**Table 1:** **The selection of contract form and arrangements: the issues arising from the PFI experience**

|  | **Issue** | **Primary concern** | **Wider dimension** |
| --- | --- | --- | --- |
| **2** | **Financing cost** | Private sector pays more for investment finance than public sector: between 2-4% more than cost of government gilts, higher during periods of financial stress, such as GFC.  Equity and debt cost of capital is higher to the private sector with project risk is priced-in. The private sector also does not have benefit of Treasury no-default guarantee and the ability to raise finance wholesale through Public Works Loans Fund.  NAO reports that redeeming a debt of £100 million over 30 years with interest of 2% costs £34 million in interest; at 4% this more than doubles to £73 million.  Other additional costs that SPV’s need to cover, including insurance, external advisers, cash reserves, and management fees add c2% to contract cost. | The differential in financing cost should reflect the transfer of investment and operating risk to the private sector, but differential cost of finance has resulted in PFI projects proving more expensive in whole project—life terms.  Differential might be expected to narrow as PPP provision and financing instruments become more sophisticated and competitive within a mature market, but as text explains managed rather than mature competitive market is more likely, and additional finance costs will always tend to make private procurement more expensive. |
| **3** | **Transaction and monitoring costs** | Large amounts spent on consultants and other bid costs that ultimately are passed back to public client (£450m in case of London Tube PPP).  Public client must establish monitoring arrangements that then add to the cost of the scheme, which can be over complicated, cumbersome, and difficult to apply at proportionate cost. | Development of standardised documentation and procurement templates should help to reduce project transaction costs as successful models are replicated and both client and contractors become more familiar with the process.  The proportion of total costs taken by transaction costs should reduce with the scale of the project.  Monitoring arrangements should be based, where appropriate and practicable, on Supplier self-reporting and quality assurance, verified by Client reality checking the delivery of defined service standards and outcomes, with robust rectification contractual process linked to Supplier-fault default and termination provisions. |
| **4** | **Termination risk** | Risk of expensive termination costs linked to a change in client requirements over contract term: for example, a hospital or school becoming surplus to requirements.    Change-in-law and policy risk.  Future financial and service delivery autonomy of Foundation Schools, Academies and Hospital Trusts can prove inconsistent with PFI provision and funding.  The long-term liability of a PFI unitary charge has proved inconsistent with a dynamic market environment where a failed school can be forced to close - unless the risks of such liabilities can be pooled or otherwise managed. | Need for robust public sector planning and risk analysis at strategic and outline business case stages, covering project development, construction, operation, and handbook stages.  Identify where contract flexibility could be important during contract-life and reflect in documentation.  Termination costs of PFI contracts onerous, even catastrophic to Client budgets. |
| **5** | **Economic and Social Sustainability** | Some early evidence of use of casualised labour employed on inferior insecure terms (health service ancillary and cleaning staff) relative to former public sector terms with little or no training opportunities.  Replacement of public-sector pensions with inferior money purchase or other schemes.  Later concern that companies were importing EU labour on inferior terms, exploiting different social security provisions to minimise UK tax and national insurance contributions, reducing incentive to employ local indigenous workers, but this applies to all forms of procurement,  Clients can specify additionalities, such as employment and training outputs, in specification, but these need to be monitored and verified. | TUPE protection for existing staff transferred to PFI operator was extended to new employees by Cabinet Office guidance.  This guidance required PFI operator to offer comparable pension arrangements but not necessarily final salary pension.  EU Postal Worker Directive Reform.  Impact of Brexit, if it occurs. |
| **6** | **Development of secondary market** | This may undermine performance incentives where contract is conveyed to new purchaser investing little equity stake in contract.  Frequent sales of contracts for short-term financial gain can prove inimical to partnership working and continuity of service. | Robust secondary market increases market confidence and assists market benchmarking of price and services. |
| **7** | **Long lead in times and lack of competition** | NAO notes continuing insufficient public sector capacity to procure complex PPP/PFI schemes and to negotiate/monitor effectively with commercially oriented private sector partners.  This has resulted in delays (many PFI projects took longer than three years to procure) linked to misspecification or inadequate preparation of contractual requirements, lack of private sector confidence in the process resulting in reluctance to enter and remain in the market | Greater use of standardised documentation.  Pooling of knowledge and know-how between public and private sectors and project teams.  Other reasons such as market abuse/collusion by private sector could have contributed to PFI delays. |