



**LOCAL
PARTNERSHIPS**

PREPARING FOR THE EXPIRY OF PRIVATE FINANCE INITIATIVE CONTRACTS

Managing PFI assets and services as contracts end



A private finance initiative (PFI) contract uses private sector investment in order to deliver public sector infrastructure or services, where the specification for the PFI contract is defined by the public sector. PFI is a sub-set of a broader procurement approach termed Public Private Partnership (PPP), with the main defining characteristic being the use of private sector debt and equity, underwritten by the public sector. The private sector's role is to develop the infrastructure, provide finance and to operate the public facilities.

PFI contracts were introduced in the 1990s and were used for designing, building and operating new public assets such as hospitals, schools, prisons, waste facilities (such as energy-from-waste facilities) and roads. Public sector organisations that have procured PFI contracts include the NHS, central government departments, waste authorities, and councils.

PFI contracts are typically for 25-30 years (depending on the type of project), although contracts less than 20 years or more than 40 years also exist.

Relatively small numbers of PFI contracts have expired already. However, larger numbers are due to expire over the next few years, reaching a peak in the mid-2030s. Many lessons have already been learned, including the need to prepare many years in advance of the expiry date, so that the contract is handed back in an optimal way and so that appropriate and measured decisions are taken for the potential future ownership and operation of the assets.

The preparation period can be as long as eight years. As the number of expiring contracts continues to grow each year, it is vitally important that public authorities do not leave key decisions to the last minute.

This document sets out guidance and details of the lessons that have been learned by Local Partnerships in our role as advisers to many of the public sector organisations that have dealt with PFI contract expiry or are in the process of dealing with the handback of their projects.



THE IMPORTANCE OF TIMELY PREPARATION

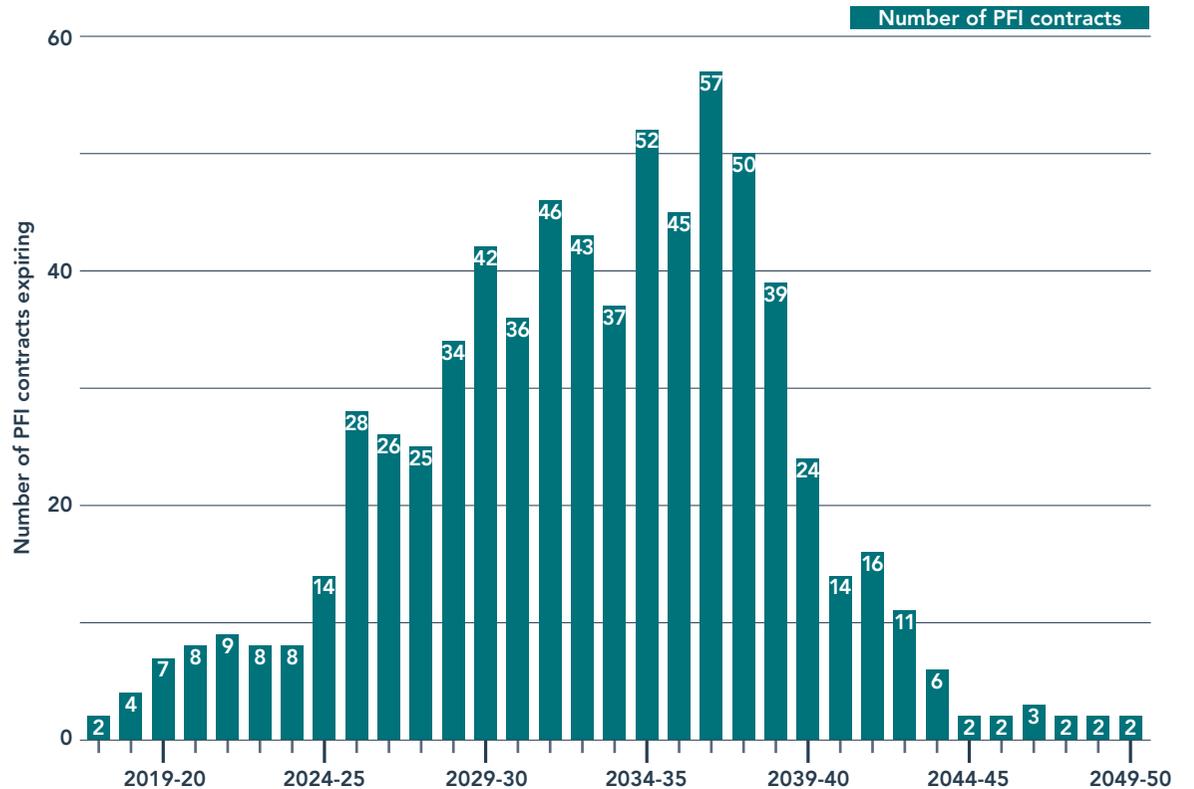


The end of a PFI contract may seem a long way into the future. However, in the first part of this decade over 50 operational PFI contracts will expire. This number rises to around 200 contracts over the next 10 years.

Dealing with contract expiry can be resource intensive and will certainly require more support than is currently being provided to the project. A key risk is the increased cost of delivery and potential disruption to services if adequate and appropriate preparation are not put in place well in advance of contract expiry. Issues such as whether services, e.g. maintenance and cleaning, are provided in-house, by a new contractor or through a new contractual relationship with the existing provider must be addressed. If the facility or assets do not revert upon contract expiry, then a decision will be needed as to whether to continue to use them and, if so, what negotiations need to take place.

It is important to understand the timeline to expiry within each contract. A number of the earlier PFI contracts do not specify a timeline at all. Others simply refer to “surveys on expiry”, to be commenced two to three years before the expiry date. Infrastructure and Projects Authority guidance suggests starting to prepare seven years from the expiry date. Such preparation should form part of a mid-term contract review, allowing for challenge to the way the contract is currently managed. It will also help the public authority identify any issues which require maintenance to achieve the required standard and what is required from an expiry process.

Timeline for private finance initiative (PFI) contracts that will expire by 2049-50^{1,2}
Over the next 10 years more than 200 PFI contracts will expire



¹ Data covers all PFI contracts across the UK.

² At the time of reporting HM Treasury does not hold data on the expiry dates of PFI contracts. The above data is an estimate produced by the National Audit Office based on the year the final unitary charge payment is made.

Source: National Audit Office analysis of HM Treasury's 2018 PFI database.

THE IMPORTANCE OF TIMELY PREPARATION



Any contract should consider three concurrent workstreams:



If managed effectively, contract expiry should be a positive experience. However, even the best providers and authorities with excellent relationships will be confronted by a myriad of issues that will need to be addressed through the process. The resolution and timing of tackling these issues will require careful project planning.

The National Audit Office (NAO) has recently published a report on PFI project expiry³ where it surveyed 107 PFI contracts of which 89 were still operational and 18 had

expired. The report draws out challenges and best practice. This is a timely report and can be used to raise the profile of this issue within public authorities.

Three key considerations the report highlights are:

- ▶ only a third of respondents thought that the role and obligations of different parties at expiry were clearly defined
- ▶ 55% of survey respondents recognised that they weren't certain about the condition of the assets
- ▶ 33% of survey respondents considered that disputes near contract end are likely, with 86% of disputes expected to relate to the quantity of rectification work

Contract expiry should be considered at an early stage – ideally well in advance of the contractual provisions – whilst maintaining a good level of control over current project delivery. Plans for an orderly handover should be developed and a strategy put in place for what happens next, to ensure that contract expiry can be a success.

To achieve this, we believe that there are specific activities that you should undertake, each forming part of the three workstreams.

³ *Managing PFI assets and services as contracts end*. This report by the Comptroller and Auditor General is available on the [NAO website](#)



During the normal operation of the PFI contract, it is important that there is appropriate and professional application of:

- ▶ contract management principles
- ▶ price performance mechanism
- ▶ lifecycle planning
- ▶ scheduled maintenance
- ▶ reactive repairs
- ▶ reviews
- ▶ benchmarking

Cosmetically, an asset may appear to be well-maintained. It is important that the public authority is fully aware of the condition of its assets and that the lifecycle and planned maintenance have been undertaken effectively.

To avoid disputes, an early understanding of the true condition of the asset needs to be established well before it is due to be handed back. This is particularly important if the handback processes are not clearly defined or are ambiguous.

The authority should undertake and explore:

- ▶ bespoke training on effective contract management
- ▶ identification of opportunities for cost savings
- ▶ regular benchmarking and market-testing to minimise overspending
- ▶ early resolution on performance issues
- ▶ application of contractual rights and, where necessary, negotiation
- ▶ consideration and implementation of contract variations to ensure that the contract remains current and effective
- ▶ opportunities for refinancing gain



**Infrastructure and Projects
Authority guidance suggests
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The first thing that the public authority will have to do is to clarify the contractual provisions on handback. The provisions, if they exist, will be set out in schedules to the contract which are very likely to have been neglected since the contract was first agreed.

A clear and simple guidance document will need to be developed. The provisions and processes for handback should be considered carefully alongside a contract variation guide for when things are not clear. For example, does the asset automatically revert to the authority after expiry or are there contractual steps that must be followed?

It is important to recognise the leverage that the authority has in terms of negotiating with the PFI contractor. Authorities will be in a much stronger position when they still have recourse to the lenders. It is important to establish when the debt is likely to be repaid and the processes for contacting lenders directly which, in some cases, may be contractually restricted. This will be important if the authority wants to access lifecycle funds.



The authority should undertake and explore:

- ▶ preparation of bespoke contract guidance clarifying the expiry process and contractual rights
- ▶ preparation of a detailed timeline of actions up to expiry
- ▶ an understanding of lessons learned on similar projects
- ▶ activation of contractual rights to undertake asset condition surveys, and recommendations of suitable surveyors
- ▶ identification of contractual rights relating to any lifecycle and furniture, fixtures and equipment (FFE) accounts
- ▶ tracking and maintenance of account balances
- ▶ implementation of the expiry processes
- ▶ preparation of a handback protocol and deed of expiry
- ▶ preparation for staff transfers and whether TUPE⁴ applies
- ▶ identification of any pensions issues
- ▶ consideration of any intellectual property rights

In order to make a success of the preparation period and get ready for decisions around project expiry, the authority should:

- ▶ initiate a review of all of the project agreements
- ▶ undertake an analysis of all of the lease options associated with the asset
- ▶ establish whether there are any extension provisions and whether to include these in options' appraisals
- ▶ commission an analysis of the accuracy and sufficiency of operations and maintenance (O&M) manuals
- ▶ commission options' appraisals for future service requirements
- ▶ establish budgetary consequences for handback, acquisition or residual payments, and costs of maintaining and operating the asset
- ▶ undertake detailed condition surveys
- ▶ establish asset valuations
- ▶ establish a communication and governance channel for negotiation with the contractor
- ▶ identify resources with appropriate levels of experience and capability
- ▶ generate and maintain a clear project and action plan
- ▶ establish a register of risks and manage it
- ▶ govern and manage the handback process

⁴ Transfer of Undertakings (Protection of Employment) regulations (TUPE)
[gov.uk/transfers-takeovers](https://www.gov.uk/transfers-takeovers)



One of the most important decisions that needs to be taken is whether the public authority intends to continue to use and operate the assets, or whether it intends to vacate and dispose of them.

Within this decision-making process is the consideration of an extension of the existing arrangements or a re-procurement, to look for someone else to manage and maintain the assets into a future lifecycle.

Unless the authority has decided to cease provision of the services, consideration of the future for the assets will require a full appraisal of all options available. If the ownership of the assets does not revert automatically to the public authority,

it is important to understand the options available under the contract and the financial implications, including the cost of terminating leases or acquisition of the assets. Options may also include alternative uses of the assets which may create different revenue and expenditure opportunities and risks.

The authority should undertake and explore:

- ▶ preparation of options' appraisals
- ▶ preparation of business cases and internal reports
- ▶ procurement of new project or implementation of replacement contracts
- ▶ assurance reviews and health checks to make sure any re-procurement is on track and will deliver successfully on time and on budget





LOCAL PARTNERSHIPS PROVIDES SUPPORT

to central and local government in resolving contractual and operational issues with PPP and PFI contracts

WE HAVE ADVISED AND SUPPORTED

public authorities across all key contractual processes such as:

- ▶ benchmarking
- ▶ market-testing
- ▶ contractual variations
- ▶ termination

We have supported 12 councils refinance 14 PFI contracts,

ACHIEVING RE-FINANCING GAIN SAVINGS TO THE PUBLIC SECTOR OF c£40 MILLION

THROUGHOUT OUR HISTORY, WE HAVE:

- ▶ provided effective challenge to PFI contractors
- ▶ negotiated and settled disputes
- ▶ identified, negotiated and delivered savings

LOCAL PARTNERSHIPS IS ACTIVELY INVOLVED

in government cross-departmental "Contract Expiry" networking, where the main purpose is to share best practice and disseminate lessons that have been learned

Local Partnerships contributed, alongside the LGA and the IPA, to the **2020 NAO REPORT** Managing PFI assets and services as contracts end



Michael Berrington

Programme Director – PFI & PPP
michael.berrington@local.gov.uk
0207 6643 266 | 07717 700 111



Oliver Mangiapane

Project Director
oliver.mangiapane@local.gov.uk
07920 767 783

Local Partnerships is a joint venture between the Local Government Association, HM Treasury and the Welsh Government. We occupy a unique position in the public sector. We facilitate change by working impartially and collaboratively across all parts of central, local and regional government, and the devolved administrations.

We work solely for the benefit of the public sector.

Our experts provide trusted, professional support and advice over multiple disciplines, helping local and combined authorities make best use of limited resources as demand for services continues to rise.



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HM Treasury

