Infrastructure and Projects Authority

Expiry Toolkit: PFI Structure and Parties

Understanding your PFI parties Information to check

February 2022

IPA Expiry Toolkit - Release 1.0

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Contents

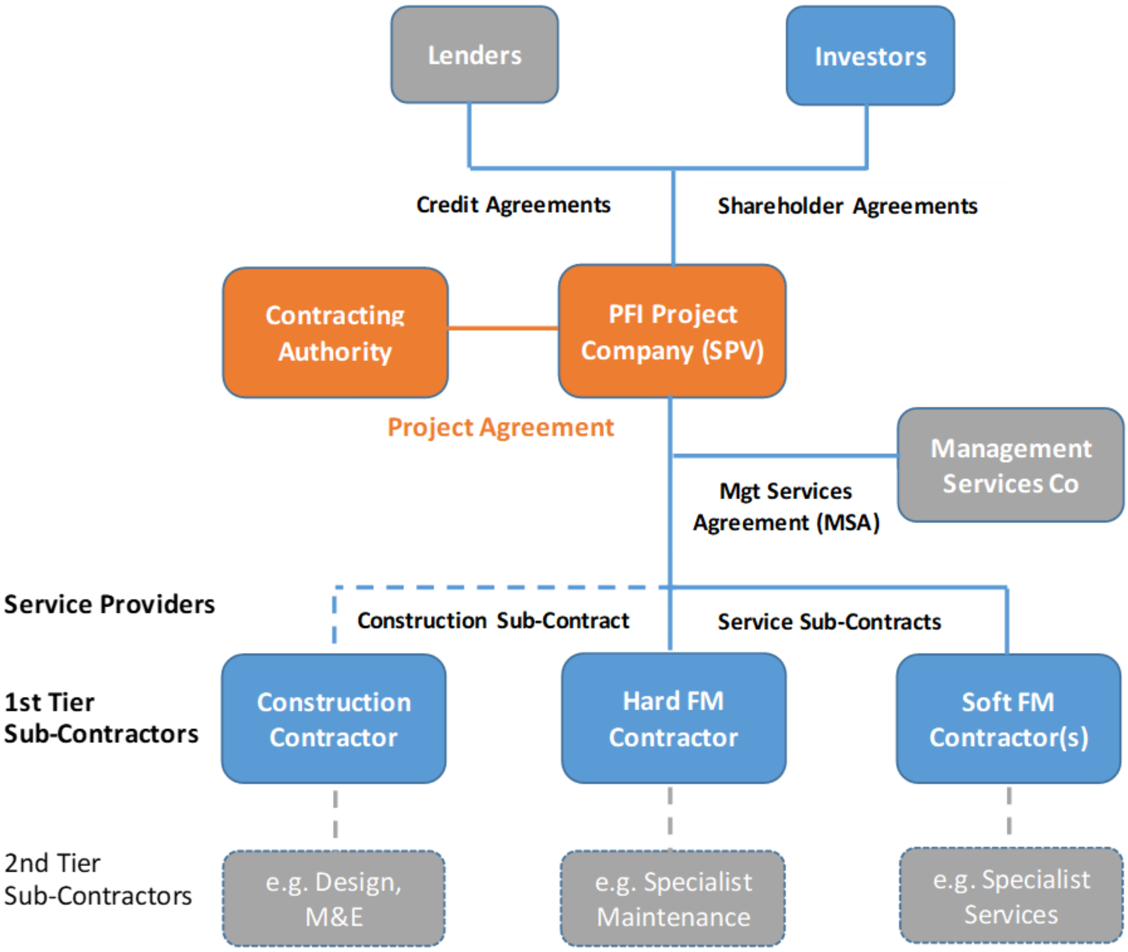
Introduction

In preparing for PFI contract expiry and service transition it is essential to have clarity as to the PFI parties involved in the process, including their interest in the expiry process, the activities that they are responsible for, and the information they hold that will be relevant to asset handback and services transition.

Summarising structural information by way of an organogram, together with supporting explanatory text, can be an effective means of presenting the relatively complex contractual relationships within a PFI project to wider stakeholders.

Typical PFI Structure

Simplified Generic PFI Operating Structure



Note: This is a typical structure for an accommodation based PFI project but actual structures will vary greatly, particularly in relation to sub-contract arrangements

Relevant PFI Parties

Explanatory Notes and Information to Check

PFI Project Company (SPV)

The legal entity that is the counterparty to the PFI project agreement, i.e. the company with which the authority has contracted to implement the PFI project. The PFI Project Company (PFI Co) will typically be a special purpose project company, sometimes referred to as a special purpose vehicle (SPV), with no other business than the specific PFI project. It will typically be a UK incorporated limited company, with no employees and with all the principal activities that are required to undertake the PFI having been subcontracted.

Information checklist:

- ☐ *Copy of Project Agreement*
- ☐ *Updated (free) online Companies House search undertaken*
- ☐ *Key company data confirmed/updated*
- ☐ *Latest accounts held*

Related analysis

- ☐ *Financials reviewed and cross-checked to the project financial model*

Investors

It is important to understand both the legal ownership and control of the PFI Co, and who is making decisions on behalf of those controlling parties. The shareholders (owners) of PFI Co are likely to be corporate entities. There may well be a holding company structure, i.e. one or more levels of further SPVs, typically required to help implement the lending and investment required for the PFI.

Undertaking a (free) online Companies House search will verify the shareholding structure, the controlling party/parties and the directors of the PFI Co. Due to the high level of concentration of ownership of PFI projects, with c.50% of all PFI projects linked to 10 specialist fund management groups, such as 3i and Equitix, it is likely that the shareholders of PFI Co will be one or more PFI funds. The directors of the PFI Co will thus typically also be from these specialist institutional fund managers, representing the PFI funds, which they will be managing and advising.

Information checklist:

- ☐ *Current shareholding structure of PFI Co identified*
- ☐ *Ultimate controlling party(ies) identified*
- ☐ *Current directors of PFI Co and relationship to shareholders identified*

Related analysis

- ☐ *Incorporate this analysis into a wider mapping and stocktake of the strength and quality of your relationships with these parties and individuals*
- ☐ *Review of project governance structures (formal relationship channels with investors)*

Lenders

PFIs are typically project-financed with banks or bond holders providing c.90% of the finance required to set up the PFI (e.g. to construct the underlying assets, such as a school or hospital). This project debt is typically repaid over the life of the project with final scheduled repayment typically 12- 24 months before project expiry. However, in some contracts in which there is no automatic transfer of assets to the authority at nil value on contract expiry (for example LIFT contracts), lenders may have a continuing interest in the project up to and beyond expiry. The borrowing agreements between the lenders and the PFI Co will include restrictions on the actions of PFI Co (for example: no additional borrowings, requirements to hold cash reserves, additional reporting obligations, contract variations to be subject to prior lender approval) designed to protect the lenders. These measures fall away once the lenders have been fully repaid.

Information checklist:

- ☐ *Copies of applicable financing agreements (these should have been provided at transaction outset or on any refinancing but can be reasonably requested if not held)*
- ☐ *Details of any refinancing implemented*
- ☐ *Identity of lenders to PFI Co and type of debt (bank/bond)*
- ☐ *Amount of debt outstanding, repayment profile and expected final repayment date*
- ☐ *Copies of technical and financial reports to funders – see below*

Related analysis:

- ☐ *Check (via contract review) and then utilise your rights to see information provided by PFI Co to funders (periodic reports by the lenders' technical adviser can usefully supplement regular SPV performance reporting)*

Management Services Company (MSC)

Since the PFI Co (as an SPV) typically has no employees, day to day management activities will often be subcontracted by way of a management services agreement to a MSC, sometimes also referred to as the SPV manager. The MSC may be an entity related to the Investors or may be an independent company. All periodic performance reporting by PFI Co is most likely prepared by the MSC on behalf of the PFI Co, whilst the project's general manager liaising on behalf of PFI Co will similarly most likely be an MSC employee. The decision-making authority of the MSC will have been delegated by the Investors and may be limited.

Information checklist:

- ☐ *Identity of MSC (if applicable) & its relationship to Investors*
- ☐ *Identity of formal PFI Co representatives (e.g. SPV general manager)*

Related analysis:

- ☐ *List and diarise all reporting requirements under the project agreement and cross-check with current PFI Co reporting*

Service Providers

A typical PFI involving a building and related services will have three first tier (i.e. direct) sub-contractors:

Construction contractor – principally involved in the construction phase, but will remain legally liable for construction defects up to 12 years after construction completion (this potentially applies also to later works, e.g. variations).

Hard FM service provider – typically undertakes all asset related services including buildings maintenance, wider estates services, utilities management, and often provides and manages the helpdesk function. These services are typically not subject to benchmarking or market testing and are therefore sub-contracted to the Hard FM service provider for the full contract term. The Hard FM service provider is often an entity related to the original construction contractor.

Soft FM service provider – typically undertakes the provision of people oriented services within the PFI scope, such as catering, cleaning, waste management, security. Except in early projects (before contract standardisation in 1999), such soft FM services are typically subject to periodic benchmarking/market testing provisions.

Note that in some contracts, and in some sectors, for example, street lighting, waste and prisons, there may be a single main operational sub-contractor / service provider. In all projects the first tier subcontractors are likely to have further sub-contracted specialist service elements, for example, lift maintenance may be sub-contracted, or meals prepared off-site in kitchen facilities under separate contract or lease arrangements. There may be a total of 50+ contract arrangements supporting the delivery of services in a complex PFI contract.

In preparing for expiry, it is important that the authority identifies the sub-contract structure supporting the delivery of the PFI services because this will help to understand better:

- The assets, services and wider capabilities that may need to be re-procured or brought back in-house.
- Who has on-the-ground responsibility for maintaining what assets.
- The scope and location of the information on people, assets and the systems that will need to be transferred from the PFI on or before expiry.

Information checklist:

- ☐ *Copies of sub-contracts and interface agreements held*
- ☐ *Identity of sub-contractors and scope of subcontracts*
- ☐ *Identity of key contacts within each sub-contractor*

Related analysis:

- ☐ *Clarify, through commercial/legal contract review, where key obligations and risks that relate to expiry, such as lifecycle risk, sit within the contract structure, how obligations such as record keeping and performance reporting are passed down to sub-contractors*
- ☐ *Milestone dates for latent defect liability expiry, market testing, break options, etc.*
- ☐ *Arrangements and staff numbers that may be subject to TUPE*
- ☐ *Identification of supporting systems, e.g. CAFM, BMS systems, and how these are used*
- ☐ *Existence and location of supporting assets, e.g. O&M manuals, licences, warranties*
- ☐ *Analysis of which contracts need to be re-procured, licences novated, etc.*
- ☐ *Cross check completeness of asset registers*
- ☐ *Update the authority expiry risk register*

Additional Considerations

Risk Allocation

Beyond the basics of identifying the various PFI parties, it is important to identify also the commercial interests of the parties that will impact on the expiry process. A key area to understand is lifecycle (major maintenance) risk. For example, who has a potential financial interest in minimising major maintenance expenditure in the final years of the contract - is it the PFI Co (investors) or the hard FM contractor? Who faces what consequences if asset surveys show that remedial work is required to meet contract conditions? Who will be driving the negotiations with the authority on asset condition at handback - the SPV general manager, the investors, or the hard FM contractor?

Preparing for commercial negotiations on expiry therefore requires not only an understanding of the project agreement but also the PFI parties and how the provisions of the project agreement have been passed down from PFI Co to its sub-contractors.

Networking

There is likely to be an imbalance between the breadth of PFI experience of the authority, who may have only a single or a few PFI projects, and the investors and their service providers, who will be managing multiple PFI projects. Clarity on the PFI structure and the parties involved should help an authority to network on expiry related issues with other authorities on similar projects with the same investors and service providers. Sponsoring departments and the IPA can also assist most effectively if there is clarity within the authority as to the underlying PFI parties, scopes and contractual responsibilities.

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