

Public Private Partnerships in the UK - Lessons for International Projects

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November 23, 1999 by Adrian Montague, Chief Executive, UK Treasury Taskforce**

I am very pleased to take this opportunity of giving you an insight into the public-private partnership programme in the UK.

In this presentation:

- I will tell you about the programme's major achievements;
- I will look at the lessons we have learned and the challenges that remain; and then
- I'd like to spend a moment or two reflecting on how the public sector has organised itself to negotiate these deals with private sector contractors.

Key Features

Our PPP programme started in 1992. Then it was called the Private Finance Initiative. It was the brainchild of John Major's Conservative administration. But it has been taken over and much improved by our present Labour Government - to the point where private finance has largely become common ground between the two major political parties.

The PPP programme has several key features:

- first of all, the number of deals we have completed and the additional investment we have triggered as a result;
- next, the areas in which we have been able to make PPP work;
- and, finally how we have improved the management of PPP deals.
- Let me say a word about each of these in turn.

PPP Deal Flow

The sheer volume of PPP deals is quite striking. We have closed more than 250 deals, and new deals are closing at the rate of 30-40 a year. As this slide shows, since the Labour Government took office, we have completed deals to a capital value of US\$8 billion. That makes a total of almost US\$20 billion since the Private Finance Initiative started in 1993. Looking ahead, we are forecasting a pipeline of deals in each of the next three years of about \$5 billion, or over 20% of total net public sector investment over that period. So, as you can see, there's no doubting the success of PPP in boosting public sector investment levels.

The PPP market is in good shape, too. There is strong competition in all sectors, except we could hope for a greater spread of interest in IT projects. The financial markets have responded well: debt can be sourced not only from the banks, but also from public capital markets and private placements, bank tenors have lengthened, and equity is available

from institutions as well as contractors. PPPs are no longer an embryonic market, but rather one which is steadily maturing.

It's not only the amount of private capital we have raised, but also the sheer diversity of deals which capture people's attention.

Range of sponsors and projects

The PPP programme started life as a central government initiative. But relatively little public capital spending in the UK is directly committed by central government departments. So, if PPP was to become a general procurement tool, it had to spread down to the local level. And so it has - to the point now where local authorities account for a large proportion of all PPP projects. At the last count, there were well over a hundred local authority PPP projects. And PPPs are also widely used in our new devolved territories (Scotland, Wales and soon Northern Ireland) which perhaps correspond better to Canadian provinces.

The types of PPP deal have mushroomed, too. At first, PPPs were concentrated in what we have come to regard as the classic sectors for private finance - roads and bridges; railways, rolling stock and train systems; airport terminals; privately managed prisons. But soon we began to extend PPPs into the provision of social infrastructure as well - hospitals and medical equipment, schools, universities, and social housing. You will also see PPP deals for Government accommodation, waste-to-energy plants, and water treatment projects. We are developing PPP techniques to apply not just to capital investment on a new asset, but as a vehicle to bring private skills into the management of a flow of capital expenditure over time - for instance, in flood and sea defence projects and in the refurbishment of the London Underground. And we are using PPPs to re-equip Government departments with state-of-the-art computing capability, and modernising their working practices at the same time.

The example of schools projects is instructive and particularly pleasing. Two years ago, when I was appointed, everyone thought that it would be a bridge too far to apply PPPs to schools projects. They were simply too small to generate market interest. Our answer to this was to bring forward groups of schools in the first wave of projects in order to establish critical mass sufficient to attract market interest. So schools are a great milestone for PPPs. They have been a success because we listened to the market. It is not enough for public authorities to decide what sort of deals they want, they must also be aware of what sort of deals the private sector is willing to do.

We are continuing to expand the use of private finance in building public infrastructure - now we are bringing forward a number of pilot projects in the social housing sector. Indeed, there are very few types of capital projects which we have not successfully financed under the PPP programme. PPPs are truly a widely used and versatile financing technique. We've now done enough deals to think we know how to get the best out of PPPs. And our experience has a number of lessons for Governments abroad who are at earlier stages in their own private finance programmes.

Getting the best out of PPPs

Prioritisation. In the early days we were not active enough in controlling the flow of projects to market. In each new sector, we have learnt to take it slowly at first, by identifying a few strong pilot projects and completing them successfully, in order to build both confidence and experience before increasing the flow of projects to the market. Prioritisation is especially important for us at the local authority level where there are more projects in development than there are central Government funds available to finance them. So it has been critical to marshal local authority projects to make best possible use of the available support.

Bankability. At the outset, deals tended to come to market badly thought through and with incomplete documentation. This was because the public sector was looking to the public sector to develop a project, and not merely to deliver a project developed by the public sector. We now see fewer requests for bids without conditions of contract or a well-developed payment mechanism. People have recognised that the public sector must work out what it wants before it can expect a sensible bid from the private sector. As a result the concerns about bankability are now much diminished.

A template for future PPP deals. In the early days the government wasted a lot of time reinventing the wheel by spending many hours of expensive consultants' time in devising new solutions to old problems. This all contributed to delay in negotiation, uncertainty in bidders' minds as to the terms on which they would be asked to contract, and above all to high tendering costs. To put a stop to this, in July we published our guidance on Standard Form PPP Agreements for use by all Government departments and local authorities. The guidance provides a common point of departure for PPP deals so that bidders have the comfort of knowing in advance what the basic risk allocation in a PPP project is likely to be. In this way, we will encourage PPP deals to evolve into a commodity product, just as other capital market products have done. We want to create an assembly line approach as this simply makes the deals cheaper to bid for and faster to negotiate.

Optimisation of risk transfer. In preparing the standard agreement, the idea was not just (as sometimes happened in the early days) to stuff the bidders with as much risk as possible. Above all, PPPs are about making the best possible use of taxpayers' funds. Experience has taught us that excessive risk transfer is not smart - either the bidders will charge an excessively high risk premium or they simply balk at accepting the risk altogether. We seek optimal, not maximum risk transfer.

Testing Value-for-Money. In the beginning, the Government compelled departments to test out PPPs before committing conventional capital spending. That contributed to the belief that PPPs were about the accounting treatment of capital investment, not about value-for-money. That's a mistaken impression that Ministers have taken every opportunity to correct. The justification for PPPs must be that they make better use of taxpayers' funds than conventionally funded alternative procurement methods. It's still quite early days, but we've got every reason to be pleased with the results. Our National Audit Office reviews completed PPP projects. Their reports support the conclusion that

PPPs deliver value-for-money. The reports aren't unequivocal, of course, and there's nearly always some feature or other in a complex procurement which can be improved on. But the NAO is onside, and the core message is clear: PPPs are delivering the goods.

Completing the policy framework: we have had to devise an entirely new policy framework for PPPs. At the outset, the position of PPPs as an entirely new procurement route meant that the existing rules either created unintended obstacles or exposed gaps in existing policy thinking. It has been necessary to have a high quality team within the Treasury working on reforming and completing the policy framework in parallel to the negotiation of the early deals, and to deploy ministerial support at a senior political level to push through the necessary reforms. For example, we have worked hard at improving the position of public sector employees who transfer to the private sector as a part of these deals in order to address what Ministers saw as legitimate concerns on the part of their trades unions. And the last brick in the wall dropped into place earlier in the summer when we announced the new Accounting Guidelines for PPP deals after a long, difficult and public debate with the accounting profession. So, against the background of a stable policy framework, our priority now is to focus on producing a good flow of strong, well-structured deals, but we hope our work on the policy framework here will be useful abroad in showing the main policy considerations which need to be addressed in a private finance programme.

What are the outstanding challenges?

We have learned some important lessons, and we believe that the PPP machine is running more smoothly, but there is still much to do. We've fixed the easy bits. The next set of challenges are harder to grapple with. In their different ways they go to the core of the PPP programme.

Strategic planning: Public investment capital was scarce in the past. PPPs then offered an easy way, sometimes the only way, of boosting investment in public infrastructure. Now things have changed. The Government's finances are healthy, and capital for investment may be more readily available. We therefore need to look hard at strategic investment planning in the public sector to ensure that we continue with PPPs where they offer best value for money even in the face of a natural temptation to take the easy way out through conventional capital spending. *We now see PPPs not only as a way of boosting investment in public infrastructure but also as an essential part of the Government's continuing mission to modernise the public sector* - so they have acquired a strategic as well as just a financial dimension

Better quality of public sector project management. It is not enough to plan investment better - we must also seek to improve the management of individual procurements. The public sector does not have a good reputation for project management. Too many procurements are hindered: by the appointment of low-level negotiators lacking the clear authority to take even quite small decisions; by an emphasis on process rather than the quality of the outcome; by unexplained delays in evaluation; and by late changes in policy resulting in new bid requirements or, sometimes, even in the

cancellation of the project. Project management in the public sector can never be as straightforward as in the private sector. The public interest is a more demanding yardstick than the bottom line incentives which drive the private sector, inevitably there are many more stakeholders to be consulted, but there is still much to do to avoid delay and reduce the high tendering costs of PPP deals.

PPP requires new skills in public sector authorities. What I call the "technology" of PPP projects is undoubtedly complex. PPP deals call for skills that are still in short supply - writing output specifications, for example, or negotiating the complex contracts that underlie PPP deals and, above all, an understanding of the financing products that investment bankers use to bolt these deals together. Appointing the right consultants (the best, not just the cheapest) and making sensible use of them goes some way to address the skills deficit, but only so far. Private finance requires private sector skills. The challenge for public sector authorities is to equip themselves with the private sector skills to make these deals work.

The Taskforce

The Treasury Taskforce has tried to fill this gap. The Taskforce was set up to be the focal point across government for PPP deals. Our job has been to get the deals done and make the process work. We work in partnership with Departments and local authorities to achieve the best value-for-money for the private sector. It has not been plain sailing all the way. I tell Departments that "I'm from the Treasury and I'm here to help". In the early days this produced a nervous titter from the audience, but nowadays we are at least given the benefit of the doubt.

The Taskforce is an odd creature. It's a team of private sector transactors, about a dozen strong, with a track record of doing PPP deals in the private sector. We're employed by the Treasury, not seconded - so we've been able to demonstrate that we are part of the home team. We're "in, but not of" the Treasury. I do not have a civil service reporting line, but report direct to the Treasury Minister responsible for the PPP programme, so we can deploy the political authority necessary to unblock problems. And, because our *raison d'être* is to push forward PPP deals, we are able to work effectively to broker solutions in differences between Departments and the "real" Treasury without getting drawn into the usual battlegrounds.

The Taskforce's life is almost at an end. At the outset we were given a two-year mandate, and time has simply flown by. We think the Taskforce has been a success, and it's certainly been widely copied overseas as there are look-alike taskforces in the Netherlands, Italy, Ireland, South Africa and Japan, but now it's time to move forward.

What of the future?

At the end of July, the Government announced that it wanted to form a new Public Private Partnership, Partnerships UK, to replace the Taskforce and carry on its work.

The aim of Partnerships UK is to deliver better value for money by working on the side of the public sector. It will not be just an adviser like the Taskforce, but rather a co-sponsor working in partnership with the public sector procuring authority. In effect, by helping the public sector to direct its procurement effort more professionally, it will enhance the public sector's "intelligent client" capability.

So Partnerships UK will provide the public sector with the core private sector skills that are so badly needed. The size of its staff has not yet been settled, but needs to be large enough to make a material contribution to improving the quality of public sector procurement of PPP deals.

Because it has to act as a business, Partnerships UK needs to generate revenues. But Partnerships UK will not operate as a bank - its role is not to provide long term debt for PPP projects. Instead, in support of its core project development function it will provide development funding to get PPP deals off the ground. For example, Partnerships UK might help pay the costs of a PPP bidding process or might bundle together projects which individually are too small to be economic for private sector bidders.

In Partnerships UK, we are trying to create a unique organisation, one which combines private capital and management with a public mission. We are challenging the received wisdom of the public sector which says that private sector businesses are always profit maximising and, if you will, red in tooth and claw. Like any radical new idea, there are lots of questions. And, to be frank with you, we don't yet have all the answers. We are confident that we'll find them and that Partnerships UK will open for business, as planned, next Spring.

Conclusion

PPPs in the UK have developed a long way since their introduction six or seven years ago. Originally just a way of finding additional resources to boost public sector investment in public infrastructure it has turned into a valuable procurement tool in its own right. With our emphasis on value-for-money, the results PPPs have been achieving justify all the attention they receive - we are seeing a regular flow of cases where PPPs achieve lifetime savings in cost of 20% or more. The economic justification is simply that PPPs make taxpayers' money go further and create additional investment.

Our programme has been raising a lot of international interest, and Partnerships UK is seen by many overseas as a radical innovation which promises much. This last slide shows all the countries that have had a dialogue with the Treasury in London about the uses of private finance. We certainly think PPPs are an interesting model to study ladies and gentlemen, PPPs have been a success in the United Kingdom. I hope our experience has much to contribute to their wider use overseas.