P.F.I: Profiting from inflation?

Understanding the impact of inflation on the affordability of NHS PFI contracts.

CHPI | Centre for Health and the Public Interest

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Key Facts:

£28.4 billion – the turnover of 99 NHS PFI companies between 2004 and 2021.

£1.9 billion – the pre-tax profits made by 99 NHS PFI companies from NHS Trusts between 2004 and 2021.

£1.07 billion – the dividends paid out to 99 NHS PFI companies between 2004 and 2021.

£47.6 million – the total amount paid out in Directors fees by 99 PFI companies between 2004 and 2021.

£131 million – the total amount generated by PFI companies in interest payments in 7 NHS PFI contracts between 2004 and 2022 in return for issuing high cost loans.

£470 million – the estimated increase in the costs of annual PFI payments for NHS Trusts as a result of the spike in inflation for the two years 2022-23 and 2023-24.

Introduction:

About the Private Finance Initiative

1. The Private Finance Initiative was first introduced in the UK in 1992 across a range of public services, such as schools, hospitals, roads, transport and defence.

2. The traditional way of building hospitals is for the government (or a public body) to borrow money, usually via the Public Works Loan Board, and to contract with a construction company to build the hospital. The public body then takes over the running of the hospital.

3. With a PFI contract, a public body such as an NHS hospital trust contracts with a consortium of private companies which have set up a specific company for the purposes of running the contract. This PFI company is known as a Special Purpose Vehicle (SPV). This company borrows money, contracts with a construction company to build the hospital and then usually contracts with another company to provide all the ancillary services needed by the hospital, such as cleaning, catering, portering and building maintenance, but not clinical services.

4. Individual NHS Trusts make annual payments to the PFI company over the course of a period which is sometimes as long as 40 years, with an average of 31 years for NHS PFI schemes. These annual payments, known as a 'unitary charge', are allocated by the PFI company to cover the cost of building the hospital, the cost of running the hospital and providing ancillary services, the maintenance of the

building, the interest repayments on the loans, the profit made from the contract by the PFI company, and any tax the PFI company pays on these profits.

5. In 2017 the Centre for Health and the Public Interest (CHPI) examined the accounts of the Special Purpose Vehicles and identified that £831 million had been made in the form of pre-tax profits out of the 107 PFI companies which had been set up to deliver projects to the NHS between 2010 and 2016.[1]

6. Because of the continued interest in the impact of PFI on the finances of NHS Trusts, the potential leakage of scarce NHS revenue out of the system in the form of PFI profits and dividend payments as well as the impact of steep rises in inflation on the amounts paid by NHS Trust to PFI companies we have refined and updated our previous analysis in this briefing note and augmented it with an analysis of the impact of inflation on the payments made by NHS Trusts.

The profitability of NHS PFI Schemes 2004 to 2021

7. Table 1 sets out data on the income, profits and dividends for the 99 companies (SPVs) which have been established to provide PFI contracts to NHS Trusts between 2004 and 2021.[2]

Table 1 Turnover, Profit Before Tax and Dividends for 99 NHS PFI schemes 2004 to 2021

Year	Turnover £,000	Profit Before Tax £000	Dividends Paid £000
2021	1,685,296	159,061	85,203
2020	1,540,335	184,477	114,629
2019	1,469,675	169,174	66,494
2018	1,405,216	172,483	86,396
2017	1,392,498	160,847	86,266
2016	1,359,792	197,499	98,264
2015	1,449,762	219,980	85,986
2014	1,459,259	160,383	100,131
2013	1,487,314	155,703	74,958
2012	1,467,788	103,892	61,302
2011	1,936,476	50,923	58,197
2010	2,375,380	68,251	67,141
2009	1,875,611	73,956	31,331
2008	1,965,119	9,462	21,334
2007	1,729,173	30,104	12,996
2006	1,708,911	22,167	10,099
2005	1,234,820	9,456	8,000
2004	870,303	29,567	5,030
Total	**£28,412,729**	**£1,899,340**	**£1,073,756**

[1] Centre for Health and the Public Interest 'P.F.I – Profiting from Infirmaries' 2017
[2] Compared to our 2017 study, we have refined the number of companies in this analysis to better reflect those contracts which relate to NHS Trusts. As we have previously identified, the database held by HMRC which is said contains the details of all the PFI schemes in the UK is out of date and inaccurate. In order to identify which NHS Trusts have PFI schemes or similar privately financed projects, - such as Local Improvement Finance Trust (LIFT) schemes - we reviewed the accounts of all NHS Trusts in England.

8. The shareholders in the companies analysed here are the companies which form part of the PFI consortium. These companies own shares equivalent to their initial equity stake in the projects and the dividends and profits recorded here are payable to them on the basis of their individual shareholdings.

9. These equity stakes are comparatively small given the size and value of the contracts. For example, in the case of the University College London Hospital PFI scheme the size of the current equity stake is £2.82m and to date, £199 million in dividends have been payable to the shareholders.

10. It is important to note that these data only provide an indication of the profitability of these contracts and there are a number of caveats that need to be understood.

11. First, the profits and dividends recorded here do not reflect the full amount of profit and returns made from these schemes. For example, these profits and dividends do not include the amounts generated by the service companies who deliver the facilities management service under the contract to the Trust on a day to day basis, for example, through providing cleaning, maintenance and portering services. Therefore, in addition to the profits set out here, these companies will also make a return based on the income they receive under the contract.

12. Also, this data does not capture the returns generated by the loans issued by the companies in the PFI Consortium to part finance the building of the hospitals. These loans often have interest rates of between 8% and 15% which are way in excess of the cost of borrowing which is available to the government when it raises funds to pay for investment in public infrastructure.

13. We separately analysed 10 of the most profitable schemes and identified that the interest payments made on 7 of these loans totalled £131.2 million between 2004 and 2022.[3] As a result, the total interest payments generated by the companies in the PFI consortium who have made these high cost loans are likely to amount to a very large cost to the taxpayer across the 99 NHS PFI schemes. These interest payments will continue to be made for a large part of the life of these contracts.

14. Finally, the returns set out here do not include the returns to those banks and bondholders who have provided the bulk of the finance to fund the original construction of the hospital or healthcare facility. The interest rates on these loans are not as high as on the loans issued by the companies, but still amount to a large additional cost associated with these projects.

15. The second caveat is that because of the complex financial models which underpin the financing of PFI schemes it is only possible to fully assess the profitability of these schemes when the contract term has ended. This is due to both accounting rules but also the timing of various debt repayments and payments to shareholders. Due to the lack of publicly available information about these financial models – because of issues around commercial confidentiality – it is not possible to comment

[3] These subordinate loans are often issued by the consortium as loan stock. The total value of the loan stock issued which generated this payable interest was £77 million

on whether these data, in and of themselves, provides a full account of the profitability of these schemes.

Additional costs of PFI schemes: administrative expenses and Director remuneration.

16. In the course of this analysis, we identified a number of additional costs associated with the operation of PFI schemes which require further scrutiny, and which potentially raise further questions about the value for money of these arrangements.

17. Although, the SPV's which have been set up to manage these schemes have no employees, they often fund Director remuneration out of the income received from the NHS under the contract. These Directors are often provided by the companies in the consortium which make up the SPV. Since 2004, the company accounts for the 99 SPVs that we examined record that £47.6 million has been paid out in fees for Directors.

18. In addition, since 2004 £871 million has been paid out in administrative expenses, an average of 3% of their income (turnover). It is unclear from the company accounts data what these expenses are for, although it is possible that they could include legal fees associated with legal disputes, or fees associated with managing the finances of the company. It is also not clear if the payment of Directors fees is included in these expenses.

Affordability - the impact of inflation on PFI payments on the finances of NHS Trusts.

Paying for PFI

19. In the majority of cases, the responsibility for making payments to the PFI lies with the NHS Trust. This means that the costs associated with making the Unitary Charge payments must be met out of the budgets of each NHS Trust which has a PFI contract. As a result, the financial burden is not shared across the NHS or the wider budget of the Department of Health and Social Care but is instead borne by the local healthcare economy.

20. In addition, because under these contracts Trusts are committed for upwards of 25 years, they must prioritise payments to the PFI companies above other items of expenditure, for example on staff costs or funding for other types of services. This can create financial problems, particularly when budgets are reduced in real terms, as has happened over the past decade. When Trusts are required to make efficiency savings the cost of their PFI obligations are locked in for the duration of the contract and cannot be cut.

21. Some recent estimates suggest that for some NHS Trusts, the percentage of their total budget (income/expenditure) which goes to pay for their PFI deal can be up to 13% of their total income.[4]

RPI inflation and annual PFI Unitary Charge payments

22. As is the case across the public sector and the wider economy, the impact of inflation on the NHS means that budgets will be stretched, and this also applies to those Trusts with PFI contracts whose payments increase according to a set indicator of inflation each year. This arrangement is unlike a household mortgage which does not change according to inflation and where the real value of the mortgage debt actually reduces as inflation increases.

23. The argument behind increasing the Unitary Charge payments by inflation made by the Treasury in the early 2000s was that this would enable the public sector to bear the risk of inflation and lead to a cheaper and therefore better value for money contract with the private sector. [5]

24. At the point when they signed the contracts with the PFI schemes, NHS Trusts made an assessment about the affordability of their PFI and assumed an average rate of inflation over the course of the scheme at around 2.5%. This meant that each year they expected that the Unitary Charge payment would increase by this set amount

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[4] Michael Goodier ' Some hospitals are spending more on PFI debt than they are on drugs' Newstatesman May 2022.
[5] See for example this explanation given by the Treasury in the initial development of the PFI policy "Authorities [NHS Trusts] are generally willing to assume some level of inflation risk in a PFI Contract, partly to balance the mixture of their own funding resources, and partly because passing all inflation risks to the Contractor is unlikely to be value for money." HMT Application Note – Interest Rate and Inflation Risks in PFI Contracts

(apart from in circumstances where there are changes to the contract). They also assumed that the government (in the form of the Department of Health and Social Care) would provide them with sufficient income through their local NHS budgets to cover inflationary increases.

25. Importantly when the contracts were signed, the Unitary Charge payment was linked to a measure of inflation the Retail Price Index (RPI) which is higher and widely accepted to be less accurate than the more commonly used and more reliable Consumer Price Index (CPI).

26. The RPI measure was used because it has historically been used in the financial markets.[6] In those instances where loans are linked to RPI, the money coming into the SPV through the Unitary Charge needs to also increase by RPI in order to meet the higher debt repayments. However, this form of financing for PFI schemes is relatively uncommon in the NHS – just 14 out of the 50 PFI schemes that we looked at had debt linked to RPI inflation. These 14 schemes were mainly financed by Bonds and the remainder of the debt was in the form of loans linked to the LIBOR or SONIA interest rates.[7]

27. Despite the fact that the loans to the PFI companies often do not increase by RPI the aggregate value of the Unitary charge payments that we examined broadly increased by this measure over a 6 year period.[8]

28. Over the past two years (financial years 2022/23 and 2023/24) there has been a significant spike in inflation with RPI inflation increasing from 2.1% to around 13.8% projected for this year. We wanted to understand how this spike in inflation has impacted the payments by NHS Trusts and whether they have received sufficient support from the wider NHS and the government to enable them to afford these contracts.

29. We examined the financial accounts of the Trusts with PFI contracts to understand the annual increases to their Unitary Charge payments from 2017/18 onwards. We also surveyed 100 of these Trusts to understand their PFI charge for last year (2022/23) and their projected charge for this current financial year (2023/24). We extracted usable data from this survey relating to 54 Trusts. We then estimated the difference between what their annual Unitary Charge payments were as a result of

[6] See for example this explanation from the Treasury as to why RPI was used as the chosen index in PFI schemes: "RPI remains the most commonly used index in the financial markets (e.g. for index-linked gilts) and commercial markets (e.g. for wage negotiations); accordingly it may often be easier for a Contractor to price its own cost forecasts against this index, that is to 'price off RPI', thus offering better value for money" [HMT Application Note – Interest Rate and Inflation Risks in PFI Contracts](#).

[7] We examined the financing arrangements for the PFI contracts associated with 50 Trusts and found that 14 of them had debts, mainly Bonds, which were linked to RPI inflation.

[8] We recognise that all PFI contracts are different and in some cases not all of the annual Unitary Charge payment will be linked to RPI. Also, annual Unitary Charge payments can go up or down each year depending on contractual changes. Due to a lack of publicly available information regarding these contracts it is not possible to view the financial models behind each of these contracts which would enable us to understand this in more detail. Our analysis of the 54 NHS Trusts in our study shows that the average percentage increase in Unitary Charge payments across a 6 year period were as follows; 2018/19 (3.6%); 2019/20 (3.2%); 2020/21(1.8%); 2021/22 (1.8%); 2022/23 (8.3%); 2023/24 (12.8%). These trends broadly track RPI inflation we assume that any differences can be attributed to either different parts of the Unitary Charge being index linked or contractual changes which may have occurred.

the recent large spike in inflation and what they would have been had inflation been at 3%.[9]

30. Table 2 shows that these 54 Trusts collectively faced an affordability gap of £264 million over the current and previous financial years – that is they have been required to find this additional amount over and above what they had expected to pay for their PFI contracts had RPI been 3%. If these same metrics were applied to the Unitary Charges of all the NHS Trusts with PFI schemes the total shortfall would be £470.3 million over a two year period.[10]

Table 2: Estimated Affordability Gap for PFI for the past 2 years due to rises in RPI inflation for 54 NHS Trusts.

Total estimated Unitary Charge payments in 2022/23 if RPI inflation had been 3%	£1,389,161,773
Difference between actual 2022/23 Unitary Charge payments and if RPI inflation had been 3%	£71,357,567
Total estimated Unitary Charge payments in 2023/24 if RPI inflation had been 3%	£1,430,836,626
Difference between actual 2023/24 Unitary Charge payments and if inflation had been 3%	£192,834,302
Total "affordability gap" over 2 years (in cash terms)	**£264,191,869**

31. In the event that this affordability gap is not funded by the government this means that money to meet these additional contractual payments has to be taken out of other parts of the Trusts budget or cause them to go into deficit.

32. Our survey also asked whether the Department for Health and Social Care or the wider NHS had provided these Trusts with additional funding to meet these costs and almost all of them said that no additional funding had been made available.

33. For some Trusts, with smaller PFI schemes these additional costs are likely to be manageable. However, for Trusts with larger PFI schemes, the inflationary impact of PFI has had a significant impact on their finances. For example, Barts Healthcare Trust in London which has the largest NHS PFI scheme in the UK has seen its PFI payments increase from £120 million in financial year 2019/2020 to £150 million in 2023/24.

34. University College Hospital in London which has seen its Unitary Charge payments increase by £16 million over the past 2 years reported in its most recent annual report that:[11]

[9] We have chosen 3% mainly for illustrative purposes as this was close to the average RPI increase across the 5 years prior to 2022/23.
[10] The total Unitary Charge Payments made by NHS Trusts in 2021/22 according to the Trusts Consolidated Accounts was £2.268 billion.
[11] University College London Hospitals Annual Report 2022/23

"As in 2022/23, exceptional inflationary pressures, particularly in the energy markets and in relation to our PFI costs, continue to present significant financial risk into 2023/24.

In addition to this, our PFI costs, including interest payments of £40m each year, continue to rise in line with the retail price index each year, currently running at over 13.5% which is well in excess of the inflation that UCLH is funded for despite some additional inflation funding being provided."

35. In general, it is clear that the index linking of Unitary Charge payments to RPI is impacting the ability of some Trusts to balance their books and to provide healthcare services to their local communities.

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36. In the event that the PFI companies' income increases thanks to inflation-linked increases in the Unitary Charge, while their costs increase at a rate less than this, they are likely to make additional profits.

37. Whilst the linking of Unitary Charge payments to RPI may have some justification in relation to the financial dimension of these projects, it is not clear that payments to the PFI contractors which provide cleaning, maintenance and other services should also increase by RPI inflation, since it is unlikely that their costs, which are often largely labour costs, will increase in the same way.

38. Whilst we have not found any evidence that any form of profiteering has occurred, given the very significant impact that inflation has had on the finances of the NHS policy makers should consider whether the increased amounts going into the PFI companies as a result of these contractually mandated inflationary increases are permitting PFI companies to make additional profits on top of those we have already identified, and if so whether they are justified.