Finance Committee

Inquiry into the methods of funding capital investment projects

The Royal Edinburgh Infirmary: A Case Study on the Workings of the Private Finance Initiative

Margaret Cuthbert and Jim Cuthbert

INTRODUCTION

This paper complements the paper "The Implications of Evidence Released Through Freedom of Information on the Projected Returns from the New Royal Infirmary of Edinburgh and Certain Other PFI Schemes" by Jim Cuthbert and Margaret Cuthbert, March 2008, also submitted to the Finance Committee. That paper demonstrates the large scale of the financial returns projected to be earned by the equity holders in the NRIE scheme, and certain other PFI schemes for which detailed financial projections are now available. The scale of these financial returns suggests that there may well have been problems in the process of PFI and in the methods of monitoring and scrutinising the procedures which led to the PFI contracts. The areas highlighted in the current paper suggest where some of these problems may have arisen.

The paper is based on a study of the PFI documents relating to the new Royal Edinburgh Infirmary, (NRIE). The documents are the Full Business Case, the Addendum to the Business Case and the contract papers released by Lothian Health Board under a Freedom of Information request. The full documents give a clear picture not only of how the construction companies, bankers, etc. saw the PFI programme but also the advice they were being given by their consultants. The purpose of the paper is to highlight a number of areas where the methods used in assessing risk, value for money, and affordability appear questionable. While the paper is concerned solely with the NRIE, the issues raised are likely to be of wider relevance to other PFI schemes.

The Finance Committee may wish to consider what changes to procedures and what safeguards may be required to prevent the recurrence of similar problems in future schemes involving public private partnerships.

The new Royal Infirmary of Edinburgh is part of a complex project which also includes University of Edinburgh medical teaching and research facilities. This paper concerns only the NRIE – an 872-bed hospital comprising traditional wards and an Assessment Unit, for quick short response. The Royal Infirmary of Edinburgh NHS Trust chose to follow a private finance initiative for the design, build, maintenance, and service provision of the new Royal Infirmary of Edinburgh (NRIE), and in so doing, received support from Lothian Health, the Scottish Office, and the Treasury. In both the Full Business Case prepared by the Trust and its Addendum, the Trust set out the process by which it had chosen the private finance initiative over a traditional method of provision.

Although versions of the Full Business Case and the Addendum were placed in the public domain soon after the contract was signed, much detail was withheld. However, towards the close of 2007, due to a Freedom of Information decision by the Scottish Information Commissioner, Lothian Health released the full contract of the NRIE.

This paper is largely based on the additional material which was not publicly available until end 2007. Of particular interest in this additional material are two consultancy firms' reports[1] commissioned by the Lenders to the NRIE scheme, to check the financial soundness of their investment. Thus, while the Full Business Case gives the perspective on how the public sector, (NRIE Trust, Lothian Health, Scottish Executive and Treasury), viewed the case, these reports give an almost unique perspective on how a major PFI scheme looked when viewed from the private sector side of the fence.

[1] Moores Rowland Health Consulting and Mott MacDonald: appointed to conduct Due Diligence and a Technical Audit of the NRIE on behalf of the Lenders immediately prior to the signing of the contract. These reports are in NRIE Bible of Documents, vol 12 part 1.

Despite the copious amount of material which is now in the public domain, (over 9,000 pages in the contract documents released under Freedom of Information), it still does not appear possible for an outsider to re-create the full detail of the value for money or affordability calculations. This paper, therefore, does not attempt to carry out a full dissection and critique of the process whereby the Trust decided that the NRIE represented value for money and was affordable. Instead, what this paper does is identify a large number of issues where the approach adopted appears questionable. We should stress that this is not just a matter of our judgement alone: as will be seen, before the contract was signed in 1998, a good number of the issues we highlight were flagged up as problematic by the consultants engaged by the Lenders.

ISSUES

In its Full Business Case of July 2007, and in the Addendum, the Trust set out its case as to why it believed that (a) significant transfer of risk to the private sector was taking place, (b) the Consort PFI case gave better value for money than a traditional financing method, and (c) the Consort bid was affordable. In this section, we group the various issues we consider under the headings of risk, value for money, and affordability, with a final heading covering other issues including wider considerations with respect to value for money.

Risk

In assessing the amount of risk transferred under PFI the Trust agreed the final process with the Scottish Office. In addition, a paper produced by the Scottish Office Economics Division was referred to in finalising the Trust's approach. (FBC, 11.1.5). Nevertheless, the following serious issues arose in the way risk was handled.

Invalid Inclusion of Interest Rate Risk
In the Full Business Case, (para 1.4.2), the Trust stated, "It is an essential requirement of the PFI process to be able to demonstrate a substantial transfer of risk from the public to the private sector". The most important category is that risk which is transferred exclusively under PFI. In para 11.4.5, a total of £48.71 million of such risk was identified by the Trust. Of this total, the largest component is "changes in interest rate" risk of £41.97 million, which the Trust noted as affecting government borrowing cost in the public sector. According to the report produced by Moores Rowland for the lenders, this interest rate risk should not have been included, and they cited the PFI Unit of the NHS Executive as stating that this risk had been disallowed in other cases.

Wrong Inclusion of Common Risks
There are also risks transferred to the private sector under both the PFI and more traditional design and build schemes, (modelled in the case of the NRIE by a public sector comparator). £10.51 million was identified by the Trust under this heading.

To show value for money, the Trust developed a Public Sector Comparator (PSC) model prior to tendering the contract. In comparing the PSC with the PFI option in the value for money comparison, however, the value of risk transferred was added by the Trust to the Net Present Value of the PSC. As Moores Rowland pointed out, this was incorrect since the value of those risks common to both the PSC and the PFI was included in this calculation: as this type of risk was common to both options, this £10.51m should not have been counted as part of the risk transfer difference. Thus, in total, the public sector comparator was inflated by a minimum of over £52 million on these two points alone, in its comparison with the PFI proposal: (on a project of capital value £180 million as recorded in the Scottish Executive website)

Scheme Wrongly Assumed to be Off Balance Sheet
There are two important aspects of demonstrating risk transfer. One is that the expected value of transfer risk is added to the PSC side of the comparison in making the value for money comparison with the PFI option. The other is that, for a PFI scheme to be regarded as "off balance sheet", substantial risk transfer has to be demonstrated. In the case of the NRIE, the Trust felt "that the project agreement represents a contract for the provision of services with the risks of ownership clearly lying with Consort as a result of which it would be inconsistent for the new facility to appear on the balance sheet of the Trust." (FBC, para. 11.6.3). In other words, the Trust were confident that sufficient risk transfer had been demonstrated for the NRIE to be off balance sheet. In the

event, however, the public sector Auditor decided that the NRIE should be on balance sheet. Since this means that the Trust has to pay a capital charge for the asset, this has fundamental implications for the validity of the value for money and affordability assessments underlying the PFI scheme.

Value for Money Assessment

Length of Depreciation Period Used
The report by Moores Rowland (page 80) points out that, for depreciation purposes, the case assumes buildings will have a life of 45 years, but that no expenditure has been included in the economic analysis to cover substantial reprovision after 45 years - which this assumption would imply is necessary. This comment applies to the PFI costings, where the facilities charge has been assumed constant (in real terms) at £4.5 million from 2028 to 2061. In the public sector comparator, however, very substantive spikes in lifestyle costs are projected to occur in 2035 (£24 million) and 2045 (£44 million). This suggests that the effect of this point has been to disproportionately favour the PFI option.

Discount Rate Used
In carrying out the value for money comparison, the discount rate used for calculating Net Present Values was 6% in real terms, equivalent to 9% in nominal terms. As regards its impact on the capital costs part of the calculation, on the PSC side, choice of discount rate has a limited effect, since construction costs are included as capital costs in the early years of the project: that is, as regards the PSC, there is no long run sequence of interest charges and debt repayments to be discounted. On the PFI side, however, interest charges and debt repayments do appear as a component of the unitary charge, and are therefore discounted over the long term at the discount factor used. The higher the discount rate used, the smaller the effect of future years on Net Present Value. Therefore the approach has, by design, a differential effect on the PSC and PFI sides of the calculation.

Why was this done? A rationale for this approach is described in Cuthbert and Cuthbert (2008), and relates to the need to account for the effects of the capital charge in the PSC/PFI comparison. If, as was the hope of the Trust when the contract was being prepared, the NRIE PFI scheme would be “off the books”, then the PSC should include the effect of the capital charge, but the PFI should exclude it: the natural way to achieve this would have been to add the cost of the capital charge to the PSC, while the PFI, of course, does not include the capital charge. An equivalent way of achieving the same effect, however, would be to make no allowance for the capital charge in the PSC, but to ensure that an amount equivalent to the capital charge was subtracted off from the cost of the PFI. The use of the high discount factor in discounting the PFI side has the effect of reducing the net present value of the PFI by approximately the NPV of the capital charge. But as we have noted above, the use of the high discount factor on the PSC has no such effect because, in the PSC, construction costs appear as capital costs in the early years of the project. The effect of the high discount rate in the value for money comparison, therefore, is to penalise the PSC relative to the PFI by approximately the value of the capital charge.

In the event, the public sector Auditor judged that insufficient risk transfer had actually been achieved in the case of the NRIE and that the scheme should be “on the books”. This means that a capital charge applies to both PSC and PFI options. The use of the high discount rate for the value for money comparison is therefore inappropriate: and will have seriously distorted the comparison in favour of the PFI option.

The Handling of VAT
There is an apparent anomaly concerned with the recoverability of VAT which appears to distort the Value for Money comparison between the public sector comparator and PFI alternatives. Unlike most other points identified in this paper, this particular issue appears to be a generic problem likely to affect all major capital schemes in the health sector, and does not relate specifically to the way that the NRIE project was handled.
Consider the following:

- According to NHS Estates in their document *VAT Recovery Procedure Notes,* “The NHS has a unique VAT position derived under the Contracted Out Services rules. In many respects these VAT rules are not conducive to supporting capital expenditure, in fact they are counter productive… In terms of capital expenditure, new build construction work is not recoverable."

- According to HM Customs and Excise in its notice on VAT recovery, August 2005, VAT is recoverable on PFI arrangements.

The implication of this is that VAT on new build is not recoverable under the PSC option, but VAT is entirely recoverable under the PFI route. This appears to build in an inherent bias towards the PFI route in new capital build programmes in the health service. We are not aware of the logic underlying these rules. It appears to be an area that requires to be probed.
There are further ramifications of this point for the calculation of the capital charge which is payable under public sector procurement. In line with the above philosophy, the capital charge is calculated on a capital value which includes the cost of VAT. For the NRIE, the capital charge calculation was 6% of the total of the capital build (given in this calculation as £197.7m), fees (£18.9m) and VAT thereon (£34.6m): that is 6% of £251.4m. This inclusion of VAT in the calculation has the effect of making the PSC appear relatively costly compared with the PFI option, not merely in terms of the initial capital cost, but also in terms of the annual revenue charges thereafter.

Affordability

Assessment of Capital Charge in Year 1 only
In para 4.15.4 of the Full Business Case the capital charge which would be levied on the NRIE under the public sector procurement model is calculated. This is given for a single year only, and is calculated as 1/45th of the capital cost of the building, plus 6% of the total capital cost. This single year presentation of the capital charge is potentially highly misleading. Had it been calculated for subsequent years, it would have been seen that, for example, the capital charge in year 2 would be 1/45th of capital cost, plus 6% interest on 44/45ths of the capital value (uprated for inflation), with the proportion of the capital value on which the interest component is levied declining by 1/45th in each subsequent year. Even though the capital charge is uprated for inflation each year, the overall effect is that the capital charge will be fairly stable over the life of the project.

Just how misleading the effect of the single year presentation could be is illustrated by the following quotation from para 14.6 of the Addendum to the Full Business Case, "Under PFI the facilities payments are indexed at RPI – 50% compared to the Public Sector Option where it is reasonable to assume that capital charges, based on regularly revalued assets, will increase in line with inflation. If an inflation rate of 3% is assumed, partial indexation under PFI compared with full indexation yields a net present value benefit of £42 million".

Contrary to this quotation, it is totally unreasonable to assume the capital charges will increase with inflation: they will in fact be relatively stable. The appropriate comparison in the above quotation would be to compare the PFI facilities payment, indexed at RPI/2, with an effectively flat capital charge under the Public Sector Comparator. This would show this element of the PFI increasing much faster than the PSC capital charge, rather than the reverse.

The highly misleading quotation, given above, is not formally part of the affordability calculation, which was only carried out for year 1. Nevertheless, the fallacious reasoning underlying this quotation is likely to have given the Trust a quite unreasonably optimistic view of the long term affordability of the PFI option.

Private Patient Income Assumptions
An important assumption in the affordability analysis is that private patient income would increase from £913,000 to £1,813,000 by 2003/04. The reason given for this increase was the expectation that the Trust's consultants who use facilities at the private Murrayfield hospital would want to make more use of the new facilities at the NRIE. Moores Rowland felt that these assumptions were optimistic and stated: "We feel that the Trust may have overstated the extent to which they may be able to attract private patients to the new Royal Infirmary. … The amount at risk is a sum of £300,000 per year and we believe that there is a high probability that this income will be lost." (Moores Rowland, page 40).

Inconsistency in Drivers for Payment Mechanisms
The Trust is in the position that it is buying hospital services from the consortium, while at the same time it is being funded by Lothian Health to produce a defined package of healthcare outcomes. An important issue arises relating to a potential mismatch between the metrics used to govern payments from the Health Board to the Trust on the one hand, and from the Trust to Consort Healthcare on the other.

The largest part of the unitary payment from the Trust to Consort is the facilities usage payment, which accounted for around £23.6 million of the over £27 million of the initial unitary charge. The facilities usage payment is based upon the number of Bed Occupancy Units (BOUs) in the main hospital wards and non-bed attendances (NBAs) in the Assessment Unit.
As regards payments by Lothian Health Board to the Trust, negotiations are carried out in terms of a different unit, namely finished consultant episodes, (FCEs). There is thus a potential problem for the Trust if the link between the movement of the FCE metric and the BOU metric is badly forecast. In fact, as the consultants Moores Rowland point out, in their financial planning for the new hospital the Trust were assuming that they would need to increase FCEs by 25% between 1995/96 and 2002/03, while at the same time reducing BOUs by 30%. The consultants noted that achieving this would rely heavily on the success of the Assessment Unit and community support facilities: and that there would need to be careful monitoring of progress.

As Moores Rowland said “Inpatient activity is counted on the basis of occupied bed days rather than finished consultant episodes. This serves to protect Consort from the impact of failure to achieve clinical performance targets which could reduce hospital throughput.” The implication is that it would be the Trust that would bear the risk if the planned BOU output did not yield the desired number of FCEs.

The question that arises is: did the Trust take adequate steps to verify that it would be possible to increase FCEs as planned with the planned reduction in BOUs.

Use of Capital Charges on Old Buildings to Generate Surplus Income
The Moores Rowland report contained an extensive discussion of the way in which the Trust intended to exploit the technicalities of the capital charge regime in order to generate a £15 million surplus over 6 years, and to make the PFI affordable. The following discussion draws heavily on the relevant parts of the Moores Rowland report: (paras 6.3.2 –6.3.3). The Royal Infirmary of Edinburgh NHS Trust owned a number of buildings and hoped to revalue these assets downwards in April 1998. Essentially, NHS assets tended to be valued according to standard “existing use” valuation. However, the NHS was increasingly allowing Trusts to move the valuation of assets, particularly those which were old and of little use, onto a “functional suitability” valuation. Under this method, the Trust would be allowed to revalue the identified buildings at the lower functional suitability valuation, and then depreciate the assets over the remainder of their life, which would usually end when the Trust moved out into new premises. By this method, the Trust hoped to reduce its asset valuation by £41.7 million. In turn, under current cost accounting, this would mean that the Trust would reduce its depreciation and capital charges from £12.2 million in 1997/98 to £9.7m in 1998/99.

Why would such a revaluation downwards matter? Well, such a revaluation would produce a lower capital charge, at that time running at 6% of the current asset value. Capital charges are non-cash costs, and at that particular time, the NHS in Scotland ran a capital charges pool to cover capital charge costs: the size of the pool was adjusted regularly to take into account changes in asset valuations. It might appear that the downward adjustment in the Trust’s asset valuation would mean that the capital charges pool for the NHS would also be adjusted downwards. In fact, what the Trust hoped to do was to run two separate asset valuations: on the one hand, in its claims for funding, it would maintain its existing asset valuation within its contract price calculations; and, on the other, in the calculation of its costs, it would use the lower functional suitability valuation in its expenditure calculations. The surplus accruing to the Trust resulting from higher capital charge elements in its prices to the Health Board and the lower capital charges it was paying out, could then be available to meet “exceptional costs” incurred by the Trust in its move from its existing buildings to the new hospital. The Trust hoped to accumulate £15.485 million in this way over a six year time period. Approval was sought from the Scottish Office. Subsequently NHSiS Management

Executive gave the necessary approval for the process for writing down the value of the buildings to release capital charges, and for these funds to be retained by the Board.

This procedure, whereby the use of two separate asset valuations would generate a cash surplus for the Trust, raises a number of issues. In particular, was this a standard procedure used in other PFI schemes? And would a similar procedure have been available if a public sector procurement option, rather than a PFI approach, was being implemented?

Guarantee from Secretary of State
One of the background documents now released under Freedom of Information is a letter from the then Secretary of State for Scotland (Donald Dewar)[2], which gives a form of guarantee that the Scottish Office would ensure that the Trust would have sufficient resources to make payments falling due under the PFI contract. The letter states "if any Trust were unable to meet its obligations, the Secretary of State would intervene in a timely manner to ensure that either the Trust itself, or any body to which its liabilities are transferred, is in a position to meet its liabilities on time and in full."

This is apparently a standard letter normally issued to prospective Lenders to PFI schemes.
From one viewpoint, this is an entirely reasonable approach for government to take: effectively, by telling potential lenders that they do not need to worry about the risk of the Trust not being able to meet payments, it should result in a cost reduction for the public sector – since there is one less risk against which lenders need to build in a risk margin.

From another point of view, however, the existence of this type of guarantee is likely to have an unavoidable effect on all parties to the PFI deal: namely that it will reduce the extent to which they feel they will need to take great care to make sure the affordability calculations are sound. There is no way of knowing to what extent this may actually have happened: but there must be a good chance that if the reassurance given by the Donald Dewar letter had not existed, then greater attention would have been paid to questionable aspects of the affordability calculation, (like the treatment of capital charges, the optimistic assumption made about private income, and the risks attaching to the different drivers for payments to and from the Trust).

Wider Value for Money and Other Issues

The Handling of Land Sales
The Trust owned a number of sites: Princess Margaret Rose Hospital (7 hectares), the Dental Hospital, (which is a building in the city centre in Chambers Street), and the City Hospital, (22.19 hectares) which would be vacated with the opening of the new hospital. The land relating to these sites was sold to provide part of the funding of the overall project. The land values were determined in 1996 and were uprated in the contract by the retail price index until the sales took place. In 1996 the land was valued by a commercial valuer at £10.457m. The land was released in tranches, with Morrison making payments to the consortium of £3.499m in 1998-99, £0.45m in 2000-01, and £8.326m in 2002-03, giving a total payment of £12.275m from Morrison to the consortium. The Trust did not receive the money for the land directly: it received it at a later date as a reduction in its unitary charge, with Consort reducing the Trust's unitary charge by twelve equal payments of £1.284m for the land between 2003 and 2009. Effectively, the Trust made a loan to Consort between the dates when Morrison paid for the land and the eventual reductions in the unitary charge. A letter from Ryden International to the RIE, (which can be found within the contract papers), confirms their opinion that the disposal agreements are on a true commercial basis.

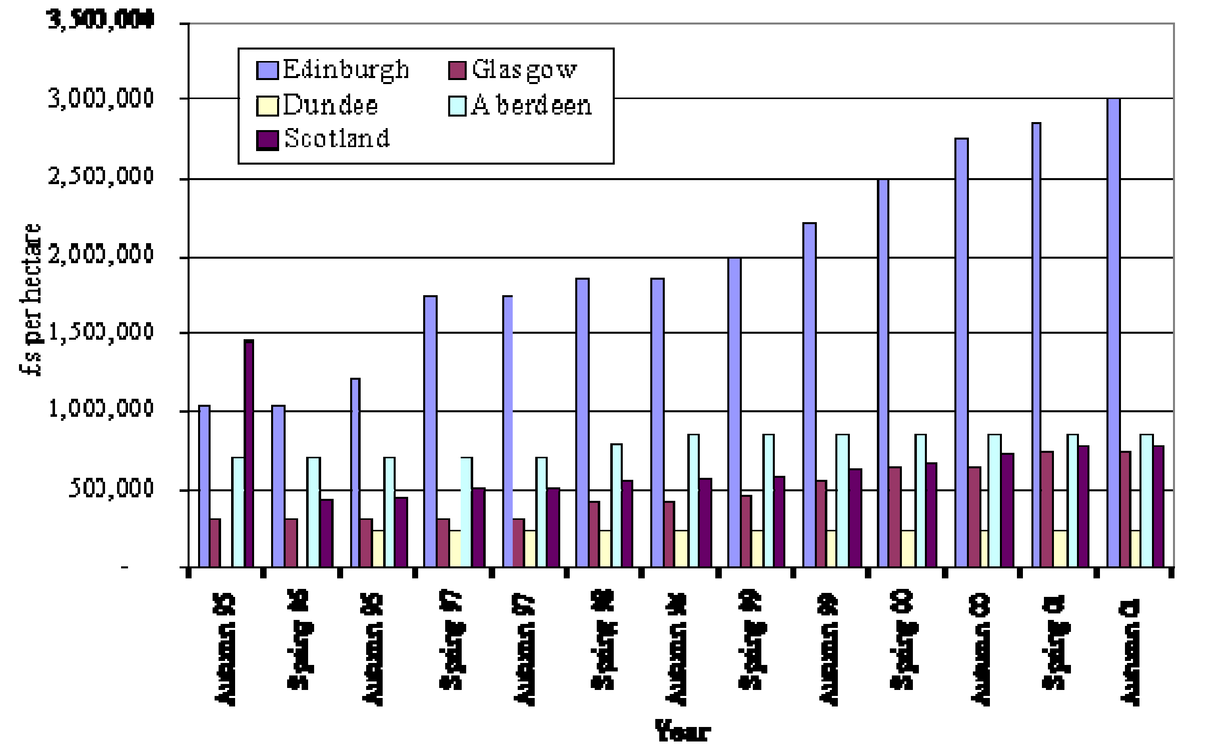
The initial valuation of the land is not something on which we can make any comment, although we draw attention to the Scottish Executive publication, http://www.scotland.gov.uk/Publications/2002/11/15744/12727 , on land values and trends in land values in major cities in Scotland in the period 1995 to 2001. This indicates that bulk residential land in Edinburgh in the Spring of 1996 was just over £1 million per hectare.

[2] Letter from Donald Dewar to Consort Healthcare et al, 4 August 1998

There are, however, other issues which should be explored concerning the next two phases of the transaction, namely, the indexation of the land price up to the date of purchase, and then the arrangements for the deferral of the payments to the Trust.

Over the period of indexation, the rate of increase of the retail price index was about 2.5% per annum: on the other hand, as can be seen from the Figure below, (which shows the official property market valuation report for residential bulk land from the Valuation Office)[3], the price of residential bulk land in Edinburgh increased from just over £1 million per hectare in Spring 1996 to around £1.8 million per hectare in Spring 1998, an increase of approximately 30% per annum. It is important to note that the final contract was not signed until August 1998. Given this, the question must arise as to whether the Trust should not have been able to negotiate a more favourable deal on land price indexation. It is of interest to note that from Spring 1998 to Spring 2001 the price per hectare rose by a further 16% per annum.

Figure 3.1
Trends in Residential Bulk Land Values in Scottish Cities, 1995-2001



Source: Property Market Report, Valuation Office, Spring and Autumn editions 1995-2001

As has been noted above, the Trust was in a position of effectively making a loan to the consortium as regards the land purchase price over the period between the payment by Morrison to the consortium, and the eventual reduction in the unitary charge. We have calculated the internal rate of return on this loan as 4.9% per annum on an average debt equal to 53.3% of the land purchase price. 4.9% is a relatively low rate of interest for the Trust to earn, compared, for example, with the internal rates of return being paid by the consortium on other sources of finance. Given, however, that the Trust would ultimately have to pay, (via the unitary charge), for whatever rate of interest it chose to earn on the land loan to the consortium, the fact that the Trust earned a low rate of interest on this loan does not in itself appear to be an issue. There is a question, however, of the way this loan was used by the consortium. It is clear from the detailed financial projections now

[3] Land Values And The Implications For Planning Policy, DTZ Pieda Consultings, for Scottish Executive, 2002.

released under Freedom of Information, (see Cuthbert and Cuthbert, 2008), that the land loan was used for immediate pre-payment of senior debt, on which the internal rate of return was 7.8%, rather than to reduce the requirement for subordinate debt on which the consortium was earning an internal rate of return of 12.4%. There may be compelling reasons why the land loan was used for prepayment of the least expensive form of debt: but it would be worth questioning these.

Handling Change
One aspect of the NRIE contract, which could prove highly significant in the longer term, relates to the arrangements for working out adjustments to the unitary charge when there is a change to the specification of the service required. These arrangements are set out in the Addendum to the Full Business Case, page 25. The main principle to be employed is that the unitary charge will be adjusted so that the internal rate of return of equity will be preserved.

This principle might at first sight appear to be clear and straightforward. Unfortunately, however, the principle as stated does not offer any unambiguous way of working out the required change to the unitary charge. To appreciate why not, it is appropriate to refer to the discussion of internal rates of return in Cuthbert and Cuthbert (2008). It is pointed out there that the reward to a lender depends not just on the internal rate of return, but also on the average notional outstanding debt on which this rate of return is being earned. It appears that it would be possible, consistent with the above rule for pricing individual changes, to arrange the adjustment in the unitary charge so that the internal rate of return was indeed preserved – but the average notional debt increased, perhaps substantially. This raises the possibility that the consortium might be able to profit significantly from service specification changes, while respecting the letter of the above rule.

Issues to be considered include: is the Trust alert to this possibility – and if so, have they taken any steps to prevent the consortium profiting significantly from service specification changes. Have there been any significant specification changes in the operation of the contract to date – and if so, what has the resulting effect been, both on the internal rate of return on equity, and on average notional outstanding debt.

The Costing of Certain Ancillary Services
An analysis of service costs for NRIE and 5 comparator hospitals was carried out by the consultants Mott MacDonald (ref: Table 3 of their report). This showed that for cleaning, laundry, waste management and portering, NRIE projected costs lay within the range of the other hospitals. However, for catering, the NRIE cost per bed was £2,330.28, (at 1996 prices), well above the range for the other hospitals which was £1,321.59 to £2039.00.

This raises the question of whether an excessive cost allowance for catering had been built into the NRIE contract.

Termination Arrangements
At the end of the initial concession period the consortium has very substantial residual rights. The full picture of residual rights is highly complex. We summarise the main points here, which are that:
If the Trust terminates the sub-lease and “walks away” at the end of 25 years, then the consortium is left in possession of the building and of the remainder of the lengthy lease on the land, with an option to purchase at any time within a seven-year period from the end of the contract period.

If the Trust does not “walk away” after 25 years, then it is bound to pay Consort an annual management fee for the next 25-year period, which fee increases with the retail price index. Its only way out of this is to pay the net present value of the management fee over the remainder of the second 25-year period.

Further, part of the Little France site was identified as a possible area of expansion for the Trust: this was denoted as the Expansion Area. The Trust has the right to develop this site: however, if the Trust exercises its option to “walk away” from the main hospital after 25 years, it must vacate the expansion area.

Full details of the lease and termination arrangements may be found in the Addendum to the Full Business Case.

Clearly substantial value must attach to the residual rights which the consortium has under the contract, although, as far as we are aware, no attempt has been made to attach a value to these rights. In the light of the calculations in Cuthbert and Cuthbert, 2008, the net present value of the non-service element of the unitary charge over the 25-year concession period amounts to more than twice the original capital value of the hospital. By that time the hospital has been paid for more than twice over. Given this, the question that arises is: should the Trust not have negotiated rather less generous termination terms than those in the current contract.

CONCLUDING REMARKS

This paper has highlighted a large number of issues which are likely to have affected the decisions taken in the NRIE procurement process. Some of these issues are specific to the NRIE case: but a good number are generic – that is, they are likely to affect most PFI procurement decisions. If the issues identified in this paper are not addressed, then value for money and affordability calculations in future procurement decisions will continue to be seriously flawed – resulting in the kind of cost implications identified in the companion paper Cuthbert and Cuthbert 2008.

There is, however, a more basic underlying issue. As has been noted in this paper, many of the problems described here were in fact identified during the PFI process – but by consultants acting for the lenders. This raises the fundamental question: why was the customer side of the negotiation either unable to identify the same points – or to act on them, if they were identified. This suggests that the customer side were either acting with inadequate training and support: or were subject to additional pressures which meant that they could not address these issues. There is a real need to determine exactly why things went wrong on the customer side, and to make sure appropriate remedial steps are taken for future procurements.

References:

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