

# PPP in education: going beyond the PFI model

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The UK has been one of the most active countries in the use of public-private partnerships (PPP) for the delivery of educational facilities. The PPP model used in the UK is widely known as PFI (private finance initiative). To date, more than 700 PFI projects have been implemented, amounting to almost £55 billion of capital cost. Education ranked third after health and defence for the amount of PFI projects (£7.7 billion of capital cost and £29 billion of future PFI repayments). Projects were implemented under the Building Schools for the Future programme, which was managed by Partnerships for Schools.

### What is PFI?

PFI is essentially a design, build, finance and operation (DBFO) method of financing public infrastructure, which has included hospitals, defence, schools, roads and social housing. Under PFI, the private company has to raise the finance to design, build and maintain the public facility for a certain period, which typically exceeds 20 years. In return, the private company is paid a regular fee by the government. In the UK, the fee is called the Unitary Charge and is linked to performance; that is, penalties are imposed if the facility is not maintained to agreed standards. Hence, the private company is encouraged to be 'clever' in its design-and-build to ensure that future maintenance costs are kept low. Penalties imposed on a private company for non-performance can sometimes exceed the maintenance cost of the facility.

### Criticism of the PFI programme

The PFI programme in the UK has faced many criticisms. Both the National Audit Office and the UK Parliament Treasury Select Committee on PFI issued reports that were critical of the way the PFI programme was implemented. The Chairman of the multi-party Parliament Treasury Select Committee, Andrew Tyrie MP, said:

*PFI means getting something now and paying later. Any Whitehall [government] department could be excused for becoming addicted to that. We can't carry on as we are, expecting the next generation of taxpayers to pick up the tab. PFI should only be used where we can show clear benefits for the taxpayer. We must first acknowledge we've got a problem. This will be tough in the short term but it should benefit the economy and public finances in the longer term. PFI should be brought on balance sheet. The Treasury should remove any perverse incentives unrelated to value for money by ensuring that PFI is not used to circumvent departmental budget limits.*

*It should also ask the OBR [Office of Budget Responsibility] to include PFI liabilities in future assessments of the fiscal rules. We must also impose much more robust criteria on projects that can be eligible for PFI by ensuring that as much as possible of the risk associated with PFI projects is transferred to the private sector and is seen to have been transferred (Commons Select Committee, 2011).*

In July 2010, the Secretary of State for Education, Michael Gove, announced that the Building Schools for the Future programme was to be scrapped. Projects that had been awarded but had not yet achieved 'financial close' would not proceed, thus cancelling more than 700 school revamps already signed up to the scheme.

### PFI: myths and fallacies

The Commons Select Committee report (2011) was rather scathing. It debunked a number of myths and exposed some fallacies of the UK PFI model, of which the following are some examples.

#### PFI projects offer value for money

The Select Committee reported that 'The use of PFI has the effect of increasing the cost of finance for public infrastructure relative to what would be available to the government if it borrowed on its own account' (House of Commons Treasury Committee, 2011: 6). The cost of borrowing by a private company will always be higher than if the government were to borrow the money. An example was given that if the government were to borrow the money itself, it would have been able to build 1.7 times the project procured through PFI. This was due to the differential borrowing rates of the private sector and the government. Other methods could have been used in the place of the more expensive PFI to ensure that facilities were maintained properly – for example, the London Borough of Lewisham established a sinking fund to ensure non-PFI schools were maintained properly.

#### Risk allocation

In PFI projects, the construction risk is generally transferred to the private company, which is supposedly better able to manage this risk. However, the logic of this is questioned in the report as the cost of construction is then 'fossilised' and is charged to the government at a higher interest rate for the next 20–30 years, resulting in a loss in value to the government. Other methods such as design-build could have been used to achieve the same results at a much lower life cost to the government. Moreover, some of

the claimed risk transfer may be illusory – the government ultimately is accountable for the delivery of the services and would therefore not allow the PFI contract to cease.

### PFI projects create value through innovation

The Committee reported that there was no conclusive evidence that PFI has created value through innovation. In fact, it was reported that some PFI projects were poor in design and construction. The Royal Institute of Architects said ‘the quality of buildings procured through PFI schemes remained poor in many cases. The poor quality of the building designs lead to a number of issues such as rising maintenance costs over the lifetime of the building’ (RIBA, 2011). The National Audit Office commissioned the Building Research Establishment to compare the design quality between a group of PFI and a group of non-PFI buildings. It found that there were no ‘meaningful differences’ in build quality between the two groups (quoted in House of Commons Treasury Committee, 2011).

### PFI projects are completed to time and budget

PFI projects are supposedly procured with more certainty regarding the price and time. The Committee concluded that not only was there no convincing evidence that this was true, but PFI projects also took more time to conclude due to the lengthy procurement process, usually two to three years longer than traditional procurement methods.

### Off balance sheet

For a long time, PFI was the ‘only game in town’. It allowed government agencies that did not have the capital budget to complete public facilities using private money. The cost did not appear on their ‘balance sheet’ or liability list. This was allowed under EU public accounting rules. However, under International Financial Reporting Standards 2009/10, all PFI debts have to be included in the financial accounts of government departments for financial reporting purposes. This will result in not only the capital cost of the PFI project being included but also all future maintenance cost: a double whammy. At the end of 2010, the government estimated that £40 billion of PFI liabilities had to be reclassified as ‘on balance sheet’ (OBR, 2011).

## Other criticisms of the PFI model

The Parliament Committee also noted several other criticisms of the PFI model, including the following.

### Inflexibility of PFI

Once a PFI contract is signed, it is cumbersome to amend the terms for the duration of the contract. In the case of schools, designers faced difficulties in trying to predict how the learning environments would evolve, exacerbated by poor levels of participation of key stakeholders – including teachers, pupils and the community – in the design process. There have also been doubts about the direct relationship between the quality of infrastructure and the quality of pupil education.

### Weak public sector expertise

It was acknowledged that the public sector lacked the experiences and capacities of the private sector in PFI contracts. Evidence was provided on the importance of improving procurement and project

management skills in the public sector. One expert witness said, ‘In terms of commercial skills and capabilities, the UK public sector has spent the 20-year life of UK PFI attempting to create the necessary capacity. For many years there seemed to be too little appreciation in the higher civil service ranks of the extent of the difficulties of complex procurements’ (Lonsdale, 2011). In many ways, PFI has exacerbated the problems in this area. Owing to the complexity of PFI, the public sector has become too reliant on expensive external expertise, and the expertise has tilted towards financial skills.

### Lack of competition in the market

Competition is generally required to drive costs down and result in value for the government. The Committee pointed to a lack of

## Box 1

### The Perdana University, Malaysia

Under the 10th five-year Malaysia Plan (2011–2016), the government proposed promoting the development of industrial clusters in the health sector by focusing on education, research and skills training. The primary goals for this sector were to foster strategic alliances, promote investment in high-end medical technology, strengthen the presence of the Malaysian health-care brand globally and use PPP to drive high-income economic growth. In order to meet these goals, the Government had to meet several challenges, including the shortage of local and specialty medical talent (over the years, many medical students were sent abroad at high cost to the nation), a need for upgraded infrastructure and operating systems and a need to improve the research environment.

The project comprises the development of the Perdana University, the Perdana Life Sciences Research Centre and the 600-bed Perdana University Teaching Hospital. The total project cost is estimated at £500 million. The Perdana University will be the first university with dual-curricula Medical Schools (John Hopkins University and Royal College of Surgeons, Ireland). It will serve to attract Malaysian and foreign medical talents to teach and mentor the best medical students in the country. It will also help the Government save on the cost of sending students abroad for training while stemming the brain drain of Malaysian medical specialists. The Teaching Hospital will make available the best training opportunities for graduate and post-graduate students while offering world standard health care to medical tourists. The Life Science Research Centre is a collaboration with John Hopkins University to attract world class medical researchers to the country.

The key advantage of this PPP project is that the private sector promoters will be assuming all the risks pertaining to its design, build, finance and operation. They will also assume the revenue risk for the project; the only obligation of the Government is its commitment to send a small number of students to the university over the next 10 years. The Government in turn has facilitated land identification and acquisition for the project at commercial rates, assisted in securing temporary buildings for the university (the construction of the new campus will take two years) and provided a small grant from the PPP Facilitation Fund for road and infrastructure construction for the new site.

competition in the UK PFI market due to the high cost of bidding. The long, complex and costly procurement process limits the appetite for consortia to bid for projects and also meant that only companies with deep pockets who can afford to lose millions of pounds in failed bids can be involved. Smaller companies have often been excluded.

## Searching for a more equitable and responsible PPP model

The aim of PPPs is to tap private sector capital to boost sustainable development while reducing exposure to financial risks (Nwasike, 2012). One of the criticisms of the PFI model is the lack of equitable risk allocation between the public and private sectors. While some developing countries have been successful at PPPs, they face the challenge of weak capacity of the public sector to effectively engage with the private sector 'due to limited specialised knowledge, skills and weak institutional capacity' (ibid.).

The Perdana University project in Malaysia is an example of a PPP project that has a more equitable risk allocation while still meeting the government's objectives (see Box 1). The private sector-initiated project is to build the first privately owned university with dual-curricula medical schools (Royal College of Surgeons, Ireland and John Hopkins University), a life science research centre and a private teaching hospital. This collaboration between the Malaysian Government's PPP Unit and the corporate sector is seen as a landmark for the country.

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