation tax rates that have declined from 26% in 2011 to 19% in 2017).[49]

A potential negative impact on national finances is the effect of outsourcing where former staff are gradually replaced by workers on poorer salaries and conditions[50], involving higher welfare payments by government and less tax revenue. Finally the risk of commercial collapse by contractors imposes additional costs on the taxpayer and delays to public authority plans. There have been several high profile cases of major PFI contractors hitting serious financial difficulties, such as Jarvis which had to withdraw form a TfL contract and most recently Carillion. In the latter case although not all were employed on PFI contracts,377 workers have been made redundant. In addition, 30,000 firms, large and small, have lost payments of up to £1bn, sending a chill through the whole construction sector. The government has to take on pensions liabilities and other public services have to plug gaps in provision.

Meanwhile PWC may be earning up to £750,000 a week advising the Cabinet Office on contingency plans for Carillion.[51]

At the same time the supposed positive effect of using private finance on the national debt has been called a 'fiscal illusion'. One declared aim of PFI was to keep the impact of renewing public infrastructure off the government accounts. The possible increase in national debt had PFI not been used is marginal. The Office of Budgetary Responsibility estimate in 2011 that if PFI contracts were all recognised as debt in the National Accounts this would increase the level of debt by around 2.5% of GDP.[52] Before the financial crisis in early 2008 net public sector debt stood at 34% of GDP.[53]

The impact of PFIs on public authorities is not limited to the costs of specific projects. Unitary payments are a ring-fenced item of expenditure for those public bodies with PFI contracts, and this serves to intensify the impact of austerity measures. Cuts to the income of local authorities, hospitals and government departments are therefore focused on a smaller element of total spend. For instance, in the NHS unitary payments for PFI contracts in 2016-17 represented no more than 1.5- 2% of total NHS spending but for some indebted Trusts PFI payments represented up to 18% of their operating income.[54] This inflexibility may mean that public authorities have fewer resources available for new investment and the development of new methods and techniques. Finally outsourcing has denuded local authorities, hospitals and government departments of skills and expertise in developing, managing and running public services. Such loss of skills to the public sector and in the wider economy will require additional resources to re-establish.

Other costs to the wider public ensue. For instance the first wave of PFI projects saw average cuts in bed numbers of between 7 and 44%. This contributes to bottlenecks in A&E and hence to longer waiting times for ambulances. The half-finished Midland Metropolitan Hospital will have 135 fewer acute beds and in an area with above average levels of ill-health[55]. Fire safety issues in construction impose additional costs, not only on the public authority concerned but also on other parts of the public sector. Poor outsourced services, such as those documented for hospitals and prisons create health hazards and add to the pressure on health services.[56]

PFI contracts have had negative environmental effects. The quality of the built environment is poor. One survey concludes that PFI has produced some especially poor design and notes: "*..the big business, big warehouse box, maximum spend, maximum fancy finances and minimum care and craft on the building model that PFI exemplifies*".[57] Many PFIs have led to the complete demolition of old schools and hospitals. This not only reduces our architectural heritage and experience, it is also a costly environmental approach to meeting new needs.[58] Sheffield city council's PFI contract with Amey for highways maintenance intended to fell and replace 17,500 trees or half of all trees lining the city streets: to date 5,500 have been felled an act condemned as 'ecological vandalism'.[59] Friends of the Earth has criticised the PFI business model for waste schemes which relies on increasing levels of waste, thereby reducing incentives for recycling and the reduction of waste.[60]

International evidence on the effects of PPPs indicates that: "PPPs can even exacerbate inequalities, decrease equitable access to essential services and jeopardize the fulfilment of human rights".[61]

Conclusion

The Treasury has made no systematic analysis of the validity of VfM tests, and of the realised benefits of the use of private finance. Investors have been over-compensated for 'risk' through interest rates and overall rates of return to equity, while insulating themselves against risk and failing to secure benefits to the public sector over and above the basic provision of an asset which could have been secured at half the cost. The overall balance of risk and reward

means that ratings agencies give 'A' ratings to the PPPs it is paid to assess. Moody's recently reaffirmed the 'A' for the operating performance of its rated PPPs, the majority of which are in the UK: "*Predictable, contract-related cash flows; the resilience of project structures to external events (i.e., demand risk); and the relative creditworthiness of offtakers underpin a 'stable outlook'*".[62]

The nature of the contracts developed by SPVs has provided too much insurance against risk, creating a moral hazard of irresponsible behaviour. Investors in SPVs have displayed a rapaciousness and indifference to the problems now being encountered by the public sector as they struggle with ring-fenced payments for inadequate assets. Commenting on one aspect of this rapaciousness – refinancing – a Public Accounts Committee report described one refinancing deal as *"the unacceptable face of capitalism in the consortium's dealings with the public sector"* .[63] Private investors have shown clearly that they have no concept of a social contract – not even the limited one of paying taxes on profits backed by government guarantees! In turn this has created a risk against which the SPVs cannot wholly insure themselves, but was easily foreseen: popular outrage and political campaigns against the whole PFI model.

By understanding the nature of the contract between the SPV and the public authority we are able to focus solutions on this central problem. The simple and effective way to end PFIs is to get control of the contracts by taking over the SPVs – the organisations at the heart of the contract. In the next section we argue that solutions which avoid tackling the contracts end up as little more than tinkering. We also argue that we need to avoid solutions which, being utterly bound up in contractual shackles, put the public at the mercy of the very people who have profited.

Section 3: How do we solve a problem like PFIs? The benefits and drawbacks of proposed solutions

Introduction

Were there a simple way to unravel PFIs there would be less debate – among researchers, campaigners and in the press. Many economic interests are now enmeshed in PFIs and public anger is finely balanced by political timidity and the unwillingness of the financial sector to relinquish profitable deals in a time of vanishing yields. The public interest lies more clearly than ever in abandoning any future PPPs and unravelling operational PFIs, PF2s and NPDs. The private interest remains just as firmly in maintaining current PFIs and lobbying for a future 'pipeline of PPPs. How do we align those two antagonistic sets of interests?

Principles for ending PFI

We can divide solutions proposed so far into two types: those which seek to work around that fundamental antagonism and those which propose meeting the challenge head-on. The former seek to amend contracts, 'claw' back' money through taxation, or to redistribute the debt around the public sector, the latter proposals involve aligning public and private interest by ending the contract. Hence the issue that arises more than any other when solutions are discussed is the basic PFI contract and the numerous and complex sub-contracts and financial agreements which, it is argued, can only be changed, unpicked or broken at significant cost. A Treasury Select Committee noted in 2011:

"PFI contracts are inherently inflexible. Specifications for a 30 year contract must be agreed in detail at the start of a project. The PFI financing structure also requires negotiation with the equity and debt holders before any substantial changes are made during the life of a contract. Debt and equity holders have little to gain from changing profitable contracts so will be unlikely to agree to changes unless they significantly enhance profitability. We have received little evidence of the benefits of these arrangements, but much evidence about the drawbacks, especially for NHS projects. The inflexibility of PFI means that any emergent problems or new demands on an asset cannot be efficiently resolved".[64]

When considering solutions we started with a set of principles which should be applied in assessing their effectiveness. Any solution should, we believe:

- Be consistent with ending profiteering and the financialisation of public services and infrastructure projects, and the resultant commodification of public services;
- Challenge the privileging of commercial priorities and contractual interests at the expense of principles of public interest and mutual benefit;
- Ensure the interests of service users, employees and taxpayers trump those of private commerce;
- Be transparent and accountable to the public;
- Be applicable to PFIs across the UK and in all sectors, and be applied consistently.
- Demonstrate significant savings to the public purse.

In this section we discuss first approaches which seek to end contracts through termination or buy-out. These cases provide examples of savings from ending contracts, but have also fuelled fears that to do so is prohibitively

expensive. Secondly, we consider the pros and cons of 'work arounds': centralisation of debt, windfall taxes, renegotiation of contracts, and default. We do not see any of the solutions as 'wrong' but wish to lay out the merits and limitations of each.

Ending the contracts, ending the PFI model

Buyouts require public authorities and SPV shareholders to agree voluntarily to terminate the contract and private sector players receive lump sums such as the present net value of outstanding principal and interest payments. Terminations may often be enforced on the SPV by the public authority because of the inability of the SPV to meet the terms of the contract, or sometimes because austerity measures drastically reduce the ability of the public authority to meet its commitments, or because private investors seek to end a contract. Termination may be through public authority purchase of equity or, for instance in the case of Metronet and GMWDA, simple transfer of ownership. One third of PFI/PPP contracts by capital value have been subject to buyout, termination or major problems.[65]

Buyouts

To buy out a PFI contract is effectively to request the owners of the SPV to agree to a termination, rather than the termination being forced by circumstances, and penalties on the public body for terminating the contract through buyout may therefore be higher. Eleven buyouts of PFI contracts occurred between 2004 and 2014. It is a solution with some support and some experience and appears as the only, if very expensive, way of ending a contract without lengthy court proceedings. In September 2017 John McDonnell's commitment to bring PFIs 'back in house' was widely interpreted as meaning buyouts and as such the estimated costs were huge: an oft-cited one being £50bn to £60bn for the NHS alone.[66]

The first buy out of an NHS hospital was Hexham hospital, part of the Northumbria Healthcare NHS Foundation Trust. According to figures released under an FoI request and analysed by Mark Hellowell, the Trust paid a termination fee of £114.2m which it financed by securing a loan from the local authority at public sector borrowing rates. In spite of having to pay the termination fee but because of lower capital and operating costs, the Trust estimated it would make savings of just £14.5m over 25 years, or about £0.5m per year – representing 6% of total unitary payments in 2013-14. There were additional savings to the Trust as the 'dividend' payments made to the Department of Health would be reduced by £10.2m (2014-2033).

Northumbria Trust secured savings from the buy-out process but there is a caveat here because savings for the Trust were to an extent achieved through costs to the other parts of the public sector. The reduction in the 'dividend', as Hellowell points out, was an equivalent cost to the Department of Health, therefore on balance no public money was saved from that element. He also notes that for the local council the loan to the Trust: "*reduced its ability to borrow for its own capital requirement and exposed itself to considerable financial risk. Given the tight financial constraints faced by Local authorities in the coming years, few Trusts are likely to have this option*" .[67] Hellowell concluded that in general buy-outs were not a viable method for ending PFI schemes. He did, however, hold out more hope if some central co-ordination of such buy-outs were in place.

It is useful to consider this suggestion: would government involvement in buy-outs across a sector or on behalf of a local authority allow for additional savings? A buy-out is a commercial agreement. If the government accepts the contractual obligations of a PFI, as it must do in these circumstances if it is to avoid legal proceedings, then there seems little room for manoeuvre on most components here, as Treasury advice on renegotiation also indicates. It

may be that some gains could be made by applying a higher discount rate, but again, their hands would likely be tied by general Treasury guidance.

Hellowell provides the following breakdown of the termination fee for the Hexham PFI.

Northumbria Healthcare Trust's estimate of the termination fee	
Component	**Estimate (£m)**
Senior debt repayment	50
Mezzanine debt repayment	1.8
Interest rate and retail price index swap breakage	27
Sub-contract breakage	0.2
Cash balances	(5.5)
Market value of equity	14.5
Transaction costs	1.0
Corporation tax gross-up	18.2
Total	107.2

Two areas in the above table might allow for some leverage. The Trust incurred transaction costs of £1m to secure the termination. The main cost was probably employing Deloitte to make a cost comparison between termination and continuation of the contract. As Hellowell suggests such transaction costs could be covered by government contribution, although, as he also concedes elsewhere, that would be to shift costs from one public body to another. Nevertheless the cost of employing civil servants to do the work undertaken by Deloitte could be rationalised – possibly reducing costs per buy out to £100,000. The other point of note is that the Trust compensated the SPV owners for the corporation tax they expected to pay on the termination fee. Government control might insist that the companies are responsible for this, and would achieve additional gains if the lump sums awarded were taxed at source and not allowed to disappear into tax havens. Such a measure would therefore have positive effects in the form of savings for the Trust but it could be offset by negative effects on the willingness of SPV owners to agree to termination. These two measures could increase total savings from the buy-out by perhaps £19m. Central government co-ordination to assert more leverage on investors might yield some additional savings, but the exercise is still likely to be, as most of the press have rushed to point out, an expensive exercise.

One major problem with buyouts is that the solutions are secret, and, because of the nature of the contracts, the private investors benefit from the process by being able to walk away with all the risks of investment removed and all benefits claimed. The termination deal for Hexham deal included a £1.3m increase in the market value of SPV equity in the final termination fee. The investors, Lend Lease, commented later: "*The most significant company balance sheet change in 2014 was the receipt of a £15.8m dividend from Hexham General Hospital SPC Holdings Limited in October 2014. This cash was retained in the company pending a decision on whether to use it for purchasing additional shareholdings in PFI project companies or returning it to investors*".[68]

To summarise: a buy-out ends the PFI contract securing some, though limited and uncertain savings and, properly implemented, can bring back services and buildings under public control and provision. It has, however, the following disadvantages:

- As a contractual, commercial arrangement, negotiations for termination will centre on what is acceptable to equity holders and the public interest is subordinate.

- The approach does not challenge the PFI model and discourage PFI investors. On the contrary, investors and lenders have much to gain.
- The termination agreement is, like the contracts themselves, shrouded in secrecy and public accountability and input into the process sidelined.
- Each buyout will be conditional on local circumstances and provide a local situation. Ideally some consistency is needed on issues such as compensation within and across sectors.

Termination

Up to 2017 there have been 20 terminations of UK PFI projects, the largest being in 2007 when Transport for London ended two PPP contracts for the maintenance and renewal of various Tube lines. Up to the moment of termination £8.4m of unitary payments had been made and projects savings have only been made public for a few: (£1m by the Royal Armouries, Leeds; £225m for TfL's underground power supply contract £10m on its Oyster Card contract and £250m on City Link and Woolwich DLR extensions). In the case of the Sheffield waste contract termination was found to be too costly and risky but the contract was renegotiated, see 3.1 below. For those that were terminated the terms have not usually been disclosed, but two examples indicate that savings can be made from this route.

In May 2017 the Greater Manchester Waste Disposal Authority (GMWDA) ended its £638m contract with the joint venture company Viridor John Laing (VJLM) by buying the company for £1, effectively a straight transfer of ownership. GWMDA has calculated that refinancing would save £20m a year, a saving which represents 12% on the annual unitary payment of £165m per year. GMWDA also hopes for operational savings that would bring total savings to £37m per year or 22% of annual unitary payments. GMWDA will pay back outstanding bank loans at full value but payment of equity debt has been the subject of negotiation and the full terms of the financial settlement fee are subject to commercial confidentiality.[69] GMWDA did not take the opportunity to bring the operation in-house but put the contract out to tender again, this time in three separate lots: Viridor quickly registered an interest.

Similar levels of savings are apparent from the most significant terminations of a PPP - that of eight of Transport for London's ten PPPs between 2008 and 2013 with a total capital value of £20bn. The three largest PPPs were owned by Metronet and Tube Lines and were to provide investment, and maintenance on 12 London underground lines. Metronet was forced into administration and was transferred to TfL; TfL bought out shares in Tubelines in 2010 for £310m. In the case of Metronet the outstanding debt obligation, of £1.7bn, had been underwritten by government who passed the funding to TfL to assume Metronet's obligations. It appears that no refinancing occurred, so the high cost of private finance continued to be paid. In the case of Tube Lines, however £135m of the £1.5m of outstanding debt was refinanced.[70] While savings on the debt obligations of the three PPPs were limited, and the public therefore continues to pay for the high cost of private finance, operational savings were significant. Overall, on top of gains made by refinancing and in spite of the costs of termination (estimated at £170m to £410) TfL made £2bn of efficiency savings by: *"removing duplication between the companies and the costs of managing the contracts, competitively tendering sub-contracts which Metronet and Tubelines had awarded to themselves, improving planning and scheduling, and gaining much greater flexibility to adjust its operations in response to changing conditions instead of being forced to use a rigid contractual framework for a long period."*[71] In the case of Tube Lines, Standard and Poor's has acknowledged that savings that could be made *"by no longer having to pay shareholder dividends, and by renegotiating subcontracts, refinancing debts, and making various efficiency savings".*[72]

Even tendering for specific contracts to private firms **but outside of the structure of the PPP** itself brought benefits. TfL terminated the Prestige project for the 'Oyster' ticketing system in 2010, and re-tendered the work under a

normal three year operating contract. As a result TfL paid £10m per year less than the costs under the PPP deal, while stipulating higher standards of work.[73]

In addition to buyouts and terminations sixteen projects have been cancelled, usually before any unitary payments were made; between 2003 and 2013 a common reason being either affordability to the procurer or the withdrawal of bids leaving only one bidder. The cost of cancellation has been estimated at £144.3m.[74]

To summarise: cases of successful termination indicate that significant savings can be made both through refinancing and operational efficiencies. However, the process relies on a specific set of circumstances to enable termination to take place, such as break clauses in the main PFI contract, bankruptcy of the SPV, or extreme financial constraints on the public authority. Termination has not necessarily or even usually ended outsourcing.

Mending PFI – the work-arounds

Renegotiation of unitary payments

The immediate call by many campaigners is that the terms of the PFI contract be renegotiated. A recent proposal suggests that: *"Instead of considering termination or nationalisation, policy-makers should plan to use their power and enter into new bargains with the small number of equity investors and lenders who own the vast majority of individual PFI companies".*[75] However a central problem for reliance on renegotiation is the difficulty of getting the SPVs owners and the creditors around the negotiating table and with a willingness to consider proposals which are aimed at reducing public costs and therefore private profit. One recent proposal therefore includes some methods of compulsion, which themselves then present legal difficulties.

What sort of potential gains are likely through renegotiation?

One of the key costs imposed by the PFI model is the inflexibility of the contracts. This is clear from advice given by HM Treasury and the NAO in 2011 and 2013 during reviews of PFI and a drive to encourage public authorities to identify and agree savings on the contracts. HMT's review of 684 operational PFI contracts in February 2011 concluded that savings of £1.5bn over the lifetimes of the contracts were possible. In July 2011 it issued guidance on where such savings could be achieved and in February 2012 it required government departments to report progress in identifying and agreeing savings.

The guidance advised that major areas within the contract were effectively non-negotiable, namely long term fixed rate borrowing for construction and lifecycle maintenance (on the latter savings could jeopardise the value of the asset when it was returned to public control). That left soft services and insurance premiums.[76] The advice given for these areas reveals both further areas of profiteering (higher than needed premiums being paid by public authorities for instance), and the difficulties of and significant transaction costs of renegotiation. The report commented (para 3.19):

> *"Commercial teams in authorities should prepare thoroughly for commercial negotiations and have clear objectives for the public sector going into the negotiation. The principle of variations in PFI project agreements is that the Project Company is left in a "no better, no worse" position, and this includes making sure that the public sector is rebated if variations actually improve private sector returns."*

The rest of the advice must have given many a hapless project manager severe headaches, but they dutifully complied and by June 2013 government departments had reported £1.6bn of signed savings which could be

retrieved over the remaining lifetime of the contracts. The National Audit Office assessed the reliability of 15 of these reports on whether there was 'sufficient evidence' to support claims for savings. It found that there was sufficient or partial evidence to support 93% of the signed savings.[77] The two departments sponsoring half of all PFI contracts – Health and Education – reported together just £63m of the total. The Department for Transport reported £478m and the MoD £252m.[78]

Even if we accept the original £1.6bn as a realistic figure it represented just 0.7% of total unitary payments then due: total unitary payments of the 667 PFI contracts which were operational according to the Treasury database dated 31.3.2013 amounted to £218bn[79]. In addition the Treasury reported £2bn of 'pipeline' savings - which express the hope of future savings, (the NAO could verify £1.3bn of these). In total therefore departments reported maximum signed and pipeline savings of £3.6bn or 1.7% of total unitary payments due between 2013 and 2039.

A public authority will have significant transaction costs in a renegotiation and would need to be very sure that some concessions could be wrested from the SPV. A national government negotiating body might have more leverage and provide economies of scale for renegotiation across PFIs but in the absence of central resources renegotiation is a tortuous road with limited rewards at the end. On the other hand it promises rich pickings for consultancy firms and lawyers: some of them the same firms who advised that the PFI option was value for money. Moreover, as has happened in the past, significant details in the variation to contracts is also likely to be branded commercially sensitive, removing transparency yet again from the contracting process.[80]

Nevertheless there is some evidence that renegotiation can bring gains, Most recently Sheffield City Council, having considered terminating its waste management contract with Veolia agreed in December 2017 that the costs and risks of termination were too high. The new agreement has been secured after Veolia proposed an annual reduction in payment amounting to £3.558m per year (or 13% of the total estimated unitary payments in 2017 of £27m), as well as a one off payment by Veolia of £5.6m to resolve 'a number of outstanding disputes'. Details are confidential.[81] It should be noted that this came about after Sheffield City Council agreed initially to terminate the contract in January 2017 and this may have induced Veolia to consider changes.

The NAO report described above indicates that the main gains from 'renegotiation' were realised by the Department of Transport and much of that appears to have stemmed not from renegotiation but from Transport for London's termination of eight of its ten PPPs.

To summarise the problems of relying on renegotiation:

- Companies have little incentive to give ground, especially for deals guaranteed by government and negotiations will centre on what is acceptable to investors;
- Transaction costs for public authorities are high;
- Coalition plans to make savings had miniscule effect;
- Renegotiations are secret as are the revised contracts providing little public guarantee of beneficial outcomes;
- The solution does not challenge the PFI model but could perpetuate it.

Centralisation of PFI Debts

In the health sector, a proposal has been made to centralise NHS PFI debts in the Treasury as the first step to discussions on reducing NHS PFI debts. It is not clear if the proposal is to transfer all unitary payments to the

Treasury or just the 'availability charge'. The proposal is part of a bid to restore a publicly provided NHS, and as a response to the havoc wreaked on hospital finances by PFI.[82.] The problems in the NHS are such that relief from unitary payments is urgent: in 2014 four out of six Trusts with deficits over £25m had PFI schemes. In London in 2013/14 seven out of the ten NHS trusts with the biggest deficits also had large PFI obligations.[83] At Peterborough hospital PFI payments represent half of the Trust's annual deficit.[84]

However, the scheme can only be seen as an interim step in particular the proposal does not offer any guidelines on how the debt burden is to be reduced or the contracts ended.[85] The proposal is therefore only hopeful that the Treasury would be able to renegotiate payments to secure reductions in payments. However, once the debts are fully acknowledged by the government this could serve to make them truly gilt-edged actually enhancing the value of the debts on the banks' balance sheets. In addition, nothing is said which indicates how to resolve the outsourcing that has occurred through PFIs or the other costs of PFI.

Centralising unitary payments in the Treasury can be no more than an interim step. However, the proposal recognises the need for central control and direction if the next step – ending the contracts is to be realised.

Windfall tax on PFI companies

Value for Money assessments were based on ensuring an internal rate of return for SPVs, which in turn assumed a certain rate of tax. For instance, according to one calculation, most of the PFI deals that one offshore infrastructure funds – HICL - has ownership stakes in "were signed between 2002 and 2007 when corporation tax was 30%".[86] Currently corporation tax is 19% and likely to fall further. Research shows that 105 PFI companies in the NHS could have saved up to £84m between 2008 and 2015 as a result of changes to corporation tax, and that between 2016 and 2020 they could gain a further £106m.[87] In addition SPVs have been able to claim building costs for a new structure as an allowable revenue deduction for tax purposes.[88]

These facts have prompted calls to reduce tax benefits enjoyed by SPVs. In October 2017 one amendment to the Finance Bill proposed to cap the interest that PFI companies can write off against tax. It is a solution which might be simple to administer, although its savings have not been costed. A second amendment aimed to ensure eventually that "companies involved in PFI" – that is those who have "entered into a PFI contract with a public sector body either under the PFI or the PF2 initiative" - pay tax at the rate it was when their contract with government was signed.[89]

There are advantages to the Exchequer. PFI contracts in the NHS represent about 24% of the capital value of all PFI / PF2 projects, giving overall gain in collected corporation tax of about £0.5bn 2016-20 (given NHS lost tax of £106m see above). Such losses to PFI companies might act as a deterrent to potential future investors, and through that it could have an impact on the numbers of equity sales. However, it is difficult to predict if overall the sums would be large enough. If it were a deterrent, then the gains to the government would be correspondingly reduced.

Tax measures can be a valuable accompaniment to other, more comprehensive approaches to PFI providing annual savings to set against the overall costs of compensation, but as a 'stand-alone' approach the idea is a very limited one, failing to address all the more pressing and deep-seated problems. For instance, a windfall tax is a one-off payment when the public sector requires steady and assured annual budget allocations. In fact, the proposal provides no immediate nor even longer-term relief to users of services and workers in the public sector. It is unlikely that a specific change to the methods for taxing SPVs could in addition stipulate that funds so raised are returned to the public sector bodies concerned. If such a stipulation could be made, the gains to the hospitals would not be large. An overall gain 2016-20 of £106m that translates into £1m per hospital contract, or about £200,000 per year. If

that money were to be returned to the hospital concerned it would be useful in today's straitened circumstances, but only mildly in the face of deficits sometimes exceeding £100m.

The proposal also fails to take account of the transaction cost of administering the tax which if factored into any fiscal gains would reduce them, perhaps significantly. Calculating taxable amounts is complex: company accounts are not some objective reflection of a company's activities but works of art. As one report comments: "If the government was able to calculate that discount…"[90] – the operative word is 'If". Indeed if taxation is to be used to control, or make PFIs less attractive to investors, there are many, more comprehensive, approaches. One is a concerted attack on tax havens which are UK Crown dependencies: some suggestions are outlined by Tax Justice Network.[91] Another is to campaign to raise corporation tax generally.

It should also be considered that the tax is not free of legal complications: a windfall tax which singles out SPVs could open a floodgate of judicial reviews every time a change in corporation tax is made, on the grounds of unfair discrimination. Finally, and perhaps most importantly, a windfall tax would not address the high cost of private finance or inflexibility of contracts, and would leave the SPV contracts in the hands of those who currently own them

In summary a windfall tax as a solution to PFIs implicitly accepts the logic of the PFI model but seeks to ameliorate just one of its more scandalous aspects.

Default

The final 'work around' is to default on the debt. It is a solution usually discussed in the case of sovereign debts. Countries that default may do so explicitly in defence of the 'public interest' sometimes invoking the 'odious debt' argument.[92] Odious debt has been defined as: "having been contracted by a corrupt regime, not contracted in order to meet the needs of the people, and contracted where the lender was aware of the immoral use that the funds would be put to."[93] Odious debt is therefore a narrow legal term that only refers to a specific category of debt. However some of its premises have fed through into the concept of 'illegitimate debt', a term with much broader reach but lacking an accepted definition and therefore any legal precedents for its application. It has, however, been actively debated since the late 1990s when Jubilee campaigns were under way.[94]

Debt is described as illegitimate where it has been set up in violation of law or universally accepted legal principles or where the debt is legal by strictly defined criteria but nonetheless violates socially accepted norms. In addition the following characteristics of 'illegitimate debt' have been identified:

- incurred by undemocratic means,
- entered into without transparency,
- based on fraud or deception,
- incurred for non-viable projects,
- set up in such a way that it cannot be serviced without undermining basic human rights (such as health),
- based on grossly disadvantageous terms, such as usurious interest rates and/or onerous and harmful conditions,
- concerned with purchasing overpriced or unnecessary goods and services.[95]

Conceptually, PFI payments may be said to fall into most of these categories. Section two described the lie at the heart of the PFI contract and conflicts of interest are apparent in the roles played by the Big Four accountancy firms.

However, there is as yet no legal basis for default or haircuts for debt such as PFI, however strong the arguments on grounds of equity and justice. In that situation there is the danger that default by a specific public authority would simply end in protracted law suits.

Default on debts, or insisting on a haircut puts the public sector firmly before private interest, is open and transparent and can provide financial relief for services. The undeveloped legal basis could result in uncertainty for the service concerned, high legal costs and could only relate to each specific PFI contract – no court case would have any general applicability.

Section 4: Nationalising Special Purpose Vehicles: principles, policies and mechanisms

Introduction

This section first, outlines the advantages of nationalising SPVs, and why it is an appropriate response to the PFI problem. It then considers the principles to be used to determine the price of equity and to handle outstanding liabilities. Finally, it considers administrative mechanisms. The section provides the reasoning that informs the estimates of costs and savings from nationalisation outlined in section 5.

Basic advantages of nationalising SPVs

Taking ownership of the SPVs is to take ownership of the contracts with the public authorities, giving the proposal a number of strengths lacking in other solutions. First, unlike buyouts and terminations nationalisation allows the government to 'write the rules' for the end of PFIs. Buy-outs involve commercial negotiations between individual public bodies with limited resources and major financial entities with access to expensive legal and commercial advice. Nationalisation means that levels of compensation to shareholders, banks and bond-holders and the public are determined by act of Parliament. Secondly, unlike default, centralising the debt, windfall taxes and renegotiation, nationalisation of the SPVs and ownership of the contract challenges the PFI model. Thirdly, unlike renegotiation, unitary payments can immediately be reduced for the majority of PFI projects: they would no longer need to cover all the costs incurred by private ownership including shareholder dividends, directors' and auditors' fees and charges for management companies.

There are other important strengths. Other forms of profiteering will end. It would no longer be possible to trade in SPV equity and so extract additional wealth from ownership. The flow of funds to tax havens by investment funds would stop. Nationalisation would overcome the problem of commercial confidentiality of contracts because this would be waived under public ownership, indeed nationalisation is the only solution which makes contracts available to the public and renders transparent the gains and costs to all parties of the process ending the contract. Thus as a result of the above strengths, the measure fundamentally challenges the PFI model, as it is the various opportunities for wealth extraction and rent-seeking behaviour that make PFI deals attractive to investors.

Is nationalisation appropriate in this case?

There is no single model to justify public ownership. The economic realities of 'market failure' including monopoly or the need to safeguard national security or promote public health explain why nationalisation and municipalisation is a tool used frequently by conservative and social democratic political parties alike.

In the UK public ownership has been in response to a range of market failures and the need for strategic direction of the economy: a few historical examples are provided below.

- Private monopoly: coal (cartel), railways, canals, telegraph and telephone, gas, electricity. All of these, except coal, are 'network' industries rendering them 'natural monopolies'.
- The need for government control of strategic sectors either for defence or export purposes, or the 'commanding heights' of the economy: Rolls Royce, UCS, Royal Ordnance, cars. Railways, coal, iron and steel, etc., national freight fit into this category also, as do the banks nationalised and part-nationalised in the wake of the 2007-8 financial crisis.

- The need to limit state subsidies: British Sugar.
- The need to provide 'public goods' or 'merit goods': health, education, water and sewage and various sectors which have been municipalised - council housing, parks, highways.
- Needs of war and national defence: land and factory requisitioning, takeover of transport, conscription of labour and capital for war.

The nationalisation of an entity like an SPV, where the main assets owned may be entirely 'intangibles' and in the form of an income stream in many cases underwritten or subsidised by government, is outside the usual scope of nationalisation. Nevertheless the proposal to nationalise the SPVs seeks to end the negative impacts on society of excessive profits, low wages, tax avoidance and outsourcing, while ensuring that the positive externalities of state provided services are fully realised.

The process of nationalisation

1. Nationalisation of SPVs will require an Act of Parliament.

We have considered the programme for nationalisation. There are three options here which could be considered in the light of the conditions prevailing when the Bill is drafted. Whichever programme is followed legislation must apply the same criteria for the compensation and for the future management of operations.

- Nationalise SPVs individually, for instance where specific hospital trusts or schools projects are facing very high PFI charges, deficits and cuts to staff and provision.
- Nationalise SPVs in sectors where an integrated, national and planned approach is required, such as waste management and roads. As such nationalisation of SPVs can be part of programmes to improve R&D and technical innovation, reap economies of scale and manage environmentally sustainable demand.
- Nationalise all outstanding PFIs and PF2s at the same time in order to break interest rate swaps swiftly and at minimal cost as outlined below. This is the authors' preferred approach as it is straightforward and provides certainty for the both the public sector and private investors and creditors, see section 5.

2. Once the net assets have been bought by the government, all the assets and liabilities of SPVs would be owned by the taxpayer but vested in a Non-Departmental Public Body (NDPB)[96] which would administer the SPVs for the remainder of their lifetimes.
3. We have considered the responsibilities of the new NDPB. It should have two primary responsibilities: to renegotiate the PFI contract with the public authorities handing back all service contracts to them, and to refinance outstanding liabilities. Both should be guided by the principle of maximum gain to each public authority concerned. In addition the new NDPB may also serve as the driving force in rebuilding the public sector's capability to manage and carry out the range of services which have been outsourced in recent years. The central direction through the NDPB provides the consistency and authority to deal with numerous and different types of PFI contracts.
4. We have also considered the independence of the new NDPB and the implications for staffing. Important decisions will be made by this organisation, and the public needs assurance that decisions contrary to the spirit of the Act are not smuggled in through the back door. Avoiding this may require specific guidance in the legislation.

Compensation following nationalisation: historical and legal considerations

Nationalisation means transferring ownership of the SPV to the government. Nationalisation of SPVs is not an end in itself but the first step to controlling PFI contracts, returning service provision to public authorities and ending profiteering from public need. Compensation for shareholders is a simple transaction cost to bring public

infrastructure back under public control and accountability. It is necessary to establish in the Act the principles under which compensation would be awarded in order to reduce the scope for subsequent shareholder challenge and to ensure that the provisions in the Act relating to compensation reflect the reasons for nationalising SPVs.

Historical considerations

Historically compensation has been awarded for tangible assets which are nationalised, and from which the government expect to receive further use. PFIs are merely alternative methods of *procurement* and SPVs are a different type of company being mechanisms for raising and financing debt and acquisition is simply a transition to ending the contract and the SPV itself.

Historical precedents show that levels of compensation awarded are not simply the outcome of an accountancy exercise but reflect the balance of political forces. Various historical examples where governments expropriate private owners, whether through nationalisation or through other reassignments of property rights demonstrate this: the dissolution of the monasteries, enclosures reassigning land between the 16th and the 19th centuries, requisitioning during the Second World War or nationalisation after it. The abolition of slavery in the British Empire involved payments for compensation to slave owners of £20m, or 25% of the national budget: thirty years later in the US slaves were freed with almost no compensation paid to former slave owners.

In the UK, market value or the value of assets 'as between a willing buyer and a willing seller' has frequently, but not always been awarded for tangible assets. This principle meant that high levels of compensation were evident during the 1945-51 Labour government. Compensation to coal owners amounted to £166.6m, to railway owners £901m for what Hugh Dalton called 'a very poor bag of physical assets'.[97] This generosity may be ascribed in part to the role of the New Fabians who developed Labour Party economic policies in the 1930s and who were concerned at that time with the possibility of 'civil war' if compensation were not generous[98]. However, there are significant exceptions. Factories, land and stately homes were requisitioned during the second world war with compensation issues delayed till hostilities were ended.[99] In 1977 the Aircraft and Shipbuilding Industries Act took over a range of aircraft, shipbuilding and marine diesel companies. Compensation, exchanging shares for government bonds, was based, for listed companies, on the average quoted price of shares for the six months before the election of the Labour government in February 1974: for unlisted shares the value of bonds was decided by negotiation with the right of appeal to a special tribunal. In the case of Northern Rock (2008) no compensation was allowed.

Legal requirements

Property rights are neither absolute nor universal: they are defined by the laws of each sovereign state. When a government decides, in the public interest, to reassign property rights in a specific instance there is no obligation for it to compensate those disadvantaged by the change. Public interest in a sovereign country is paramount in decisions on compensation: there is no fixed formula and compensation is 'determined in each case by Parliament'.[100]

There is no legal requirement under UK or EU law to pay market value. The Court of Appeal upheld decisions by the British government when it refused the claims for compensation submitted by Northern Rock in 2008 and by shipbuilding and aerospace companies in 1977. Both of these were taken to the European Court of Human Rights by a group of the shareholders. In both cases the court ruled that: *'Legitimate objectives in the "public interest", such as those pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value.'*.[101] And both decided that in such cases the Court 'will substantially defer' to national governments.

Legal arguments for full compensation under international law have turned on cases where the expropriation was deemed 'unlawful'.[102] Such arguments do not apply to this proposal because it will be implemented through an Act of Parliament and because the proposal will have been thoroughly aired in widespread public discussion of which this paper forms a part. Resolution 1803 of the UK General Assembly of the UN states that governments have the right to expropriate foreign investors on the grounds of "public utility, security or the national interest," and to provide "*appropriate compensation in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law".*[103] 'Appropriate compensation' can range from full to no compensation. Case law indicates that full compensation may be relevant where a foreign investor was invited to undertake a project and where alternative sources of investment were not available, however, it need not be paid where there is full scale nationalisation 'as part of economic reform'.[104] We consider that nationalisation of SPVs is in indeed a part of economic reform. One authority argues that partial compensation tends to be the norm and is justified "where the past practices of the foreign investor were harmful to the host state or where there had been inordinate profits made from the investment".[105] Significant issues here are the length of the contract, bad industry practices and 'inordinate' profits. Other countries have pursued the claim that items may be deducted from compensation such as past excess profits, overdue taxes or recompense for claimed damage from bad business practices.

Valuation of nationalised SPVs

1. Compensation should not be based on market value. The reasons for this are:

- Any sum given for market value is an estimate: there is no 'price discovery', no 'auctioneer' for establishing share price as SPVs are generally not quoted on the stock market and sales of shares are arranged via private negotiation.[106]
- Market value could be established through analysis of past sales of equity of SPVs, but the value of the shares will reflect future anticipated profits at the same excessive rates of return. The 'market value' of PFIs relies on explicit or implicit government support and subsidy. It is therefore perverse to consider compensation based on anticipated future earnings themselves underpinned by tacit or explicit government financial support.

2. Our estimates of the cost of compensation are based on the book value of SPVs. Book value represents the difference between company's assets and liabilities as stated in their annual reports and financial statements.

- Book value is a practice widely used for expropriations across the globe according to a UN investigation[107];
- Book value is viewed in accountancy analysis as an accurate measure of owners' equity whereas market value reflects expected future earnings which are 'abnormal earnings'[108];
- This principle would also appear to be in line with the safeguard for the public outlined by the Treasury in 2003 that where a PFI is considered to have 'fallen into default' by reason of poor performance the public sector has the right to terminate the contract and "*compensation is only due to the private sector for the true value of assets taken over by the public sector less any rectification costs. In extreme circumstances this could result in no payments*".[109]

3. The government should award shareholders compensation in the form of government bonds. The sums awarded should be according to the book value of each SPV, each shareholder receiving such compensation in proportion to its share of equity in each SPV. Historically in cases of compensation for expropriation UK governments have issued specific types of stock.

It is suggested that the following conditions might also be applied to the awards:

- Limitations imposed on the subsequent sales of bonds, in order to avoid speculation in this form of government stock.
- Tax on interest on the issued bonds should be at source to avoid compensation income ending up offshore, ie, an equivalent of PAYE.
- Where investors have transferred their equity in SPVs to their pension funds in lieu of payment, it is expected, or could be legislated for, that investors must reimburse any losses of expected revenue and make up any deficits incurred.

Deconstruction of the PFI contract, service contracts and financial agreements.

Service contracts

We propose that the new NDPB should immediately renegotiate contracts between SPVs and the public authorities so that all continuing service contracts for hard and soft FM are directly between the service contractors and public authorities. The public authority would now pay service charges directly to the service providers, according to the payments agreed in the original contract between the SPV and the service providers. The effect of this is to restore to the public authorities the margins appropriated by the privately-owned SPV when acting as conduit for service payments. Substantial savings can be made in this way with significant reductions in total annual PFI payments. The public authorities may use these additional monies either elsewhere in the service, or to intensify the monitoring of existing privately-provided service contracts.

We propose that the Act stipulates that as service contracts are ended, either at break clauses or because of poor performance, the services **MUST** be taken over to be performed by the public authority. We have been concerned that many buyouts and renegotiations have not ended outsourcing, yet that is a major aim of this proposal and is essential if the full efficiency gains are to be reaped. A further option is to stipulate in the Act or a supplementary Act levels of service provision, rates of pay and working conditions under which all public contracts must operate. This could have the effect of encouraging contractors to seek to end the contracts themselves.

Availability charge

The 'availability' charge may be broken down into three elements: lifecycle costs, interest and principal on senior and shareholder loans, and allowance for dividends to the SPV.

We propose that the availability charge continues to be paid by the public authority to the SPV with the following optional exceptions:

- Lifecycle costs are removed from availability charge payments to the SPV. As the public authority now has direct responsibility for hard and soft FM it is logical that it retains monies for lifecycle costs.
- Whatever element was allowed for dividends to the shareholders in the SPV in the original PFI contract is returned to the public authority OR
- Allowance for dividends remains with the SPV at least initially to ensure liabilities can be met.

Senior and shareholder debt

Senior and shareholder debt forms the largest element of the availability charge and would continue to be paid through the SPV. Senior debt may have been insured through interest and inflation rate swaps: we propose below to

pay off interest rate swaps separately and this reduces interest rates on senior debt significantly. All interest and principal payments on shareholder debt and on the senior bond would be honoured as far as possible from the assets of the publicly-owned SPVs, that is from whatever proportion of the availability charge continues to be paid to the SPVs by the public authorities.

We propose that as soon as possible the NDPB refinances all senior and subordinate debt. We suggest that a suitable rate of interest would be that at which local authorities can borrow, either from the Municipal Bonds Agency or from the PWLB. We suggest this to ensure a level playing field between those local authorities which used PFI to finance capital investment and those which borrowed in the traditional manner from the PWLB[110]. Refinancing would secure significant savings for the public authorities. It would reduce creditors' anticipated return on their loans, but fluctuating rate of interest for senior bondholders would be replaced with fixed rates, while former shareholders would exchange their unsecured loans for secured repayments.

Interest rate swaps.

Payment of interest under interest rate swaps are also part of the availability charge, as the fixed higher rate was agreed at the time contracts were signed. Interest rate swaps increased the cost of private finance for public authorities, fixing rates at a high level while costs of government borrowing have been historically low. Interest rate swaps have also had negative effects on SPV accounts. The NAO estimates that collectively the net position on swaps in SPV accounts is £-5.8bn but suspects the figure could exceed £-6bn. It also estimates that SPVs collectively show £4.4bn in cash held at the year end. The reasons for these cash surpluses were not discussed in the report, but at least one cause is the need to build up reserves to finance interest rate swaps. The NAO comments: "if the shareholders wanted to buy-out the contract this payment would be required to exit the swaps".[111]

There are three possible options to deal with interest rate swaps.

> Option A: All swaps are broken and breakage fees paid to the extent that cash balances on the accounts of SPVs allow. Additional costs to the Treasury are avoided.
> Option B: All swaps are broken but no breakage fees are paid. This represents default but could be justified given (a) the setting of the premium on the senior debt interest rate was opaque and that (b) such contracts were signed under a form of duress. According to the NAO *"public bodies had little option but to agree to PFI contracts that used interest rate swaps. Public bodies and the PFI companies didn't want to be exposed to interest rate movements. HM Treasury was not willing to provide protection against future interest rate movements".*[112] Finally (c) given low rates of interest since 2008 the counterparties to the swaps have made very significant gains indeed.
> Option C: Swaps are not broken but renegotiated as part of the refinancing of the senior debt.

Post nationalisation: effects on public debt and borrowing

The national debt would increase in line with the one-off costs of bonds issued to the SPV shareholders. The effects on the government's budget would be neutral until the end of the contract as total payments would remain the same: however the public authorities concerned would see their overall costs of debt and services reduced and would have additional monies to deliver services. As service and maintenance contracts are ended and workers are directly employed on improved wages and conditions, normal economic analysis would expect this to result in increased tax revenue and reduced welfare benefits as outsourcing payments decrease. The increase in the national debt is insufficient to risk "a significant rise in the risk premium on all government borrowing".[113] The current gross

UK national debt, as at March 2018 stood at £1.78 trillion: the likely cost of nationalising SPVs described in section 5 represents 0.14%.

Conclusion: Pros and cons of nationalising SPVs

The government will incur an initial cost of compensating former owners. However, significant savings are expected to arise from:

- Refinancing debt
- Transferring service contracts to public authorities thereby eliminating the SPV margin on service contracts
- Achieving other economies, potentially, eg through more rational use of resources across sectors or across local authorities.

Problems can be found to each and every solution, and this is true if the government nationalises SPVs. The most contentious element of any nationalisation proposal is compensation…for the shareholders, loan and bond holders and sub-contractors. After the announcement by John McDonnell that the 'presumed preferred approach to ending PFIs in the UK was to nationalise SPVs through an exchange of shares for bonds', many commentators rushed to judgement on the cost.

John Laing Infrastructure Fund, a firm whose shares slipped significantly after McDonnell's announcement, argued that it would be entitled to 86% of the value of their investments in PFI due to: "legal contract provisions regarding the compensation to which a project's equity investors would be entitled". Scaled up to the 700 odd PFIs on the Treasury database this equates to a total figure of £51bn".[114] Nevertheless JLIF has recently announced that it sees the political environment in the UK as increasingly inhospitable and plans to shift its focus overseas.[115]

Others have assumed either that the proposal means expropriation without any compensation or, at the other extreme that "the returns on PFI are so significant, the price at which investors would be willing to sell might be extremely high".[116] The former view is unwarranted, the latter expresses a common fallacy concerning the powers that can be contained in an Act of Parliament.

Hence Moody's review of Labour's policy to renationalise energy and water networks expresses a more nuanced view:

"In principle, the UK Parliament can change existing laws, licences and even private contracts, including financing documents. In practice, however, any future Labour government is likely to be constrained by a desire to avoid damaging investor confidence in the UK's institutional arrangements and legal agreements….

It would be necessary for parliament to determine the compensation payable for any assets or companies that are nationalised or transferred to a new form of ownership….. the level of compensation would fall within the wide discretion of parliament…. Although the process of nationalisation and the level of compensation could be subject to judicial review, primary legislation cannot be overturned by UK courts. If an Act of Parliament was found to be incompatible with the European Convention of Human Rights, which protects against deprivation of property6, the courts could issue a declaration of incompatibility but not overturn the legislation.

Investors could also appeal to the ECHR, as they did in the nationalisation of Northern Rock, but the Convention allows states to act in the "general interest" and the ECHR has previously taken the view that national authorities are better placed than an international judge "to appreciate what is 'in the public interest'".[117]

There has therefore been a broad range of responses to Labour's nationalisation plans, but we need to consider the pros and cons of nationalising SPVs without preconceptions as to what levels of compensation must be awarded, could be awarded, and the powers of the judiciary.

Section 5: Acquiring SPVs based on current net shareholder equity

Introduction

This section estimates the cost of nationalising SPVs based on the stock of PFI/PF2 projects at 31 March 2018. Secondly, it identifies the current scale of offshore infrastructure fund, pension fund, other private sector companies and public sector ownership of SPVs. Thirdly, it proposes a means of differential treatment of SPV assets and concludes with estimates of the potential savings from nationalisation, in particular, re-financing senior and subordinate debt, eliminating the cost of private ownership especially operating profits, operational cost reductions post nationalisation and the implications of interest rate swap breakage costs.

Data and methodology

HM Treasury data consists of current PFI and PF2 projects in the UK. PFI projects in Scotland are included, although Scottish Government Non-Profit Distributing (NPD) projects, essentially PFI projects with a non-profit component, have been excluded because they are a Scottish Government responsibility[118]. The NPD hub programme had 47 signed projects with a capital value of £2.7bn by December 2017. Some Local Improvement Finance Trust (LIFT) projects are included in the HM Treasury current projects database, but the programme only operates in England.

The HM Treasury database of current PFI projects identified 716 contracts at 31 March 2016. The data to 31 March 2017 was expected in December 2017 but was only published in late March 2018 at the conclusion of this research. In the absence of the release of information on the current number of PFI projects by HM Treasury, the total of 716 projects was amended to take account of two projects that were in procurement in 2016 and 19 projects that will conclude by 31 March 2018, giving a total of 699 current at this date. The HM Treasury data to 31 March 2017 identified 715 current projects of which 699 were operational and 16 in construction, but the data did not take account of the projects planned to conclude by 31 March 2018. Therefore, the figure of 699 current PFI/PF2 projects remains a reasonably accurate total number of projects at 31 March 2018 on which to estimate the cost of acquiring SPVs.

The rate at which current PFI contracts are concluded and new projects are signed varies annually. In addition, further buyouts and terminations are likely given the rate of 74 PFI projects subject to buyout, bailout, termination and major problems by early 2017[119].

A sample of 100 SPVs reasonably proportionate to the different sectors, capital value, geographic location, and date of financial close in the projects in the HM Treasury current projects spreadsheet was used to identify net shareholder equity, operating profit and administrative costs using the latest SPV annual accounts for either 2016 or 2017 from Companies House. The distribution of SPV equity ownership by offshore infrastructure funds, other private sector companies including Carillion, pension funds and the public sector was obtained from offshore fund portfolios (only UK assets), HM Treasury current projects spreadsheet, the ESSU PFI Equity Database updated to January 2018 and SPV filings at Companies House.

The analysis was complicated by the large number of contracts, significant differences in the scope of contracts in different sectors and the lack of data, for example, the ratio of principal paid and interest charges on remaining debt are generally unknown. In these circumstances a degree of homogeneity had to be assumed.

Cost of compensation based on net shareholder equity (book value)

The value of current net shareholder equity was calculated using the above sample of 100 SPVs. The sample identified 42 SPVs with total current net shareholder equity in their balance sheet of £373.2m and 58 SPVs with a negative shareholder equity of £801.0m. This implies that, translating the sample to all 699 SPVs, a total of 294 SPVs currently have net assets totalling £2,612m – [(373.2/42)*294] -and 405 SPVs currently have net liabilities totalling £5,593m. Assuming the 100 SPVs in the sample are reasonably representative, this implies that the majority of SPVs are effectively bankrupt at this moment. Many state in their accounts that they anticipate future payments to render the SPV a going concern in the future.

Firstly, it is proposed the state would acquire those SPVs with net assets at the value of the current shareholder equity. On a simple calculation this means a total cost of acquisition of £2,612m. On the basis of the sample and assuming a normal distribution a 95% confidence interval would mean that between 231 and 356 SPVs would have net assets. Assuming an average value of net assets of £8.89m (373.2/42), the cost of buying the net shareholder equity of all SPVs with net assets is between £2.1bn and £3.2bn.

Secondly, the share capital of the 405 SPVs with current negative shareholder equity in company balance sheets will be acquired for £1.00 each.

Table 1 indicates that the public sector share of total equity is 1.9%. This would not need to be compensated, providing a deduction from the total cost of acquisition of 1.9% or just under £50.0m. The distribution of SPVs with net shareholder equity and those with negative shareholder equity will vary over time and will ultimately impact on the acquisition cost of SPVs at the time of nationalisation.

The owners of SPVs

Offshore infrastructure funds have equity stakes in 546 SPVs (51.3% of total equity), other private companies and financial institutions with 42.1% of equity, pension funds in 85 (4.7%), and the public sector 102 (1.9%). (Table 1).

Offshore ownership by infrastructure funds

Fourteen offshore infrastructure funds had an average 67.3% equity in 546 SPV companies in January 2018. This is based on the actual equity ownership in the offshore funds using portfolio data on infrastructure fund web sites or company annual reports and accounts. These funds have 100% ownership in 206 projects.

SPV companies are registered in the UK and liable to pay UK corporation tax. However, offshore infrastructure funds such as HICL Infrastructure Company Limited (Guernsey), John Laing Infrastructure Fund Limited (Guernsey), 3i Infrastructure plc (Jersey), International Public Partnerships Limited (Guernsey) and Bilfinger Berger Global Infrastructure SICAV (Luxembourg) are registered companies in tax havens, often with shares listed on the London Stock Exchange. John Laing Infrastructure Fund announced on 23 March 2018 that it intends to terminate its Guernsey registration and become a UK based investment trust. Private infrastructure companies, such as Semperian PPP Investment Partners Holdings Limited (Jersey), are also registered offshore. They are the ultimate parent company and receive annual profits and dividends from SPVs and raise capital from the issue of shares to financial institutions and wealthy investors via nominee companies in return for 5%-8% annual dividends. Most funds seek to obtain 100% equity ownership of PFI projects in which they have invested.

The five largest listed offshore infrastructure funds made a total profit of £2.9bn in the five-year period 2011-2017 but paid no corporate tax in the offshore territories. This represents a potential loss of over £600m in UK tax revenue

had these companies been registered in the UK (based on UK corporation tax rates that declined from 26% in 2011 to 19% in 2017.[120]

Offshore infrastructure funds usually own infrastructure assets in other countries in Europe and North America, but these assets are not included in this analysis.

PFI project final business cases expect a 12%-15% rate of return, yet the average rate of return was 28.7% in the sample of 114 transactions involving 334 PFI projects between 1998-2016.[121] This is in effect a 100% premium – a doubling of the anticipated return, assuming an average 14% rate of return as expected in the final business cases. Although offshore infrastructure funds were the prime purchaser in these transactions, the beneficiaries were mainly the original construction companies and financial institutional shareholders in SPVs. Taking retrospective action to recover these financial gains would be extremely difficult if the companies and financial institutions no longer held other PFI assets.

Other private company and financial institution ownership of PFI equity

The 42.1% equity owned by UK and foreign companies and financial institutions, includes construction companies, banks and facilities management companies. Two of the main holders of PFI equity are Innisfree infrastructure fund which has 47 PFI projects with an average 72.7% equity stake. Dalmore Capital has an average 53.8% equity in 30 projects, although the HM Treasury current projects database appears to understate Dalmore's ownership. There may also be a lack of clarity between Dalmore Capital's assets and those of the Pension Infrastructure Platform managed by Dalmore.

Prior to its liquidation, Carillion plc had obtained nearly £500m by selling equity in 49 PFI projects prior to its liquidation in January 2018.[122] It currently has 25%-90% equity stakes in 12 PFI projects with a capital value of £1,281m. In addition, it has a33.33% equity in the Aberdeen Western Peripheral Route (a Scottish Non-Profit Distributing (NPD) project with a capital value of £469m. It is involved in joint ventures, such as a 50% equity in Aspire Defence Services Limited, which had a £94m turnover in 2016 delivering the MoD Allenby-Connaught PFI project (£1.6bn capital value).

Pension fund PFI equity ownership

Pension funds have acquired equity in PFI projects by directly acquiring equity stakes in SPV companies in the same way as other financial institutions. In addition, they have three indirect methods to obtain PFI equity stakes:

- Seven PFI construction companies transferred equity in PFI project(s) to their company pension fund in lieu of the employers annual cash payment to the pension fund. Interserve, Costain, Laing, Skanska, Vinci and Amec pension fund equity stakes were obtained by this process. The Kier Group did likewise, but the Kier Pension Fund later sold two PFI equity stakes.
- By investment in secondary market infrastructure funds, such as HICL and JLIF that have been acquiring equity in PFI projects (for example see London Pensions Fund Authority and Transport for London Pension Fund pension fund investment in Semperian)[123]. Both public and private sector pension funds may invest in offshore funds via a widely used web of nominee companies, which conceal the extent and scale of investment.
- By investment in the Pension Infrastructure Platform (PIP), managed by Dalmore Capital (part-owned by 3i Infrastructure Fund), which was established to facilitate wider pension fund investment in infrastructure projects.

Pension funds had an average 37% shareholding in 85 SPV companies in January 2018 (Table 4 in Appendix), or an average 4.7% of all shares in 699 SPVs. However, given the lack of transparency in pension fund investment in PFI equity ownership, the scale of actual ownership is almost certain to be higher.

Direct pension fund investment in offshore infrastructure fund shares has been excluded from this analysis on the grounds that they reflect wider financial investment strategies and are not connected to specific PFI projects. Examples include the Transport for London Pension Fund (29.1%) and London Pension Fund Authority (12.1%) equity in Semperian PPP Investment Partners Holdings Limited (Annual Return to I January 2016, Jersey Financial Services Commission) and Bradford City Council's 6.87% equity in GCP Infrastructure Investments Limited (Annual Report at 30 September 2015). It is important that pension funds that received PFI equity stakes in lieu of annual cash payments by the employer do not suffer financial losses (see below for methodology).

Public sector ownership of SPV equity

Public sector ownership of PFI equity in SPVs is divided primarily between local authorities and central government. Local authorities have equity stakes in 83 PFI projects including 55 school projects and 22 Joint Services Centre projects in which NHS trusts have equity in six projects. Local Improvement Finance Trusts (LIFT) are modelled on PFI and developed by Community Health Partnerships (Department of Health), which currently retains an average 25.6% equity in 14 projects in the HM Treasury PFI current projects database.

In addition, HM Treasury has 10% equity in six PF2 projects, five in Primary Schools Building Programme projects (the rebuild or refurbish 260 schools in England of which 214 are funded by capital grant funding and 46 via PF2[124]. The Midland Metropolitan Hospital, Sandwell, is the remaining project. The PF2 programme, launched in late 2012, was effectively a rebrand of PFI with the main exception of encouraging public sector shareholding in PFI projects, although managed by HM Treasury.[125]

Some local authorities have recently sold their equity in PFI projects. For example, Leicester MBC sold its entire shareholding in four BSF projects (three of 10% and one 1%) to Semperian in 2014 and Lancashire County Council sold equity in one BSF project and marginally reduced it in three others in 2016.[126] PFI equity owned by local authorities, NHS Trusts, the Department of Health (Community Health Partnerships) and HM Treasury is already in public ownership so no costs are attributable in the cost of nationalising other SPV equity.

Modification to compensation: proposed differential treatment of PFI assets

The cost of acquisition of the 294 SPVs to be acquired by the state could be varied to take account of the excessive gains in trading PFI equity and UK tax avoidance by offshore infrastructure funds described above. It is important to note this measure is intended to deal with UK tax avoidance by infrastructure funds offshore tax havens. It is not a windfall tax connected to changes in the rate of corporation tax since the date of financial closure of PFI projects. It is also proposed to adjust payments to pension funds that have suffered any losses from the receipt of PFI equity stakes in lieu of employers cash payments. Section 4 proposes that the Nationalisation Act should include a clause relating to the specific cases where SPVs have been sold to firm pension funds in lieu of annual contributions, which decrees that the sum received should be paid back.

The cost of acquisition could be varied by reducing the price paid for PFI equity held by offshore infrastructure funds in lieu of the significant scale of UK tax evasion cited above. For example, every 10% reduction would reduce the total cost of acquisition which could finance a 10% increase in the price paid to acquire equity held by pension funds - see Option B, Table 1 (although this should exclude direct investment in offshore infrastructure funds for the

reasons noted above). Alternatively, in Option C the payment for shareholder equity could be reduced by a relative proportion of the £600m UK tax losses as a result of infrastructure funds being located in offshore tax havens, which could in turn be used to deal with any pension fund losses.

These measures are likely to be contested by the offshore infrastructure funds and their nominee shareholders. Other methods could also be explored to achieve the same objectives.

Table 1: Adjustments to cost of acquisition of SPVs

Category of PFI equity ownership	[*1] % of equity	Option A share of shareholder equity in 294 SPVs (£m)	Option B Cost of each 10% variation (£m)	Option C 42% of £600m offshore tax loss (£m)
Offshore infrastructure funds	51.3	1,340	-134	-252
Other private ownership	42.1	1,100		
Pension funds	4.7	122	+12	+25
Public sector	[*2]1.9			
Deduction from total cost of compensation			-121	-227
Total	**100**	**2,562**	**2,437**	**2,331**

Sources: Companies House; HM Treasury current PFI project, March 2016; Infrastructure fund web sites; European Services Strategy Unit PFI Equity Database 1998-2016.

*[*1.] Based on total 699 projects in HM Treasury current projects, 2016 amended for 19 contracts concluding by 31 March 2018 and two recently signed new contracts:*
*[*2.] Shareholder equity of £50m already owned by public bodies and therefore excluded from the acquisition costs.*

The total cost of Option A will be £2,562m without adjustments; Option B will be £2,437m based on a 10% reduction for SPV equity held offshore and 10% increase for pension funds that received SPV equity in lieu of cash allocation; Option C will be £2,331m based on the avoidance of UK corporation tax.

The proposed modifications are based on an analysis of SPV equity ownership in January 2018, which identified equity ownership of offshore infrastructure funds, pension funds, the public sector and other private companies and financial institutions.

Honouring liabilities and anticipated reductions in the cost of finance

There are several ways in which the extraction of future profits can be achieved by the public acquisition of SPVs and their ultimate abolition. It does not deal with historic costs, substantial as these have been[127]. The government should honour all liabilities it inherits as a result of nationalisation but can secure substantial refinancing of outstanding interest payments.

Senior debt

It has not been possible to isolate the level of outstanding principal without having a good sample of contracts. Therefore, it has not been possible to identify absolute levels of savings on interest payments. We can therefore only give percentage savings on interest.

The NAO estimate the outstanding £199.1bn unitary charges are divided 60/40 between services and debt.[128] Sixty per cent of the unitary charges i.e. £119.5bn is expenditure on services that will have to be provided irrespective of ownership. It is fundamentally wrong to treat this expenditure as debt when it is a contractual commitment for services. The remaining 40% of the outstanding unitary charges, i.e. £79.6bn is PFI debt. The shareholder investment was about 10% of total finance raised.

We have not been able to establish an average figure for interest rates on senior debt but we assume that reducing the interest rate to the PWLB rate of 2.5% might lead roughly to a 50% reduction in interest payments[129].

Where senior debt is secured through index-linked bonds, the ratio will be slightly different as bonds are based on a risk-free rate, usually taken as the interest on long term Treasury gilts, rather than LIBOR.

Subordinate debt

Subordinate debt is 10% of the outstanding debt and interest payment of £79.6bn i.e. £7.96bn. SPV shareholders usually contribute subordinate debt to PFI projects in addition to share capital. Subordinate debt is unsecured debt at relatively high interest rates. A relative proportion of this debt is sold in PFI equity transactions, although it is rarely, if ever, specified.

A sub-sample of 30 projects from the 100 SPV sample referred to above, identified an average interest rate of 12.43% for outstanding subordinate debt in SPV annual reports and accounts for 2016 or 2017. If the interest on subordinate debt is reduced to the 2.5% PWLB cited above this would represent a cost reduction of between 75%-80% on the level of interest paid on subordinate debt. Repayments of principal on subordinate debt are made towards the latter part of the contract period. On the one hand this means that savings on interest still to be paid will be larger but also that very high interest payments have already been made. By the 'rule of 72', an interest rate of 12.5% implies that the investors will have had been repaid the principal after 5.76 years. There is therefore an argument, where the interest payments have been made for about 10-15 years, for reducing the level of the outstanding principal on subordinate debt to compensate the public for what are effectively usurious rates of interest charged so far. The current PWLB 2.5% rate of interest would then be applied to the recalculated level of outstanding debt.

Inter-company loans

Inter-company loans between parent and subsidiary PFI companies are widely used with interest rates varying between 5% - 15%. They are usually additional to subordinate debt, although the national scale of inter-company loans is difficult to determine without a detailed inspection of all SPVs and related companies. The high cost of these loans is ultimately borne by SPVs.

In some cases, SPV shareholders make additional loans where a PFI project has experienced construction or operational problems. For example, ESP (Holdings) Limited is the SPV holding company for the Edinburgh PPP1 schools project. Its four shareholders issued a subordinated loan note of £5.5m in 2016 at an interest rate of 13.07% until 2033. to finance remedial works following the collapse of an external wall at Oxgangs Primary school in January

2016 and subsequent defects in many other schools in the PFI project.[130] Financing significant building defects in a blaze of national publicity is obviously highly profitable too.

The national scale of inter-company loans is difficult to determine without a detailed inspection of the all SPVs and related companies. If the interest on inter-company loans is reduced to the 2.5% Public Works Loan Board cited above a similar cost reduction of between 75%-80% on the level of interest paid on inter-company loans.

Elimination of interest rate swaps

Some PFI projects have interest rate swaps negotiated with financial institutions as a form of insurance against rises in interest rates. A swap replaces a variable fixed interest rate with a fixed rate. Prior to the 2008 financial crisis the risk of interest rate rises was real, but the subsequent significant decline in bank rates has meant financial institutions have to date benefited hugely from swap deals at the expense of PFI projects. It means they are almost certain to strongly resist breakage. Future increase in interest rates could change this situation. Swap deals have significant breakage costs, the Hexham Hospital buyout incurred a £27.0m swap breakage fee, 25.2% of the total cost of the buyout.[131]

An NAO analysis of the 75 largest PFI deals by capital value identified 33 projects with interest rate swaps. They estimated the largest deals *"...would cost more than £2bn to break, on average adding an additional 23% on top of the outstanding debt in these deals".*[132] Part 4 suggested three possible options for interest rate swaps: all swaps are broken and breakage fees paid to the extent that cash balances on the accounts of SPVs allow and additional costs to the Treasury are avoided; all swaps are broken but no breakage fees are paid; or swaps are not broken but renegotiated as part of the refinancing of the senior debt.

Reducing infrastructure costs for public authorities

Nationalisation will eliminate profiteering by SPV shareholders and reduce the cost of operating public buildings and providing FM services.

Administrative costs of ownership:

SPV administrative costs include fees to directors, accountants for annual audits and project management, which is often outsourced. Administrative costs were identified in 70 of the sample of 100 SPV accounts for 2016 or 2017 referred to above and totalled £55.0m. Assuming this represented all 699 SPVs then the total administrative costs are £549.2m, which could be cut by 50% if undertaken by public sector auditors. These amounts could either be savings to the public authorities and/or provide for the administrative expenses of the new NDPB.

Operating profits:

Annual operating profits of SPVs are the pre-tax profits earned from managing and supplying hard and soft facilities management services to PFI projects: these would be eliminated by their public acquisition. The sample of 100 SPV annual reports and accounts for either 2016 or 2017 identified total annual operating profits of £204.7m or £1,431m per annum based on 699 SPVs. These amounts would represent savings to the public authorities concerned, see section 4.

Post-nationalisation cost reduction in the provision of services

The new NDPB would renegotiate contracts between SPVs and public authorities so that all continuing hard and soft FM service contracts are directly between the service contractors and public authorities (see Part 4).

Where there is a history of poor performance public bodies should explore the grounds for termination of the contract. Public bodies should immediately identify whether they need to intensify the monitoring of private contractor performance and fully apply financial deductions in accordance with the terms of the contract. Authorities will also have an opportunity to address employment and equality issues in cooperation with trade unions and community organisations. Some contractors may seek to continue the provision services until a break clause in the contract comes into effect. In some circumstances this could be up to five or seven years after nationalisation unless a termination can be negotiated. Some may have won the contract on low margins and be willing to exit. As service contracts are concluded or terminated the legislation will require that services must become in-house directly provided by public authorities.

It is vital that nationalisation of PFI/PF2 contributes to the wider termination of financialisation, marketisation and privatisation of the public sector. It creates an opportunity to make radical changes in the organisation, planning and delivery of public services.

The NAO estimate the provision of services, mainly hard and soft facilities management such as support services, repairs and maintenance, utilities and whole life costs, and represent 60% of the £199bn outstanding unitary payments or £119.4bn.[133] These are primarily provided by subcontractors or subsidiaries of the main contractor. Although financed through the unitary charge, were outsourced to private contractors that usually bid in the expectation of obtaining an average profit of between 6%-12%. This operating profit is additional to the SPV operating profit described above.

The current number of 699 PFI/PF2 projects will decline to 11 by 2045, assuming no further projects are signed. The decline was charted using the HM Treasury current PFI/PF2 projects (March 2016) which produced a figure of 9,931 contract years between 2018 and 2045 and contract year cost of £12m (£119.4bn divided by 9,931). The data was not adjusted for inflation and are therefore indicative figures.

An average 7.0% private contractor profit was assumed for cost reduction purposes. Larger savings are likely, however some resources will be needed to finance improvements in the quality of services and/or improve staffing levels and terms and conditions where contractors failed to meet TUPE requirements or to implement subsequent improvements in national terms and conditions. The elimination of the 7.0% profit rate will achieve a £8,358m cost reduction between 2018 and 2045 to finance these improvements and reduce public sector costs. However, the transfer of service contracts to public authorities could speed up the process of service contracts being concluded or terminated. If this was condensed into a ten-year period 2018-2027 the annual cost reduction would increase from £588m - £457m to £889m - £758m.

Summary

Firstly, the cost of acquisition of SPVs would be between £2,331m - £2,562m depending on the adjustments made to the level of compensation to offshore infrastructure funds and pension funds and/or compensation for lost UK taxation.

Secondly, the interest rate on senior debt could be reduced by 50% and by 75%-80% for subordinate and inter-company loans.

Thirdly, stopping the extraction of SPV administration costs and operating profits would achieve an initial annual cost reduction of £1,431m which will decline as contracts are concluded or terminated.

Fourthly, the elimination of private contractor profit in service contracts could be £765m - £634m per annum if contracts are concluded or terminated and brought in-house over a ten-year period 2018-2027.

Finally, post-nationalisation savings would be obtained by local authorities, NHS Trust and government departments after the new NDPB renegotiates contracts between SPVs and public authorities so that all continuing hard and soft FM service contracts are directly between the service contractors and public authorities.

Summary of cost of SPV acquisition and cost reductions

Item	Estimated £m
Cost of acquisition of SPVs	2,331 - 2,562
Anticipated annual reductions in the cost of finance	
Senior debt refinanced loans [*1]	interest rate reduced about 50%
Subordinate debt and inter-company loans refinanced	interest rate reduced 75%-80%
Stopping extraction of money by owners	
Administrative costs eliminated	reduced by 50%
SPV Operating profits eliminated	1,431
Total annual savings that can be calculated	**1,431**
Post-nationalisation savings to local authorities, NHS Trusts and other public bodies from provision of services	
Operational cost reductions from bringing service contracts in-house over a ten-year period 2018-2027	758 - 889

*[1]as of 31 March 2018. All the figures will reduce annually as current PFI projects reach conclusion. Assumed no new PF2 projects are approved

Sources used in the analysis

HM Treasury Private Finance and PF2 current projects 31 March 2016; European Services Strategy Unit PFI/PPP Equity Database 1998-2016 plus 2017 amendments; UK Companies House; Jersey Registry Office; Guernsey Registry; Company Annual Reports; Infrastructure fund websites.

APPENDIX – TABLES

Table 1: PFI projects by government department

Department	Capital Value (£m)	Number of projects	as % of total capital value	Notes
Department of Health	12,953.20	127	21.81	Mainly hospitals
Ministry of Defence	9,519.71	41	16.03	Military facilities, IT infrastructure and communications, Military housing
Department for Education	8,585	172	14.45	Schools
Department for Transport	7,840.65	61	13.20	Mainly roads and highway maintenance, street lighting, tram and light rail, Underground rail.
Scottish Government	5,681.92	82	9.57	Largest share – schools
Department for Environment, Food and Rural Affairs	3,450.93	28	5.81	Mainly waste projects
Home Office	2,874.35	40	4.84	Mainly emergency services especially 'Airwave' communications and successors
Department for Communities	2,463.67	60	4.15	Mainly housing
Northern Ireland Executive	1,689.46	33	2.84	Various: schools, hospitals, IT, libraries
Department for Work and Pensions	1,102.70	3	1.86	Offices
Ministry of Justice	863.31	20	1.45	Prisons and courts
HM Revenue and Customs	804.1	4	1.35	Offices
Welsh Assembly Government	693.02	22	1.17	Various: roads, schools, hospitals, waste
Department for Culture, Media and Sport	352.38	17	0.59	Leisure facilities, libraries
Security and Intelligence Agencies	331	1	0.56	Offices (GCHQ)
HM Treasury	141	1	0.24	Offices
Department for Business, Innovation and Skills	21.84	1	0.04	Royal Research Ship Ernest Shackleton operated by British Antarctic Survey
Foreign and Commonwealth Office	17.1	1	0.03	Berlin Embassy
Cabinet Office	6.7	1	0.01	Sunningdale 'National School of Government'. December 2016 sold to Berkeley Homes and Audley Retirement.
Crown Prosecution Service	2.9	1	0.00	'Compass' – IT system for case national case management.
TOTAL	**59,395.29**	**716**		

Source for Tables 1 and 2: HM Treasury, Infrastructure and Projects Authority *Private Finance Initiative and Private Finance 2 projects: 2016 summary data*: https://www.gov.uk/government/publications/private-finance-initiative-and-private-finance-2-projects-2016-summary-data. NB: All figures for future unitary payments are nominal and undiscounted, as provided in the database above.

Table 2: PFI projects by sector

Sector	Capital Value	As % of total
Hospitals and Acute Health	14,349.48	24.16
Schools (non-BSF)	7,909.77	13.32
Military facilities	6,851.30	11.54
Roads and Highway maintenance	6,317.06	10.64
Waste	4,094.70	6.90
Schools (BSF)	3,988.32	6.72
Offices	3,790	6.38
Emergency services	2,498.72	4.21
Housing	2,149.99	3.62
IT infrastructure and communications	1,851.62	3.12
Street lighting	1,423.21	2.40
Tram / Light rail	800.14	1.35
Prisons	736.31	1.24
Other[1]	568.03	0.96
Underground rail	475.16	0.80
Social care	282.20	0.48
Leisure facilities	274.15	0.46
Data not provided[2]	213.30	0.36
Courts	209	0.35
Housing (military)	199.03	0.34
Equipment	194.34	0.33
Libraries	147.50	0.25
Energy	43	0.07
Secure Training Centres	19.00	0.03
TOTAL	59.4bn	100

Table 3 Buyouts and terminations of UK PFIs 1997-2017		
Sector	**Buyouts (no.)**	**Terminations (no.)**
Education	1	1
Health	3	2
Housing	0	0
Transport	3	6
Highways	1	0
Waste management	1	2
Fire and rescue	0	3
Water treatment	0	0
ICT	0	2
Criminal justice	1	1
Public administration	1	0
Defence	0	1
Miscellaneous	0	2
Total	**11**	**20**

Source: Whitfield *Buyouts*

Table 4: Causes of termination	
Poor performance	6
ICT problems, cost overruns and delays	3
Failed to obtain planning permission	2
Poor demand forecasting	1
Construction flaws	2
Technical flaws	3
Reduce cost of financing	3
Total	20

Source: Whitfield *Buyouts*

Table 5: Credits or 'specific and special revenue grants' and allocated for Local authority PFIs 2010-2017							
	2016-17	**2015-16**	**2014-15**	**2013-14**	**2012-13**	**2011-12**	**2010-11**
Local authorities (£,000)	1,177,395	1,185,934	1,111,657	1,045,239	908,875	814,625	768,639
Fire and rescue authorities (£000)	9,891	11,592	11,575	10,657	11,243	8,462	7,486
Waste authorities (£,000)	14,010	14,010	14,084	14,010	14,010	14,010	14,033
Police and Crime Commissioners / Police authorities (£,000)	65,221	65,244	63,337	56,053	51,658	51,997	36,545
Total (£,000)	1,266,517	1,276,780	1,200,653	1,125,959	985,786	889,094	826,703
Total PFI payments (£bn)	10,361.48	10,465.21	10,205.75	9,744.17	9,257	8,478	7,744
Local Authority credits as % total unitary payments	12.27	12.20	11.92	11.56	11	10	11
Total PFI payments England only (£bn)	6,699.00	6,617.75	6,342.58	6,041.11	5,516.10	4,913.93	4,374.79
Local Authority credits as % total PFI unitary payments England only	18.98	19.29	19.17	18.64	17.87	18.09	18.90

Source: Revenue Outturn (RG) Specific and Special Revenue Grants: 2011-2017:
https://www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing

Table 6: Pension fund ownership of PFI equity in SPVs

Pension fund	**No. of projects**	**Average % equity stake**
Interserve plc	32	20.6
Pension Infrastructure Platform	11	37.5
Costain plc	8	41.0
Vinci plc	5	98.0
Skanska plc	5	50.1
John Laing Group plc	4	27.5
Amec plc	1	50.0
PGGM (Netherlands) 90/10 Joint Venture with Lend Lease PFI Infrastructure Fund	19	*[1]44.3

Source: Companies House; HM Treasury current PFI project, March 2016; Infrastructure fund web sites; European Services Strategy Unit PFI Equity Database 1998-2016;
*[1] represents 90% of equity to reflect PGGM's share of JVC

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[90] https://www.theaic.co.uk/aic/news/citywire-news/infrastructure-funds-face-new-windfall-tax-threat-from-labour
[91] https://www.taxjustice.net/solutions/. As Crown dependencies the UK government has considerable powers of action over tax havens popular with SPV equity holders such as Guernsey and Jersey.
[92] A recent example is Ukraine's default in 2015 on its $3bn bond with Russia: https://www.ft.com/content/c12c7286-046a-11e5-95ad-00144feabdc0
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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/519571/Classification-of-Public_Bodies-Guidance-for-Departments.pdf
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[102] Sornarajah, M. (2010) *The International Law on Foreign Investment* CUP, 3rd edition: chapter 11.
[103] UN General Assembly Resolution 1803 (XVII) on *Permanent Sovereignty over Natural Resources* (1962). Para 4http://socialdemocracy21stcentury.blogspot.co.uk/2010/07/nationalization-its-legality-under.html
[104] Sornarajah *International Law* p.448.
[105] Sornrajah *International Law* p.449.
[106] Sometimes the SPV owns an issuing company which may be a PLC, and there are 30 SPVs listed on HMT database which are PLCs. However, information share prices are not quoted on the LSE.
[107] Sornrajah *International Law*.
[108] Ohlson, James A. 1995. 'Earnings, Book Values, and Dividends in Equity Valuation'. *Contemporary Accounting Research* 11 (2):661–687; Feltham, Gerald A., and James A. Ohlson. 1995. 'Valuation and Clean Surplus Accounting for Operating and Financial Activities*'. *Contemporary Accounting Research* 11 (2):689–731.
[109] HM Treasury *PFI: Meeting the investment challenge* para 3.49.
[110] Clearly, PFI projects undertaken by public bodies which would generally borrow from the PWLB are a minority of all PFI projects. However, we felt that making all payments at PWLB rates would simplify legislation. The Municipal Bonds Agency was established in 2015 as a private company owned by local authorities and the Local Government Association to provide loans at a lower interest rate than is available through the PWLB.
[111] NAO *Choice of Finance* p.51
[112] NAO *PFI and PF2* para 2.19
[113] CHPI 'State's purchasing power'
[114] https://www.theguardian.com/politics/nils-pratley-on-finance/2017/nov/13/pfi-firms-labour-government-jeremy-corbyn; http://www.telegraph.co.uk/business/2017/11/13/labour-plan-end-pfi-contracts-could-leave-taxpayer-hook-billions/
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