

Technical annex: Proposed analytical framework for evaluating the performance of private financing and traditional procurement

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Proposed analytical framework for evaluating the performance of private financing and traditional procurement

A comprehensive analysis is needed to consider the costs and benefits of private financing and traditional procurement. The proposed framework (shown in Figure 1) takes a whole life perspective, from the project development phase (T_0) to decommissioning of the asset (T_∞). The aim is for an analysis of costs and benefits that is beyond the cost of financing which invariably will be higher under private financing. The framework includes quantitative and qualitative aspects for the different categories as shown in Table 1. The availability of data on both privately financed and traditionally procured projects will be key to developing the analysis¹. It is intended that the framework will be piloted and refined over the coming months. Private financing in this context refers to the Private Finance Initiative (PFI), and PF2.

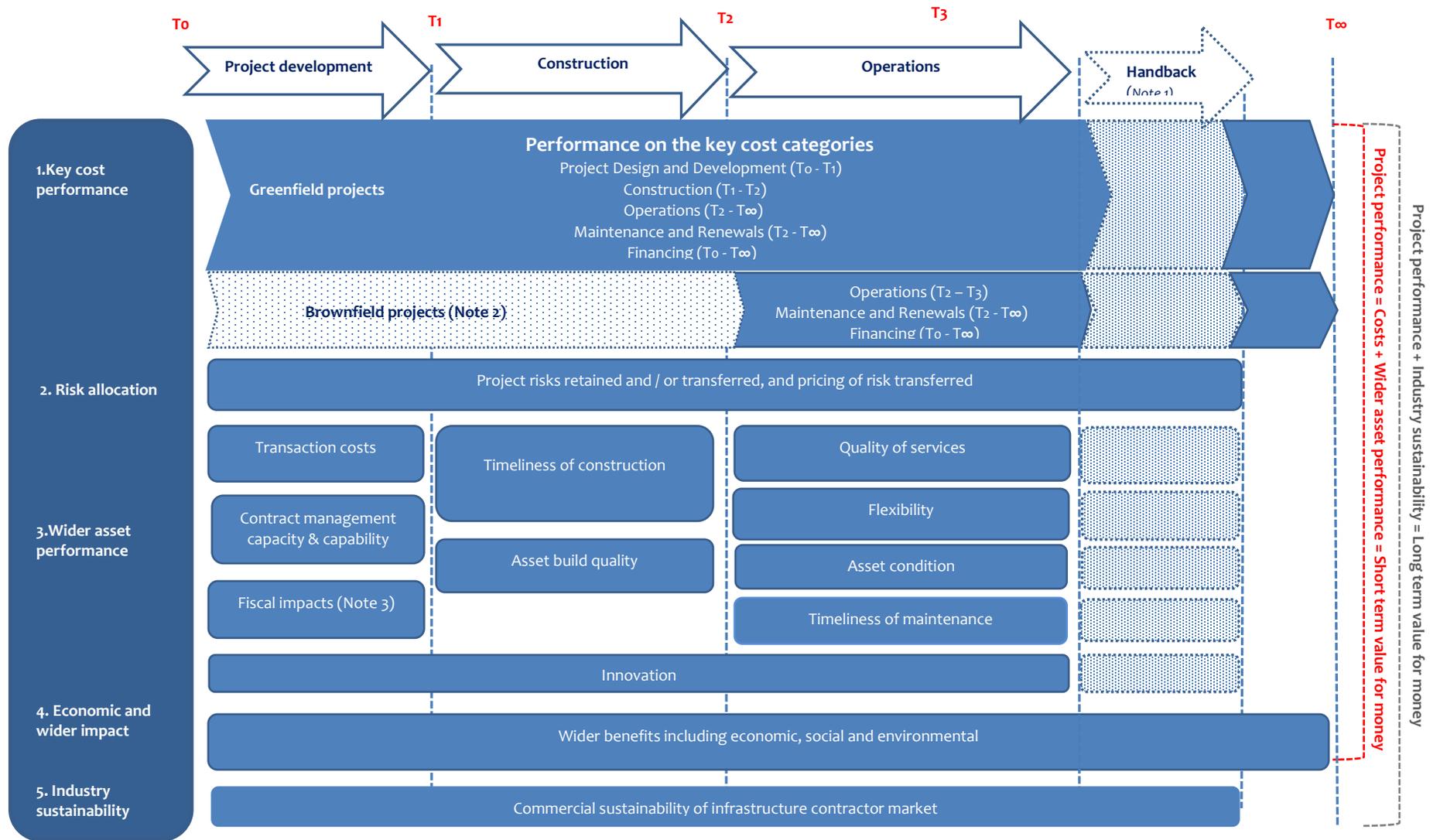
The analysis completed under the framework categories *Key Cost Performance*, *Risk Allocation*, *Wider Asset Performance* and *Economic and wider impact* will influence short-term value for money. The analysis of costs and benefits also needs to take account of the prevailing environment. For example, following the 2008 financial crisis, the cost of raising financing for the M25 PFI contract increased.² The consideration of the final framework category, *Industry Sustainability* impacts long term value for money.

Table 1: Explanation of the categories within the framework

Category	Explanation
<p>1. Key cost performance</p>	<p>Analysis of the core costs that arise across the phases of the project lifecycle.</p> <ul style="list-style-type: none"> • Design and development costs covering design, feasibility, consent and planning activities. It excludes transaction costs. • Construction costs. • Operational phase costs which are generated by operations, maintenance, and asset renewal activities. • Cost of financing. For private financing this would include the cost of debt and equity finance, and will take account of refinancing. The public cost of financing also needs to be considered. • Decommissioning costs arising at the end of life of assets. <p>A distinction is made between ‘greenfield’ and ‘brownfield’ projects. Greenfield projects involve the development and</p>

Category	Explanation
	<p>construction of a new asset. Brownfield projects involve the enhancement of existing infrastructure assets, and may not involve significant project development or construction activity.</p> <p>The asset handback period applies to privately financed projects, and is the period leading up to the asset being handed back to the public sector.</p>
<p>2. Risk allocation</p>	<p>Analysis of risk allocation over the project’s lifecycle to establish whether risk transfer was realised in practice, and if the cost for the risk transfer represents value for money. Risk allocation is particularly relevant to the private financing model. Risks in privately financed projects are allocated directly through the contract, and indirectly by the financial structure³ of the project company. The analysis of risk transfer will also be informed by renegotiations and post contract changes on operational projects. A review of PFI operational contracts was initiated by HM Treasury in 2011.⁴ The transfer of risks needs to be analysed across the whole supply chain (see category 5), and not only at public procurer and project company level.⁵</p>
<p>3. Wider asset performance</p>	<p>Comprehensive measures of costs and benefits of the approaches beyond core project costs.</p> <ul style="list-style-type: none"> • <i>Transaction costs</i> for legal, financial, and technical advice incurred in the development stage of projects. • <i>Contract management capacity and capability</i> of the public procurers. Contract management expertise is necessary to realize value for money.⁶ Developing this expertise is an additional cost to public procurers. • <i>Fiscal impacts</i> relate to budget certainty and balance sheet treatment. Private financing ringfences budget allocations providing funding certainty to public procurers. When fiscal constraints arise, there is a greater likelihood of capital and maintenance investment being deferred under traditional procurement. <p>Traditional procurement is accounted for on the government’s balance sheet. Under national accounting rules, not all the liabilities under private financing contracts are reported on the government’s balance sheet. This results in a favourable fiscal position under the key Public Sector Net Debt (PSND) measure, and may distort the selection of financing models.⁷</p>

Category	Explanation
	<ul style="list-style-type: none"> • <i>Timeliness of delivery</i> of construction and maintenance works will analyse actual delivery performance for construction and maintenance works against expected timescales. The late completion of both leads to delays in users accessing the infrastructure service. • <i>Asset quality</i> of the delivered infrastructure will consider the design and construction quality of the asset. • <i>Quality of services</i> delivered to users which can include several metrics for example, the reliability of journeys for roads infrastructure. • <i>Flexibility</i> benefit of being able to respond to a changing environment or service requirements. This is curtailed under the private financing model. There is a trade-off between flexibility and cost efficiency, with more flexibility often being achieved at a price.⁸ • <i>Asset condition</i> throughout the operations phase. This is influenced by the level of maintenance and lifecycle renewal of the asset. • <i>Innovation</i> in the design of infrastructure assets, and the processes and methods for delivery and management of projects. Elements of the private financing institutional structure simultaneously encourage and constrain innovation.⁹ The aim would be to assess the innovation arising under similar privately financed and traditionally procured projects, and to test the relationship between innovation and outcomes on whole life costs.
<p>4. Economic and wider impact</p>	<p>To consider the extent to which economic, environmental and social benefits are delivered under private financing and traditional procurement. Traditional procurement may take account of unlocking more social and economic value given the wider remit of the public sector.</p>
<p>5. Industry sustainability</p>	<p>Focusing on analysis of the commercial sustainability of the relevant parts of the construction industry. This will look at the financial structures and risks across the contracting supply chain. Risk allocation, and levels of transaction costs have an impact on the construction industry’s competitiveness, and its financial sustainability.¹⁰</p>



Note 1. For privately financed projects Note 2. Development and construction activities relating to existing infrastructure Note 3. Budget certainty and balance sheet treatment

Figure 1: Proposed analytical framework for evaluating the performance of private financing and traditional procurement

End notes

¹ The Allen Consulting Group (2007), Performance of PPPs and Traditional Procurement in Australia

² National Audit Office (2010), Procurement of the M25 Private Finance Contract

³ Miller, R., Lessard, D. (2014), MIT Press, The Strategic Management of Large Engineering Projects: Shaping Institutions

⁴ National Audit Office, (2011), Savings from operational PFI contracts

⁵ Makovsek, D., Moszoro, M. (2017), Risk Pricing inefficiency in Public Private Partnerships, Transport Reviews

⁶ National Audit Office (2014), Transforming government's contract management

⁷ Burger, P., Hawkesworth, I. (2011), OECD Journal on Budgeting, How to attain value for money: Comparing PPP and Traditional Infrastructure Public Procurement

⁸ Ross, T., Yan, J. (2015), OECD/ITF, Journal of Comparative Policy Analysis: Research and Practice, Comparing Public-Private Partnerships and Traditional Procurement; Shaoul, J., Stafford, A., Stapleton, P. (2013) The Fantasy World of Private Finance for Transport via Public Private Partnerships

⁹ Barlow, J., Koberle-Gaiser, M. (2009), California Management Review, Delivering innovation in hospital contracts: Contracts and Collaboration in the UK's Private Finance Initiative Hospitals Program

¹⁰ Department for Business Innovation and Skills (2013), Trade Credit in the UK Construction Industry: An Empirical Analysis of Construction Contractor Financial Positioning and Performance