Managing PFI and PPP contracts

Facilities managers increasingly find themselves bidding for and managing private finance initiative (PFI) or public-private partnership (PPP) facilities. The facilities can range from schools and hospitals to offices, laboratories and airfields. However, as these facilities are being managed under PFI/PPP arrangements, it is sensible for a facilities manager to consider managing them differently to avoid cost and political surprises.

Governments have always paid private contractors to build roads, government offices, schools, airbases, prisons and hospitals with tax money. Typically, they paid to have things built, then to have them managed. The Conservative government created PFI in 1992, under which contractors paid for the construction costs (private finance) and then rented the finished project back to the public sector, often for terms of 20, 25 or 30 years. When Labour came to power in 1997, PFI was further developed under the rubric of PPP, despite the party's intense criticism of PFI while in opposition.

While the Government still funds the majority of public works directly, it is gearing up for a massive increase in private involvement in public services. By the end of 2003 more than 600 such deals with a capital value of over £38 billion had been signed.

BIG PLAYERS

PFI/PPP is much more about facilities management than construction. Z/Yen looked at a sample of 18 educational projects and 44 health projects in 2003. The capital costs of the 18 educational projects were £868 million and the committed running costs were £2.787 billion, expiring in 2032. Analysis revealed a 20-year period where the commitment is a steady £100 million per annum.

Capital costs of the 44 health projects were £210 million and the committed running costs were £1.041 billion, expiring in 2036. Here, there is a 20-year period where commitment is fairly steady at £30 million per annum.

Taken together, over three-quarters of the expenditure will fall to the facilities managers.

However, facilities managers are running to a long-term, tight programme to get profit out of the projects in a world where governments (and the public) change priorities. The paradox for facilities managers is how to stick to long-term cost control while remaining flexible in the face of change.

When the National Audit Office (NAO) examined 37 major PFI construction projects[1], it found that 22% were over budget. However, similar NAO reviews of public sector construction projects had found that 73% were over budget. There were equally dramatic improvements in delivery time.

However, an Audit Commission report[2] found that the quality of schools built under traditional public sector procurement was better than PFI schools.

PRINCIPAL ADVANTAGES

There are supposedly two principal advantages of PFI/PPP over traditional government procurement:

- PFI/PPP transfers the risk of delivery to the contractor
- PFI/PPP allows government to fund more infrastructure projects today

These two advantages for government are the source of the facilities manager's risks. Facilities managers must be hypersensitive to long-term costs and aware that projects will be judged first and foremost on political grounds. Most contractors now recognise the importance of facilities as the source of long-term profitability and involve facilities managers in the design and build stage. However, to avoid cost surprises following the handover, facilities managers should ask some sensible questions:

- Contract length makes earlier savings much more valuable, so how can longer-term savings be brought forward?
- Have our cost decisions been well grounded in long-term analysis? They may have to last for some time.
- Do we fully understand the discount rate used by the public sector body, the inflation rate or RPI-X, the ultimate ownership of assets and the tax implications?
- Has cost variance reduction been evaluated in addition to simply least cost; should we pay more for cost certainty?
- Are there investments we should make (and fund ourselves) over and above the contractual requirements because they will either reduce our cost risk or our cost variance?
- Where we can get third-party income, have we been cautious to use this to reduce our cost surprise risk, rather than just going for volume or taking the income as profit?

PFI/PPP gives facilities managers a profile and importance they might not have had. Facilities managers control the greatest proportion of longer-term public sector provision of services through private sector companies. Great career opportunities are there for facilities managers who are not afraid to study the slightly more complicated financial and political background to PFI/PPP.

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1. National Audit Office, *PFI: Construction Performance*, (5 February 2003)
2. Audit Commission, *PFI in Schools*, (January 2003)