



Infrastructure UK

Value for Money in PPP Projects The UK Experience and Lessons Learnt

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UK Definitions

- *“The optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user’s requirements. VfM is not the choice of goods and services based on the lowest cost bid.” HM Treasury*
- *“The (minimum) economic resource required to generate and sustain a desired capability” National Audit Office*
- *VfM is a comparative process which lies at the heart of UK project methodology (not just for PPPs) and should be tested across every stage of a project’s development. It is enshrined in our “business case” approach to projects . VfM tests (comparing options) help good decisions.*
- *The UK revised its VfM methodology in 2006 and is doing so again now.*

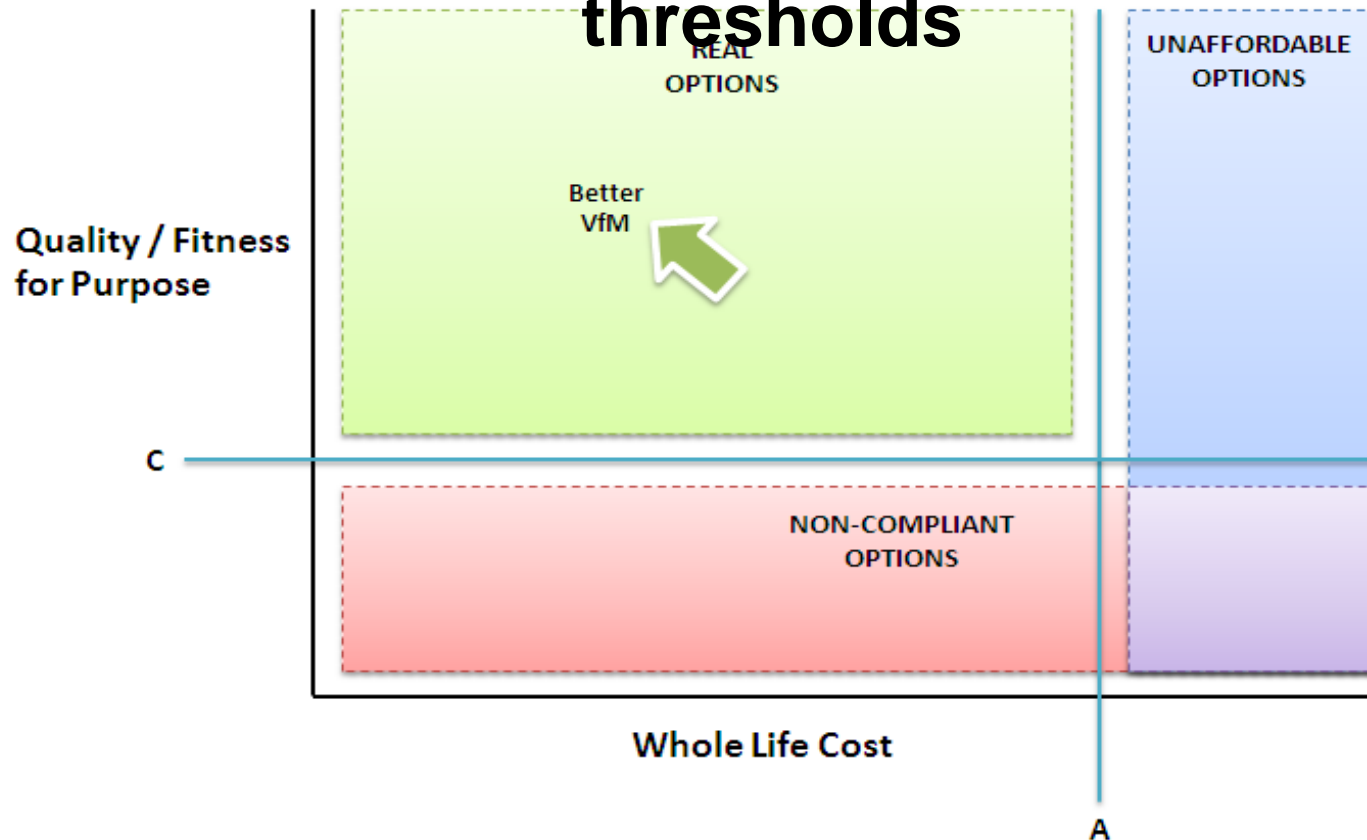


VfM Tests

- The UK uses VfM to test project proposals in two primary ways:
- The first test: is this a good project (does it represent value for money)?
 - This involves a cost / benefit analysis of the different options for taking forward the project
- The second test : is this a suitable project to be privately financed?
 - This traditionally has applied
 - (a) a qualitative test to see if the project is of a type likely to be suitable for private financing and
 - (b) a quantitative test to assess if private finance will offer better value than public finance
- The VfM approach also helps determine suitable thresholds of affordability and quality.



Affordability and Quality thresholds



A: Affordability – options costing more than A are unaffordable

C: Compliance – options below this level or non-compliant

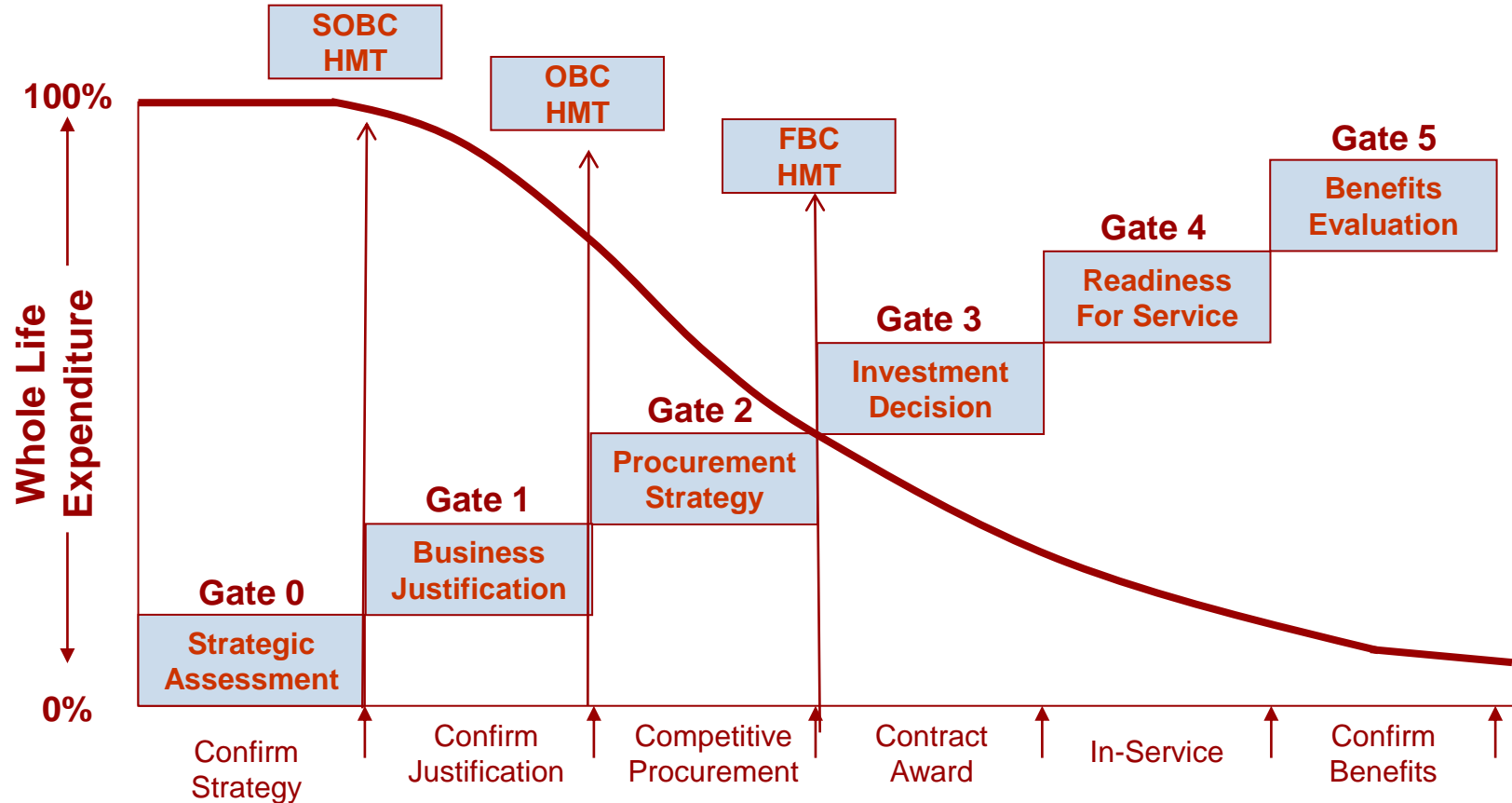


VFM APPLICATION

- We have learnt that you should not evaluate VfM at a single point but throughout a project's life
- We focus in particular on three key points
 - Project inception – Programme Level (“Strategic Outline Business Case” stage)
 - Prior to public launch of procurement - Project Level (“Outline Business Case” stage)
 - Prior to contract signature - Procurement Level (“Final Business Case Stage”)
- We have also learnt that the early stages are most critical – but frequently the late stages receive more attention. The ability of VfM tests to meaningfully influence project outcomes diminishes over time . It is important to **START RIGHT**.



Ability to influence outcomes





UK's Approach revised in 2006

Strategy : Program Inception

Development of departmental capital strategy and programme - Specific investment options identified and appraised - Capital projects prioritised within Department's capital programme - areas which may be suited to PFI/ PPP identified



Stage 1 Programme Level Assessment : Strategic Outline Business Case

Applied to the subset of investment identified as potentially suitable for PFI /PPP to coincide with agreement of departmental budgets

Output: Publish investment programme. Pass Stage 1 assessment onto project teams within the programme



Stage 2 Project Level Assessment : Outline Business Case

Constitutes part of the Outline Business Case for each project. Analysis from Stage 1 updated with project specific information and key VfM issues identified. Undertaken prior to publishing the OJEU Notice

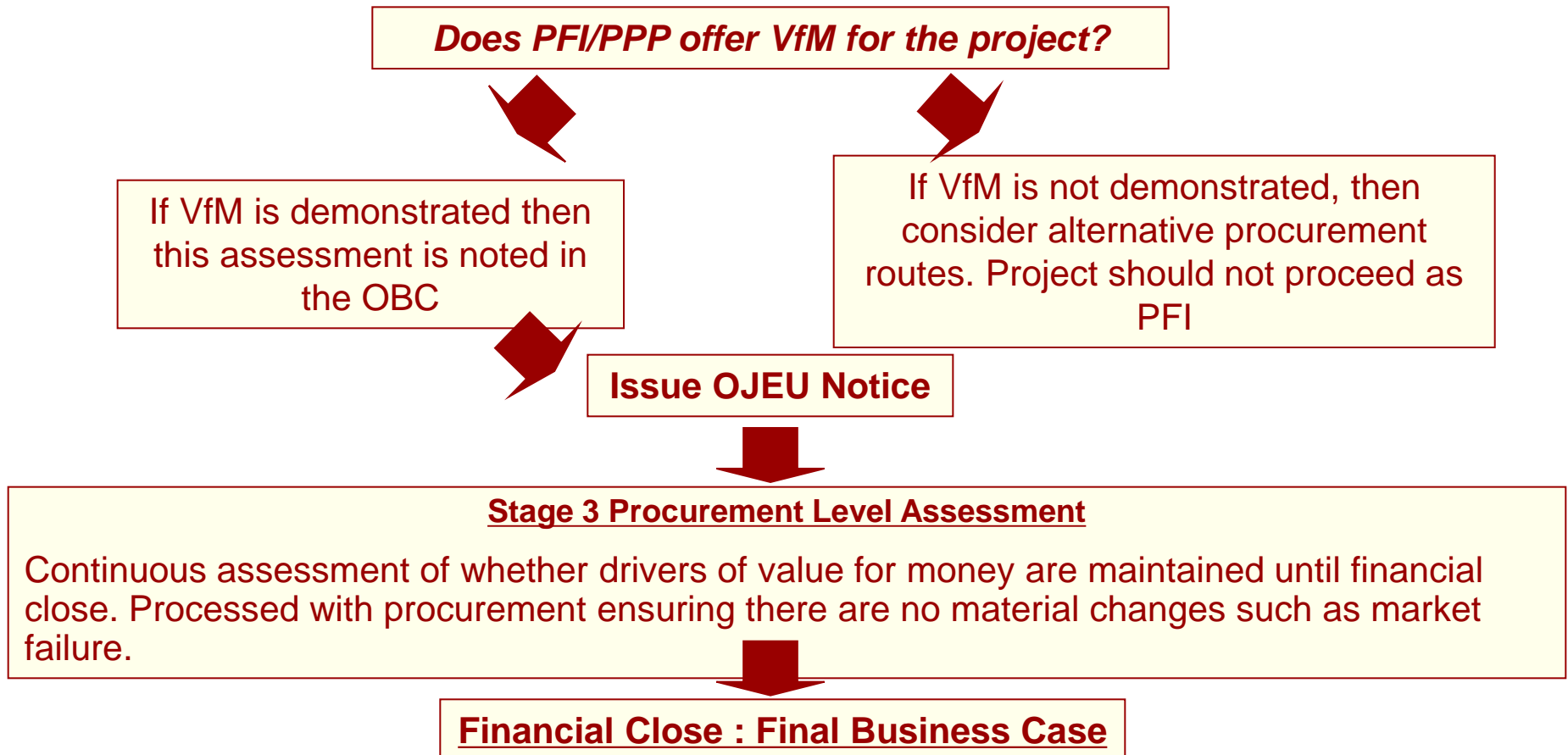
Output: An overall VfM judgement for or against PFI/PPP made based on qualitative and quantitative assessments



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UK's 2006 Approach





TEST 1 – OPTIONS’ APPRAISAL

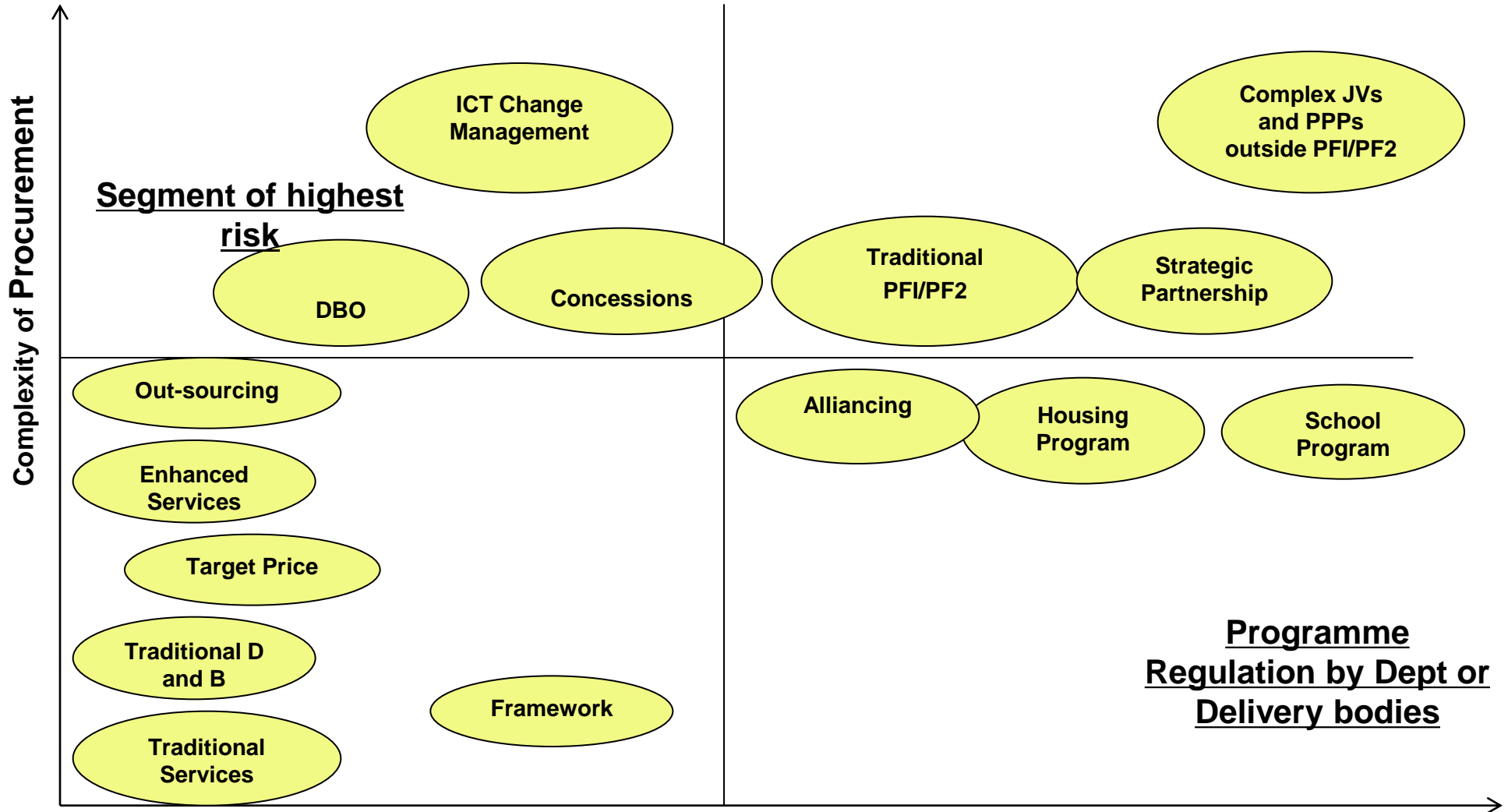
- We have learnt that it is vitally important to consider all feasible options for delivering a project at the start of the development process, in order to choose the right contracting model.
- We have found that sometimes projects have simply looked at a PFI approach against a traditional public sector approach (i.e. Only two options).
- We now emphasise that private finance is only one of a range of possibilities (see models on next two slides). The option tests should be transparent about any constraints or assumptions (since these are often unsaid and can skew the analysis).
- All options should be tested by comparing net present costs against net present benefits (on a discounted basis). Our VfM methodology will be updated to make this clearer.
- Accurate data across programs (to input to models) is vital.



Example options - Privatisation, PPP, Outsourcing

	Regulation	Asset transfer	Accountability for service provision	Private capital at risk
Privatisation	Regulator to regulate pricing, service	Permanent transfer of assets	Transferred to private party	Yes
PPP	Terms usually in the contract	Management of assets usually returns to government	Accountability retained by public authority	Yes
Outsourcing	Terms in the contract	No - short term management of assets	Accountability retained by public authority	Limited

Example Range of Procurement Models





Test 2 - Qualitative and quantitative tests for private finance

- In the UK it is felt that too much emphasis has been given to the quantitative analysis (as if it provided mathematical proof of VfM) and too little to the qualitative (which involves judgement). We now aim to redress this balance.



Qualitative tests: Viability, Desirability and Achievability

- Badges of suitability for Private Finance approach
 - Contractual fixed price (fixed price has a value to public sector)
 - Long term predictable need
 - Long term solution (whole life costing)
 - Stable policy framework
 - Private sector can manage risks and be responsible for delivery
 - Performance related payment
 - Effective risk allocation (placed with party best able to manage it)
 - Private capital at risk
 - Big enough to justify procurement costs (minimum £50m)
 - Competitive bidding market
 - Public Sector Governance and QA (skilled team)



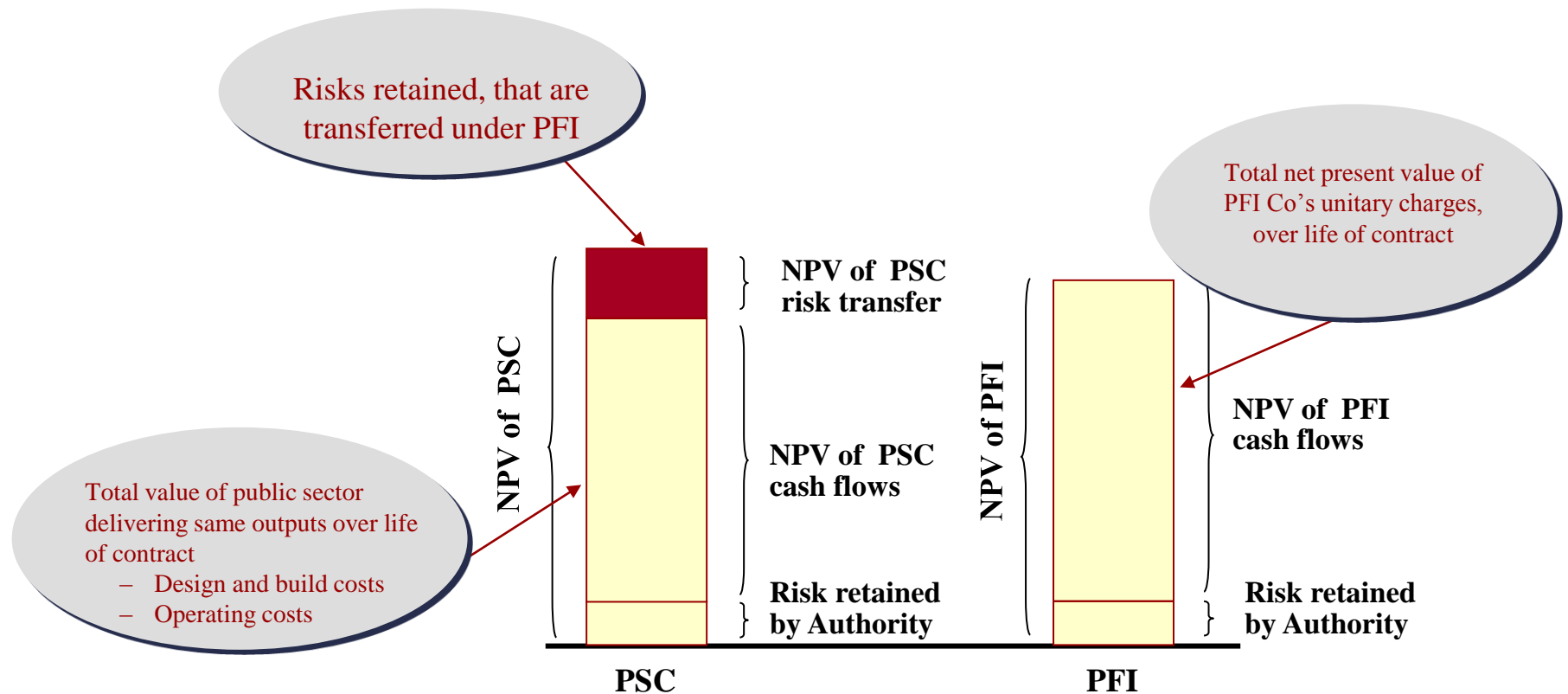
Qualitative test - Badges of unsuitability for private finance

- Project/service likely to undergo significant change
- Demand / solution not inherently long term
- Risk of obsolescence (no privately financed ICT projects allowed now in UK)
- Too small
- Too complicated
- Procuring Authority inadequately skilled



The Quantitative Test - Public Sector Comparator

Typical Profile of Net Present Cost of PSC vs. PFI





Public Sector Comparator

- Numerically based system
- Compares risk adjusted costs
- Provides a “should cost” model
- Quantifies risks
- Question : Is the extra cost of the private finance outweighed by risk transfer to the private sector and private sector efficiencies?



Public Sector Comparator - Lessons

- Advantages – can be apparently helpful with political /public perception
- But....challenges:
 - Can be misused and misleading (spurious specificity)
 - Avoids use of real judgement
 - Timing of final output does not help with decision making process
 - Reliant on a single-point, cost-based test based on Net Present Values
 - Needs empirical data and sector experience (limited at start of programme)
- Therefore UK revised its methodology in 2006
 - Whole Life Approach with three key stages (see slide 5 above)



UK's Further Re-assessment in 2012 found

- Projects had not been considering a full range of options. They too often simply compared traditional public sector procurement against PFI
- Too much reliance was placed on outcome of the quantitative assessment
- The comparator was only as good as the information put into it. Sometimes inadequate
- Figures were capable of manipulation (questions on the reliability of optimism bias) and inadequate evidence was available for some figures
- PFI could be done for the wrong reasons (to obtain off balance sheet finance)
- UK system of PFI credits (funding for PFI) tilted balance in favour of PFI approach
- Some projects were done where the case for PFI was marginal – especially in the face of increasingly expensive long term debt



Government's Response 2012

- Abolished PFI credits
- New Transparency (control total) on national accounts
- Withdrawn quantitative model (to rework)
- Recognises that PFI is just one of many delivery models
- Published Procurement Route Map
- Published new PF2 policy and guidance
- Will revise VfM guidance over Summer
 - Quantitative model only one of many analytical tools
 - Importance of testing a number of options
 - Importance of proper “starting gate” assurance
 - Work on optimism bias and holding of contingencies



Some other ideas

- Valuing accelerated delivery (delivering services earlier)
- Valuing enhanced delivery (delivering services to a higher standard)
- Valuing wider social impact (greater benefits to society as a whole)

..... But no UK policy on these as yet.



Journey from simple to sophisticated regimes

LOW RISK

- Lowest Cost
- No dialogue
- Simple objective evaluation
- Tight central approval
- Strict standard contracts

HIGHER RISK

- Best Value for money
- Dialogue /negotiation
- More complex subjective
- Delegated approvals
- Varied contracts

Value of Quantitative Test to Developing countries ?

- Is there really a public sector alternative – but
- A “should cost” model still has a value



Conclusions

- VfM is a concept that compares options and informs decisions – it is not however a perfect science; it can be abused and judgement is still required
- UK will be revising its approach over the Summer (especially around quantitative analysis).