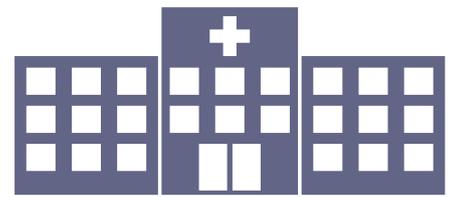
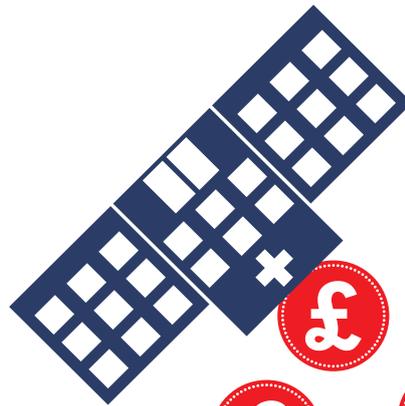
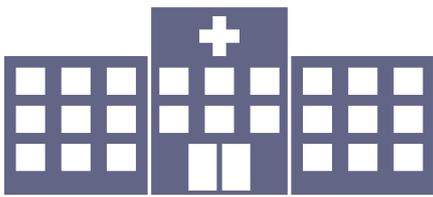


# P.F.I.

## Profiting From Infirmaries



**The Centre for Health and the Public Interest (CHPI) is an independent think tank committed to health and social care policies based on accountability and the public interest.**

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This report has been written by the CHPI research team.

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# Contents

.....	
<b>Executive Summary</b>	<b>4</b>
.....	
<b>Key facts</b>	<b>7</b>
.....	
<b>Introduction – About the Private Finance Initiative</b>	<b>8</b>
.....	
<b>SECTION 1: The total amount of profit across the Department of Health’s PFI schemes as a whole.</b>	<b>10</b>
.....	
<b>SECTION 2: The amount of NHS expenditure on PFI projects which went to pre-tax profit between 2010 and 2015.</b>	<b>11</b>
.....	
<b>SECTION 3: Who do the profits go to?</b>	<b>15</b>
.....	
<b>SECTION 4: PFI profits and the current under-funding of the NHS.</b>	<b>17</b>
.....	
<b>Conclusion and recommendations</b>	<b>19</b>
.....	
<b>Annex 1: Note on methodology</b>	<b>21</b>
.....	
<b>References</b>	<b>23</b>

# Executive Summary

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1. This report looks at how much profit has been generated by the private companies owning and operating NHS hospitals and other facilities under the Private Finance Initiative over the past 6 years, and the impact of this on NHS finances at a time of severe funding shortfalls.<sup>i</sup> It identifies for the first time the amount of taxpayers' money which has been transferred to the profits of PFI companies.
2. It is based on a study of the official Treasury database on PFI schemes and the accounts of PFI companies which are held by Companies House. It finds the following:

## ***Total value and cost of PFI to the NHS***

- Over the past 6 years (between 2010 and 2015) the NHS and local authorities in England have spent a total of **£10.7bn** on hospitals and other healthcare facilities built under the Private Finance Initiative.<sup>ii</sup>
- There are currently 125 PFI contracts with private companies overseen by the Department of Health. The capital value of the assets which have been built is **£12.4bn**. However, over the course of the life of the contracts, the NHS will pay in the region of **£80.8bn** to PFI companies for the use of these assets.
- Just **8** companies have equity stakes in **115 or 92%** of the 125 Department of Health PFI schemes. This raises concerns over how competitive any future rounds of PFI tendering can be, and over the potential for the abuse of market power resulting from existing contracts.

## ***The amount of taxpayer funds which have left the NHS in the form of profit***

- The PFI companies which hold the NHS hospital contracts have made **£831m** in pre-tax profit over the past 6 years.<sup>iii</sup> This profit is in addition to the profits made by the banks on the loans they have made for the building work, by the construction companies which built the hospitals, and by the companies which provide maintenance and other services for the hospital buildings. The PFI companies whose profits are the subject of

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i The Private Finance Initiative is a scheme whereby private companies borrow money from banks and shareholders to build NHS hospitals and facilities. The NHS pays an annual charge to the PFI companies partly for use and maintenance of the hospitals but also to pay back the money, and interest, the private companies have borrowed. The contracts with the PFI companies can last for up to 40 years. This means that the NHS is legally committed to paying an annual charge to the private companies running these hospitals for the foreseeable future.

ii The 6 years from 2010/11 to 2015/16 but note that the unitary charge for 2015/16 is an estimate.

iii For 107 of the 125 PFI schemes where financial information was accessible.

this report employ only a handful of people whose main role is to receive and allocate the income from the NHS paid by the hospital trusts.

- This means that around **8%** of all the money which the NHS has paid to these companies over the course of these 6 years has left the NHS in the form of pre-tax profit and is not available for patient care.
- These contracts generated **£480m** of dividends which were paid out to those who had invested in the companies, equivalent to almost **5%** of all the money the NHS has paid.
- The returns expected by those investing in and lending to PFI projects are also far higher than they would get if they invested elsewhere, even though they are very low-risk, because the government guarantees that the payments will be made so long as the hospital is available for use and the services meet the standard set out in the contract.
- In some instances the amount of NHS funding for PFI hospitals which goes to pre-tax profit is much greater than **8%**. In **13** contracts it was **over 20%**. The PFI company which runs University College Hospital London (UCLH) generated **£139.7m** in pre-tax profit over the course of 2010 – 2015, **31%** of all the money paid to it by the NHS Trust. In total between 2005 (when the scheme first became operational) and 2015 the NHS Trust has paid the PFI company running the UCLH **£724.8m**, out of which the company has made pre-tax profits of **£190.4m** and post-tax profits of **£150.1m**. The total capital value of the hospital according to the Treasury is **£292m**.<sup>iv</sup>

### ***The impact of this on NHS finances and the overall funding shortfall***

- The cumulative deficit of all NHS hospitals over the period covered by this study was **£3.4 billion**.<sup>1</sup> The impact of this underfunding would have been reduced by **just under a quarter** if the **£831m** in pre-tax profits made by PFI companies had instead gone to fund patient care.
- The government has increased the amount to be given to the Department of Health by **£4.5bn** in real terms between 2015 and 2020/21. If the PFI companies continue to accrue profit at the same rate as in 2015 – (i.e. at an average of 9.4%) they will earn around **£973m in real pre-tax profit**.
- This will mean that the equivalent of **22%** of the new money for the NHS will be potentially paid to private companies in the form of pre-tax profit – almost £1bn that would otherwise be available for patient care over the next 5 years.

iv The SPV provides other facilities services for the hospital trust in addition to constructing and maintaining the PFI hospital so in this case the unitary charge figure has not been used. The funds paid by the NHS includes turnover from the provision of services and the financial asset interest receivable which combined are greater than the unitary charge figure. It is unclear whether the capital value provided by the Treasury includes capital enhancements and further building work carried out since the financial close of the contract in 2000. Any further work will likely increase the capital value.

## Recommendations

3. In order to ensure that the best use is made of scarce public funds to care for patients at a time of extreme austerity the NHS and the government should look at ways to curtail excessive profit-making from PFI contracts. The following strategies are available:
  - Use public sector loans to buy out PFI contracts (11 PFI contracts have been bought out since the 1990s, including two NHS hospitals)
  - tax PFI companies to recoup some of the excess profits which have been made;
  - cap the amount of profit which can be made by a private company which has an exclusive public sector contract with the NHS;
  - ensure that when PFI companies sell equity stakes in their contracts the profits made from the sale are shared with the NHS party to the contract;
  - mandate greater transparency of equity sales to prevent the unnoticed consolidation of market power by a few investors, with the potential to reduce competition at the expense of taxpayers in future; and
  - re-negotiate the contracts with the PFI companies to reduce the amount that the NHS pays.
  
4. Finally, as we have noted in a previous report, the government should reconsider its use of the Private Finance Initiative and consider using public borrowing to fund new capital investment in hospitals.<sup>2</sup> This is likely to be much cheaper and will mean that less money for patient care will be wasted in payments to shareholders, which is particularly important when the NHS is going through the most austere decade in its history.

## Key facts

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- **£12.4bn** - the estimated capital value of the hospitals and other healthcare facilities which have been built using PFI.
- **8** - the number of companies which have equity stakes in **92%** of all the PFI deals in the NHS.
- **£80.8bn** – the amount the NHS will pay to PFI companies over the course of the life of these contracts.
- **£10.7bn** – the amount of taxpayers’ money which has been spent in the last six years for which data are available (2010 to 2015) on hospitals and other healthcare facilities built under the Private Finance Initiative.
- **£831m** - the amount in pre-tax profit which the PFI companies have made over the past 6 years and which has not been available for patient care.
- **£973m** - the estimated additional amount which would be available for patient care over the next 5 years if the NHS did not pay profits to PFI companies
- **One quarter** – the amount by which the total NHS hospital deficit would have been reduced over the past 6 years if these profits had not been paid by the NHS

# Introduction – About the Private Finance Initiative

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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.<sup>v</sup>
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 private company set up for the purpose 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. The NHS makes 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 the current 125 health PFI projects. 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. The NHS Trust only starts paying for the hospital once it is built and can be used to treat patients - in effect it is paying the private company for the use of the hospital for the duration of the contract, similar to a rental agreement.
6. According to the Treasury's database there are currently 125 PFI contracts with private companies overseen by the Department of Health, and the value of the assets which have been built is £12.4bn. Over the course of the life of these contracts, the NHS will pay in the region of £80.8bn to the PFI companies concerned.<sup>3 vi</sup>
7. Private Finance Initiative contracts have been criticised for a number of reasons. The first is that using the Private Finance Initiative is much more expensive than the traditional method using public borrowing. Typically a PFI deal will raise 90% of the money to build a hospital in loans from banks and

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v One of the very first PFI schemes to open was the Skye Bridge in 1995 which was first commissioned in 1992

vi The Treasury figure is nominal, not discounted, and will include the cost of services provided as well as repayments of borrowings to fund construction.

other financial institutions and 10% in the form of shares or equity owned by private companies.<sup>4</sup>

8. Both the banks and the shareholders expect a significant return on their investment. But research has demonstrated that the returns expected by those investing in and lending to PFI projects are far higher than they would get if they invested elsewhere.<sup>5</sup> In 2011 the Treasury Committee found that the cost of financing a PFI scheme through loans and equity stakes was double the cost of government borrowing.<sup>vii</sup>
9. It has also been argued, second, that these high rewards are not justified, as once building has finished PFI projects are not risky investments - the government guarantees that the taxpayer will always make the payments to the PFI company unless the hospital is not available for use or the service falls below the standard set out in the contract, in which case a penalty can be issued.
10. However the National Audit Office has found that such penalties are rarely issued.<sup>6</sup> Even when a penalty is levied, it is the maintenance or other contractor carrying out the work who is fined; the PFI company is generally financially unaffected. As a result the income and profits of PFI companies are almost fully guaranteed for the duration of the contract, a point which is reiterated yearly in many PFI companies' financial accounts.<sup>viii</sup>
11. A third concern about PFI relates to the impact these high costs have on the NHS Trust which has contracted with the PFI company. For a hospital trust such as Barts Health NHS Trust in London the costs of paying the £145m a year for its two PFI schemes have become unsustainable; in the last financial year the government has had to loan the Trust £115m to enable it to keep making its revenue payments.<sup>7</sup> Because the Trust is legally obliged to make the payments to the PFI company it must prioritise these payments before all other commitments.
12. The aim of this report is to:
  - determine the total amount of pre- and post-tax profit which has been generated by the Department of Health's PFI deals over the course of the last 6 years for which data are available (2010 - 2015),
  - examine how much of the NHS funding for PFI projects has gone out of the health service in the form of pre-tax and post-tax profit,
  - identify schemes where the rate of profit is particularly high,
  - and examine the implications of PFI profits for NHS finances.
13. It concludes with recommendations on how to address the impact of PFI on the NHS. A note on the methodology used is set out in Annex 1.

vii In 2011 the Treasury Committee found that "The cost of capital for a typical PFI project is currently over 8%—double the long term government gilt rate of approximately 4%" (House of Commons Treasury Committee Private Finance Initiative Seventeenth Report of Session 2010–12 <https://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/1146.pdf>)

viii Services provided by the companies involved in PFI contracts are to different extents negotiable over the contract period. A review of the costs of services provided will often happen every 5-7 years but concerns have been raised over how rigorous and effective these reviews are.

## SECTION 1: The total amount of profit across the Department of Health's PFI schemes as a whole.

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14. The PFI companies which run PFI schemes are required to submit annual accounts to Companies House. These accounts allow us to identify the amount of income generated by each company from the contracts they hold with the NHS, the amount of this which goes to paying off the debts and loans which have been used to build the hospitals, and the percentage of this which was declared by the company as pre-tax profits or losses, as well as the amount of tax paid.
15. We looked at the pre-tax profit aggregated across all the 107 PFI contracts for which the full data was available. This allows us to establish the profitability of the health sector's 'PFI business' as a whole.
16. From 2010 to 2015 these 107 PFI contracts made a pre-tax profit of £831m. This translated into a post-tax profit of £680m. This profit is in addition to the profits made by the banks on the loans they have made for the building work, by the construction companies which built the hospitals, and by the companies which provide maintenance and other services for the hospital buildings. The PFI companies whose profits are the subject of this report employ only a handful of people whose main role is to receive and allocate the income from the NHS paid by the hospital trusts.
17. However the profits cited above understate the scale of the profitability of these schemes because these figures are reported net of losses. Losses have been made by some PFI companies over these years, primarily due to financial instruments taken out initially to protect against interest rate changes affecting their loan repayments. These losses are not expected to be persistent and will not affect the overall profitability of a PFI contract over its lifetime. So it is reasonable also to look at the gross profits made, disregarding these losses.
18. Without taking losses into account, from 2010 to 2015 the 107 PFI contracts made total pre-tax profits of £971m, which translated into post-tax profits of £810m.
19. The next section examines the proportion of the money that the NHS has paid to these PFI companies over the past 6 years which has left the health service in the form of profit.

## SECTION 2: The amount of NHS expenditure on PFI projects which went to pre-tax profit between 2010 and 2015.

20. In order to understand how much of the NHS budget which was allocated to hospitals went to pre-tax profits rather than patient care we needed to calculate the total amount which the NHS had paid to PFI companies. In this case NHS expenditure is calculated as the 'unitary charge' payments which the NHS has made to PFI companies between 2010 and 2016. These payments cover the cost of services provided with the PFI building and repayment of the money borrowed, with interest, for the hospital's construction. As such it represents the whole life cost of the asset and captures nearly all the income earned by the PFI companies over this time period.<sup>ix</sup>
21. As Table A shows, the £831m which left the NHS in the form of pre-tax profit (net of losses) between 2010 to 2015 in the 107 schemes we analysed is 8% of the money paid by the NHS to PFI companies. This is the size of the 'leakage' to profits after some of the funds received from the NHS had been used to make repayments on the loans the PFI companies had taken out in order to construct the building.<sup>x</sup>

**Table A: Percentage of NHS payments 2010 – 2015 which goes to pre-tax profit**

Year	2010	2011	2012	2013	2014	2015	Total
<b>NHS payments</b>	£1.4bn	£1.6bn	£1.7bn	£1.8bn	£1.9bn	£1.9bn	<b>£10.5bn</b>
<b>Pre-Tax Profit</b>	£68m	£75m	£130m	£161m	£215m	£183m	<b>£831m</b>
<b>%</b>	4.8%	4.6%	7.4%	8.9%	11.3%	9.4%	<b>7.9%</b>

22. As Table B shows, in 13 contracts more than 20% of the payments made by the NHS over the six-year period went to pre-tax profit. For some NHS PFI contracts, the share of pre-tax profit was over 30%. The contract for the PFI scheme at University College Hospital London is especially concerning: our analysis shows that between 2010 and 2015 31% of the payments by the trust to the PFI company went towards pre-tax profits.

ix The total income (typically Turnover + Interest Receivable) in the SPV's accounts will differ from the unitary charge payments and some of the reasons for this are explained in the annex.

x Because not all the profit and loss data was available from the Treasury data set for all of the Department of Health's PFI schemes we had to estimate the amount of NHS payments to these companies which would go out of the NHS in the form of pre-tax profit. For the 18 schemes where there was no profit and loss data, the HMT data set shows that the NHS paid the PFI companies **£259m** between 2010 - 2015. Assuming that the percentage of NHS funding that went to pre-tax profit was the same as the average for each of the six years this would total a pre-tax profit of **£20m**. In effect, this analysis demonstrates that we could estimate that around **£851m** of NHS spending in these years had no direct benefits to patients receiving care.

**Table B: NHS PFI schemes where over 20 % of NHS payments went to pre-tax profits \***

Procuring Authority	Project Name	Total NHS payments 2010–2015 £m	Total pre-tax profit 2010–2015 £m	% of NHS payments to pre-tax profit	Company (% equity stake)
Peterborough and Stamford Hospitals NHS Foundation Trust	Acute Hospital services	£212m	£80m	38%	Peterborough Hospital Investments Ltd [InfraRed Capital Partners] (49%); JILF Holdings Ltd [John Laing] (30%); Macquarie Peterborough Hospital Investments Ltd [InfraRed Capital Partners] (21%)
County Durham and Darlington NHS Foundation Trust	University Hospital of North Durham – Dryburn District Hospital	£122m	£46m	38%	Balfour Beatty (50%); Barclays Infrastructure Funds (50%)
University College London Hospitals NHS Foundation Trust	University College Hospital	£448m <sup>xi</sup>	£140m	31%	Credit Suisse (43.3%); Semperian (40%); Interserve Plc (8.3%); Dalmore Capital (8.3%)
Buckinghamshire Healthcare NHS Trust	Wycombe & Amersham	£96m	£29m	30%	Innisfree (100%)
Portsmouth	Provision of New Residential Respite Care and Day Care Facilities in Portsmouth and Associated Services	£4.7m	£1.4m	29%	Interserve Plc (100%)
North Staffordshire Combined Healthcare NHS Trust	Reprovision of mental health facilities	£30m	£8m	27%	Semperian (100%)
Gloucestershire Hospitals NHS Foundation Trust	Partial site redevelopment	£28m	£8m	27%	Gloucester Healthcare Partnership Limited [Semperian] (100%)
Oxleas NHS Foundation Trust	Joint procurement to reprovide mental health services	£16m	£4m	26%	RBIL Limited [Semperian] (100%)
Leeds Teaching Hospitals NHS Trust	Wharfedale Hospital	£12m	£3m	26%	BAM PFI Investments (75%); Foresight Group (25%)
Kirklees	5 new Primary Care Centres	£14m	£3m	22%	Semperian (100%)
North East London NHS Foundation Trust	Goodmayes Hospital	£15m	£3m	22%	Semperian (100%)
Hull and East Yorkshire Hospitals NHS Trust	Maternity and acute development - Hull Royal Infirmary	£18m	£4m	21%	Semperian (100%)
Cornwall Partnership NHS Foundation Trust	Bodmin Hospital	£19m	£4m	21%	Barclays Infrastructure Fund (100%)

(Source: Treasury PFI Database, Companies House accounts)

\*NB percentages will not exactly tie due to rounding of NHS payments and pre-tax profit figures.

23. Interestingly, 8 of these 13 contracts reached financial closure in 1997-2000, which makes them some of the earliest hospital PFI contracts entered into by the NHS. One explanation of why the profit levels are so high in these cases is that potential investors in the early PFI schemes considered them to be risky, because relatively few hospitals had been built in this way, leading them to seek a higher return.

xi As stated in the methodology 'Total NHS payments' is calculated as the unitary charge which captures almost all the NHS income earned by the PFI operator in most cases. However for UCLH the SPV provides other facilities management and so the 'Total NHS payments' figure is calculated as the sum of turnover from the provision of services and the financial asset interest receivable which combined are greater than the unitary charge figure provided in the HMT data.

24. However, as the PFI market became more mature and investors became aware that these types of contracts were less risky than previously thought, the risk premium will have tended to fall, so that in the later PFI schemes the returns required by the PFI companies will also have reduced.
25. Because of the exceptionally high rates of pre-tax profits declared by the company which runs the University College London Hospital scheme we looked at all the company's published accounts back to when the hospital first became operational in 2005. As Table C shows, between 2005 and 2015 UCLH NHS Foundation Trust has paid the company a total of £724.8m, out of which the company has made pre-tax profits of £190.4m and post-tax profits of £150.1m. This alone is enough profit to build an additional hospital given £150m is more than the individual capital cost of 102 of the 125 PFI building projects. The total capital value of the hospital, according to the Treasury, is £292m.<sup>xii</sup> Over the future of the contract UCLH will pay the PFI company a total of £1.95bn, which means that there will be a significant opportunity for the generation of future profits.<sup>xiii</sup>

**Table C: University College Hospital London PFI Scheme – Profit Loss Accounts 2005 – 2015**

Year	Total NHS payments (£m)	Pre-tax profit	Post tax Profit	Tax Charge	Pre-tax profit as % of Total NHS payments
2005	£46.7m	£2.17m	£2.17m	Nil	4.6%
2006	£50.6m	£9.14m	£9.14m	Nil	18.1%
2007	£55.9m	£11.25m	£11.25m	Nil	20.1%
2008	£60.3m	£11.92m	£11.92m	Nil	19.8%
2009	£62.9m	£16.33m	£11.25m	£5.08m	26.0%
2010	£62.5m	£19.05m	£13.56m	£5.48m	30.5%
2011	£64.8m	£19.82m	£15.01m	£4.81m	30.6%
2012	£68.7m	£22.03m	£15.06m	£6.97m	32.1%
2013	£79.9m	£25.74m	£19.03m	£6.71m	32.2%
2014	£82.2m	£26.40m	£20.28m	£6.12m	32.1%
2015	£90.3m	£26.55m	£21.42m	£5.13m	29.4%
<b>Total</b>	<b>£724.8m</b>	<b>£190.4m</b>	<b>£150.1m</b>	<b>£40.3m</b>	<b>26.3%</b>

xii The SPV provides other facilities services for the hospital trust in addition to constructing and maintaining the PFI hospital so in this case the unitary charge figure has not been used. The funds paid by the NHS includes turnover from the provision of services and the financial asset interest receivable which combined are greater than the unitary charge figure. It is unclear whether the capital value provided by the Treasury includes capital enhancements and further building work carried out since the financial close of the contract in 2000. Any further work will likely increase the capital value.

xiii The HMT figure is nominal, not discounted, and will include the cost of services provided as well as repayments of borrowings to fund construction.

- 26. In fact, as can be seen in both Table A and Table C above, there is a trend towards increasing profitability over time in PFI contracts. This is expected, as the profitability of PFI contracts tends to follow a pattern of very low, or even negative, profits in the early years, but gradually increasing to reach very high levels in the final years of the contract.
- 27. This is because the debts incurred to construct the buildings are front-loaded and so are paid off early on in the contract. So in later years the unitary charge payment from the NHS is mostly profit after operational expenses are taken out.
- 28. Figure 1 shows a generic cash flow profile for a typical PFI project. This demonstrates that an increase in profits (red bars represent dividends) is expected after debt (pale and dark blue bars) is paid off early on in the project.

**Figure 1: Cash flow allocation for a generic PFI scheme with equity draw down (£000).<sup>8</sup>**



Source: Mark Hellowell, 2012

## SECTION 3: Who do the profits go to?

29. What is striking when looking at the official Treasury PFI database is how few companies are equity owners of the Special Purpose Vehicles which have been established to run individual PFI schemes. As Table D shows, according to the Treasury Database just 8 companies appear to have stakes in 115 or 92% of the 125 Department of Health PFI schemes.<sup>xiv</sup>

**Table D: Companies with major stakes in the NHS PFI business**

Company/Group	No. of equity stakes in PFI SPVs
Semperian	24
Innisfree	19
Barclays	16
HICL	16
InfraRed Capital Partners	13
John Laing	10
Aberdeen Asset Management	9
Interserve	8
<b>Total</b>	<b>115</b>

30. Moreover many of these companies have joint equity stakes across multiple PFI schemes. This raises the questions of how competitive the market is for PFI. Competition is meant to ensure that good value-for-money bids are made and is one of the purported advantages of choosing PFI procurement over public sector procurement.
31. However, evidence from the NAO showed that in 33% of PFI projects examined between 2004-2006 there were only two viable bidders, mostly due to other bidders pulling out, or to lack of interest.<sup>9</sup> This limits the potential gains from private sector competition, and leaves the tendering process vulnerable if one of the two bidders pulls out and prevents there being another bid's role as a benchmark of value for money.
32. With a new round of PFI likely to take place in the form of PF2, there is a risk that bids from different consortia of companies may appear to be in competition with one another but in fact won't be, due to the joint financial interest that binds many of the companies together in existing PFI companies. This is partly mitigated by the fact that the current owners of the SPVs ('secondary equity') often differ from the companies that initially bid for the contracts ('primary equity'). More research is needed into the impact on the competitiveness of the market during the tendering stage.

<sup>xiv</sup> Details of ownership were ascertained using Treasury PFI equity holders data, Companies House filings, infrastructure fund prospectuses, company websites, and stock exchange regulatory notices. However numerous equity stakes sales have taken place and not all are reported publicly so this information may not be up to date.

33. In addition, the consolidation of ownership within the PFI market could lead to a small number of players wielding excessive market power over smaller public sector authorities which are tendering for and managing PFI contracts, with the potential for these companies to dictate commercial and contractual terms.
34. Further, it was difficult to identify from the information filed with Companies House the full extent of equity ownership across all the PFI contracts that we examined. This is problematic because a lack of visibility over equity ownership hinders the ability of public authorities to prevent abuse of market power and collusive behaviour emerging in existing and new PFI contracts. This would negatively impact the value for money of PFI projects.

## SECTION 4: PFI profits and the current underfunding of the NHS.

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35. The NHS is currently experiencing one of the most severe shortages in funding since its creation, due to the government's decision to limit the increase in the amount given to the NHS each year. When the NHS is underfunded it is required eventually to either cut treatments to patients or reduce the amount spent of doctors and nurses, or both. In the short run, NHS organisations run up deficits.
36. The cumulative deficit for NHS hospitals over the period covered by this study was £3.4 billion.<sup>1</sup> If £831m had not left the NHS in the form of the pre-tax profits of PFI companies over this period, the impact of this underfunding would have been reduced by almost a quarter.
37. The government maintains that they have given the Department of Health an additional £10bn between 2015 and 2020-21 to address the NHS spending shortfall; the Nuffield Trust and other health think tanks agree, however, that this actually amounts to a £4.5bn real terms increase.<sup>10</sup> Using the data from the analysis set out above we have calculated the amount which the NHS will pay the PFI companies over the same five years to 2020-21 and the amount of this which is likely to leave the NHS in the form of pre-tax profit.
38. Because the annual payments from the NHS are set out in the contracts the future income streams for the PFI companies are exceptionally predictable, and these are also set out in the Treasury database. Over the course of the next 5 years – i.e. 2016/17 to 2020/21 – the Treasury estimates that the NHS will pay £10.4bn (in real terms) to PFI companies for the use of PFI hospitals.<sup>xv</sup>
39. If the PFI companies continue to accrue profit as a percentage of the unitary charge paid at the same rate as in 2015, i.e. at 9.4%, they will earn around £973m in real terms pre-tax profit over the next 5 years. This means that the equivalent of 22% of the £4.5bn given by the government to the Department of Health will be paid to private companies in the form of pre-tax profit. Or put another way, almost an additional £1 billion would be available for patient care if the NHS was not required to pay pre-tax profits to PFI companies.
40. However, the profitability of PFI companies is expected to grow over time, as explained in Section 2. As a result it is necessary to estimate the amount of NHS funds which might go to the PFI companies in the form of pre-tax profit if we assume that their profit margins continue to grow as they have done over the past 5 years.

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xv Based on estimated unitary charges for all 125 PFI schemes.

41. We examined how much might be lost to patient care if the average profit rate over this period increased to 12% and further to 16%. As can be seen in Table E, if the upward trend in profitability across the NHS PFI business as a whole continues, an increasing amount of NHS spending will leak out of the system, away from patient care towards pre-tax profits.<sup>xvi</sup>

**Table E Percentage of future NHS payments to PFI companies in pre-tax profits**

£m (15/16 prices)	2016–17	2017–18	2018–19	2019–20	2020–21	Total
NHS payments to PFI companies	£2.02bn	£2.06bn	£2.08bn	£2.09bn	£2.10bn	<b>£10.35bn</b>
9.4% of NHS payments to pre-tax profit	£190m	£194m	£195m	£196m	£198m	<b>£973m</b>
12% of NHS payments to pre-tax profit	£243m	£247m	£249m	£251m	£252m	<b>£1.24bn</b>
16% of NHS payments to pre-tax profit	£324m	£329m	£332m	£334m	£336m	<b>£1.66bn</b>

<sup>xvi</sup> All figures given in real terms (2015/16 prices) and based on estimated unitary charges for all 125 PFI schemes.

## Conclusion and recommendations

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42. The data presented here shows that the profits generated by PFI companies are in many instances over and above those that could be made in other parts of economy. This suggests that they are being generated as a result of the highly favourable contracts which the PFI companies have struck with NHS trusts.
43. There is a legitimate debate about how much, if any, profit should be generated through contracts to deliver publicly funded healthcare. The current Chief Executive of the NHS finance regulator NHS Improvement has described the profitability of some NHS PFI hospital deals as ‘absolutely ridiculous’.<sup>11</sup> But what is unarguable is that the current state of NHS finances requires consideration of whether PFI companies should continue to make such large profits from NHS hospitals and other facilities.
44. Some of the options available to government have been considered before. For example the former Conservative Minister for the Cabinet Office, Francis Maude MP, considered the introduction of a one-off tax on PFI to recoup what he described as the ‘ghastly’ profits which had been made, but he never followed through on the initiative.<sup>12</sup>
45. In one PFI scheme, Northumbria Healthcare NHS Foundation Trust, the NHS succeeded in buying out a PFI contract after it was lent £114m by the local council, saving it an estimated £3.5m a year on the PFI contract for the Hexham General Hospital.<sup>13</sup>
46. In the light of the evidence presented in this report we recommend that the government re-visit the following options as a matter of urgency.
  - Use public sector loans to buy out PFI contracts ( so far eleven PFI contracts have been bought out since the 1990s, including two NHS hospitals);<sup>14</sup>
  - tax PFI companies to recoup some of the excess profits which have been made;
  - cap the amount of profit which can be made by any private company which has an exclusive public sector contract with the NHS;
  - share with the NHS trust concerned the profits made from sales of equity stakes in PFI contracts;
  - mandate greater transparency of equity sales to prevent the unnoticed consolidation of market power by a few investors; and
  - re-negotiate the existing contracts to reduce the amount that the NHS pays.

47. As we have noted in a previous report the government should reconsider its use of the private finance initiative and consider using public borrowing to fund new capital investment in hospitals.<sup>2</sup> This is likely to be much cheaper and will mean that less money for patient care will be wasted in payments to shareholders, which is particularly important when the NHS is in the most austere decade in its history.
48. Finally, it should be noted that PFI is not a party-political issue. All three major parties have extended the use of PFI in the NHS whilst in government. The challenge now is to move on from political point-scoring in this policy area and to find a sustainable way of funding the building and maintenance of NHS hospitals and other healthcare facilities.

# Annex 1: Note on methodology

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## *Why Pre-tax profit?*

1. We used the measure of ‘pre-tax profit’ because even where the PFI companies’ profits are taxed we want to know how much ‘leaks’ from the NHS – i.e. the receipts from taxes on these profits may go to fund other aspects of public services such as defence or transport, and not the NHS. Pre-tax profit is also a standard measure of profitability, as post- tax profit is affected by various adjustments.
2. In order to calculate the amount of pre-tax profit made by PFI companies in the NHS we looked at two sources. The first was the Treasury database of all PFI contracts held by the government. This lists the capital value of all Department of Health PFI projects (i.e. the total funding requirement for all projects at their dates of financial close), the yearly payments to the PFI operator for each year of the contract (known as the Unitary Charge), the companies which have an equity stake in the PFI companies, and the Companies House registration number for each PFI operating company.
3. Special companies have been set up to deliver PFI contracts, known as Special Purpose Vehicles (SPVs). These SPVs are established in order to take out loans to pay for the building of the hospitals and to raise funds from shareholders. For 18 of the entries on the Treasury database there was insufficient information to carry out an analysis of the profits made and the tax paid. In four instances the SPV company number listed in the Treasury spreadsheet was inaccurate and so we had to use the correct company number. In total we looked at 107 NHS capital schemes between 2010 - 2015.
4. The second source was the Companies House database which contains the accounts of all the PFI companies. These accounts include the turnover of the companies, the profit made before tax, the amount of tax paid on the profit and the profit after tax.
5. The vast majority of the income that these SPV companies receive is from the annual unitary charge payments made by the NHS or local authorities for the use, maintenance, and services provided in the PFI-built facilities. In addition, SPVs may receive some income from immaterial interest on bank deposits and other ‘Interest receivable...’, aside from interest receivable on the finance debtor (part of the unitary charge payment). An example of another income source under ‘interest receivable’ is gains on financial instruments.

6. Whilst the gains on financial instruments can be large in individual financial years they tend not to be persistent over many years and may partially reverse out as a loss on financial instruments in later years. This gives us some certainty that we can use the unitary charge figures as a reliable proxy for income received by the SPV. Even so, the unitary charge payment in a given year will not tie exactly to the income recognised in the SPV's accounts if different year-ends have been used. We recognise that any remaining differences between total income received by the SPV and the stated unitary charges represent a limitation of the approach used.
7. Having compiled this data for each of the hospital schemes we aggregated it to identify the overall profits and tax paid on PFI schemes between 2010 and 2015. We excluded the profits and losses of any financial years in which the unitary charges had not yet started to be paid.
8. What we have not assessed in our analysis is the overall rate of return on capital or the costs to the NHS and local authorities of the loans which have been taken out by the private companies and which are being paid back each year as part of the unitary charge. Accessing this data and information is much more difficult due to commercial confidentiality restrictions. However, because we have not been able to access this data it should be noted that the figures set out in this report are not a full account of the amount of profit or returns on investment which is leaving the NHS each year due to the use of the Private Finance Initiative. For the individual investors in the SPV further profits can be made from sales of their equity stakes. Sales have typically generated annual returns of between 15-30% for investors.<sup>15</sup>
9. Finally, in a number of cases the PFI companies which are providing hospitals and other facilities to the NHS declared a loss over the six year period. This does not mean that money was not being made from the NHS during these years, as the banks and other institutions which had lent money to the PFI companies will have been receiving their loan repayments. In addition, the most risky aspect of a PFI contract is building the hospital on time and the potential for cost overruns. This is because the income streams from the NHS or local authority do not start to arrive until the hospital/healthcare facility has been built and can be used. This means that there may be a shortfall between the requirement to make loan repayments and the income received.

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