# Cynulliad Cenedlaethol Cymru
# The National Assembly for Wales

## Y Pwyllgor Cyllid
## The Finance Committee

**Dydd Iau, 31 Ionawr 2008**
**Thursday, 31 January 2008**

**Cynnwys**
**Contents**



Cofnodir y trafodion hyn yn yr iaith y llefarwyd hwy ynddi yn y pwyllgor. Yn ogystal, cynhwysir cyfieithiad Saesneg o gyfraniadau yn y Gymraeg.

These proceedings are reported in the language in which they were spoken in the committee. In addition, an English translation of Welsh speeches is included.

**Aelodau'r pwyllgor yn bresennol**
**Committee members in attendance**

| | |
|---|---|
| Mohammad Asghar | Plaid Cymru<br>The Party of Wales |
| Alun Cairns | Ceidwadwyr Cymreig (Cadeirydd y Pwyllgor)<br>Welsh Conservatives (Committee Chair) |
| Janice Gregory | Llafur<br>Labour |
| Alun Ffred Jones | Plaid Cymru<br>The Party of Wales |
| Jenny Randerson | Democratiaid Rhyddfrydol Cymru<br>Welsh Liberal Democrats |
| Joyce Watson | Llafur<br>Labour |

**Eraill yn bresennol**
**Others in attendance**

| | |
|---|---|
| Chris Nicholson | Partner, Pennaeth y Sector Cyhoeddus, KPMG LLP<br>Partner, Head of Public Sector, KPMG LLP |
| Richard Threlfall | Cyfarwyddwr, Cyllid Corfforaethol KPMG<br>Director, KPMG Corporate Finance |
| Gronw Percy | Cynghorwr Arbenigol i Ymchwiliad y Pwyllgor Cyllid i Bartneriaethau Cyhoeddus Preifat<br>Expert Advisor to the Finance Committee Inquiry into Public Private Partnerships |
| Simon McCann | Cynghorwr Arbenigol i ymchwiliad y Pwyllgor Cyllid i Bartneriaethau Cyhoeddus Preifat<br>Expert Advisor to the Finance Committee Inquiry into Public Private Partnerships |

**Swyddogion Gwasanaeth Seneddol y Cynulliad yn bresennol**
**Assembly Parliamentary Service officials in attendance**

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|---|---|
| John Grimes | Clerc<br>Clerk |
| Abigail Phillips | Dirprwy Glerc<br>Deputy Clerk |

*Dechreuodd y cyfarfod am 1.33 p.m.*
*The meeting began at 1.33 p.m.*

## Cyflwyniad, Ymddiheuriadau, Dirprwyon a Datgan Buddiannau
## Introduction, Apologies, Substitutions and Declarations of Interest

[1] **Alun Cairns:** I call the meeting to order and I thank everyone for their attendance. We have some substitutions and apologies. Angela Burns is not here on medical grounds, Alun Davies is on Assembly business and has sent Janice Gregory as his substitute, Lynne Neagle is away because of a family matter, and Ann Jones is also away on health grounds.

[2] I remind everyone that they have the right to speak in English or Welsh. Headsets are available for people who need to hear the translation. I ask people to switch off their mobile

phones. The usual Standing Orders will apply.

1.34 p.m.

## Ymchwiliad i Bartneriaethau Cyhoeddus Preifat—KPMG
## Inquiry into Public-Private Partnerships—KPMG

[3] **Alun Cairns:** Item 2 takes forward the preliminary investigations of those involved with the private sector into private investment in public services. We have received evidence from a headteacher of a school financed by the private finance initiative, the chief executive of a hospital, and the Auditor General for Wales, who gave us a broad overview. I am delighted to announce that Gronw Percy and Simon McCann from PricewaterhouseCoopers and Morgan Cole have been appointed as our expert advisers. We will come to them in the next item on the agenda.

[4] I am pleased that representatives of KPMG have also kindly agreed to give evidence to the committee. They have provided a paper. Please introduce yourselves for the record, and you may then give us a brief introduction of around five minutes on the points that you want to bring to our attention. We will then move to questions from Members.

[5] **Mr Nicholson:** Thank you for inviting us to give you this presentation. I am Chris Nicholson, and I am a partner in KPMG's corporate finance group, based in London. I have spent the past 10 years working on private finance initiative and public-private partnership projects in the UK. I also have overall responsibility for KPMG's services to the public sector in the UK.

[6] **Mr Threlfall:** Good afternoon. I am Richard Threlfall, and I am a director in KPMG's corporate finance group. I have been advising central Government and local government on PFI and PPP for the past eight years or so. I also advise private sector bidders on project bids.

[7] **Mr Nicholson:** I have a few introductory remarks to make, which should not take more than five minutes, about the evidence that we presented. Over the past 10 or 15 years since PFI was first introduced, it has aroused a great deal of controversy. It has been quite a political issue. Attention has been drawn to some high profile cases of projects that have generated large returns for contractors. In some cases, two-tier workforces were created as a result of PFI. It is fair to say that, overall, PFI is now a much more mature form of public procurement, and many of what some might have termed the 'abuses' have been ironed out. There is also more recognition than there was 10 years ago that PFI is not appropriate in all cases. Ten or so years ago, there was a PFI-or-nothing approach in several sectors. There is now a clear recognition that that is not the case, and that, in certain areas, the best example being IT projects, PFI is recognised as no longer being an appropriate form of public procurement.

[8] In our paper, we tried to set out in outline what we see as some of the potential benefits of PFI and PPP, and some of the associated costs and risks. We then draw attention to some of the potential future developments of the PFI and PPP model, which public authorities across the UK are looking at. I shall stop there and take your questions.

1.40 p.m.

[9] **Janice Gregory:** Thank you for submitting the paper. May I just ask you to expand a little on your section in the paper on the use of alternative models, especially the not-for-profit distributing model? I am quite interesting in hearing what you have to say about those.

[10] **Mr Nicholson:** I think that some of the alternative models have been devised to try to deal with some of the ‘abuses’ that some might say happened with the original PFI model. I will deal particularly with the non-profit distributing model first. There had been concerns that some private contractors had been making excessive profits out of PFI, and so the non-profit distributing model was designed so that the private sector, whether the contractor or an infrastructure fund, did not have that equity interest in the project. The fundamentals of the non-profit distributing model are the same as PFI. In effect, what it does is cap the return, so that there is no possibility of excessive profit. So, those with an interest in the project will just provide the loans, instead of providing equity and shareholder loans, as is normal in a PFI project. Those are not the bank loans; they are loans from shareholders. The technical term for it generally is ‘subordinated debt’, which is subordinated to the loan provided by the bank. They will get a higher interest rate on those loans. Under a non-profit distributing model, the backers of the project, which in most cases will be the contractors, will get their return through two mechanisms: one, through the service that they supply to the project vehicle; and two, through the interest that they are paid on those subordinated loans. What that means is that there is a cap, effectively, on the return that they get.

[11] **Janice Gregory:** Thank you for that explanation, because it was easier to hear it than to read it, if I am honest. Taking all of that into account, do you think that there is a negative impact on the private finance market in light of what you said about the NPD model, especially the cap?

[12] **Mr Nicholson:** The non-profit distributing model has been used for a couple of school projects in Scotland—for schools in Argyll and Bute, and Falkirk—and the evidence so far is that there was just as much interest from contractors in those cases as there has been traditionally for PFI projects. Indeed, there was actually slightly more interest, but I do not think that one can read too much into that. There is no evidence to suggest that it is deterring the private sector. In fact, given the way in which PFIs more generally are now set up, the possibilities for very substantial returns, which there were in some of the early deals through refinancing and so on, have been largely eroded through the sharing of refinancing gains being built into the contract. There is no evidence to suggest that it actually deters interest.

[13] **Alun Cairns:** Does anyone else want to pursue this?

[14] **Jenny Randerson:** I also wanted an explanation on that, so I am very grateful. I am particularly interested in the municipal bond financing model. I understood that, within the Assembly’s powers, we cannot borrow, so if we were to issue bonds, we would have to take it off the other side of our balance sheet. In other words, it would have the same impact on our capital spend; we would not get additional capacity for capital spend by issuing bonds, although it might be an attractive way forward. Is that what you mean by saying that you are awaiting details of what constraints will need to be relaxed?

[15] **Mr Nicholson:** It was also our understanding that you do not currently have the powers to borrow, so it constrains the way in which you could use municipal bond financing.

[16] **Mr Threlfall:** It might help if I pick up a little on this subject. You will be aware that this model has been used very successfully for a number of years in the United States, and a number of authorities have looked at the possibility of transferring that sort of model into various UK projects. The borrowing side of it is one issue—the need for the borrowing powers—but that is not the only issue. If you look at the US models, they generally rely on a third-party revenue stream, whether from payments for buses or public transport—there is generally a third-party payment stream. That payment stream underpins a credit rating, which sits with the authority. In its bond programme, Transport for London has put in place a rating as well as having the borrowing powers. The third piece of the jigsaw, which is important and which still stands in the way of municipal borrowing being used more widely elsewhere, is

the Treasury rule around the need for security to be charged across all of the assets of an authority. The model in the United States relies on the income coming in from a particular payment stream for the security. So, there are a number of structural issues, not only the borrowing power, that would need to be considered in order to make this work successfully.

[17] **Jenny Randerson:** I have a supplementary question. Local authorities have more freedom to borrow than we do, and, although certain aspects of the ideal situation may not be in place, am I right to think that it would be easier for local authorities to use this model than it would be for the Assembly to do it?

[18] **Mr Threlfall:** It is certainly currently easier for local authorities to use this model than for the Assembly, because of the restrictions on borrowing. However, we have recently, in relation to another project for a local authority, where there is an independent revenue stream, looked into the possibility of adopting this model. There are still other aspects of the Treasury rules that make it difficult to do so.

[19] **Alun Cairns:** I will press you further on third-party revenue streams. I will put this in a simple way. If a new school was financed on this basis, after 3.30 p.m., when the school doors are closed, if the private company wanted to use the facility for any other purpose or rent it out—I am to speculating and thinking of easy ideas—that revenue stream could then give the capacity to borrow funding from elsewhere. That is a simplistic example.

[20] **Mr Nicholson:** In principle, it could; experience would show that it would not support much loan capacity, so one should not overstate that particular example. However, there are other examples.

[21] **Alun Cairns:** I used the example of a school, because we had a discussion regarding when it would become the asset of the private company after school hours, and, within the contract, they have gone well into the evening to preserve the interests of the school. Can you share with us some models that would generate a third-party revenue stream? Could you highlight some issues that would give sufficient credibility for that borrowing to take place?

1.50 p.m.

[22] **Mr Nicholson:** I stress that we are not advocating this, but tolled roads would be a way in which something would generate its own revenue stream. That is an obvious example, but other things are being looked at in various parts of the country. It may be less directly linked, but if you introduced a congestion charge, that could then help to fund some public transport investment. That would be another possible example.

[23] **Jenny Randerson:** Would it apply to bus services, for example, if you had a municipal bus company that you then sold off—or partly sold off—or issued bonds in order to raise cash for additional capital investment in your bus services?

[24] **Mr Nicholson:** Yes, in principle.

[25] **Mr Threlfall:** In principle, yes. To clarify this, the key from the position of the private sector funders is the existence of a dependable revenue stream to support the obligations underlying the bonds. If you are talking about issuing municipal bonds as the Assembly, you are effectively saying that you are taking on the debt obligation, and you are asking the funders to look through to the sources of revenue that support that. Now, those sources of revenue can be any form of third-party income—they need not be third-party income, of course; it could be some long-term agreement with another Government body to provide money.

[26] Therefore, for example, if you look at what was done with Transport for London, it is a combination of the income streams that it is taking off its various businesses, such as the London Underground, as well as the terms of its agreement with central Government, which is important in terms of giving assurance around the dependability of the revenue stream, all of which, as I say, is underpinned by the credit rating. Therefore, the trick is to do that. The third part of this is some element of tax-raising powers; you could then look to the tax-raising powers. So, a local authority, in principle at least, could look to its tax-raising powers. The problem is that, within the prudential borrowing code, you need to be comfortable that you are able to service that debt obligation, and anyone who was lending into the authority would equally wish to be comfortable.

[27] **Alun Ffred Jones:** How do the municipal bond schemes in the United States work?

[28] **Mr Threlfall:** They work very much as I have just described. They are generally set up around what I might call special-purpose public vehicles—organisations such as a transportation authority; for example, the Texas Transportation Authority. They are statutory bodies, but they have a degree of independence, if you like, from other parts of Government, and they generally have independent revenue streams. So, the key is that that body is able to go to the private market, and it is able to say, 'If you look at our ability to access money over the long term, you will see that we are a strong credit; if you lend to us, you can be confident of our ability to repay you'. That is the basis on which it works.

[29] **Alun Ffred Jones:** So local authorities, by and large, in America do not issue bonds for anything?

[30] **Mr Threlfall:** As I say, it is generally done through specialist authorities. The issue is that, again, the advantage of the authorities in America is this sort of semi-detachment from the rest of the local authority or Government. There is always a legitimate concern that, if you take on significant amounts of borrowing, if you were a local authority, and you ran into some sort of difficulty, then that obligation will fall back onto your taxpayers.

[31] **Alun Ffred Jones:** So, what would be the advantage of issuing a bond rather than borrowing money from the bank or whatever?

[32] **Mr Threlfall:** The municipal borrowing programme is essentially a way of borrowing. Again, looking at the powers currently available to UK local authorities and comparing the advantages of borrowing under the prudential code, which would be direct borrowing, versus a municipal bond programme, the advantages are perceived very largely to arise around there being a discipline that is imposed by the rating agencies on that borrowing programme and by the banks that lend to it. I would refer you to the analysis that Transport for London did many years ago, before it embarked on its programme. It looked in great detail at the pros and cons of taking normal prudential borrowing from the Public Works Loans Board versus undertaking a rating and looking to a bond-type programme.

[33] **Alun Ffred Jones:** Was that for the underground programme?

[34] **Mr Threlfall:** It supports a range of transport for London's investments, but it is the governance structure that comes with the borrowing that is seen as the key benefit.

[35] **Mr Nicholson:** Also, in the recent past, there have been some value-for-money benefits in cases from bond finance compared with bank finance. It has been a bit cheaper to borrow through a bond issue than through bank finance. However—and it is a big 'however'—it is not clear that that is now the case, because there have been difficulties with some of the insurers of bond issues.

[36] **Alun Cairns:** Joyce, you have a comment. Is it on this subject or is it on a separate issue?

[37] **Joyce Watson:** It is on this subject.

[38] Looking at the list of projects that have been initiated by private finance in Wales, I see that, primarily, they fall into the category of health. Let us assume that a pattern is developing. Were we in the Assembly to change our view about accessing public money, where would you see the possibilities under this municipal bond scheme for adding value, especially in the third-party revenue stream for a hospital?

[39] **Mr Nicholson:** In relation to a hospital, there is unlikely to be a third-party revenue stream unless you did a deal whereby there was private sector provision alongside the public sector provision. Generally speaking, if you were to go down that route it would be on the back of funding from the public sector. If I make the assumption—and it is an assumption—that private sector provision would not be pursued, there is very limited scope for third-party funding in relation to health.

[40] **Mr Threlfall:** It is important to clarify that there can be this separation between the individual project that would be taken forward under some sort of public-private procurement and the basis on which you raise funds under a municipal bond programme. Transport for London is the only example in England where it has been done, and that is borrowing a significant sum of money off the back of various forms of revenue and, as I say, support from Government. It is then using that revenue in a variety of different projects. Not all of those projects have independent revenue streams attached to them, so, in principle that money could be put into projects. So, in principle, subject to borrowing powers and so on, the Assembly could raise municipal bond finance and use it to support non-revenue-raising projects.

2.00 p.m.

[41] **Jenny Randerson:** From that list, one of the things that PFI has been used for is the concourse and entrance at the University Hospital of Wales, for which £1 million has been provided. The concourse at UHW, for those who do not know, is full of shops, banks, cafes, and so on, for patients and their families. I would assume that, in that case, you have an income stream in the rent paid by the tenants of those properties. That might be suitable for a bond issue, might it not?

[42] **Mr Nicholson:** It might be. Without knowing the details of the figures, I suspect that that is relatively small beer in terms of the total revenue stream that is required to service the debt, whether it is bond financed or bank financed. So, in principle, the answer is ‘yes’, but, in practice, it is pretty unlikely because it would not be worth doing.

[43] **Alun Cairns:** Would it be a fair summary of this section to say that it may well be suitable for larger projects, although there may be regulatory reasons why it cannot take place at the moment, and that it is only larger projects with a clear third-party revenue stream for which that model may be practical? Could it be done on a small basis, on a local-authority-type basis?

[44] **Mr Nicholson:** No. Certainly, where there is a third-party revenue stream that helps, but it is not required. You could do it on the back of funding for services provided to the public authority, along the lines of what Richard was saying. So, it is not essential for there to be third-party revenue.

[45] **Mr Threlfall:** What is important is that the lenders to the Assembly side need to be confident as to the continuation of the revenue stream to provide support. It is as simple as

that. If you can get that degree of certainty out of an arrangement with Whitehall, that might suffice. However, where this model has been used in the United States, it has not been done on that basis; it has been done off the back of confidence that there is a third-party revenue steam.

[46] **Alun Cairns:** Is your question on this topic, Alun?

[47] **Alun Ffred Jones:** I am moving on to the scale of projects.

[48] **Alun Cairns:** Before we move on to that, I wish to go back to the other model that has been suggested in the paper—the non-profit distributing model. I can see that that may hold attractions for some individuals here. How old is that model? You talked about the Argyll and Bute schools. Are there any other clear examples of where lessons have been learned five to 10 years into a project?

[49] **Mr Nicholson:** In relation to PFI and PPP, this model was adopted relatively recently. The corporate form of having a company that is limited by guarantee, which is what was used in the case of Network Rail when it took over from Railtrack, has been around for many years. However, its use for the provision of public services infrastructure, such as in this case, is very recent.

[50] **Alun Ffred Jones:** I noted that some of the PFI and PPP schemes in Wales are very small—in many cases, the cost is as low as £300,000. I recall that in one report on PFI that was published some years ago there was a suggestion that anything costing less than £20 million should be doubted—that is from memory, so I do not know whether the figure is correct.

[51] **Mr Nicholson:** You have a pretty good memory.

[52] **Alun Ffred Jones:** I beg to differ. [*Laughter*.] In paragraph 4.13, you say that it is not appropriate for smaller-scale projects. Can you define that—is it merely in terms of money or is it the type of project?

[53] **Mr Nicholson:** If we are talking about PFI, the report that came out of the Treasury that I think that you are referring to must be four or five years old now. It said that it was not appropriate for projects of less than £20 million because of the scale of the contract documentation and the complexity of the arrangements, particularly the legal arrangements that are required. That just meant that the amount that you would spend on people like us, as advisers and lawyers, was likely to outweigh any benefit that you got from greater value for money. So, that was why it was said in relation to PFI narrowly. However, if you look at PPP more generally as a way of involving the private sector in the provision of public services as a more generic term, then I would not say that £20 million is the minimum amount that is required, because there are all sorts of arrangements whereby it may well make sense to involve the private sector in the provision of public services; it depends on the particular case.

[54] **Alun Ffred Jones:** To go back to PFI, I do not know whether or not you take this £20 million as a rule of thumb, but you mentioned at some point, perhaps in your opening remarks, that it is generally agreed now that large-scale IT projects have been deemed unsuitable for PFI. That is not surprising if you think about the billions of pounds spent and the fact that projects are abandoned half way through. So, why is it that if the projects are too small, PFI is unsuitable, but if the projects are too big then they are also unsuitable?

[55] **Mr Nicholson:** The view was taken that IT projects were not suitable for PFI because most of the IT projects being looked at were, in a sense, part of the fundamental business process of an organisation. The linkages and the interfaces that exist between the system and

the rest of the organisation mean that it is difficult to specify, in service terms, what you want. Secondly, with the speed of change of IT, you are likely to get pretty rapid change over time in what you require. The combination of it being difficult to specify and the specification changing means that they are not the sort of projects that lend themselves to PFI where, in order to get the bank or debt finance, there needs to be, as Richard said, a degree of certainty and clarity about what is being delivered and what is required. Banks will be prepared to lend according to that degree of certainty.

2.10 p.m.

[56] **Alun Ffred Jones:** Along the same lines, you mentioned that there were some cases of PFI where there were examples of perhaps excess profits—I do not know if you actually said that, but you seemed to imply it—but that PFI is now a more mature form of public procurement, and so is less likely to be a rip-off. Is that what you are saying? Why is that?

[57] **Mr Nicholson:** There are two points there. Frankly, in some of the early projects, because it was a new form of procurement, and because both sides were perhaps not as skilled as they are now at specifying the required service and assessing the risks, the private sector understandably put a bigger risk premium into its bid. When it then delivered the infrastructure project, and started providing the service, in a lot of cases, or quite a number of cases, it recognised that it did not need such a big risk premium, and therefore the private sector had been making quite substantial profits, to take account of the fact that it had taken a higher risk up front. However, as the market has matured and is better able to assess the risks in building a school or hospital, delivering it on time, and providing the service, there is less of a risk premium to be taken into account, and therefore the return that the private sector makes is reduced.

[58] So, that is one reason; the second reason is in relation to refinancing gains. In its standard contracts, the public sector now says that any refinancing gains should be shared 50:50 between the public sector and the private sector. Again, that provides more of a cap on the excess profits that the private sector might be seen to have made.

[59] **Jenny Randerson:** I wish to turn to another point, which is the interesting final comment that you make in your paper about Wales facing competition on the supply side from construction opportunities elsewhere—you refer to the Olympics. You highlight construction cost inflation, and the advantages of procuring a project now, and securing its price now, rather than waiting for the future. That is obviously a factor that will apply until 2012, but what sort of premium do you think has been introduced by the Olympics, and is it already working through into public sector construction projects?

[60] **Mr Nicholson:** There are two points. It is not just about the Olympics, but I will deal with that first, and then broaden my answer. The evidence is that, in the costings for the Olympics, a reasonable premium or contingency has been included in the expectation that there will be construction price inflation because of the scale of the project. In terms of estimating what that might be, I would not hazard a guess, but that is one of the reasons why, as you might have seen, there has been quite a bit of controversy about the size of the contingency that was built into the overall cost of the Olympics—it is of the order of 30 to 40 per cent, and one of the reasons why such a large contingency was included was because of the feeling that there will be an effect on construction price inflation. We are not sure what the effect will be, but we know that there will be an effect.

[61] There is a more general point to make. Over the past couple of years, and not just in Wales, but in England, Scotland and throughout the world, PFI and PPP projects have become a much more common form of procurement, whereas, 10 years ago, we were the only area where these projects were happening. So, many of the major PFI contractors are being

attracted to opportunities in Europe, and things are also starting to take off in the United States. There is a concern that if our market is not attractive, if we do not get our procurement processes smart, if we take a long time on projects, and if we are not able to provide sufficient certainty about a pipeline of projects going forward, contractors will say that it is not worth it for them to invest the time in the UK, whether that be in Wales, Scotland or England, and that they would be better off investing their time in Spain or elsewhere. That is a real concern; Richard does quite a lot of work overseas, so perhaps he could comment on that.

[62] **Mr Threlfall:** I will comment on it by turning it around. If you look at countries that have decided that they want to take forward a significant expansion of public infrastructure, one of the ways in which they have done so is by being clear to an international contracting market, as Chris said, about the pipeline of what they want to do as a country and about the way in which they propose to go about it. They will give a strong degree of political commitment to running with a series of projects. This was very successful in the Republic of Ireland, which decided about eight years ago that it needed to invest significantly in its road programme, and it deliberately embarked on a programme of 10 major schemes under a PPP model, which has just been completed. It attracted a lot of investment from contractors in Iberia, and so on, and it has been very successful for them in bringing expertise and finance into the programme. The same approach has recently been used in Austria, and, across eastern Europe as well as western Europe, we are beginning to see a dialogue between government bodies and private investors on what governments want to do and the resources that they would look for over the long term.

[63] **Joyce Watson:** I read the report from Ireland and the points about having, as a country in a global market, a real commitment to the future development of that country in terms of capital projects. There are several layers to this; finance is crucial in the first place because nothing happens without it, and expertise is the second layer. However, there is also the labour market, because it is free flowing. At the moment, we are enjoying—perhaps disproportionately so—the skills of people mainly from Poland, and from other parts of eastern Europe. This brings us to another dimension of whether we will be committed and what it might mean in terms of how we will finance projects. However, we also need to look at the wider aspects, because money is just one part of it.

2.20 p.m.

[64] I know of the report that you were talking about because I read it with interest—I am hopeless with names so I cannot remember the report's title. The Assembly Government is putting all its money into a capital board that will redistribute some money at the end of the year. I think that that is a positive move because it is saying that we have earmarked x amount of money over a said period for that purpose.

[65] **Mr Threlfall:** To build on that point, the decision of the Irish Government to proceed with PPP projects for a number of its road schemes was, among other things, driven by a belief that it needed to bring in skills and labour from other countries and that undertaking traditional procurement was not a basis upon which it could attract the necessary interest, whereas undertaking a PPP programme was a basis upon which it could.

[66] **Mohammad Asghar:** Thank you very much for the lecture on PPP and PFI. According to your brief, it looks as if you have vast experience in 40 countries. You probably know that there is a down and an up, and PFI must be the down—horses in the front and a horse at the back of the cart. You have probably learnt about the problems with PFI and that is how you could say in your speech that they have been ironed out. What are the benefits of PFI? Wales is not an independent country yet; you are making comparisons with America, Ireland and other countries, but our hands are tied in relation to finance from Whitehall. As Jenny and others have said, bonds are another way of making money by other people, but we

are limited in that respect also. What will provide the best value for money for public services, for the people of Wales, in different sectors?

[67] **Mr Nicholson:** We tried to highlight in our submission what we see as the benefits of PFI. One is the way in which it transfers risk to the private sector, so that the private sector is incentivised to deliver the project on time and to budget, when, frankly, many public sector projects in the past were not delivered on time or on budget. Until that project is delivered acceptably, the contractor will not be paid and that provides a very powerful incentive for it to deliver. Another benefit of PFI is that there has traditionally been a tendency in the public sector to see the maintenance budget associated with public assets as the pot that is almost the residual, which you raid when you are a bit short of money, and, as a result, the quality of our public assets has often suffered because of poor maintenance. One of the consequences of PFI is that you can be sure that the public asset concerned will be maintained to the level that you specify, and I think that that is good news. The process of letting the PFI contract and the fact that the lenders really scrutinise the risks involved in the project—in many cases in a better way than the public sector has traditionally done so—is another benefit of the PFI process. I do not know whether Richard has anything further to add.

[68] **Mr Threlfall:** I will add just one further point on this. Some countries are embracing PPP models that certainly do not need to do so for financial reasons. Perhaps the best examples are countries in the middle east, such as the oil-rich Gulf states of Abu Dhabi and Dubai, which are both embracing PPP projects at the moment. One might reasonably ask why they are doing so when they can just go and build all the assets that they want immediately. They are doing this for two reasons. The first is because they have become convinced about the value-for-money argument in that, even if they have a lot of money, they would like it to go as far as possible. The second reason builds on the point that Chris made, which is that it gives them a certainty about the longevity of the assets and their maintenance, because those states are looking to a future where they may not have as much money as they have today and they want to ensure that, at that point, they have assets that have been maintained properly over that time, rather than assets that have been run down.

[69] **Alun Ffred Jones:** These countries may want to build up their assets, but I would suggest that money is certainly no object to them. So, whether or not this is more expensive may not be a relevant question for them. They may also need to import the expertise needed to control such projects.

[70] **Alun Cairns:** Let us leave that hanging; I think that there would be different views around the table.

[71] I need to bring the session to a close as we have run slightly over time; with your indulgence, I was happy to do that, because I felt that we were getting a lot out of it, and I am very grateful.

[72] I want to tie back Oscar’s last point to the question about the Olympics and to a statement made by the CBI in a conference in Swansea some weeks ago, at which the Minister was present along with a number of private sector players. If the policy of this institution is to strongly oppose PFI—in health and education; let us go to the extreme to make it non-party political—together with the risks of the Olympics, which I assume would compound it, what sort of message does that send to the private sector about operating in Wales?

[73] **Mr Nicholson:** If you send a clear message that you are serious about investing in the infrastructure of Wales and that you have the money to do so, then the private sector will come up with a programme of infrastructure investment that it can make money from, and it would therefore be committed to pursuing that. However, that is quite a big if. If you give the

impression that you do not like the private sector and are ambivalent about involving it, then the risk is that it will think that there are better opportunities elsewhere. To a degree, it depends on what the message is and how it is portrayed.

[74] **Alun Cairns:** Finally, if you were advising the committee that was potentially to come up with the model that would suit the political climate in Wales as well as the financial climate, what sort of guidance would you offer in terms of what we could come up with that may well meet those goals? They may be mutually exclusive; who knows?

[75] **Mr Nicholson:** My clear message, and this was brought out very well by Richard, is that there is a need to provide assurance and reassurance to contractors that there is a substantial programme, that you are serious about investing in infrastructure, and that it is worth them spending their time in Wales as part of that programme. Therefore, it is to provide some degree of certainty that you are committed to the programme, rather than it appearing as though you are not quite sure about things. It is about that size of programme and certainty.

2.30 p.m.

[76] **Mohammad Asghar:** I have a point on Dubai and Abu Dhabi. They are doing it only because the oil is running out, as you know very well, and they are heading off time. That is why they are planning these 99-year contracts for big buildings, roads, transport and infrastructure, as a different angle, to generate finances for the country in due course. On the benefit of PFI and PPP, is it that the time span is taken care of and that the money is paid for 20 or 30 years? The lifespan of that project virtually finishes after that time, so can a new PFI or PPP start again?

[77] **Mr Threlfall:** There are several benefits to PFI schemes. Primary among them is the value for money that can be obtained. There are some secondary benefits, particularly in some political set-ups, around the certainty of the use of money to support an asset over the long term.

[78] **Alun Cairns:** Thank you, Mr Nicholson and Mr Threlfall, for your attendance and for your excellent paper, which brought together several issues, and provided us with evidence on which to probe a little further. We are still at a relatively early stage of our inquiry. We hope to conclude towards the end of April or by June, but no later than that, I hope. If you wish to make any additional points at any stage, please feel free to do so. That is open to anyone who wishes to draw our attention to anything, or to underline certain points, as we continue to take evidence. We are extremely grateful for your time and efforts. As I said, if you want to give further evidence, please feel free to do so. Thank you both.

[79] **Mr Nicholson:** Thank you for listening, and good luck with the inquiry.

2.32 p.m.

## Ymchwiliad i Bartneriaethau Cyhoeddus Preifat—Cynghorwyr Arbenigol
## Inquiry into Public-Private Partnerships—Expert Advisers

[80] **Alun Cairns:** Item 3 relates also to the inquiry into public-private partnerships—that is, private investment in public services. We are joined by Gronw Percy and Simon McCann, who are expert advisers to the committee. You have provided us with a paper, for which we are grateful. Could you introduce yourselves, and say something about your background? You will be new to many Members, as only three of us were on the interview panel. Could you also talk about your paper, as well as about issues that we may need to consider as a committee, and about where we go from here? You heard the previous evidence session, which brought together many issues. Can you give us some guidance, and Members will then

ask questions, or suggest where they would like the committee to take the inquiry? We are aware that it is the committee's inquiry, not mine or the special advisers'.

[81] **Mr McCann:** Thank you, Chair. I will tell you a little about myself, and then speak to part of the part of the paper; Gronw will then speak to the second part. We have provided you with a paper, which is mainly in the form of bullet points, largely because we did not feel able to draw any detailed conclusions at this early stage. We have also provided you with two annexed papers, which deal with some of the common themes raised in the evidence that we have seen so far. We would be happy to take questions on those.

[82] To tell you about my background and experience, I am a solicitor with about 15 years' experience. Much of that has been spent procuring major projects in construction, information technology and services—some on a PPP and PFI basis, and others on capital spend and a variety of other models. I also have three and a half years' experience in the Welsh Assembly Government's legal service, so I am familiar with the public side of things. I would not say that I am an advocate of PFI or, indeed, of any particular form of PPP. My main driver is always achieving a solution that delivers what the public sector is looking for, which also achieves a fair balance of risk and reward between the parties, so I hope to come at it from a fairly objective perspective.

[83] We saw two key questions in all of this with regard to whether there is a role for public-private partnership in future major projects in Wales. First, does it work? How well does it meet the public sector's needs? Secondly, does it provide value for money for the public sector? One comment from the evidence jumped out and hit us between the eyes, and that was the one from Unison saying that we need a wide-ranging and genuine debate on a range of options and not just PFI. Understandably, much of the evidence has concentrated on PFI, because that has been the majority of the experience so far, but we need to look at the other models that are out there.

[84] It is probably better if I pass over to Gronw to tell you where we have got to with the evidence, where we would like to take it from here, and the common themes that we have seen so far.

[85] **Mr Percy:** I am Gronw Percy. I am an assistant director with PricewaterhouseCoopers, based in Cardiff. I have close to 20 years' experience as a chartered accountant, and most of that was spent advising on financing transactions between the public and the private sector, and so on. For the past two years, I have worked specifically on various forms of PFI transactions, liaising very closely with the Treasury and so on. It has meant that I have been based and spent a lot of time in London, but I am keen to take some of the lessons learned there to Wales and to look at how we can move things forward in Wales.

[86] As Simon said, we identified what we believe to be the key questions. Is there a role for it? Does it work? Does it provide value for money? The committee has gone out and obtained evidence. On how we would like to work with the committee going forward, initially, we could provide you with an analysis of the evidence that we have had. We can summarise that and try to identify some key themes. From that, we can work out what further evidence is required, what the conclusions are, how we address the themes and concerns coming out of it, and perhaps we can explore how to overcome those for Wales, perhaps by looking at whether different models could help to address those concerns. So, it will be about leading you through that process by evaluating what we have, summarising it, identifying gaps, identifying how we get more evidence, and trying to bring it to a complete picture, if you like.

[87] As we can see, we are now at the stage of going through what we have, and we hope to present to you at the next session a high-level analysis of the responses to date. In this

paper, we have given you some of the themes. They focus heavily on PFI. Value for money is a big issue, and there are some workforce concerns. A real issue for the committee and for Wales in this inquiry is the complexity of PFI and the skills needed to manage the process, whether it is PFI or a public-private partnership project. To get best value, you need to have the skills. That is an issue.

[88] **Alun Ffred Jones:** We have taken evidence on Neath Port Talbot Hospital at Baglan Moors, which is a biggish contract. The managers seemed very happy with how it had panned out. I would like a further breakdown of the costs of that project. Perhaps we were furnished with them at the time, but I did not quite grasp all of them. It is about this business of separating the cost of the building and paying back the fee for building it, which is fairly straightforward, presumably. In-built are the services that it provides. I am not sure what services they are, but the fees are fairly hefty, in the round. Perhaps we should examine the A55 project in north Wales, but perhaps that is too simplistic. It is a big project, but it is just about maintaining the road, I suppose. What were the costs involved there, and how do they compare with similar projects? Is that worth pursuing?

2.40 p.m.

[89] **Alun Cairns:** Absolutely. I would support that. There was a question that I did not get a chance to put to KPMG because time was running out. Paragraph 2.3.1 states that,

[90] ‘It is then a judgement whether this fee is good value for outsourcing risk management or whether there are imperfections in the financial markets and the public sector could manage these risks more cost effectively than the private sector’.

[91] So, it seems to me that this risk premium is the big issue. In addition to the points that Alun Ffred made, which I support, can we also have a briefing or session on the risk premium, to say, ‘This is what you are getting for your money’ or whatever?

[92] **Mr McCann:** Risk premium runs through all contracts, and not just PFIs and PPPs. The Office of Government Commerce strongly supports the use of an NEC3 partnering contract, as does the Welsh Assembly Government. Effectively, that works in a similar way in that you buy yourself certainty on the final outturn cost by paying a risk premium up front in return for, it is to be hoped, an improved outcome.

[93] **Alun Cairns:** Could we look at the Baglan Moors hospital, which is generally thought of as a good example? It worked for the chief executive anyway, who was very happy with it, but let us not forget that he is not the taxpayer who is paying for it. Could we look at the risk premium in relation to that hospital, and perhaps Members will make different judgments as to whether that was good value? Is it fair to ask for a similar comparison to be made with a public sector model that has worked on a similar basis, so that we can compare like for like?

[94] **Jenny Randerson:** May I ask a different question?

[95] **Alun Cairns:** Does anyone else want to pursue this point first? I see not, so go ahead.

[96] **Jenny Randerson:** In the KPMG presentation, there was an explanation of not-for-profit organisations, and we have a good and comprehensive Members’ research service briefing about local improvement finance trusts. However, your notes refer to the local asset-backed vehicle model and the Barnet bond model. Is the Barnet bond model the same as the one that we were talking to them about, or is that different? Is that the model that Transport for London used? I think that I understand the rest, but I do not understand the detail of those two.

[97] **Mr Percy:** We could certainly look at that and try to summarise some of the differences. The local asset-backed vehicle model is really looking at how you can combine different things. Instead of making payments for services, it is about looking at whether you can package different assets. It is often used within regeneration projects where the public sector provides the land as part of the deal, rather than the money. It looks at how you can combine assets and money to get a better end result. Those are the types of principles within it.

[98] **Alun Cairns:** Sorry to interrupt, but I am aware that Alun Ffred wants to leave. Please feel free to carry on if you were pursuing a line of information.

[99] **Mr Percy:** I think that we have covered what I wanted to cover on the process that we hope to follow, which we hope will meet your objectives.

[100] One theme that I want to mention, which I think you need to cover, is the implications of the new accounting rules for PFI contracts, because that is quite a major issue that will have an impact on us, for the public sector balance sheet.

[101] **Alun Cairns:** I wish to draw Members’ attention to the paper that was handed out at the beginning of the meeting, which is the inquiry work plan. It is a broad-brush plan, and it refers to who we want to give evidence and roughly when we want them to come here. During our next session in two weeks’ time, it is suggested that we hear evidence from the unions and the Welsh Local Government Association. In the following session, we propose to take evidence from private sector organisations, such as the Confederation of British Industry, and BT, which has specifically expressed concern. We have heard evidence from the headteacher of a PFI school and the chief executive of a PFI hospital, both of whom said that PFI worked for them, operationally, although other questions were raised. Given that we are talking about health and education, which are the two big portfolios, I thought that it would be useful to invite the British Medical Association or the Royal College of Nursing, and perhaps the teaching unions to give their views. I am trying to be balanced as I am conscious that, up to now, many of the arguments have been pro that. I think that we need to reconcile some of the issues. I would like to ask our advisers whether there are any people whom they think we should consider at this stage, although it will evolve, I am sure.

[102] **Mr McCann:** One gap that we noticed when looking at the respondents was that there was not much representation from the contractor/provider side. I think that we would like to ask one or two of those. Certainly, there are people in Wales who have trenchant views on PFI from the contractor/provider side whom we could invite.

[103] **Mr Percy:** That is a major one, and that would pick up on that certainty issue and how much of a risk there is for Wales.

[104] **Jenny Randerson:** Reference was made earlier to the auditor general having done a report. At the very least, we will be able to find that and consider it, but is there value in inviting him to this committee? Was it the Auditor General for Wales who did the report?

[105] **Mr Grimes:** Jeremy Colman gave us a background paper at our first meeting.

[106] **Alun Cairns:** I know that he did some work on this when he worked with the National Audit Office before he became auditor general.

[107] **Jenny Randerson:** Is it worth inviting him to look at the value for money aspects, or would that be going over the same terms as the paper?

[108] **Alun Cairns:** I will be guided by the committee. My preference would be to do a bit more work and then invite him here to reconcile our views. Are you happy with that?

[109] **Jenny Randerson:** Yes; inviting him to come in towards the end would be the obvious answer.

[110] **Alun Cairns:** He will be able to highlight some clangers or let us know if we have missed something. Are there any other points that you wish to raise with Simon and Gronw? Do you want to raise anything with us, Simon or Gronw?

[111] **Mr McCann:** I think that we are okay.

[112] **Alun Cairns:** I thank you both for the paper and the discussion on how you see it going. I certainly see it going along the lines that you have mentioned. Some papers have highlighted best practice or good examples. I know that we have discussed some projects, and I think that the committee would want to learn from experiences elsewhere. We can talk about that as evidence emerges.

[113] **Mohammad Asghar:** What is a comfort zone? You state in your letter that, on conventional wisdom, it is unlikely that the public sector would be able to outperform the private sector market and risk management provided that the project is within the comfort zone of the market. Are we in the comfort zone?

[114] **Mr McCann:** That is KPMG's letter, but I think that I know the point that it is making, namely that there is an established market in certain types of projects in PPP and the private sector has developed expertise to meet those. That is what it calls the comfort zone. Where you have a new or an innovative project, there is less experience and you may be out of the comfort zone to some extent, which may attract a higher risk premium. I think that that is the point that it is making.

[115] **Janice Gregory:** I feel a bit awkward making a comment, given that I am only subbing on this committee, but I will refer to the NAO report mentioned in the Members' research service brief, which is another wonderful brief prepared by Dai and his team. If I were a permanent member of the committee, I would refer to paragraph 5.22 of the report, which talks about construction performance under PFI. When we talk about value for money, these are public buildings that will be used by many people. I would have liked us to have looked at that in more detail as a committee, in terms of the delivery of the construction and the design and related difficulties. My other point was on the standardising of PFI contracts. In my constituency, I know of the difficulties that the local authority encountered in terms of a contract for a school, in terms of its complexity and the differentials between contracts. However, I am not going to be on the committee.

2.50 p.m.

[116] **Mr McCann:** It was undoubtedly a feature of the first-wave PFIs that they were incredibly complex and took far too long to negotiate, but things are now getting more standardised and faster.

[117] **Jenny Randerson:** Having looked through the list of Welsh projects, the emphasis, as Joyce said earlier, is on health projects. Quite a few have been done for the Cardiff and Vale NHS Trust. Would it be worth having someone in from the trust who deals with the PFI projects, or from any of the other trusts that have done several projects, so that we can have some kind of overview of their experience? The British Medical Association and the Royal College of Nurses will tell you what it is like to work in those buildings, but it would be very useful to know what it was like to commission them and to continue to manage them as time

goes on.

[118] **Alun Cairns:** We partly had that with Paul Williams, the chief executive of Bro Morgannwg NHS Trust.

[119] **Jenny Randerson:** I am sorry, but I was not here for that meeting.

[120] **Alun Cairns:** We partly had that, with quite strong evidence.

[121] **Jenny Randerson:** I had forgotten that.

[122] **Alun Cairns:** The process that I have tried to follow is, first, to discover whether it works for the people who are operating and working in those building. Members will have drawn their own conclusions, but my personal perception was that it does. Secondly, I try to discover whether it is value for money. I am sure that we can reflect on that.

[123] **Jenny Randerson:** Delete that proposal and I will read the Record of the meeting that I missed.

[124] **Alun Cairns:** Is there anything else that anyone else wants to add before I bring this item to a close? I see that there is not. I thank you both, again, for your attendance. I hope that it has given you a feel for how the committee wants to pursue the inquiry. I also thank Dai and Eleanor for the excellent brief that they provided, highlighting a range of issues. Is that brief available to the public?

[125] **Mr Grimes:** Yes, it is.

[126] **Alun Cairns:** So, the brief is available to the public, should anyone want to look at it. It is obviously factual, without any views; it just highlights various areas and reports. I, again, thank you both.

2.52 p.m.

## Mesur ynghylch Gwneud Iawn am Gamweddau’r GIG
## NHS Redress Measure

[127] **Alun Cairns:** The final item on the agenda is the NHS Redress Measure. Stage 1 of the Measure passed through the Assembly this week. I contributed to the debate and sought to present the views of the committee. You will remember that officials had advised us that the financial memorandum would be updated before we got to the end of Stage 2. Unfortunately, that was not possible, for whatever reason, and, by coincidence, the financial resolution was not attached to the motion that passed through the Assembly earlier this week. So, it has been proposed for Tuesday, 5 February. We have had some updated figures, but they did not come in time for us to have a meeting, although, in fairness, I should say that they are not the final papers. As Stage 1 has passed, effectively, there is very little that we can add or say at this point. Are there any comments or points that people may want to make in relation to this?

[128] **Jenny Randerson:** I wanted to know whether we will have a substantive debate on the financial aspects next week. They were referred to last week in the debate—I referred to them and you talked about them—but there is an issue here that we should not allow to pass. It so happens that, on this draft Measure, we are all united, in that we all agree with the principle of it—we all accept the fact that it will cost more, and clearly the Minister believes that she can afford it—but I do not think that, as a Finance Committee, we should allow the point of our existence in relation to Measures to get overlooked. We are setting a precedent with this Measure. A lot was said last week about the fact that it was very skeletal in nature

and so on, but we let it go despite that, because of circumstances. However, in future, Measures will be put before us on which there is division and concern, and which might result in serious cost pressures if they do not fulfil expectations.

[129] The problem is that some key policy issues are still to be decided. These will make a world of difference with regard to how much this Measure will cost. The first is the issue of the level at which we cap the maximum compensation. If we cap it at £20,000, there will be a world of difference between that and the amount that it will cost if it is capped at £30,000. Secondly, a paper was presented to the Proposed NHS Redress (Wales) Measure Committee—the details of which are also included in a paper that has been presented to this committee—setting out the level of the standard legal fee and the basis on which that legal fee would be paid. The third issue is the stage at which legal advice would be available. Will it be available from the start, or will it kick in at a certain point in the process? All of these are fundamental decisions that still have to be made and that will all affect the final cost. So, we should at least use our allotted quarter of an hour next week to raise these issues as things that need to be decided, while accepting that, in principle, we all agree on it.

[130] **Alun Cairns:** I agree. Does anyone want to add anything to that?

[131] **Janice Gregory:** This is such an important Measure for so many people that I would hate us to do anything that would delay it. The letter from the Minister gives the assurance that she will come back to the Finance Committee and, as she puts it here, to 'Jonathan Morgan's committee', with potential costs and savings. In the summary, the Minister talks about Easter. There is obviously ongoing work in terms of trying to identify or pin down the costs, even more than is the case at the moment. The Minister has not said, 'This is it. I want it passed and I will do no further work'. There is work to be done on it.

[132] **Alun Cairns:** I wholly accept that. John, in terms of the process, the procedure, and the various Stages, where do Standing Orders formally request us to comment? It may be that all of these issues, as Jenny Randerson highlighted, will have an impact on the cost. It may be simply that the Standing Orders are not right, that we are not commenting at the right Stage, or that we need generally to learn the lesson in terms of what has happened, as it is the first Measure. I accept absolutely the Minister's positive intentions to liaise with the committee and to provide us with the information; there simply has not been enough time to get it. I am worried that, if we say, 'This is an important Measure, so…', as a reason for doing this, the same reason could be used for any Measure. We do not want to set a precedent. That is my worry with regard to the process.

[133] **Janice Gregory:** It is the first Measure, Chair. It is important that we make the point that we want to learn lessons from this.

[134] **Mr Grimes:** Standing Orders set out our role very simply. Standing Order No. 14.2(i) states that the committee may also consider and, where it sees fit, report on:

[135] 'Financial information in explanatory memoranda accompanying proposed Assembly Measures'.

[136] **Alun Cairns:** Does that mean that we can do it at any Stage?

[137] **Mr Grimes:** Yes. We have done it; and we have said that the information is lacking. We are entitled to go on and pursue this in the context of our financial role.

[138] **Alun Cairns:** In light of the point made by Jenny Randerson, that the financial impact will not be clear until key policy decisions have been taken, we may want to comment at that stage.

[139] **Jenny Randerson:** Are you suggesting that we do not use our opportunity in Plenary this week to comment, but that we hold fire until later?

[140] **Alun Cairns:** It is up to Members how they want to speak in Plenary. I would not want to curtail anyone on that.

[141] **Jenny Randerson:** I assumed that, because time was allocated to us in Plenary, there was an expectation that we could use that time rather than just saying, ‘They forgot to add it last week’, or, ‘It was not completed in time for last week’.

[142] **Janice Gregory:** There has been recognition of that, has there not?

[143] **Alun Cairns:** Yes. It is not my job to stop anyone from saying anything. I am looking for broad support with regard to the way in which we proceed from here. Should it be in a letter? I tried to make the point last week in a helpful way that I hope that a precedent has not been set whereby we have not been able to comment properly on the financial note that goes with a Measure. Providing that this is a one-off and that it is not a precedent, then we are content. We could reserve the right to comment at a later stage on this Measure, when the other financial information is acceptable. Are we happy with that? I see that we are. John, do you have what you need?

[144] **Mr Grimes:** Yes. Do you want the debate?

[145] **Alun Cairns:** I do not think that we need the debate.

[146] **Jenny Randerson:** We changed our mind, in that we have drawn attention to the fact that we can comment later. It would be better to do it then.

[147] **Alun Cairns:** We will word it as I did my summary, and state that we hope that this is not a precedent. We will comment briefly.

[148] **Janice Gregory:** We should state that we hope that there will be a further opportunity to comment. That is important.

[149] **Alun Cairns:** Yes, and we will add that we accept that there has been every positive intention.

[150] That was the final item on the agenda. Would anyone like to make any additional points on that item? I see not. Thank you. I now bring the meeting to a close.

*Daeth y cyfarfod i ben am 3.02 p.m.*
*The meeting ended at 3.02 p.m.*