

Private Finance Initiative – Norfolk and Norwich University Hospital

This briefing gives a general guide to Private Finance Initiatives (PFIs) and, in particular, to the scheme for the Norfolk and Norwich University Hospital (NNUH).

General background to PFI

The Conservative Government first announced the Private Finance Initiative in 1992. Its aim was to achieve closer partnerships between the public and private sectors and to share expertise and transfer risk from the public to the private sector. The present Government has continued to deliver public services using PFI.

Why do Governments use PFI?

PFI allows the Government to take advantage of private sector expertise to manage complex investment projects. A Treasury commissioned report by ¹Mott MacDonald concluded that publicly procured projects tended to underestimate costs and project duration and overestimate benefits in some cases by very significant margins. The report showed that PFI projects, however, benefited from higher levels of diligence and were able to reduce these risks.

By introducing private sector investors who put their own skills and own capital into the project, the public sector gets the benefits of commercial efficiencies and innovations as well as timely delivery. This results in not only better public services, but also better value for money.

How can PFI schemes be better value for money when the private sector cannot borrow money from the banks as cheaply as the Government can?

The Government can borrow more cheaply than the private sector, but judging value for money is not just about comparing interest rates. Any additional costs of borrowing are offset by the private sector taking on the risks of construction cost; time overruns and project performance; using their ability to innovate; and making more efficient use of resources.

If you take the £431 million Scottish Parliament as an example, it was publicly funded and completed in 2004; some three years behind schedule and ten times over budget. NNUH was delivered 20 weeks ahead of schedule and on budget.

¹ *Review of Large Public Procurement in the UK*, July 2002, source: http://www.hm-treasury.gov.uk/mediastore/otherfiles/greenbk_mottsrep02.pdf

What does refinancing PFI projects mean?

Refinancing is when a company involved in a PFI project repays the borrowings it raised at the start of a project with new borrowings at a later time, or alternatively it adjusts the terms of the original project borrowings.

Usually this is achieved on a more beneficial basis if the project has performed well and market conditions are good. If so this results in a refinancing gain for the shareholders of the project company.

About our PFI scheme at NNUH

Under PFI, the private sector consortium (Octagon Healthcare) raised the money (£229 million) to build a 989-bed hospital and carried the risks associated with budget overruns or the project not completing on time. The hospital buildings belong to Octagon (although the NHS owns the 63-acre site NNUH is located on). The Trust occupied the hospital once it was complete in August 2001 and started paying what is effectively rent for the building and for some services provided (by Serco) for 60 years with break options from 35 years.

The NNUH project, which at the time was the biggest ever single-build NHS hospital in the country, was completed on budget and twenty weeks ahead of schedule. Octagon is contractually bound to maintain the buildings to an agreed standard and, at the end of the contract, ownership of the hospital will pass to the NHS.

What does PFI cost us?

Currently, out of a total annual budget of £325 million a year, our PFI contract costs around £43 million a year (13 per cent of our overall budget), split between payments made by the Norfolk and Norwich University Hospitals NHS Foundation Trust (the Trust) for the occupation and provision of services within the hospital.

Part of the payment is linked to the number of patients seen at the hospital. The more patients we treat the more we may pay because we use the services more intensively and the building will require greater maintenance.

The 2007/08 costs were:

Usage payment	Value (£M)
Usage Fee	£29.00M
Facilities Management	
Maintenance	£3.16M
Grounds Maintenance	£0.13M
Domestic & Portering	£5.25M
Catering	£2.26M
Car Parking	£0.06M
Security	£0.44M
Laundry	£1.47M
Waste Disposal	£0.83M
Total	£42.60M

So what is the Trust paying for?

- 1) We pay a rent for occupation of the building, the usage fee, based on the numbers of in-patients and out-patients using the hospital.
- 2) We pay for maintenance and engineering services through the maintenance usage fee.
- 3) The Trust pays a fee for facilities management services such as, cleaning, catering, portering, etc.

The Trust can deduct sums from the fees paid for services that are unavailable for normal Trust business or for poor service delivery in accordance with agreed performance measures.

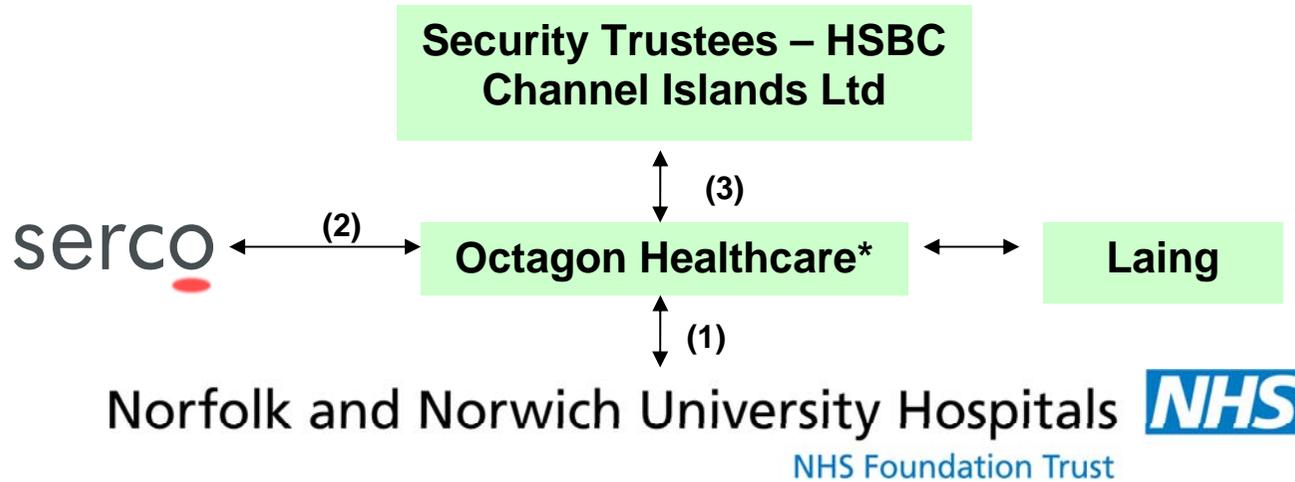
How long is the contract?

The original contract term was 60 years from the date of completion (14 August 2001). The Trust has an option to break from the contract after 35 years (on 8 January 2037). The break option can also be exercised on the 35th, 40th, and 50th anniversaries of the date of completion, 14 August 2001.

How does the contract for support services work?

Every five years all the support services provided by the consortium are market tested. The first market test took place in 2006 and the contract was awarded to Serco.

Who are the members of the PFI consortium?



***Shareholder**

Equity Share

3i Infrastructure Seed Assets GP Ltd	26.316%
Innisfree Nominees Ltd	26.316%
Trillium PPP Investment Partners No2 Ltd	26.316%
John Laing Social Infrastructure Ltd	21.052%

Notes:

The arrows show the relationships between the organisations.

- (1) The Project Agreement & Facilities Management Agreement documents cover the Trust/Octagon relationship.
- (2) The Facilities Provision Contract exists between Octagon and Serco.
- (3) The Bond Managers have replaced the primary lenders that existed before the refinancing agreement.

So who does what?

The main organisations involved in the direct management of our PFI are the Trust, Octagon and Serco. Their responsibilities are set out below.

Octagon Healthcare

The key relationship is between the Trust and Octagon. Octagon is structured so that most of its functions are passed to its sub contractors, such as Serco.

Octagon's main responsibility is to its shareholders and to manage the relationship with its financiers. As part of this role, it is responsible for managing the sub contractors.

The extent of this management role is limited to rights of enforcement where the sub contractors are in breach and enforcing sub contractors claims against other parties.

Octagon holds a number of functions:

- To effect major repairs;
- To deal with variations to the contract;
- To enforce the sub contracts;
- To maintain a specific range of insurances;
- The Liaison Procedure with the Trust;
- To Chair the Sub Contractor Liaison Panel;
- To effect all payments due under the terms of the contract;
- To issue instructions to the sub contractors.

Octagon is also responsible for giving information to the Trust and providing information it receives from the Trust to the sub contractors e.g. if Serco require a Service Variation it gives the information to Octagon who pass the same to the Trust (and vice versa). All transactions with the Trust take place in Octagon's name.

Serco

Serco's main function is to provide Facilities Management services i.e.

- Security
- Car Parking
- Grounds
- Laundry
- Waste
- Energy
- Catering
- Maintenance
- Domestic and Portering

Norfolk and Norwich University Hospitals NHS Foundation Trust

The Trust manages its obligations under the PFI through the PFI and FM Contracts Management Team within the Facilities directorate. The main responsibilities of the Trust include making sure we get value for money:

- To request all variations to the services received and the maintenance/use of the hospital building
- To monitor the service performance through the agreed performance measurement system, and to report on performance.
- To identify and administer claims for unavailability of services and hospital facilities under the contract unavailability module (this includes identifying deductions from Usage Fees);
- To inform Octagon of all information, policies and notices that may be required to permit them to fulfil their responsibilities;
- To liaise directly with the subcontracted services providers (e.g. Serco) to effect the smooth delivery and management of support services.
- To manage the Liaison Procedure
- To identify and resolve any issues of dispute with Octagon
- To identify and resolve service performance and quality issues directly with the service providers
- To develop procedures and policies that improve awareness and use of all services under the PFI service agreement across the Trust

Laing

Now called Laing O'Rourke, the company's role was to design and build a fully operational building within the terms of the design documents.

Refinancing of the PFI

In late 2003, the Trust entered into a new agreement with Octagon that provides a substantial benefit to the Trust over the lifetime of the contract. The agreements entered into provide for a number of changes, including:

- Under the refinancing, the Trust receives a benefit of £3.5 million a year that is taken as a reduction in payments made to Octagon. The annual saving is linked to inflation to keep its relative value.
- The financial gain from the refinancing arrangement for years 30 to 35 is split on a 50:50 basis as opposed to the 70:30 initially.
- The minimum contract period with Octagon has been extended from 30 to 35 years.

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