



PFI: Getting the Bill on the Fiscal Credit Card

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Contents

Summary	3
Background	4
Part 1: The Prevalence of PFI	6
Part 2: The Impact on Schools	10
Part 3: PFI Companies	13
Discussion and Conclusion	16
Appendix A: Regression Design	22
Appendix B: Regression Results	24

Summary

For over 20 years, successive UK governments used the Private Finance Initiative (PFI) - a form of a Public Private Partnership (PPP) - to use the private sector to finance and deliver public infrastructure projects. This model allowed for the payments of these projects to be repaid over decades and were often considered off-balance sheet, meaning they were not included in public debt figures and so not subject to spending rules. Despite delivering over £80 billion worth of public assets, the model was retired in 2018 after becoming synonymous with high costs and inflexible contracts and due to the 'fiscal risks' it posed the public sector.

While many consider the PFI experiment to be a failure, the new government may look to reintroduce a new version to finance its 'decade of national renewal', given the updated spending rules still do not leave sufficient headroom to finance all this expansion through conventional fiscal policy. However, to do so it will need to learn from the lessons of the past, which will remain challenging given the lack of institutional knowledge over the use and impact of PFI; this was itself one of the contributing factors to its retirement. This report therefore explores the use and impact of PFI, to fill these knowledge gaps and to arrive at a more informed view over whether and how it could be revived.

To do so, we first use the existing - albeit limited - data to understand the scale of PFI, finding that PFI repayments are on average 3.3 times larger than the value of the asset they built. While these official sources provide some insight into whether PFI offers value-for-money, we need further data to gain a clearer picture, such as what proportion of PFI payments pay for the interest costs of each contract or simply the size of each project, such as which schools or hospitals it covers. This information is only held at the local level and is often not known by central government themselves.

To overcome these data gaps, we employ freedom of information requests to all local authorities in England to identify which schools were built under PFI. We identify nearly 1,000 PFI schools and find them to be on average financially worse off than non-PFI schools after controlling for key characteristics. We then collate financial data from all local authority's annual accounts to understand the components of PFI repayments, finding over £13.5 billion is spent at the local level on PFI repayments, of which 31 per cent pays for interest costs. We then explore the profit margins made by PFI companies by analysing all accounts registered at Companies House, finding over £1 billion has been made in pre-tax profits by just a handful of companies, often registered in Guernsey and Jersey.

This report finishes with a discussion that uses the findings of this work and other research reports to arrive at a judgment over whether and how PFI could be reintroduced, concluding that the incentive of 'off balance sheet' reporting created an overbearing political incentive that meant the negative side effects of the model became a central attribute. While we do not recommend its reintroduction with this feature still in place, we hope the findings generated can override a lack of centralised information and provide policymakers with a diagnosis of the failures of PFI.

JEL Codes: E21, E62, H53

Keywords PFI, PPP, FOI, Fiscal Policy

PFI Continues to Have a Legacy in the Public Sector

Through freedom-of-information requests and analysis of local authority financial accounts, we reveal the number of PFI schools in England and how much is being spent on each contract:

- **PFI repayments are 3.3 times larger than the value of the public assets they built:** with 99 per cent of all PFI contracts having already paid off the capital value of their projects despite being only midway through their repayment schedule.
- **£13.5 billion is spent by local authorities every two-to-five years on PFI repayments:** of which 31 per cent of all PFI spending by local authorities was spent on interest costs between 2018 and 2023.
- **845 schools have been built and/or are maintained by a PFI contract:** this covers nearly half a million pupils.

PFI Schools are Worse off Than Non-PFI Schools

After controlling for key characteristics, we found that PFI schools were financially worse off than non-PFI schools.

- **PFI schools are more likely to be in debt than non-PFI schools:** 18 per cent of PFI schools are in debt, as opposed to 10 per cent of non-PFI schools. After controlling for key characteristics, we estimate PFI schools have an additional 3 per cent probability of being in debt and have 15 per cent lower reserves.
- **PFI schools spend 5 per cent less on ICT budgets and 4 per cent less on staff compared to non-PFI schools:** we find that on average PFI schools spend less on areas not covered by their PFI contracts, such as ICT and staff expenditure.
- **We do not find evidence that PFI schools are more likely to be failing than non-PFI schools:** 21 per cent of PFI schools have a poor Ofsted rating compared to 12 per cent of non-PFI schools, but we do not find a statistically significant result after controlling for key characteristics.

A Small Number of Private Companies Own PFI Contracts

Analysis of financial accounts of PFI providers has uncovered the margins made by PFI companies and who owns each contract

- **£1 billion has been made by PFI companies in pre-tax profits from all contracts:** £300 million has been distributed as dividends.
- **Eight companies own 80 per cent of all PFI schools projects:** we find many of the hundreds of shell companies can be traced to the same parent companies.
- **Of these eight companies five are registered offshore:** three companies are directly registered in Guernsey or Jersey and two have holding companies registered there. In addition, one other company used to be registered in Guernsey until recently and another once stated that majority of its shareholders are registered overseas.

Background

The Private Finance Initiative (PFI) model, created in 1992, afforded successive governments the ability to finance cost-intensive infrastructure projects by combining the design, build and maintenance into one project funded by a single private company.

PFI offered several advantages. First, the payments for the project would be spread over

25-to-45-years, with the first payment beginning only once the infrastructure project became operational, meaning no upfront capital would need to be raised. Second, the public sector would benefit from **value-for-money by utilising 'private sector innovation'**. Third, the majority of PFI expenditures would be considered 'off balance sheet' payments, meaning they did not appear in wider spending or debt figures. This allowed government departments to expand infrastructure projects without the cost being included as traditional public debt liabilities and subject to the spending rules. PFI became a widely used tool in the late 1990s and throughout the 2000s, resulting in over 750 signed contracts, each often covering multiple projects.

What started as an unremarkable financing agreement was soon accused of being the source of substantial financial pressures within affected hospitals and schools, which often cited unsustainable and rigid contracts impacting their day-to-day operations. These challenges are well summarised in two high-profile cases of Barts Health NHS Trust and Parklands High School.

Barts Health NHS Trust in London signed a PFI contract valued at over £1.1 billion and with 35 annual payments of £145 million (representing 10 per cent of their annual budget); this was the largest active PFI contract ever signed. By 2015, the trust was placed into financial special measures where it remained until December 2020.

The second well-documented case is that of the £24.1 million, 900 capacity Parklands High School in Liverpool built in 2002. After 10 years of operations the school was running at 19 per cent of the designed capacity and was placed in special measures after receiving 'amongst the lowest [Ofsted rating] in England' in 2013. A year later, **Liverpool City Council closed the school after pupil numbers dropped below unsustainable levels**. Despite this site lying empty for years the council have remained contractually obliged to continue paying their annual payments until 2028; with £20 million left to pay, this works out at £4.5 million a year, or £12,000 a day. The council **spent several years renegotiating** with the PFI company to enable them to re-open the site for educational purposes again, eventually agreeing to allow a neighbouring school to place some children within the site. This controlling company, **Equity Solutions Limited, made £748,100 in pre-tax profits from this project in 2023**.

Key Term: Public Private Partnership (PPP) and the Private Finance Initiative (PFI)

Public Private Partnerships (PPPs) is the international term for funding models that use private sector resources to fund public infrastructure. The Private Finance Initiative (PFI) is the United Kingdom's version of this model, which similarly funds infrastructure projects using private money. This paper uses PPP to refer to the wider funding model and PFI when referring to the specific model used in the United Kingdom.

Despite the retirement of the PFI model, these two anecdotal stories signal the size of financial challenges on affected hospitals and schools. While much research has been undertaken to identify the overall effect of PFI on the NHS, research into the effects on schools remains unexplored, largely because, for some time, **there was no central list of which schools were affected by a PFI contract** due to the contracts being signed at the Local Authority level¹. This lack of centralised data has brought successive governments into sharp criticism by the Public Accounts Committee due to the constraint this placed on properly assessing PFI projects. This has not only hindered research but has been argued to be limiting their ability to design a new PPP model today.

¹Since this work was undertaken, the Department of Education has made a **publicly available list of PFI schools**.

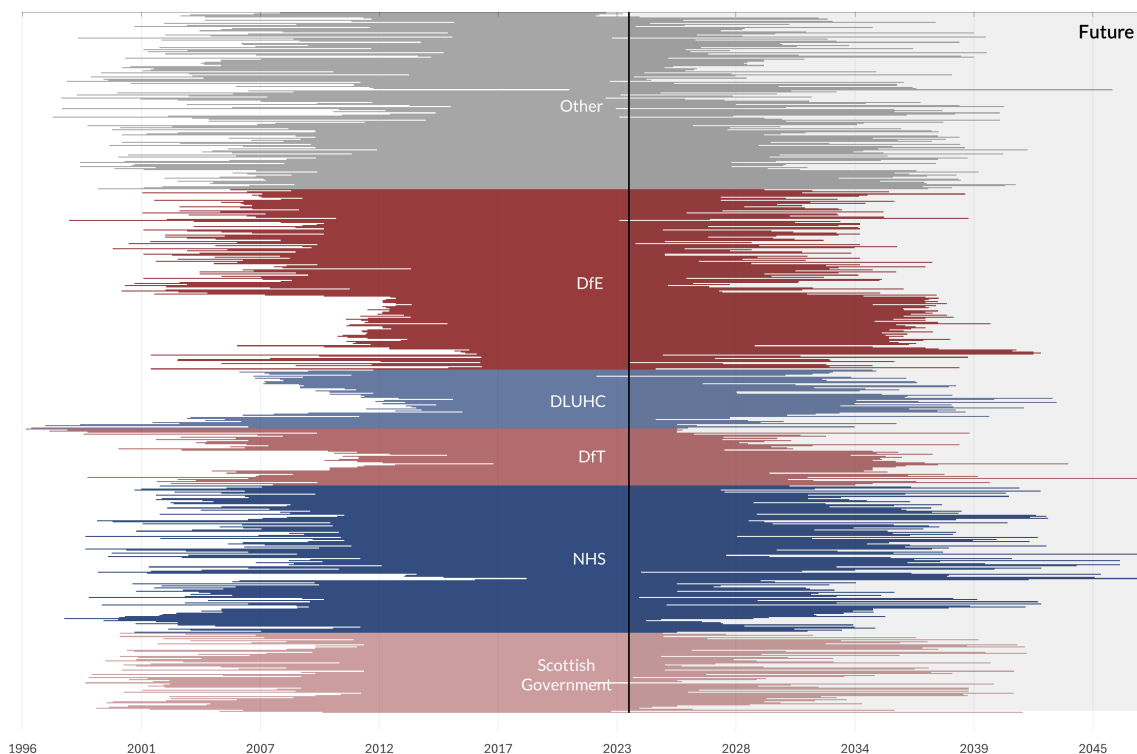
This report therefore aims to fill this knowledge gap, exploring the use and effect of PFI in the education sector by establishing a database of schools affected by a PFI contract and providing analysis into the continuing effect of these contracts today. In doing so, we aim to identify the lessons learned from how PFI arguably failed the education sector, to fill the knowledge gap needed for generating future PPP models.

Our work identifies all schools in England affected by a PFI contract through freedom of information requests and uses regressions to uncover the potential effect of being a PFI school on a range of measures of financial health while controlling for key characteristics. We combine this with analysis of every shell company (known as a Special Purpose Vehicle, or SPV) to determine the profit margins from each project and to establish who their ultimate owner is.

PART 1: The Prevalence of PFI

According to HM Treasury data there is a total of 151 billion outstanding PFI repayments to be made between 2023 and the last contract expiring in 2052 across over 700 projects.

Figure 1: The timeline of all PFI contracts by government department, 1996 to 2052

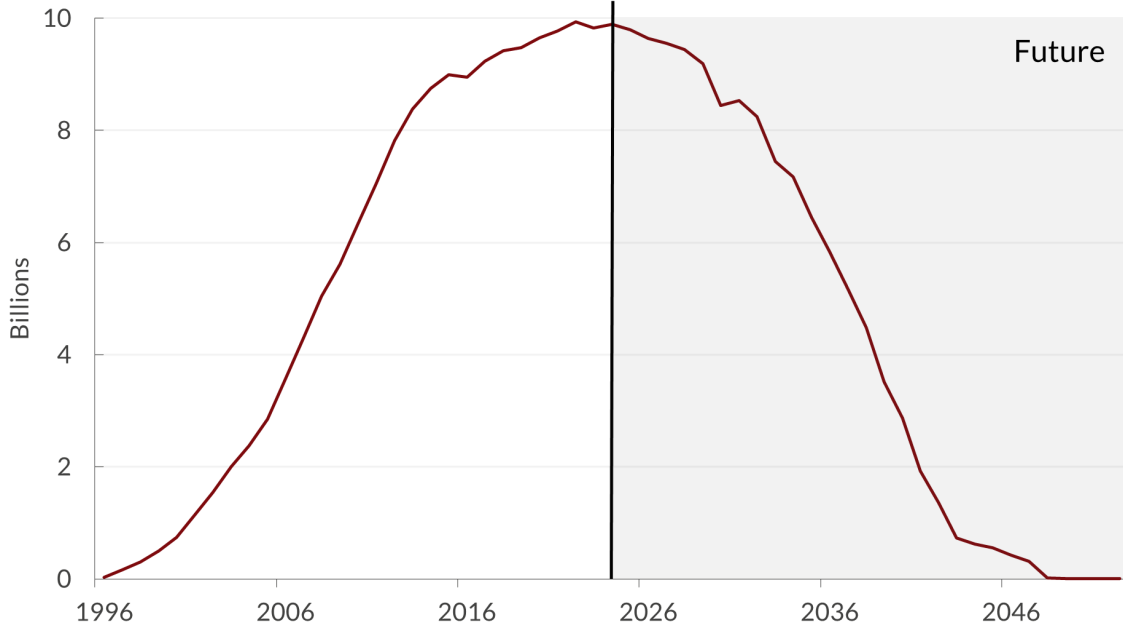


Notes: Some contracts omitted due to unknown start date

Source: Author's analysis of PFI database (HMT)

We use this data to show in Figure 1 the timeline for each project, which shows most contracts are around the midway point despite being signed in the early 2000s. For education projects, many of these contracts were signed in 2010 and will expire around 2040. This also shows the prevalence of contracts by government department, showing the two departments with the largest number of contracts are the Department of Education with 171, and the Department of Health and Social Care with 140.

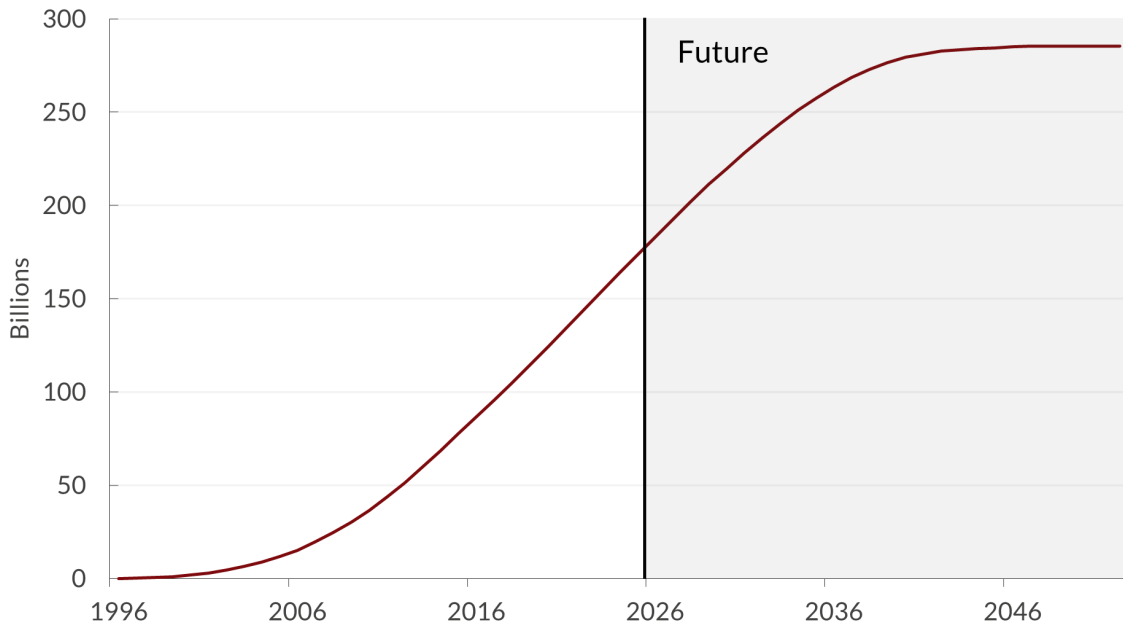
Figure 2: Annual PFI repayments by year, 1996 to 2052



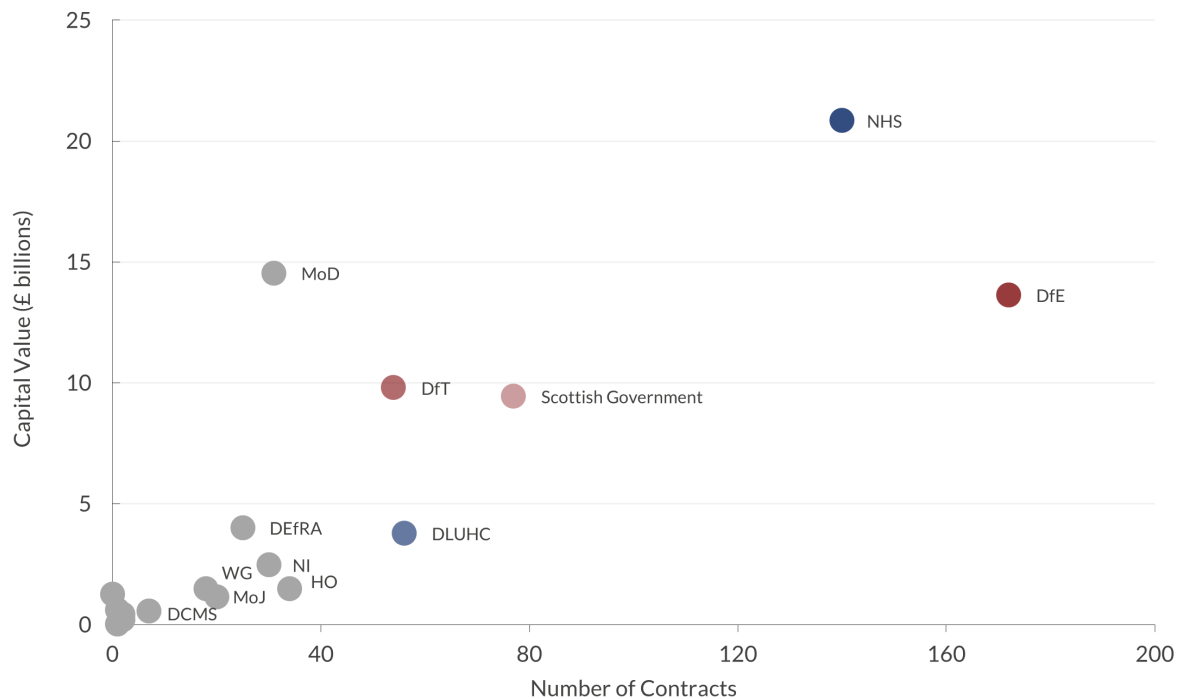
Source: Author's analysis of PFI database (HMT)

Given the start and length of these contracts we are at the peak of the PFI repayment schedule (figure 2), with £9.7 billion paid in Unitary Charges (total PFI repayments) in the 2021-22 financial year. The total cumulative cost of PFI therefore stands at £280 billion, which will be fully paid by 2052. In 2022, there was an outstanding liability of £151 billion.

Figure 3: Cumulative PFI repayments by year, 1996 to 2052



Source: Author's analysis of PFI database (HMT)

Figure 4: Capital value of all PFI contracts and number of contracts by government department

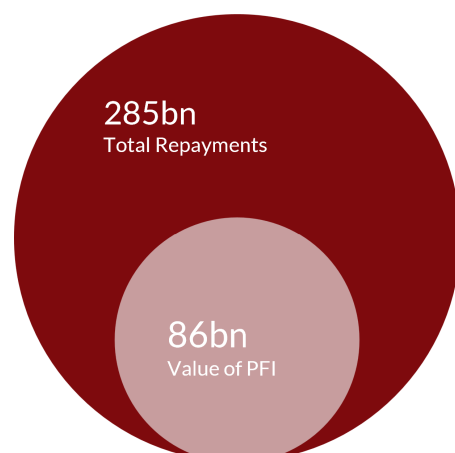
Notes: Some contracts omitted due to unknown start date

Source: Author's analysis of PFI database (HMT)

The HM Treasury data also reports the total nominal capital value for each project reported at the financial close (when the contract was signed) which helps to illustrate the financial value of the asset built by each project. In total, the value of all public assets built under PFI is £52 billion. Given the DfE and DHSC hold the largest number of PFI contracts, they naturally hold the greatest total capital value across all their projects. Despite having fewer contracts, the DHSC holds a greater total capital value of all their PFI contracts than the DfE. This is unsurprising given the higher infrastructure costs associated with building hospitals rather than schools. The Ministry of Defence have a comparatively costly PFI portfolio relative to other departments with a similar number of PFI contracts, also reflecting the costly nature of defence spending.

We can take both the total repayment costs and compare it to the value of the asset built under a PFI contract to get some insight into the cost of PFI itself. Under a conventional procurement and construction process the total cost should broadly be similar to the capital value of the project being built. To be able to compare this to PFI, we uprate the capital value of the asset built in line with inflation, but leave the total repayments as nominal given they a) reflect the total amount paid/to be paid and b) **they already price in inflation and interest risk.**

Under PFI, we see that the total PFI liabilities (£285 billion) are 3.3 times larger than the total capital value of all PFI projects (£86 billion) in



today's prices. 99 per cent of all PFI contracts have paid more PFI repayments than the capital value of their asset.

Part of the reason for this large difference will be down to the size of the maintenance element of the contract which covers the entire period of the contract. This, however, will not explain all the difference. The rest will be explained by the size of interest repayments and the general cost of using private finance, which will be greater than financing through government debt, which by definition is safer and therefore associated with lower costs.

While the information provided in official statistics is valuable, it does not provide specific information on the difference between what is a repayment of capital and maintenance costs and what is interest, which is necessary to enable sufficient scrutiny of the PFI model itself, something that has brought criticism from successive Public Accounts Committee hearings and inquiries. There is a lack of publicly available information on both key financial statistics that would enable judgement over whether PFI offers value for money, and the prevalence and impact of PFI itself.

The official PFI database offers a useful timetable of capital value and yearly repayments by each contract, it does not further break these payments down into repayment of capital and maintenance costs and interest, which would enable better scrutiny over the value for money offered by the PFI projects. These numbers, along with the majority of more detailed PFI information, are held at the local level.

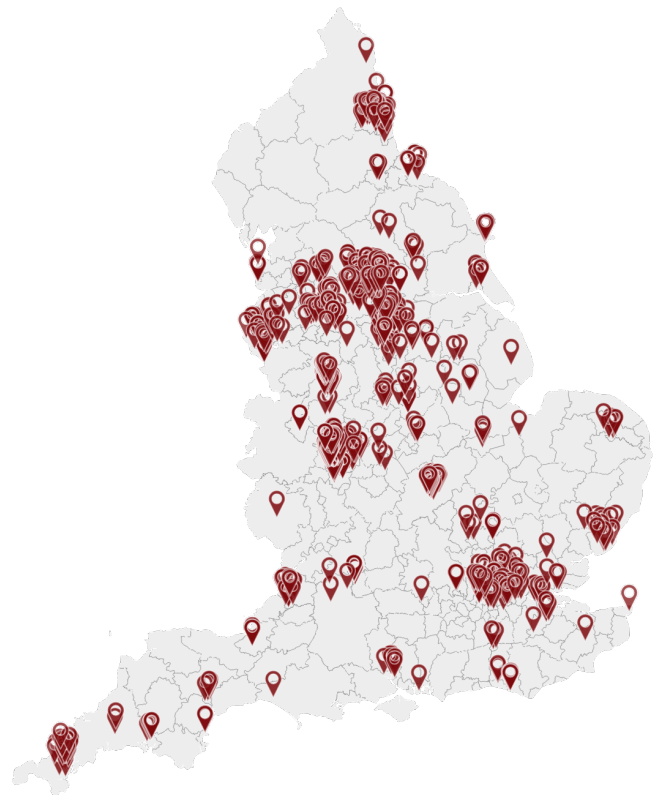
Therefore, to understand these contracts in more detail, we analyse the annual financial accounts of every local authority in England in the 2018/19 financial year and collect key information on the components of each of their PFI contracts.

We firstly use this year because PFI liabilities are reported on a two- to five-year basis, which enables us to see figures relevant to 2024 while partially evening out any yearly outliers (such as one year being more interest intensive than others in a similar way to a mortgage). We use this to estimate what proportion of all repayments are being spent on interest.

We find that local authorities in England, Wales and Scotland spend around £13.5 billion every two to five years on their PFI contracts. Of these, £4.2 billion (31 per cent) is interest payments². Table A displays the 20 local authorities spending the most on interest costs as a percentage of total payments to be made in the next five years. As can be seen, for two local authorities, interest costs represent more than 60 per cent of their total PFI payments.

²These audited accounts calculate interest by taking the total annual payment, subtracting the repayment of liability and the service charges. That remaining figure therefore doesn't go towards any delivery of service charge and is a left-over payment; classified as an interest payment.

Figure 5: PFI schools across England



Notes: Some contracts omitted due to unknown start date

Source: Author's analysis using FOI's

While more granular than the central government figures, neither set of statistics routinely and reliably lists the number of schools impacted by PFI itself, constraining the government's ability to know where the impact of PFI is being felt. As of 2018, the [Department of Education confirmed that they did not hold a central list of schools built and/or maintained by PFI](#)³. This is a particular challenge for understanding the impact on schools given at least one project in Northamptonshire covers 40 schools.

To overcome this limitation, we sent freedom of information (FOI) requests to all local authorities in England asking for each school impacted by a PFI contract. For these identified PFI schools, we obtained key figures relating to their physical and financial characteristics from the Department for Education (DfE). Our FOI request to every local authority in England fills this data gap, revealing 845 schools often located in inner-city areas, shown in figure 5.

Table A: Top 20 local authorities by of interest costs as a percentage of total costs on their PFI contracts, 2018/19

Local Authority	Number of Contracts	Total payments (2-5 Years)	Total Interest (2-5 Years)	Interest Percent
Newport	2	29.11	19.33	66.41%
Warrington	2	1.22	0.75	61.49%
Lincolnshire	1	11.00	6.75	61.32%
Wigan	1	34.77	20.36	58.55%
Moray	1	25.52	14.93	58.49%
Luton	1	16.21	8.84	54.50%
Blackburn & Darwen	2	40.14	21.68	54.02%
Barking & Dagenham	2	41.78	22.49	53.84%
Angus	4	79.45	42.08	52.96%
Somerset	1	29.26	15.12	51.68%
St Helens	1	17.33	8.61	49.66%
Essex	7	172.83	82.11	47.51%
Halton	1	13.12	6.16	46.99%
West Dunbartonshire	1	57.94	27.14	46.83%
County Durham	1	30.75	14.37	46.75%
Swindon	1	46.20	21.43	46.39%
Bridgend	1	12.25	5.40	44.08%
Bournemouth	1	12.24	5.32	43.43%
Redcar & Cleveland	3	47.36	19.38	40.92%
Cheshire	1	7.43	3.03	40.82%

Notes: as all figures are taken from annual financial accounts they may be subject to later revisions. Figures for Warrington taken from 2019/20 accounts.

Source: Author's analysis using each local authority's annual financial accounts

PART 2: The Impact of PFI on Schools

With a complete list of PFI schools we can observe some similarities and differences to non-PFI schools. In addition to the tendency for PFI schools to be located in inner-city locations due to population density, the key characteristics of PFI schools differ in ways that could reflect the design of the funding model itself.

³Since this work was undertaken, the Department of Education has made a [publicly available list of PFI schools](#).

Box: Comparing Riverly and Willowbrook Primary Schools

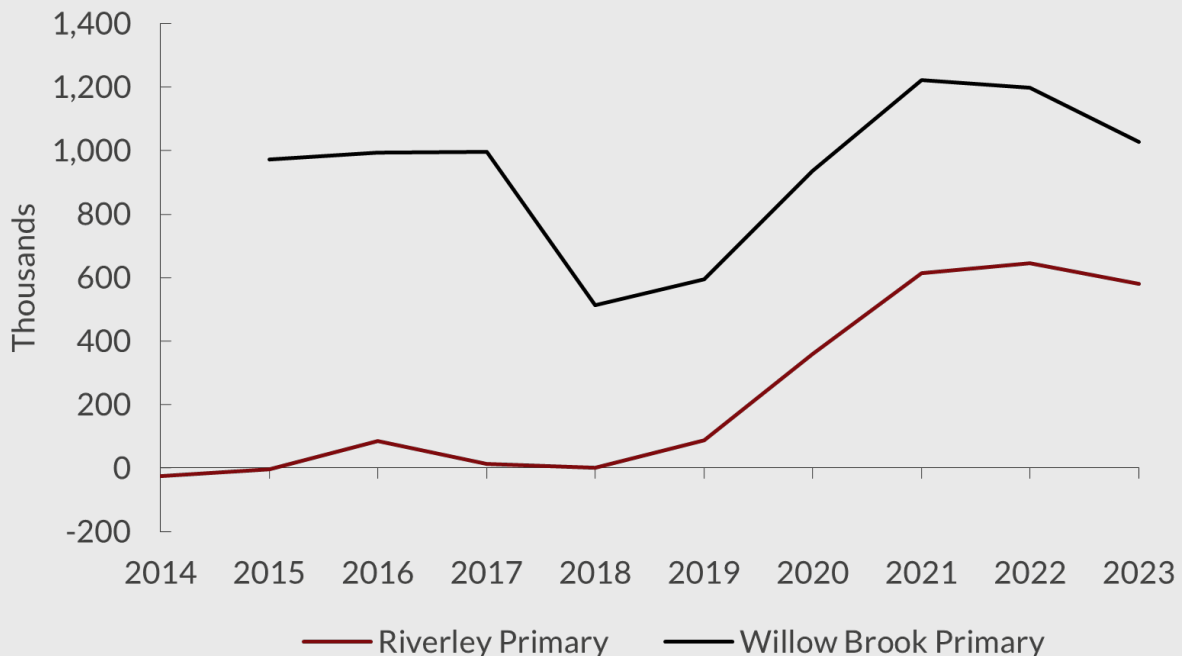
To illustrate what our statistical model will show, we can use the example of two primary schools, one built under PFI and the other not. This anecdotal story cannot tell us the full picture, but it can help us set the scene in explaining what operating under a PFI contract is like for effected schools.

Riverly Primary and Willow Brook Primary are two schools in Walthamstow within 100 metres of each other. There are 457 pupils aged three-11 in the former and 646 in the latter and both are academies operated under Griffin Schools Trust. Both began operations as an academy within a year of each other. Riverly Primary was built under PFI, and Willowbrook was not.

According to the trust's annual accounts, Riverly Primary's fund balance (based on income and expenditure and referring to the operational surplus/deficit) started out in a deficit of £25,000 in 2014 and only moved into a healthy balance from around 2019 onwards. By comparison, Willowbrook has maintained a healthy balance of £600,000 to over a million throughout its lifetime.

While the accounts themselves do not acknowledge the presence of a PFI contract as a driver behind the lower fund levels, they do state in 2014 that the trust was 'implementing cost saving initiatives' to offset the school's deficit. The task for the analysis in this report is to isolate other factors that could influence financial health and scale this up to the national level, which we perform with the statistical analysis below.

Figure 6: Fund Balance Over Time



Source: Author's analysis of Griffin Trust Annual Accounts

PFI schools are noticeably larger than non-PFI schools. On average, PFI schools hold 647 pupils, as opposed to 352 on average for non-PFI schools. The likely reason for this is that schools built under this model will intentionally be larger to a) justify the use of a PFI contract in the first place and b) have sufficient pupil numbers to support potentially more expensive repayments.

We can see some variations in school performance, as measured by Ofsted scores between the two sets of schools. While 10 per cent of non-PFI school have a poor Ofsted score (either 'require improvements', 'in special measures' or considered 'failing'), 20 per cent of PFI schools have a similar score. This, however, may be driven by a range of factors not yet controlled for, in particular, the location of the school or its financial performance.

For financial performance, we can see that PFI Schools carry greater reserves at £212,600 on average, compared to £168,900 for non-PFI schools. Despite this, only 10 per cent of non-PFI schools have negative reserves compared to 18 per cent of PFI schools. Both trends could be similarly driven by key characteristics such as the pupil capacity of the school.

To be able to answer whether these different factors can be attributed to the PFI contract itself or relate to these missing contextual factors we need to employ a regression model to uncover key differences in PFI schools while controlling for key characteristics. We detail the structure of this model in Appendix A and statistical results in Appendix B.

We use the following outcomes:

- *Whether PFI Schools have worse financial health:* Given the overall increased costs of a PFI contract and with the limited ability that PFI schools have to control large parts of their budget, we can expect their overall financial resilience to be lower than non-PFI schools. We measure this by their level of financial reserves and the probability of having negative reserves.
- *Whether PFI schools perform worse than non-PFI schools:* Given anecdotal evidence that PFI schools have poorer OFSTED results (mentioned above), and given the potential for worse financial performance, we therefore estimate whether PFI schools are more likely to have a poor OFSTED score, which we define as a 'requires improvements', in 'special measures' or 'failing school' score.
- *Whether PFI Schools have additional cost burdens:* Our research with affected teachers and school clerks identified that the service delivery aspects of PFI contracts would typically fail the value-for-money formula used in the procurement process. We can therefore expect lower expenditure on the areas not covered by PFI contracts – such as staffing and ICT costs – relative to similarly sized non-PFI schools.

We are able to compute the effects of being a PFI school on these outcomes after controlling for key characteristics. We find that reserves are, on average, 18 per cent lower than non-PFI schools. We also find that PFI schools have an additional 3 percent likelihood of being in debt than non-PFI schools, partly due to a lower reserve-to-income ratio which is 1.9 percentage points lower. We find that, for PFI schools, less expenditure on ICT and staff; finding 5 per cent and 4 per cent less respectively.

We do not however find a statistically significant result across the population of PFI schools for school performance when we apply this test to our statistical model. This suggests that while PFI schools are financially worse off on average, the teachers and support staff are able to effectively manage their school so that this challenge does not affect the core performance of the school.

PART 3: PFI Companies

While the **Public Accounts Committee (PAC)** has described the profits made by PFI companies as 'excessive', these claims were based on anecdotal stories. Knowing whether this is true or not is an important element of our overall understanding of PFI, as it could reasonably be argued that the higher cost it presents for local authorities and the lower financial reserves within affected schools simply reflects the expensive nature of building increasingly advanced schools and should not immediately be attributed to burdensome PFI contracts or 'unfairly' high costs.

To test this, we analyse the annual financial accounts of all the Special Purpose Vehicles (SPVs) used by PFI companies. PFI companies use SPVs with whom the Procuring Authority (e.g., a Local Authority) sign the contract with. These SPVs act as shell companies which collect and send any profits made from the contract to the relevant controlling company. As the accounts of each SPV are on public record, we can use them to see how much PFI companies make off each PFI contract alone while isolating gains made with other sources of income. It should be noted that this is not the sum of all profits to be made from PFI contracts, as the PAC have frequently commented on the profits made in the 'secondary market', which is when PFI contracts are sold. We do not have sufficient data to cover this market and so we focus only on profits made directly by the SPV's.

Table B: Key information on the eight largest PFI providers in education

PFI Company	Number of Contracts	N. of Schools	Pre-tax Profit (£m)
International Public Partnerships	30 (18%)	115 (16.4%)	15.39 (15.4%)
Semperian	18 (10.8%)	90 (12.8%)	8.90 (8.9%)
Equitix	17 (10.2%)	57 (8.1%)	12.80 (12.8%)
Dalmore	15 (9%)	43 (6.1%)	8.35 (8.4%)
Innisfree	13 (7.8%)	187 (26.6%)	22.73 (22.7%)
Aberdeen Infrastructure Partners	11 (6.6%)	50 (7.1%)	8.85 (8.9%)
HICL	10 (6%)	31 (4.4%)	4.59 (4.6%)
Kajima	8 (4.8%)	28 (4%)	2.90 (2.9%)

Source: Author's analysis using Companies House reports

Previous work into who owns these contracts revealed that just eight companies had equity stakes in 92 per cent of all PFI contracts in the NHS, which is behind **criticism from the NAO over the competitive nature of the tendering process** and which has been used to explain why PFI has at times failed to offer value-for-money. It is also important to understand whether these SPVs are registered offshore, given the Public Accounts Committee noted that **'tax revenue is being lost through the use of off-shore arrangements by PFI investors and the effect has not been adequately assessed'**.

We therefore research into the Ultimate Controlling Party (UCP) of each contract to establish true ownership of these contracts and to determine whether the SPV and/or UCP is registered offshore. While many companies are transparent about who their UCP is within their annual reporting, we find that many companies state that they have no UCP other than a holding company despite our research showing that those holding companies turn out to be owned by this same company.

Table C: Top 10 Most Profitable Education Projects (£ millions), 2021-22 financial year

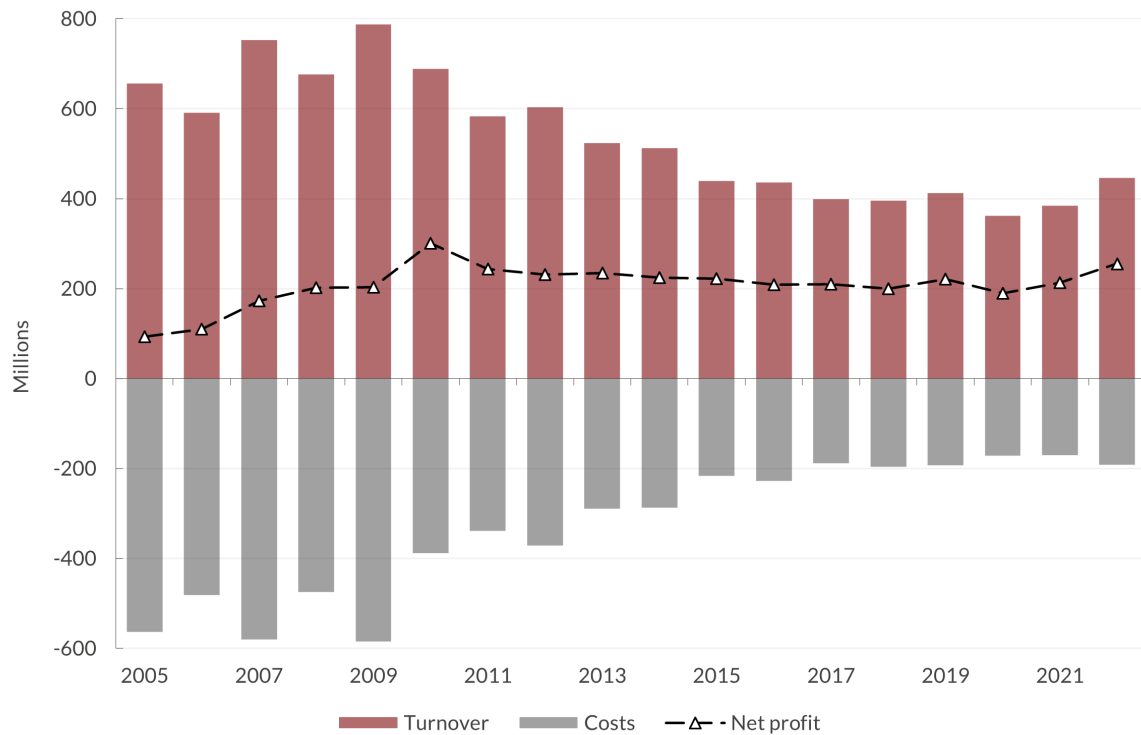
Project Name	Procuring Authority	Local	Unitary Charge Payment (£m)	Schools Covered	Annual Payment	Profit
Merton Group Schools Project - Age of Transfer	Merton		Innisfree	6	9.27	7.01
Northamptonshire Group Schools Project - 2	Northamptonshire		International Public Partnerships	42	30.46	4.25
PPP1	Birmingham Council		Innisfree	11	11.63	3.33
Leeds City Council - Combined Secondary Schools Project	Leeds		Dalmore	6	17.08	2.35
BSF Wave 3 Phase 3	Bradford		Infrastructure Investments Ltd	4	26,46	2.34
Sheffield Group NDSPPP Pilots - Phase 1	Sheffield		Innisfree	6	11.75	2.23
Stoke Schools PFI Project	Stoke-on-Trent		Innisfree	91	20.60	2.22
Redcar & Cleveland Grouped Schools PFI	Redcar & Cleveland		Dalmore	5	8.71	2.00
Bristol BSF	Bristol		Dalmore	4	19.52	1.67
Barnsley BSF Wave 3 phase 3	Barnsley		Equitix	3	13.52	1.55

Source: Author's analysis using Companies House reports

Consistent with previous research, we find that eight companies have equity stakes in 80 per cent of all 171 education contracts. This further raises questions over the competitive nature of the PFI tendering process. It partly explains why the NAO found previously that in some cases there were only two bidders for PFI contracts, something which may have led to lack of competition at the time and constrained potential value for money. **Procuring a third bidder is necessary for benchmarking** and only having two bidders leaves the procuring authority at risk of considering only one bid if the second bidder withdraws.

Many of these companies are registered overseas, such as the largest owner of education contracts – International Public Partnerships Ltd - who own 30 projects (20 per cent of all education projects) and who are registered in Guernsey. However, some caution should be added here. Firstly, each of these companies registered offshore state that they register their tax affairs in the United Kingdom. Secondly, equity stakes can be bought and sold (known as 'flipping') on the secondary market mentioned above.

Analysis of all 171 SPVs in the education sector reveals that PFI companies made £100 million in pre-tax profits in the 2021-22 financial year. While these profits are not small, it is important to remember that PFI contracts often run at a loss at the start of the contract given the high upfront costs needed to finance the construction of the project. One of the largest PFI providers mentioned above, **Innisfree, told the Public Accounts committee that there was little money to be made from the initial stages of a traditional construction project.** Therefore, we would expect these profits to even out over the project's lifetime.

Figure 7: Net Profit from PFI companies, 2005 to 2022

Notes: While we have data for the 2023 and 2024 financial years, not all companies have filled their annual accounts. We therefore only use years that have a full set of financial information. As we discuss below, we also exclude six projects who signed their contract directly with the provider without the use of an SPV to avoid double counting.

Source: Author's analysis of all SPV annual accounts

To account for this, we extend our analysis to cover all other (non-education) projects and analyse each PFI contract's financial statements from 2005 onwards. We can see in Figure 7 that this trend of high costs at the start of the project has reduced over time. Turnover has not reduced to the same degree, resulting in an overall increase in net-income since the start of these projects.

Table D: Key financial information of all PFI companies (£ billions), 2005-2024

	All Companies	Excluding Repeat Companies
Turnover	10.0	6.3
Costs	6.1	-4.3
Gross Profit	1.9	0.9
PrTP	1.0	0.5
Tax	0.2	-0.1
PoTP	0.8	0.4
Dividends	-0.6	-0.3
EBITDA	1.1	0.5
Employees	44,770	26,151

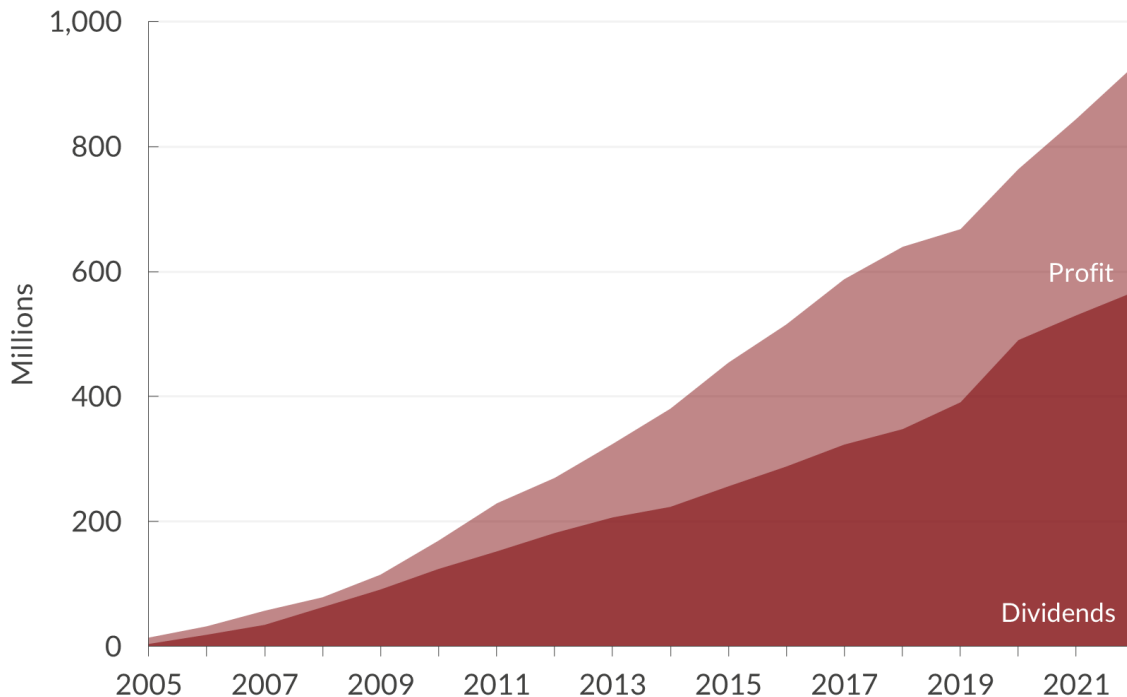
Notes: Actual number of employees. The second column excludes six companies who appear to be registered directly with the PFI project, rather than through a SPV. This column likely avoids the issue of double counting that may be prevalent when looking at all companies.

Source: Author's analysis of financial statements of all PFI providers

We find a total of £6.3 billion turnover made from PFI contracts since 2005, with pre-tax profits of around £1 billion in total, implying a profit margin of 15 per cent. We further find that around £600 million has been distributed as dividends since 2005.

To some, the fact that schools and hospitals are faced with, in many cases, high PFI costs that have a noticeable impact on their day-to-day activities (and in some instances have forced them to close), would lead them to think these profit margins and levels of dividends could be seen as remarkable. To others, these margins would seem to be broadly in line with what you would expect from a healthy UK company.

Figure 8: Pre-Tax Profits and Dividends from PFI companies, 2005 to 2022



Notes: While we have data for the 2023 and 2024 financial years, not all companies have filled their annual accounts. We therefore only use years that have a full set of financial information. As we discuss below, we also exclude six projects who signed their contract directly with the provider without the use of an SPV in order to avoid double counting.

Source: Author's analysis of all SPV annual accounts

DISCUSSION AND CONCLUSION

How do we use this report and others to judge whether PFI really was the failure many describe it to have been? To some, the fact it built £86 billion pounds worth of schools, hospitals and more means it achieved what it was designed to achieve. As John Prescott once described it, *'...not using the PPP is to deny people new hospitals, new schools and new public services ...'*. To others, the existence of rigid contracts that cost 3.3 times more than the asset they built is enough to judge the model as a failure. The question is which view do policy makers subscribe to?

For some time, a near consensus emerged both between the OBR, policy makers, the Treasury Select Committee and the Public Accounts Committees that PFI presented a fiscal risk, which

resulted in the model's retirement in 2018. However, while it appears unlikely that conventional fiscal policy can finance the additional infrastructure spending needed as part of the 'decade of national renewal', these off-balance sheet models may become attractive enough to cause a re-evaluation of this view. This temptation will be primarily driven by the desire to finance this spending with an off-balance sheet model, which was one of the advantages of the PFI model in the early 2000s when fiscal room was **considered similarly tight**.

We explore this possibility in this section, drawing on the research presented in this and other reports to arrive at a conclusion over whether and how PFI could be reintroduced. We attribute the causes of the specific failures of PFI to an overbearing political incentive which placed the short-term budgetary advantages over long-term considerations of cost, flexibility, oversight and ultimately risk. We consider whether and how a new PFI with these budgetary advantages still in place can be a success.

What went wrong

1. **Cost:** The willingness for governments to engage in PPP arrangements was partly motivated by the intended advantage that **the model would generate value-for-money through private sector innovation**. This claim, however, contrasts with the findings in this report of high repayments relative to the value of the asset PFI built, or the high proportion of PFI payments paying for interest costs (averaging 31 per cent over five years within local government). It also contrasts with previous research by the Treasury Select Committee which found that without offsetting efficiencies **PFI projects are 70 per cent more expensive than traditional procurement methods** over the lifetime of the contract. It is somewhat inconceivable that private sector efficiency can make up for a shortfall of this size, especially when considering the fact that traditional procurement already uses private sector efficiencies to construct public infrastructure.
2. **(in)Flexibility:** the rigidity of these contracts has also become a well-documented characteristic of PFI. For example, it took Liverpool City Council around ten years to **renegotiate their contract** to allow them to use the site of their closed Parklands school mentioned above for educational purposes again. There are a number of similar stories of schools and hospitals having to undertake bureaucratic tasks to perform the basic duties of running their institution, such as calling a foreign call centre to **change the heating**. Similarly, the case of the previously mentioned Parklands High School – which closed due to falling pupil numbers causing an inability to support their PFI repayments – should likely not have occurred under a contract with a sufficient set of break clauses for such potential eventualities.
3. **Insufficient Oversight:** the existence of these stories of inflexible contracts likely speaks to a weak legal and institutional framework around PFI itself. This is partly evidenced by the lack of centralised understanding of PFI, which has been much documented and criticised by successive investigations and inquiries by the select committees and the NAO. Prior to the recent release of the list of schools built and/or maintained under PFI, it took a FOI request to each local authority to obtain the first list of schools impacted by this model. This action alone speaks to a lack of oversight from central government and aligns with the description of the former chair of the Public Accounts Committee as 'institutionalised fuzzy thinking'.
4. **Insufficient Risk transfer:** PFI was justified on the grounds that it was able to shift 'risk' onto the private sector, as they would only begin receiving repayments when the project was built and operational. However, in reality, it resulted in an unfortunate combination where the material risk of overall project failure remained with the public sector, but too much financial risk was pushed on to the private sector, resulting in high costs.

Given the finding that PFI schools are larger than non-PFI schools, it may be that PFI incentivised a riskier approach of building larger projects than sustainable in order to receive sufficient per-pupil/patient funding to justify and afford a PFI contract. This created a clear risk of default should pupil/patient numbers drop below a critical level. The difference between a school or hospital functioning and being mothballed was reliant on the quality of the forecast of pupil/patient numbers when the establishment was first conceived. While the financial risk was with the private sector, the material risk of project failure remained with the public sector.

It does not need much in the way of hindsight to see that insufficient regard was given to potential unforeseen events, such as the fiscal consolidation period (which resulted in PFI repayments taking up an increasingly large proportion of effected budgets) or the 2008 financial crisis. While it would be unfair to judge PFI on the grounds of its ability to forecast a once-in-a-generation financial crisis, we can criticise it for its inability to adapt to the problems the financial crisis caused. At the very least, it appears that there was an imbalance in material risk-transfer, with a greater set of clauses included to minimise risk for the private sector at the expense of the public sector than the other way around, as contracts typically did not include sufficient clauses to allow for adjustments in use should the school or hospital fail.

Why it went wrong

While private finance will always be costlier than government debt, the expensive nature of PFI and lack of flexibility reflects some of the central drivers behind the failures of PFI, which stem from a political climate that was incentivised to overcommit to a risky and expensive funding model.

It is difficult to overstate the political benefits this model has brought to successive governments. PFI enabled the rapid expansion of infrastructure spending, delivering on key social and economic priorities without appearing on the government balance sheet. This removal of traditional financial constraints on infrastructure projects created a scenario whereby there was a virtually limitless number of PFI contracts the government could recommend. **The government could simply shift payments for traditional infrastructure off the balance sheet, even if it cost more in the long term.**

This incentive is reflected in the heavy-handed language around PFI from former ministers, such as the Health Secretary Alan Milburn who famously characterised PFI as **'the only game in town'** and it was **'PFI or bust'** in the case of limited public funds. This strong sentiment towards the model continued through to the subsequent government, with then Health Secretary Alan Johnson admitting that when building new hospitals, PFI was always *'Plan A... there was never a plan B'*.

This **'only game in town'** narrative is synonymous with the pressure central government placed on procuring authorities to sign on to PFI driven by a desire to promote off-balance sheet reporting; **PFI soon became the only choice for financing many infrastructure projects.** It is not necessarily the view of this report that all PPP models are destined to fail, rather that the failings of PFI can be explained by strong political incentives that could have blinded Whitehall to any potential fiscal risk in the model.

It appears that insufficient attention or resources were given to proper oversight or governance structures, which is reflected in the overt lack of centralised data. Much criticism has been levied at government and Whitehall over their lack of understanding around PFI, which this report shares.

The fact there was no structure in place to monitor PFI speaks to a likely attitude that placed the goal of shifting projects off-balance sheet above the effective implementation of a high-risk

funding model, which is almost certainly a major contributing factor that amplified the potential negative side-effects of PFI into a central feature.

The future of PPP models in the United Kingdom In principle, a procurement model that combines a repayment mortgage with a full repairing lease should not be impossible, especially given **this is routinely seen in the private sector**. Using this model to facilitate a transaction between the public and private sectors can, however, be inherently difficult due to **an asymmetry of knowledge, experience and objectives**. While this will always remain a challenge under any PPP model, many countries have managed to make a success of these arrangements. At the time of writing, Canada is preparing to use a PPP model to build its first high-speed/frequency rail project in the country.

We consider the underlying failures of the United Kingdom's model to be insufficient risk transfer, ineffective implementation, a lack of oversight and high cost, all likely a function of overbearing political incentives. So, the question that remains is whether this model can function in the United Kingdom without such incentives?

The ability of PFI to enable off-balance sheet spending was, at the time, due to classifications of expenditure under the European System of Accounts (ESA) which no longer apply after Brexit. The UK government can therefore make the choice to include PPP payments on the government balance sheet and remove these incentives. This was what the Treasury Select Committee concluded in their report, stating that *'PFI should be brought on balance sheet. The Treasury should remove any perverse incentives unrelated to value for money by ensuring that PFI is not used to circumvent departmental budget limits'*.

This is shared with the Office for Budget Responsibility (OBR), who in 2017 condemned the use of off-balance sheet procurement vehicles such as PFI due to the **financial risks associated with this 'fiscal illusion'**, which would have likely played a role in the retirement of the model shortly after. They estimated that if all PFI costs were included in the government's balance sheet it would total **2.3 per cent of GDP** in 2010. Based on this, and the findings presented throughout this report, it is clear that the off-balance sheet incentive is the core feature of PFI that led to schools that were too big to function, failed to deliver value for money and burdened future generations with debts with no ability to negotiate. Given the off-balance sheet incentive is at the heart of these issues, it would be difficult to justify a renewal of a PFI-like model that included this incentive.

However, from the perspective of a policymaker, this arguably takes away the central point of these arrangements in the first place. The ability to get around, what is to many, the arbitrary political constraints that are spending rules while delivering on social/growth enhancing investment projects is how previous governments have avoided falling into fiscal traps like the one the government finds itself in today. Previous fiscal rules have constrained investment, which has reduced growth today, resulting in less room to restore investment to previous levels. This 'doom loop' is what has brought many back to PFI as a way to circumvent the current fiscal trap. For this reason, a future PFI model would need to remain off-balance sheet in order for it be useful to governments.

The risks of doing so are well documented in this work and in many others. To avoid the consequences of public services struggling with repayments and local authorities spending billions every year on interest costs, we need to establish ways to minimise the political incentives that come from off-balance sheet infrastructure projects.

To do so, we can draw on the resources from international organisations like the World Bank, which detail the best frameworks and best practises for structuring PPP frameworks, which were not available when PFI was first implemented. These frameworks provide resources on how to manage and design PPP models and list many recommendations that would have likely

minimised the failures of PFI, from stating the importance of making early decisions to detailed legal resources in designing contracts and terms that spread risk and allow for sufficient flexibility. It is possible that there is now sufficient critical mass of institutional knowledge across the world of how to make these models work off balance sheet without leading to the failures of the past.

Part of this could come from how you structure secondary fiscal rules for unconventional fiscal policy. Instead of being considered wholly off balance sheet, it is possible that guardrails could be included that aim to constrain all departmental PPP spending within defined limits, or perhaps making some elements of repayments on balance sheet to avoid budgetary game playing. Either way, there will need to be some form of accountability within PFI spending, with new rules and frameworks that replicate the necessary budgetary limits policy makers face on a daily basis but within the under regulated off balance sheet market.

Creating, administering and monitoring a new PPP model under such financial and legal frameworks would test the institutional capacity of any country. This will remain the largest of many unknowns when considering a reintroduced PFI model. The United Kingdom arguably failed it's PFI experiment in the past because of its **lack of ability to design sufficiently strong legal and policy frameworks**. Whether the UK government could administer a new model with these in place would always remain an exercise in hope rather than expectation.

The core question that remains for government to answer when considering a reintroduced PFI model is whether these risks are worth it. It is argued that removing the limits from infrastructure projects can be achieved with simple adjustments to fiscal rules, such as by calculating debt using Public Sector Net Worth which allows for the benefits of spending to 'net-off' the benefits from the cost, or by simply removing investment from fiscal rules altogether. The judgment the government must make is a simple risk and reward one: whether the risks of introducing the PPP model outlined in this work are better or worse than the risks to further changes in spending rules. It is the view of this report that it would be difficult not to side with the latter

Conclusion

This report has outlined the legacy of PFI at the national and local level, uncovered the continuing impact the model has on the schools it built and estimated the margins made by the companies who own and facilitate these contracts.

We found that PFI costs are 3.3 times larger than the value of the infrastructure they built, and mostly cover schools and hospitals. To fill centralised data gaps, we read each local authority's annual accounts in the United Kingdom and sent a FOI request to every local authority in England to determine which schools were built under PFI. We found that £13.5 billion is spent by local government every five years on their PFI contracts, of which £4.2 billion (31 per cent) pays for interest costs. We uncovered 845 PFI schools, which are worse off than non-PFI schools but only marginally after controlling for key characteristics. They are, however, more likely to be in debt than non-PFI schools, suggesting the negative impact of PFI is meaningful but acute. Of the companies that own these contracts, we found that the 171 education projects can be traced back to the same eight controlling companies, often registered in Guernsey, partially confirming the concern from the NAO around the competitive nature of the procurement process and comments from the Treasury Select Committee around the offshore nature of these companies.

Based on the testimony of government bodies and politicians themselves, we conclude that the advantage of PFI payments being considered off balance sheet created an overbearing political incentive that prioritised the roll-out of PFI over effective implementation and oversight. While we do not recommend the introduction of the model with this feature still in place, there may be enough international examples and institutional capacity within government to make a success

of PFI. To do so, however, would result in substantial risk as evidenced by the failures of the past. No matter how many reforms the government introduces to make a new PFI model work, with these unknowns, avoiding these failures will always come down to an exercise in hope.

ANNEX A: Regression Design

The challenge for this paper is to compare the financial capacity of PFI schools to non-PFI schools while holding all other factors equal. This is best achieved with a ‘difference in difference’ methodology that ensures the assignment of being a PFI school is random, thereby eliminating any observed or unobserved variations in PFI and non-PFI schools that could bias our estimates. To do this, we require some form of pre and post ‘treatment’ data for each observation. However, given our setting this is clearly not possible as the ‘treatment’ is building new schools which means it will be present at the start of a school’s life⁴, meaning we cannot use such methods. By contrast, a simple OLS regression in many settings is unable to estimate the true causal effect because of the number of unobservable variables that could potentially affect the dependent variable.

In our setting, a simple regression would take the following form:

$$Y_i = \beta_0 + \beta_1 PFI_{School}_i + u_i \quad (1)$$

Where Y_i is the outcome variable (financial reserves, financial reserves relative to income, the probability of being in debt, whether the school has a poor OFSTED score, the level of staffing costs or the level of ICT costs, all measured in 2018) and PFI_{School} is a dummy that takes the value 1 for a PFI school and 0 for a non-PFI school. The standard challenge to such a basic approach is that there will be other characteristics in our unobserved error term u_i that will correlate with being a PFI school and will influence the size of financial resilience.

However, our research setting has a number of advantages that helps us utilise this simple regression model with just a few amendments. First, we have population data, i.e., every PFI and non-PFI school in England. Therefore, we do not need to worry about whether or not we have a representative sample. This means we only have to control for features that could determine being a PFI school and that could bias our estimates of funding resilience.

The second advantage of our setting is that the framework for assigning PFI projects is publicly known, meaning we can identify and control for these determinants rather than speculating what these variables could be. The assignment of a PFI project is, however, not completely random as there are a few significant variations between PFI and non-PFI schools. One example of this is the number of pupils in PFI schools, where the average capacity of PFI schools is 720, 87 per cent greater than the average for non-PFI schools. This is largely driven by the fact that PFI schools will naturally need to be of a certain size for the use of a PFI model to be viable. As PFI schools will be more likely to have a larger number of pupils, and as school funding levels are determined by the number of pupils in a school, we control for this to avoid biasing our results.

Similarly, the location of a school will highly correlate with whether it is PFI or not. Our initial investigation found a heavy concentration of PFI schools in inner-city areas. This is perhaps unsurprising for a number of reasons: first, PFI schools need to be larger than non-PFI schools, so these will likely be built in densely populated areas. The location of the school also determines financial resilience, as it is well documented that inner-city schools face additional needs and funding burdens. We extend this controlling of relative needs by controlling for the number of pupils on Free School Meals (FSM) which is standard in most school-level quantitative evaluations of this nature. Including regional controls has the secondary benefits of ruling out unobserved regional variations (such as one local authority having a higher schools budget than another) biasing our results.

⁴In some exceptional circumstances existing schools can enter a PFI contract to, for instance, renovate or expand. However, the number of schools that have done this is too small to draw causal inference.

There are also some variations in the types of schools between PFI and non-PFI schools. Academies and comprehensive schools are more likely to be PFI schools than voluntary schools. These features are important determinants of funding capacities, as academies for instance receive their funding from central government, whereas comprehensives receive their funding from their local authority. Therefore, they need to be analysed separately, thus we would need to include them as variables to control for in any regression. Lastly, we control for total income received as this will naturally influence size of funding reserves.

Our intention is to measure the effects of PFI contracts on the outcome variables listed above. Our model takes the following functional form:

$$Y_i = \beta_0 + \beta_1 PFI_{School_i} + \beta_2 Pupils_i + \beta_3 Phase_i + \beta_4 FSM_i + \beta_5 TotalIncome_i + \beta_6 Establishment_i + \beta_7 Location_i + u_i \quad (2)$$

The year the school was built remains an unobserved variable (due to a lack of data) that could bias our results. In this case, as the PFI model spurred the construction of new schools between 1992-2018, these schools will be far younger than their non-PFI counterparts. It is also reasonable to assume that the fact of being a younger school means lower running costs with newer and more state-of-the-art facilities. Without accounting for this fact, we will therefore underestimate our results of the funding pressures of PFI schools. Therefore, the interpretation of our results should be taken with this caution in mind. For the probability of being in debt and the probability of having a poor OFSTED score, we compute the marginal effects by taking the derivative of the result at the mean which produces the figures reported in this work. Finally, we normalise “reserves” variable with total income in one of our specifications to reduce any possible bias of having higher income on reserves.

All variables, other than location which uses dummy variables, are converted to logs so as to produce percentage estimates and to partially control for heteroskedasticity within the point estimate.

ANNEX B: Regression Results

Table D: OLS Cross-Sectional Regression showing the log effects of being a PFI school on a series of outcomes using a range of controls. All observations taken from 2018.

	Reserves	Reserves/Income	Debt	OFSTED	ICT Costs	Staffing Costs
PFI	-0.152** (-3.04)	-0.0188*** (-4.08)	0.144* (2.40)	0.0983 (1.53)	-0.0529** (-2.92)	-0.0408*** (-7.35)
Pupils	-0.272*** (-5.56)	-0.0139** (-3.03)	-0.0329 (-0.81)	-0.0514 (-1.18)	0.0459*** (3.37)	0.0703* (2.57)
Phase of Education	-0.0758 (-1.04)	-0.0630*** (-7.70)	1.493*** (11.86)	0.757*** (7.51)	0.304*** (11.50)	0.00324 (0.15)
FSM	-0.0178 (-1.76)	-0.00524*** (-4.99)	0.137*** (8.82)	0.365*** (19.72)	-0.0514*** (-12.48)	0.00160 (0.57)
Income	1.142*** (20.76)	0.0115* (2.25)	-0.134** (-3.16)	-0.00134 (-0.03)	0.907*** (64.02)	0.956*** (30.52)
Establishment Type	-0.146*** (-20.88)	-0.0131*** (-19.26)	-0.105*** (-8.85)	-0.0719*** (-5.53)	0.0233*** (8.02)	0.00789*** (7.37)
Location	-0.0000767* (-2.56)	-0.0000139*** (-5.00)	0.0000789 (1.65)	0.0000942 (1.92)	0.0000294* (2.45)	0.00000728 (1.90)
Constant	-2.843*** (-5.86)	0.0784 (1.77)	-0.465 (-1.22)	-2.261*** (-5.93)	-2.133*** (-17.11)	-0.0957 (-0.35)
R2	0.352	0.029		0.762	0.969	
N	16280	18544	18544	16137	18514	18538

*** $p < 0.01$; ** $p < 0.01$; * $p < 0.05$. Reference group for PFI Schools is Non-PFI schools. Shortfall data collected from School Cuts Database 2018 provided by the NEU and attributed to school characteristics taken from the official Department of Education 'Establishment Fields 2018' database. (T Statistic presented in parenthesis).