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The impending termination of PFI contracts and what should be done now

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By the time PFI really got into its stride in the early 2000s, standard form contracts had pretty much nailed down the terms and anticipated anything that might happen, good or bad, during the course of the 25 years it covered.

Included within those terms were comprehensive provisions for the expiry and hand back of the contract. The terms are well understood and are designed to ensure that the public sector is handed back an asset in the condition in which it is meant to be, on the assumption that the private sector has managed the asset over its lifespan in accordance with the contract.

Despite this, in 2020 the National Audit Office (NAO) reported concerns that many authorities were unprepared for contract expiry. A worryingly high number of authorities did not understand the contract and how it provided for expiry and alarmingly, a number of authorities were unable to even find their contracts! It may not come as a great surprise that those authorities who have struggled to provide effective contract management during the term of the contract, were the least prepared for the expiry and the aftermath.

Of course, there is not an even picture but the statistics as to the ownership of these PFI projects is instructive. In England, there were 571 projects; 80% of these are with local authorities and 155 contracting bodies have only one PFI project. Many of these have further "devolved" their projects into a school academy which has eroded further the local authority's direct interest in the condition of the asset at expiry.

By contrast, a number of local authorities manage a portfolio of PFI contracts and may have retained PFI Units that were set up in the first place to deliver such projects. Such authorities are usually well placed to manage expiry. For them, having a large number of assets coming out of PFI at a similar time represents a greater risk and so they are more likely to be alive to the need to plan ahead.

PFI contract expiring? Get back on track

For those authorities without such resource, planning ahead is likely to be more of a challenge. Some support can be obtained from the Infrastructure and Projects Authority (IPA) and Local Partnerships (LP). The IPA's guidance, 'Preparing for PFI Expiry', is essential reading for all authorities facing this situation. However, local authorities are likely to be heavily dependant upon external support for their management of the process of expiry and hand back. However, that still leaves them vulnerable in the period approaching the hand back stage, where strategic decisions need to be taken as to what to do with the assets and how that might influence the delivery of future services post-expiry.

Local authorities in this vulnerable position may reach out to other authorities which find themselves in a similar position as collaboration and mutual understanding of the issues will help the cause considerably. If resources are needed, it may be sensible for them to join together in engaging the necessary contract management resources.

By contrast, the private sector has already consolidated its ownership and management of PFI projects. The NAO report noted that the 10 largest private investors own more than 50% of contracts and that the top six management companies are responsible for almost 45% of those contracts. If nothing else, local authorities can be certain that the PFI provider is going to be well prepared for expiry.

Re-review your PFI contract

But back to the contract. Surely the comprehensive Standardisation of PFI Contracts (version 4) provisions, backed by HM Treasury's (HMT) in funding PFI, provides the necessary assurance? Well, yes and no. The contract is not much use if the authority doesn't understand it so, as a minimum, each local authority must put itself in the position of knowing its contract.

However, more is needed. The contract may well be a very good contract, but local authorities need to remember that it was entered into in a different era. It might have done a great job anticipating every risk until the contract came to a close, but nobody had a perfect crystal ball at the time it was entered into. Local authorities now face new challenges and a number of issues where simply relying on the contract is not the answer (and could even makes things worse). Climate change and net zero are perhaps the best examples of such issues as they were less of a concern in the early 2000s. A practical application of this is a contract's requirement for replacement of lifecycle equipment. Do we really want to replace that 17 year old gas boiler now with a like-for-like replacement as the life cycle provisions would have us do?

Broadly speaking, are we only thinking about preservation of the asset at end of the contract and how we continue to manage it (which is essentially what the contract aims to do)? A wider, forward looking, property based approach which is fit for the next 10 years and not one founded on what was needed 20 plus years ago will firmly place the issue into the wider estate strategy of the authority.

Anticipating future needs

More importantly, local authorities should not see their future service and asset needs as a separate issue to be thought about post-expiry. Even if the contract is not necessarily helpful in this regard, decisions about assets and services need to be taken before expiry and should be factored into the approach to expiry and hand back. This is especially the case for the small number of, particularly high value, projects which are not about the delivery of accommodation (for local authorities, schools form the majority of such schemes). The most valuable examples of these outlying schemes are housing PFI and waste PFI.

In housing schemes, the condition of a large and diverse number of housing units is a very different challenge from, for example, managing the condition of a school. This difference amplifies the importance of taking a property based approach to future delivery, rather than simply looking to ensure each unit is in decent condition at expiry. In waste, however technically complex the asset provided under the PFI contracts is, the real value and costs of such schemes lies in the service provision. The asset is provided as a means of meeting the local authority service needs (waste disposal) whereas in accommodation schemes, the services provided are simply dedicated to the management and the maintenance of the asset (e.g. cleaning, building maintenance and security). That means that the future delivery is a much more complex matter. Waste disposal looked very different 25 years ago to what it does now and one must assume that the next 25 years will similarly see more substantial change.

The general message coming from the likes of the IPA and the NAO is a critical one for all authorities to understand and take on board. However, particularly for those authorities managing a single PFI and who have to date perhaps struggled with contract management, it is essential that they work out how they will be resourced for managing the challenge. For those managing more diverse assets, such as housing and waste, the future strategy for service provision is not homogeneous and it is important that each of them look to the life beyond the contract in determining their strategy for how the expiry of the contract itself is managed.

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