



WHAT IS PPP/PFI?

FPU Factsheet 1

Public Private Partnerships (PPPs) are a key element in the Scottish Executive's strategy for delivering modern, high quality public services. The Private Finance Initiative (PFI) is one form of PPP.

PFI projects are long-term **contracts** for services that include the provision of associated facilities or properties. Under the contract, the private sector will have responsibility for designing and constructing the building or facility and maintaining and servicing it throughout the contract term. The public sector retains accountability for the main public services.

The public sector specifies its requirements in terms of outputs. This gives the private sector the scope to determine how best to deliver the services to the required quality and performance levels.

Projects are financed on a Project Finance basis i.e. lending is against the cashflows arising from the project. The recourse of the funders is limited to the project company and hence the cash flows, in most cases. This demands that the projects are commercially viable with robust cash flows.

Funders will usually put Covenants in place with the borrower to make the cash flows more secure and to secure their claim on them. They fall broadly into 2 categories Positive Covenants that compel the borrower to do certain things and Negative Covenants that restrain the borrower from doing certain things.

The private sector is responsible for financing the project up front and only receives payment from the public sector once

construction has been completed and the services have commenced. Payment takes the form of a unitary payment at regular intervals (usually annually with monthly instalments) over the life of the contract.

The aim behind PFI is to allow the public sector to employ private sector capital and management expertise in the delivery of public services. Instead of the public sector buying the capital assets and operating them, it purchases these services from a private sector operator and makes payments for them (usually) on the basis of availability and performance.

Risk transfer is fundamental to all PFI projects. Placement of risks with the most appropriate party and the subsequent efficient management of those risks are essential for value for money.

Brief History

PFI was first launched in 1992 and in the autumn of 1993 the Private Finance Panel was created under the chairmanship of Sir Alastair Morton. Universal Testing was introduced in 1994. That required all projects to be put to the market as PFI projects. In 1997 the new Government scrapped Universal Testing and set about reviewing PFI to identify improvements and realise its true potential.

Two reviews were carried out by Malcolm Bates. The first one, in 1997, focussed on improving the quality of PFI schemes and the efficiency of procurements. The Private Finance Panel was disbanded and the Treasury Taskforce was set up. Amongst other things, the Taskforce vetted significant projects for commercial viability before the



procurement process started. Other key recommendations were the strengthening of Departmental Private Finance Units, greater standardisation of project documentation and the production of new accounting guidance.

The second review reported in 1999. The main recommendations included stressing the importance of strengthening departmental deal making skills, and looking at possible options for a successor body to the Taskforce. This led to the establishment of Partnerships UK.

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