



National Infrastructure
& Service Transformation
Authority

Foundations for Contract Managers

An introduction to the fundamentals of PFI projects.

PFI Centre of Excellence

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Foundations for Contract Managers

NISTA PFI guidance

NISTA has produced a range of guidance to support public sector PFI contract managers. This can be found on the [PFI Centre of Excellence website](#). We welcome your feedback on this guidance. Please contact us via pfi-operations-inbox@nista.gov.uk.

Purpose of this Guidance

1. Explain what PFIs are and their defining characteristics.
2. Summarise the PFI lifecycle and project structure to support practical oversight.
3. Set out why PFIs need active, structured contract management, based on clear principles and obligations.
4. Provide the core knowledge to use our wider suite of guidance effectively.

Audience

This guidance is primarily aimed at PFI contracting authorities, particularly those engaged in day-to-day contract management and senior responsible owners for PFI contracts. In setting shared expectations, this guidance should be useful to all private sector parties involved in PFI contracts.

Using this document

This guidance is not prescriptive, as the activities and the level of activity required will vary based on the nature of the assets and services and the form of the PFI contract. Instead, it offers a framework which will need adapting to the specific circumstances of your project. [A PFI Glossary of Terms can be found here](#)

Legal caveat

This guidance provides foundational knowledge to support effective management of PFI projects. Given the wide range of PFI contracts, the guidance is necessarily generic and does not override the terms of your specific agreement. Any action should only be taken after careful consideration. This document is not legal, professional or technical advice. You should always seek formal professional advice where appropriate.

Icon Key



Warning



Tip



Note



Toolkits



Appendices

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1. Introduction to PFI

Public Private Partnerships (PPPs) are long-term collaborations between the public and private sectors to deliver public infrastructure or services. There is no single accepted definition of a PPP, however, the World Bank defined a PPP as:

“A long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance.”¹

The Private Finance Initiative (PFI) is a type of PPP developed in the UK. It has been used to design, build, refurbish, maintain and operate assets such as hospitals, schools, housing, waste disposal facilities and street lighting. The public sector pays for these assets and services through a performance-linked payment mechanism known as the unitary charge (UC).

As at 31 March 2024,² PFI remain a significant means of public service delivery (see diagram below).



1.1 History of PFI

PFI emerged in the early 1990s as part of broader efforts to increase collaboration between the public and private sectors in delivering public services and to address persistent challenges in public procurement and infrastructure delivery. This included:

- **Cost and time overruns** in traditional public sector projects, caused by poor design, weak project management, ineffective risk management and limited asset lifecycle planning.
- **Limited public sector capacity** to manage large-scale infrastructure projects.
- **Fiscal constraints** with governments seeking ways to fund infrastructure without increasing public debt, i.e. using private sector capital and keeping it off the public sector balance sheet.

¹ <https://ppp.worldbank.org/about-public-private-partnerships>

² <https://www.gov.uk/government/publications/pfi-and-pf2-projects-2024-summary-data>

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1.2 Objectives of PFI

PFI was designed to:

- **Leverage private sector capital and expertise** to build or refurbish assets and deliver associated services, allowing the public sector to focus on frontline delivery.
- **Deliver value for money** through competitive procurement and performance-based contracts.
- **Encourage innovation** by specifying service outputs rather than inputs.
- **Allocate risks** to the party best placed to manage them effectively.
- **Ensure whole-life asset management**, not just construction.

1.3 Key features of PFI

PFI contracts share several defining characteristics:

- **Output based delivery:** Services and asset standards are specified in terms of outcomes (e.g. availability, cleanliness) giving the private sector scope to determine how best to deliver services to meet those standards.
- **Long-term contracts:** Typically, 25–30 years covering design, construction, maintenance and operation.

- **Complex delivery structures:** A special purpose vehicle (PFI Co) manages obligations through multiple subcontracts, including construction and services contracts, supported by legal, financial and technical advisors, and governed by a series of interlinked contracts.
- **Private sector financing:** Upfront costs funded by private debt and equity. This is a key differentiator from other forms of public private partnership.
- **Performance-linked payments:** The public sector pays a unitary charge adjusted for availability and service performance for the assets and services provided.
- **Public sector accountability:** The contracting authority remains responsible for the public service even though delivery is outsourced.



PFI contracts are output-based – focus on outcomes, not inputs, when interpreting obligations.

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1.4 Differences between PFI and non-PFI contracts

PFI is not just a longer contract, it is structurally different. Key distinctions include:

Feature	Non-PFI	PFI
Contract	Separate contracts for construction, maintenance, and services (typically 5–7 years).	Single long-term contract (typically 25–30 years) covering construction and service delivery.
Financing	Public sector funds construction directly.	Private sector finances construction using debt and equity
Specification	Input-based (e.g. install heating system with specific features, undertake 6-monthly maintenance).	Output-based (e.g. maintain room temperature at defined levels)
Risk allocation	Public sector retains most delivery and performance risks.	Risks allocated to the party best placed to manage them (e.g. construction, availability, lifecycle).
Contractor identity	Contract signed with prequalified contractors	Contract signed with a special purpose vehicle (PFI Co) that subcontracts delivery.
Asset ownership	Public sector owns the asset throughout.	PFI Co typically controls the asset through a lease or licence rather than full ownership. The authority normally retains or resumes ownership at expiry.
Operational flexibility	Public sector can reconfigure assets with limited constraints.	Changes often require approval from multiple private sector parties (e.g. lenders, investors).
Contract terms	Often based on standard forms (e.g. NEC, JCT).	Bespoke, project-specific contracts with detailed performance and payment mechanisms.
Cost structure	Cost may be fixed for short periods (e.g. 5 years) with periodic renegotiation.	Costs typically fixed for initial years, with inflation-linked uplifts and periodic market testing thereafter.

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1.5 Experience with PFI

While PFI has delivered many new assets and helped improve maintenance standards, experience over time has highlighted some recurring themes that are useful for contracting authorities to be aware of, including:

- **Financing costs:** Private finance is typically more expensive than government borrowing.
- **Flexibility:** Long-term, structured contracts can take time to vary or update.
- **Complexity:** The contractual and delivery arrangements can be complex and require specialist skills to manage.
- **Performance variation:** Some projects have not consistently met contracted standards, particularly where oversight has been limited.
- **Debt treatment:** PFI was sometimes viewed as a way of keeping public investment off the government's balance sheet, which has influenced public debate.

These observations reinforce the need for strong, well-informed contract management throughout the life of a PFI contract.

2. Project structure and parties

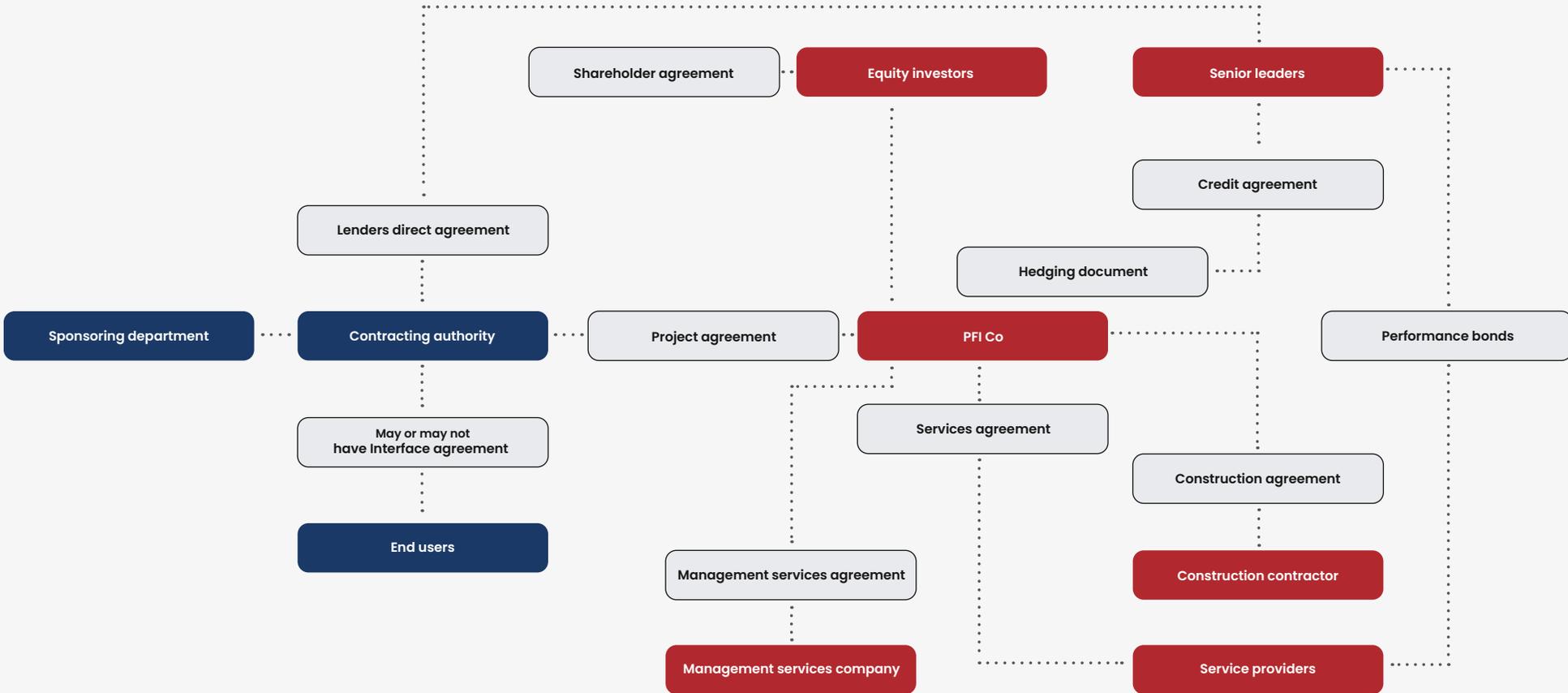
PFI projects involve a complex structure of public and private sector organisations, each with obligations set out in detailed contracts. Understanding these relationships, and the documents that govern them, is essential for effective contract management. At a high level, the main parties are:

- **Public sector:** Initiates the PFI project, procures the private partner and manages the contract throughout its life.
- **Private sector:** Delivers the infrastructure and associated services in line with the contract.
- **Users:** Use the assets and services provided under the contract, which may include public sector staff and members of the public.

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Section 2 continued

The diagram below illustrates a typical PFI structure and the contractual links between the parties, though this will vary by project. For a quick reference to the key contractual documents, see Annex A.



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2.1 Contracting authority

The contracting authority is the purchaser of assets and services under the PFI contract. It initiates the project, sets the outcomes to be achieved and is responsible for managing the contract through to expiry to ensure those outcomes are delivered. The contracting authority signs the **project agreement**, which is the main contract governing obligations, payment mechanisms, performance regimes and risk allocation.

Most contracts require the contracting authority to appoint an authority representative, who acts as the formal point of contact and is typically responsible for day-to-day oversight. This includes:

- Monitoring delivery and performance.
- Managing risk and maintaining accurate records.
- Ensuring the contract operates in line with its terms

The authority may also receive advice and support from:

- Sponsoring departments: providing policy, commercial or financial guidance.
- Internal and external advisors: Including legal, financial and technical experts.

The contracting authority plays a vital role in ensuring that the PFI contract delivers the intended outcomes for users and the public sector. This requires an intelligent client function that is capable, informed and able to act with authority across the full range of contract management responsibilities.

Regular engagement with the PFI Co through structured meetings is essential to review performance, address issues such as contract changes or unresolved failures, and ensure risks are identified and managed early.

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2.2 PFI Co

The PFI Co is a 'special purpose vehicle' (SPV) established by its equity investors (shareholders) solely to deliver the PFI contract. It signs the project agreement with the contracting authority and is legally responsible for financing, constructing, maintaining and operating the asset.

The PFI Co:

- Is governed by a **shareholder agreement**, which sets out voting rights, dividend policy and dispute resolution between investors.
- Has no direct employees and outsources day-to-day management to a management services company via a **management services agreement**.
- Passes delivery obligations to subcontractors through a **construction contract** and **services agreement** to spread the risks in the project agreement.

The PFI Co is usually required by the contract to appoint a contractor representative, typically this is someone from the management services company, who acts as the formal point of contact with the contracting authority for operational matters and manages reporting and subcontract oversight.

The directors of the PFI Co are legally required to act in the interests of the company and its shareholders. As a result, a primary objective of the PFI Co is to operate the contract profitably so that it can meet its financial obligations including paying its subcontractors, repaying senior debt and delivering returns to investors.

Investor funding is typically provided through a combination of equity and shareholder loans. Subject to sufficient cash being available, shareholder loans may be repaid with interest, and equity investors may receive dividends during the operational phase and recover any residual investment at expiry. These returns depend on the PFI Co managing the project effectively, creating a natural incentive to control costs and avoid deductions from the unitary charge.

Delivering contracted services is essential to receiving the unitary charge, which provides the project's revenue. From the PFI Co's perspective, this revenue supports payments to lenders and investors and meets financial obligations over the life of the contract.



Understanding the PFI Co's commercial drivers helps explain its behaviour: service delivery enables payment, but profit is the underlying objective.

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2.3 Senior lenders

Senior lenders provide the majority of financing to the PFI Co during the construction phase, typically through bank loans or bonds. The PFI Co enters into a **credit agreement** with the lenders, which:

- Sets out the loan terms and repayment schedule.
- Requires the maintenance of reserve accounts (e.g. for debt service).
- Includes covenants designed to protect lenders' interests, including restrictions on contract changes without lender approval particularly where changes may affect project risk, cash flow or the ability to service debt (such as variations or changes to service providers).

Senior lenders also enter into a **lenders' direct agreement** with the contracting authority and the PFI Co. This gives lenders notice of termination and step-in rights if the PFI Co defaults, allowing them to protect their investment.

Hedging documents are often in place to manage interest rate (and sometimes inflation) risk.

Lenders' influence is strongest in the early years of the contract when debt levels are high and gradually reduces as the debt is repaid, often a few years before expiry. Once senior debt is cleared, the financial discipline imposed by lenders on the PFI Co falls away.



Lender consent may be required for contract changes that alter the project's risk profile. This can delay implementation or increase costs for the contracting authority.

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2.4 Management services company

The PFI Co usually appoints a management services company, via a **management services agreement**, to manage its obligations under the contract on a day-to-day basis. This company provides a range of services, including:

- Company secretary and general management functions.
- Financial administration and reporting.
- Audit and assurance support, including internal compliance checks.
- Performance management and reports.
- Technical support such as lifecycle planning and performance monitoring.

While the management services company plays a central role in day-to-day operations, its authority is limited. Decisions with financial, legal or strategic implications, such as contract variations, disputes or refinancing, must be escalated to the PFI Co's board of directors or shareholders. Contract managers should ensure that roles and escalation routes are clearly understood and documented to support effective communication and decision-making.

2.5 Construction contractor

The construction contractor is engaged by the PFI Co to build or refurbish the infrastructure assets. This relationship is governed by a **construction contract**, which passes down the design and build obligations set out in the project agreement. In many cases, the contractor was part of the original bidding consortium and may have held equity in the PFI Co during the early stages of the project. However, it is common for construction contractors to sell their shares to institutional investors after completion.

Once construction is complete, the contractor's ongoing involvement is typically limited to any liability for defects in the works. This liability is usually defined in the construction contract and may last for up to 12 years. While the contracting authority may need to raise concerns about defects, any formal engagement with the construction contractor should be through the PFI Co, which holds the contractual relationship.

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2.6 Service providers

Service providers are the main subcontractors to the PFI Co and are responsible for delivering the contracted services throughout the operational phase. These services may be delivered directly or through specialist sub-subcontractors. Common service areas include:

- Hard FM: Planned and reactive maintenance, asset management, statutory inspections.
- Soft FM: Cleaning, catering, portering, gardening.
- Waste collection and disposal.
- Equipment supply.
- Social care services.
- Housing management services.
- Training.

The relationship between the PFI Co and the service provider(s) is governed by a **services agreement**, which sets out performance standards, reporting requirements and payment terms. Performance is typically tracked via helpdesk reports, KPIs and monthly reporting, with the PFI Co accountable for ensuring that service standards are met.

As the contracting authority, you will engage with service provider staff daily. While you do not have a direct contractual relationship with them, this sits with

the PFI Co, you are responsible for monitoring service delivery and raising issues through the agreed channels, e.g. the helpdesk.

3. Financing and payments

PFI projects are funded upfront by the private sector and paid for by the public sector over the life of the contract. This section explains how that financing structure works and how payments flow through the contract.

PFI financing has some distinctive features:

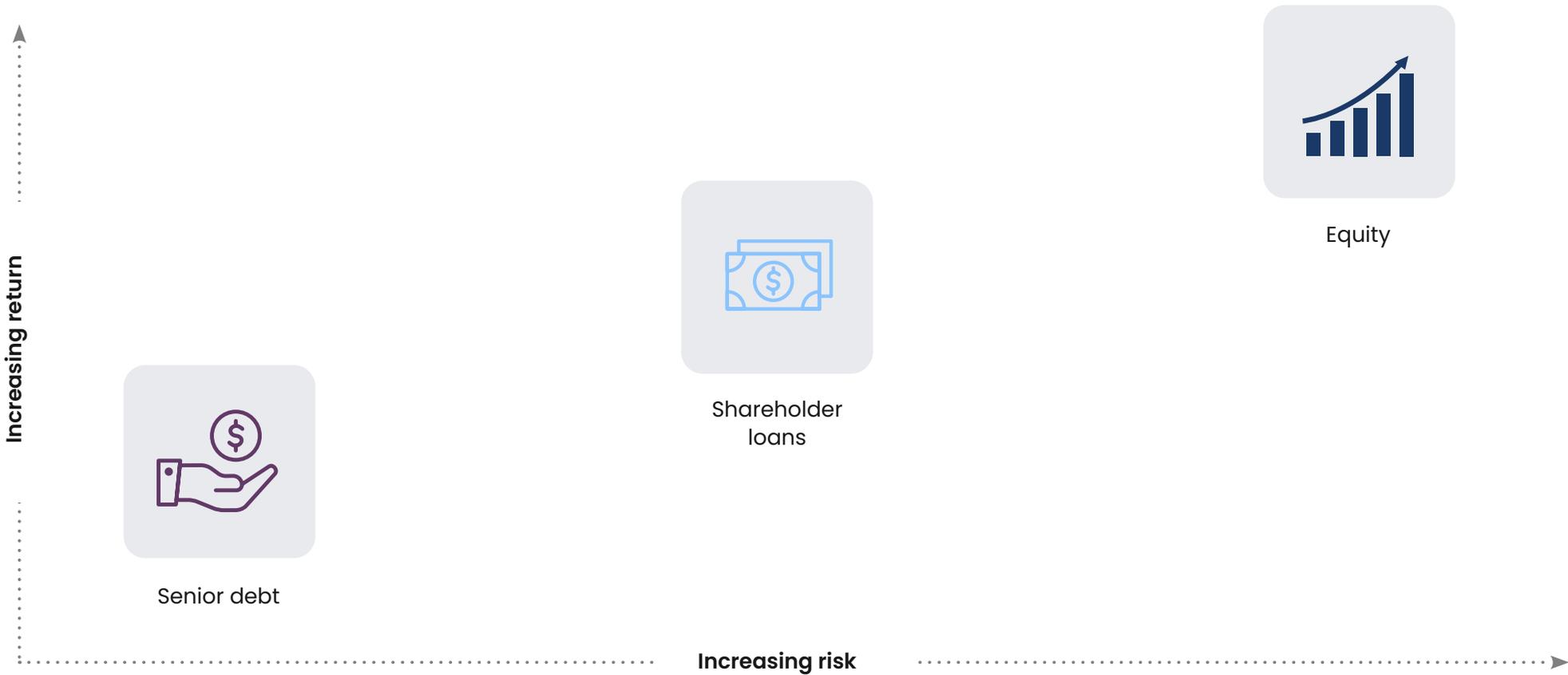
- **Private capital funds construction** with the public sector making regular payments during the operational phase.
- **Highly leveraged** with most funding from senior debt and a smaller proportion from investor contributions (equity and shareholder loans).
- **Limited liability** as equity investors are not obliged to contribute more than their original investment.
- **Control through covenants** with senior lenders exercising influence via consent rights and financial tests.
- **Investor returns** that depend on the PFI Co making a profit, creating strong incentives to manage costs.

Financial arrangements can influence investor behaviours and need to be considered.

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3.1 Who provides the finance?

The PFI Co raises finance from a mix of sources. A typical PFI financing structure is highly leveraged, with most funding from senior debt (75–90%) and a smaller investor contribution through shareholder loans and equity (10–25% with minimal equity). The different financing sources have different risk and return characteristics, which influence how each party behaves during the contract, as shown in the risk-return diagram opposite.



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Section 3.1 continued

Senior debt:

- Usually provided by bank loans or the PFI Co issuing bonds.
- Typically accounts for around 75–90% of the total finance required.
- Repaid over the term of the loan through principal and interest payments.
- The credit agreement sets the interest rate and includes covenants to protect lenders, such as:
 - Maintaining financial ratios.
 - Holding reserve accounts to retain cash in the business to draw on if needed, e.g. debt service reserve to protect debt service payments.
 - Obtaining lender approval for changes that could change the project's risk profile (e.g. contract variations, service provider changes).
- Is the lowest-risk funding and therefore attracts the lowest return.

Shareholder loans:

- Also called subordinated or junior debt because it ranks below senior debt for repayment.
- Almost always provided by the equity investors.

- Higher risk than senior debt, so it carries a higher interest rate.
- Often structured so that repayments are scheduled later in the contract, after senior debt has been substantially repaid.
- Splitting investor funding between equity and loans provides tax advantages, as interest payments (up to certain limits) are tax-deductible.

Equity:

- Represents ownership of the PFI Co through shares issued at financial close.
- Pure equity is often minimal, with most of the investor contribution structured as shareholder loans for tax efficiency.
- Equity investors receive dividends during the operational phase and any residual value at expiry, but only after all other obligations are met.
- Because equity is the highest-risk funding, it is also the most expensive.
- Returns depend on the PFI Co making a profit, so investors are incentivised to control costs, particularly in later years when most shareholder returns are due.

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3.2 Unitary payment

The unitary charge (UC) is the single annual amount specified in the project agreement, designed to cover all costs of the project over its life. It is usually expressed as an annual figure but paid in monthly instalments. The UC typically includes:

- Payments to service providers for maintenance and facilities management.
- Funding for lifecycle replacement works.
- Repayment of senior debt and interest.
- Repayment of shareholder loans and interest.
- Taxes and insurance costs.
- Recovery of equity investment and dividends to shareholders.

The unitary payment (UP) is the actual amount paid each month. It is calculated by adjusting the UC for:

- Performance deductions for unavailability or service failures.
- Pass-through costs, such as utilities, where specified in the contract.
- Indexation, usually linked to RPI or CPI, to reduce inflation risk for the private sector but exposes the public sector to variable costs.

This distinction matters because the UC is a contractual baseline, while the UP reflects actual performance and cost adjustments in practice.

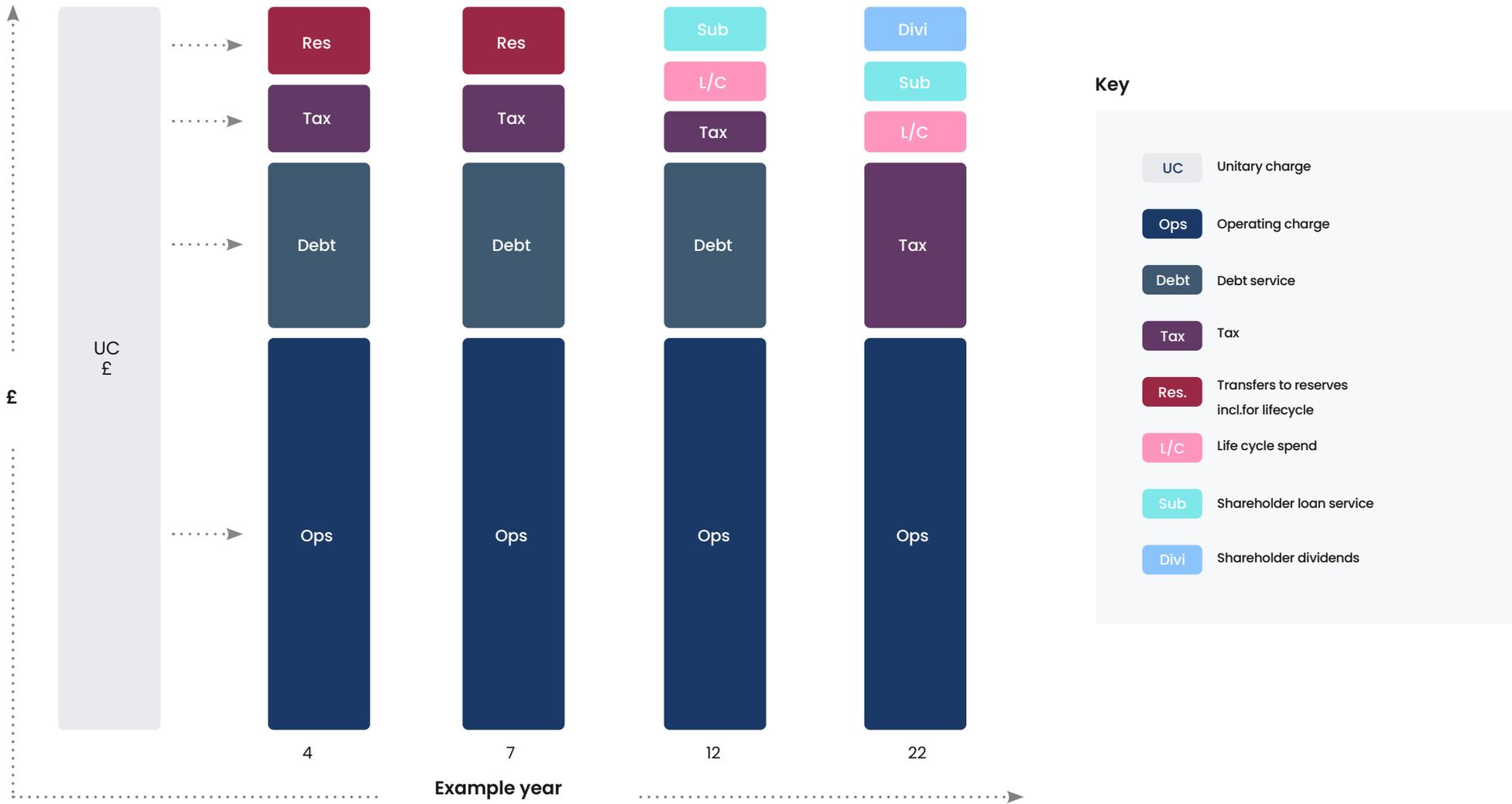


Errors in applying indexation or deductions can lead to significant overpayments. Always verify calculations.

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Section 3.2 continued

The diagram below illustrates, in simplified form, how the unitary charge is typically allocated across different cost categories over the life of a PFI contract. This is an indicative profile only and does not reflect adjustments for indexation, pass-through costs or performance deductions. Actual allocations will vary by project.



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3.3 How the money flows

The flow of funds in a PFI project reflects the contractual and financing structure. Understanding this helps contract managers see how the unitary charge interacts with the PFI Co's obligations and why financial discipline matters.

The way the PFI Co applies the unitary charge is not discretionary. It must follow a strict priority order, often referred to as the cash flow waterfall, which is set out in the credit agreement. This determines how each unitary payment is allocated between operating costs, debt service and investor returns. The typical order is:

	Operating costs and payments to service providers
	Debt service and reserve accounts (e.g. for debt service and lifecycle)
	Shareholder loan interest and repayments
	Dividends to equity investors (subject to Companies Act and covenants)

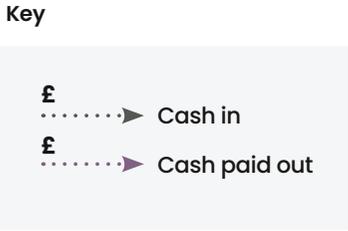
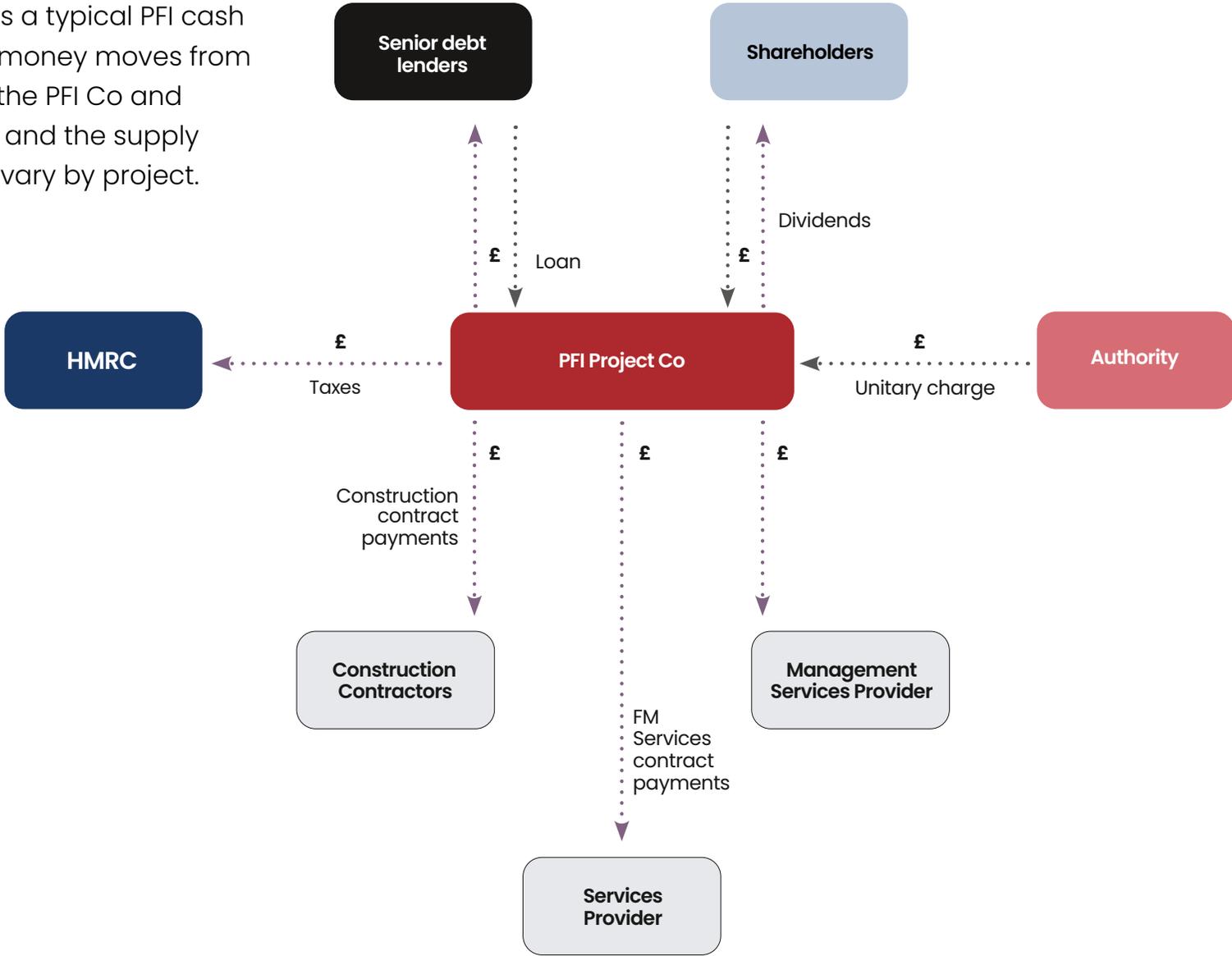


Understanding the cash flow waterfall helps you see why lenders and investors behave differently at different stages.

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Section 3.3 continued

The diagram below illustrates a typical PFI cash flow structure, showing how money moves from the contracting authority to the PFI Co and through to lenders, investors and the supply chain. Actual arrangements vary by project.



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4. Lifespan of a PFI

PFI contracts typically span 25–30 years from strategic planning through to contract expiry. Understanding the phases of a PFI helps contract managers place their current responsibilities in context and anticipate future requirements. While all phases are shown below, most readers will be working in the operations or expiry phases, so this section focuses on what matters most for those phases.

4.1 Overview of the phases of a PFI project

PFI projects progress through five main phases. Each phase has distinct objectives and activities, and decisions made early in the lifecycle have long-term implications for delivery and risk.

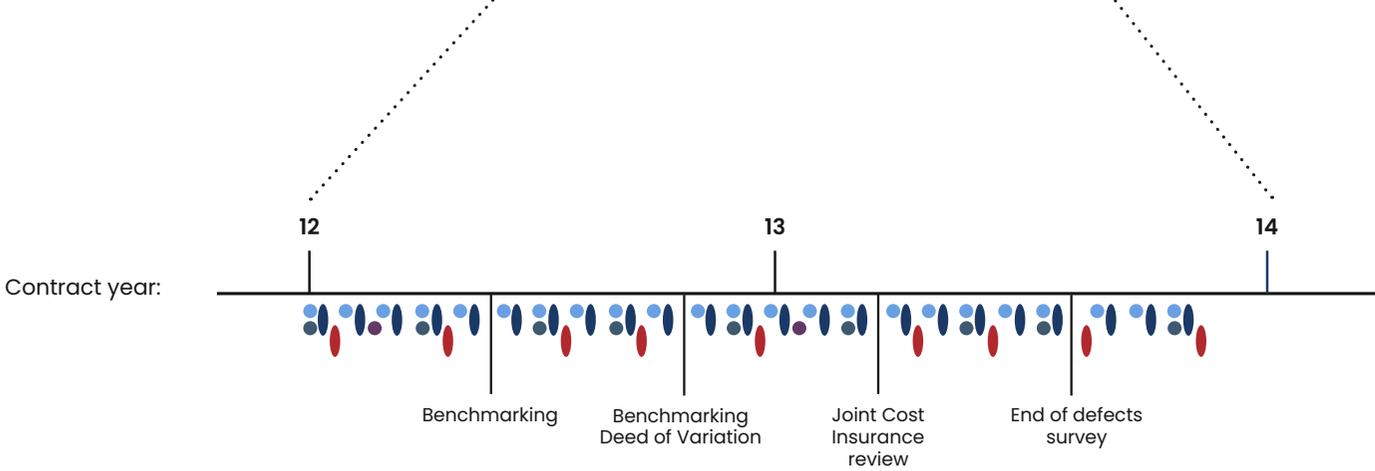
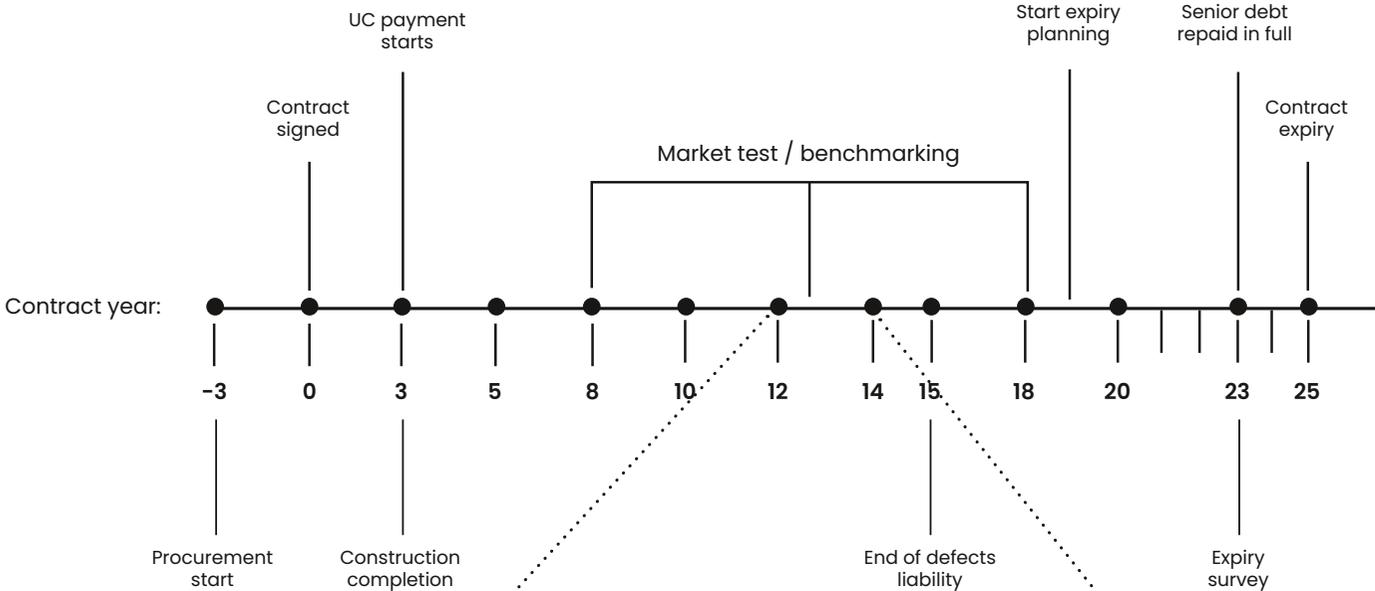


Phase	Typical duration	Key activities	Why it matters for contract managers
Strategy & policy	Pre-contract	Define long-term objectives; develop business case using a Five Case Model.	Sets the strategic direction, risk allocation and scope of services; shapes all future contract phases.
Procurement	18 months	Select private consortium; establish SPV; negotiate and finalise contract terms.	Determines payment structure, performance obligations and risk transfer; defines the contract framework.
Construction	2–3 years	SPV delivers asset; manage risks; independent certification of completion.	Monitor progress and design changes; ensure readiness for service commencement and UC payments.
Operations	25–30 years	Deliver services; maintain and replace assets; conduct benchmarking/market testing and payment mechanisms	Oversee performance, deductions and lifecycle delivery; ensure services remain fit for purpose.
Exit	Last 5–7 years	Plan for expiry; assess asset condition; manage transition.	Ensure contractual obligations are met; prote public value; prepare for future service arrangements.

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Section 4.1 continued

The diagram and table below explain the major milestones across the contract term. These events often have significant implications for planning and performance management.



Key

- Monthly reports
- Monthly operational meetings
- Quarterly contractual liason meetings
- Annual Lifecycle Plan issued
- Unitary Charge calculations submitted
- | Contract event

Foundations for Contract Managers

Section 4.1 continued

Key events and why they matter

- **Contract signed**
Marks the formal start of the PFI contract. Risk allocation, payment mechanisms and performance obligations are locked in at this point.
- **Construction completion and UC commencement**
Occurs when construction is complete and commissioning tests are passed. At this point, the UC begins.
- **Defects liability period**
Early years of operation include a defects liability period, during which the construction contractor remains responsible for latent defects. The end of the defects period does not affect the risk transfer from the contracting authority to the PFI Co, as the PFI Co remains responsible for any defects. Contracting authorities should monitor to ensure any defects are resolved before expiry, when liability will transfer back to the contracting authority.

- **Benchmarking and market testing**

Most PFI contracts include periodic benchmarking or market testing, typically every 5–7 years.

These processes allow the contracting authority to:

- Review the services being delivered.
- Assess pricing against market comparators.
- Make changes to service providers or pricing if justified.

These mechanisms are designed to share efficiency gains with the public sector and adjust prices to reflect actual market conditions compared to indexation.

However, in practice these processes have led to price increases.

- **Lifecycle peaks**

Lifecycle investment often peaks around years 10–15, when major asset replacements are due.

Underinvestment during this period can create risks at expiry and lead to disputes. Contract managers should monitor lifecycle plans and actual spend, and ensure reserve accounts are used appropriately.

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Section 4.1 continued

- **Senior debt repayment**

Senior debt is typically repaid before contract expiry, often 2–5 years early. Once lenders exit, their oversight and financial discipline fall away, at the same time shareholders expect to maximise returns.

- **Expiry planning and surveys**

Expiry planning should begin at least seven years before contract end. Contractual expiry surveys usually occur 1–2 years before expiry to assess asset condition and identify remedial works. Best practice: conduct an early survey around five years before expiry to reduce disputes and ensure assets meet contractual standards.

- **Contract expiry and transition**

At expiry, the contracting authority must manage the transition of assets and services. Each contract sets out different options for how services will continue and how assets will be handed back. Decisions made at this stage affect future service delivery, reinvestment and public value.

5. Principles and obligations for managing PFI contracts

PFI contracts were designed to transfer risk and deliver long-term value through private sector expertise. While the contract sets out obligations and incentives, these alone do not guarantee outcomes. Active, informed management by the contracting authority is essential to maintain service quality, protect public value and ensure risk transfer works in practice. This section explains the principles that underpin effective management and summarises the key obligations placed on the PFI Co.

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5.1 Why oversight matters

While the PFI Co is required to self-report performance, relying on this alone is not sufficient. Oversight by the contracting authority provides assurance that obligations are met and public value is protected. Oversight matters because it:

- **Protects value for money:** Deductions for unavailability or service failures are part of the contract design, not a penalty. Applying them ensures the contracting authority only pays for the service it receives.
- **Maintains incentives:** The payment mechanism links performance to money. If deductions are not applied, the incentive for the PFI Co to meet standards weakens.
- **Manages whole-life risk:** Oversight helps confirm that maintenance and lifecycle obligations are being met throughout the term. Underinvestment can lead to service disruption and costly disputes at expiry.

5.2 Risk allocation overview

Risk allocation underpins the design of PFI contracts and determines which party bears responsibility for cost, time and performance. Understanding this allocation helps contract managers focus monitoring where it matters most. The table below summarises typical allocations, but actual provisions vary by contract, so always check your specific agreement.

Risk	Contracting authority	PFI Co	Shared
Delivery of the public service enabled by the PFI	✓		
Authority reputation	✓		
Design and construction (time, cost, outputs and defects)		✓	
Service delivers performance requirements			✓
Health and safety responsibility			✓
General inflation (CPI/RPI/RPIx)	✓		
Cost escalation greater than inflation			✓
Change in requirement (variation from the contract)	✓		
Change in law			✓
Asset condition on expiry		✓ *	

* Responsibility for asset condition at expiry sits primarily with the PFI Co, but the authority must monitor compliance and enforce obligations.

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Section 5.2 continued

The following examples explain how this risk transfer might work and the contracting authority's role in delivering it. Note that not all the ten risks in the table are covered but all are important. Contract managers should understand where these risks sit and ensure they are reflected in the contract management plan and risk register.

Design and construction (time, cost, outputs and defects)

- **Time and cost risk:** Under a PFI contract, the PFI Co commits to design and construct the assets for a fixed price and within an agreed programme. Failure to deliver on time or budget is a risk for the PFI Co and its construction contractor.
- **Outputs and defects:** The asset's design and construction must meet the requirements of the project agreement and output specification³ including throughout the operational phase. This obligation applies notwithstanding any comments or documents provided by the contracting authority. Failure of the asset to meet the specification (commonly referred to as 'defects') remains the PFI Co's responsibility to rectify at its own cost.

Contracting authorities should understand these requirements, including the output specification, availability requirements and defect provisions. Failure to do so can result in service disruption due to asset unavailability and assets being returned at expiry with unresolved defects, issues the contracting authority would then need to fund and manage.

Service delivery performance requirements

- **Asset availability:** During the operational period, the building must be available for use as defined by the criteria in the project agreement. Availability is measured throughout the life of the contract and directly affects payment.
- **Service criteria:** These relate to activities and service that need to be delivered by the contractor (e.g. responding to helpdesk requests within a set time). Service criteria ensure the timely and effective delivery of operational tasks that support the functioning of the asset and services.

³ The precedence of the contractual documents will be set out in the project agreement, typically with the project agreement taking precedence over the output specification and, in turn, the contractor's proposal.

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Section 5.2 continued

- **Performance criteria:** These relate to aspects of the asset and services that must meet a particular standard (e.g. cleanliness or temperature levels). Performance criteria ensure that the services, environment and facilities meet agreed quality and safety standards throughout the contract term.

The payment mechanism links performance to money. Availability failures, and service and performance criteria breaches trigger deductions, which are designed to incentivise performance of the PFI Co and compensate (partially) the contracting authority where assets are not available or services fall below service and standards.

- If part of the asset is unavailable, deductions reduce the unitary charge. If the entire asset is unavailable and no service is delivered, the payment mechanism typically provides that none of the unitary charge is payable for the affected period.
- KPIs apply to service and performance criteria and are measured through failure points and deductions. Even if all KPI failure points are triggered, deductions usually represent only a small proportion of the total unitary charge.

Contracting authorities should understand how availability, service criteria and performance criteria are defined in their contract, how deductions apply and how failures impact service delivery. Failure to monitor and enforce these provisions can lead to value for money being lost and service continuity being compromised.

General inflation and cost escalation beyond inflation

- **General inflation:** The unitary charge is fixed in the contract, with provision for indexation in line with general inflation (usually RPI or CPI) on all or a proportion of the UC. Indexation typically occurs annually and should be agreed between the PFI Co and the contracting authority. The calculation can be complex, so it is important to check accuracy.
- **Cost escalation beyond inflation:** Other than indexation, the PFI Co bears the risk of cost escalation until the first benchmarking or market testing exercise, typically every 5–7 years.

Contracting authorities should understand how indexation is applied and ensure calculations are correct to avoid overpayment. They should also be aware that while inflation risk sits with the contracting authority, real term cost increases are a PFI Co risk (or benefit) between market testing points. Failure to monitor these provisions can lead to affordability issues and missed opportunities to enforce efficiency obligations.

Foundations for Contract Managers

5.3 PFI Co obligations

The project agreement sets out the obligations that transfer key risks to the PFI Co. These obligations define what the PFI Co must deliver and form the basis for performance monitoring and assurance. Understanding them is essential because the contracting authority remains accountable for the public service and must ensure it receives the outputs it is paying for. Risk transfer only works if these obligations are actively managed and enforced throughout the contract term, recognising that some risks and reputational impacts remain with the contracting authority. The table below summarises the main obligations and what they mean for contract managers.

Obligation	What it means in practice	Why it matters to the authority
General obligations	<p>There is a general obligation to:</p> <ul style="list-style-type: none"> • Not engage in any other business outside that permitted by the project agreement • Procure or take responsibility for other parties in the consortium. • Ensure compliance with all safety matters through the duration of the project. 	Sets the baseline for behaviour and accountability across the delivery chain.
Design and construction	<p>To design, finance, construct and commission the assets in accordance with the programme. During construction, the project agreement defines the circumstances in which the PFI Co can seek an extension of time to the programme or financial compensation from the contracting authority. This obligation ensures that the asset is built in accordance with:</p> <ul style="list-style-type: none"> • Output specifications set out by the contracting authority. • Construction proposal of the construction contractor. 	Time, cost and quality risks are transferred; defects remain the PFI Co's responsibility under the contract.
Service delivery	<p>The PFI Co is obliged to:</p> <ul style="list-style-type: none"> • Deliver services as required in the output specification. This may include maintenance and soft facilities management. • Monitor performance as set out in the output specification and performance regime. This includes ensuring that the facilities meet the availability conditions and service delivery levels as well as following good industry practice. • Operate the payment mechanism, this includes the self-reporting of failures, calculating financial deductions and submitting monthly invoices. 	Day-to-day value depends on outputs being delivered and deductions applied correctly.

Foundations for Contract Managers

Obligation	What it means in practice	Why it matters to the authority
Refinancing	Sharing with the contracting authority any gains made on refinancing the project.	Ensures fair sharing of gains and supports value for money.
Insurance	<p>Maintain specific insurances for the asset including identification of insured parties and limited of indemnities.</p> <p>Generally, the requirement is to maintain insurances required by good industry practice such as third-party public liability insurance, property damage insurance and business interruption insurance.</p>	Protects both parties against major risks; failures can disrupt service or create unplanned costs.
Handback	Manage the handback of the asset at the expiry of the project agreement. This may include obligations on calculating any residual value payment, transfer of data and information, surveying asset condition and addressing any issues identified in the survey. These obligations have financial implications for the PFI Co.	Determines the condition of assets returned to the authority and the scale of end-of-term risk.
Early termination	<p>The project agreement sets out the basis upon which an early termination can occur. This can be:</p> <ul style="list-style-type: none"> • A voluntary termination. • Following an event of default by the contracting authority or PFI Co. • A force majeure event. • In response to other specific circumstances <p>The project agreement sets out the basis for calculating any compensation due in the event of early termination.</p>	Provides certainty on rights, process and financial consequences if the contract ends early.
Dispute resolution	<p>In the event of a dispute between the contracting authority and the PFI Co, a dispute resolution process is to be followed. This commonly means:</p> <ul style="list-style-type: none"> • The parties to consult with each other over a defined period to attempt to resolve the issue. • Where consultation fails, seek an expert determination. • A force majeure event. • If either the contracting authority or the PFI Co is not satisfied with the expert determination, the matter could be referred for arbitration or to the courts 	Offers a structured path to resolve issues and maintain service continuity.

Foundations for Contract Managers

These obligations form the basis for performance monitoring and enforcement. Understanding them helps the contracting authority focus oversight on what matters most for maintaining service quality and protecting public value.



Contracts also include provisions on subcontracting/assignment, intellectual property, confidentiality/FOI, tax, corrupt gifts and similar ancillary matters.

- Governance and decision-making under the project agreement.
- Financial oversight, including affordability and correct application of the payment mechanism.
- Expiry and handback, ensuring assets are returned in the required condition.

These residual risks mean the contracting authority must remain actively engaged throughout the contract term.

5.4 Contracting authority responsibilities and residual risk

PFI contracts transfer significant delivery and performance risks to the private sector, but some responsibilities remain with the contracting authority. These include:

- Statutory compliance (e.g. health and safety, safeguarding), even when day-to-day delivery is outsourced
- Reputation and service continuity for the public service.

Foundations for Contract Managers

6. Managing a PFI contract

Building on the principles in Section 5, this section introduces core contract management practices and practical actions to help maintain service quality, protect public value and manage risk throughout the operational phase



The contract sets out the cost of delivering services to the required standard, so the contracting authority is entitled to expect those services to be delivered. The payment mechanism ensures the PFI Co shares in the financial impact when this does not happen and is incentivised to reduce and remedy failures.

6.1 Core principles for effective PFI contract management

Effective management of a PFI contract depends on applying principles that, while not written into the project agreement, were assumed when the contract was drafted. These practices provide the foundation for effective management ensuring that risk transfer operates as intended and that the contracting authority receives the services and asset condition it is paying for.

- **Understand the contract**

PFI contracts are complex and bespoke. Contracting authorities should understand the project agreement and its key schedules, including the output specification, performance regime, payment mechanism and handback.

- Consider creating a concise contract summary and a contract management plan to capture essential terms, processes and specifications.
- Keep a version-controlled set of all executed variations and relevant subcontracts.

Annex B illustrates the structure of a typical PFI contract and how key provisions, such as asset condition and maintenance, may be spread across different parts of the documentation.

- **Follow contract processes**

Apply the formal processes set out in the project agreement, for example for monitoring and change control. The PFI Co and its investors are typically more included to use these processes rigorously; if the contracting authority does not, it risks weakening its position and reducing enforceability.

Foundations for Contract Managers

Section 6.1 continued

- **Maintain records and data**

Keep a complete and accessible record of all key documents, including:

- **Contractual document** for example the project agreement, financial model, schedules, subcontracts and all executed variations.
- **Operational documents** for example performance reports, asset surveys, as-built drawings, asset registers and maintenance plans.

Organise these records in a clear, accessible filing system with version control and an index to support continuity, audits and expiry planning.

- **Build constructive relationships**

PFI is long-term partnerships, and relationships strongly influence outcomes. This relies on all parties understanding the PFI contract and the different perspectives of the parties. Professional engagement should balance collaboration with the contracting authority's obligation to enforce the contract when required (and without fear of damaging the relationship).

6.2 Core actions to assure performance and deliver risk transfer

Monitoring and assurance are central to making risk transfer work and ensuring the contract delivers what is paid for. The actions below set out practical steps for contract managers to maintain service quality and enforce obligations throughout the life of the contract.

Understand the output specification

The output specification sets the standards for asset availability and service performance that underpin the payment mechanism and risk transfer. These requirements are often spread across multiple schedules and definitions, making them complex to navigate.

- Locate and review all relevant provisions in the project agreement and schedules including availability requirements, service criteria and performance criteria.
- Capture these obligations in the contract management plan so they are embedded in day-to-day management.
- Ensure the contract management team understands these requirements and can apply them consistently when monitoring performance or resolving disputes.

Foundations for Contract Managers

Section 6.2 continued

Monitor maintenance and lifecycle plans and delivery

Maintenance and lifecycle obligations sit with the PFI Co under the contract, but they must be actively monitored to ensure assets remain safe, functional and compliant throughout the term.

- **Maintenance:** Covers day-to-day activities such as reactive repairs and planned preventive maintenance (PPM), including statutory checks (e.g. fire safety, electrical testing, water hygiene).
- **Lifecycle:** Refers to the planned replacement of major components (e.g. roofs, plant, finishes) to maintain contractual standards over the full term.

Most contracts require the PFI Co to build up a lifecycle fund, often monitored by lenders, to ensure money is available for major works. The performance regime and lifecycle fund are designed to incentivise effective and efficient asset maintenance and replacement. If assets are well maintained, deductions are minimised and any surplus in the fund may be paid as dividends. If maintenance drifts toward reactive or lifecycle replacement is deferred, this increases the risk of service

disruption and may create short-term cash surpluses that can support dividend payments, particularly as senior lender oversight falls away once the debt is repaid.

The contracting authority should:

- Review maintenance and lifecycle plans (though there is typically little provision for the contracting authority to direct lifecycle).
- Check lifecycle spend against financial model forecasts (where spend data is available under the contract).
- Undertake assurance checks that maintenance and lifecycle tasks have been completed to the required standard.
- Review PFI Co condition surveys (where available) or exercise rights to undertake surveys.

Assure performance reporting and availability

PFI contracts require the PFI Co to self-monitor and report performance against the performance and service criteria. This should be transparent and accurate but should not be accepted without verification.

Foundations for Contract Managers

Section 6.2 continued

Contract managers should:

- Review monthly performance reports for completeness and consistency with contractual requirements.
- Sample underlying records (e.g. helpdesk logs, failure reports) to confirm that issues are logged and categorised correctly.
- Check availability assessments against the contract definition, including less visible criteria such as statutory compliance.

Apply the payment mechanism and check the payment calculation

The payment mechanism is core to risk transfer because it ensures the PFI Co shares the financial impact of failures and incentivises rectification and improvement. However, the mechanism and associated calculations are complex, creating scope for error or misinterpretation if not checked.

- Understand the performance regime and payment mechanism including service and performance criteria to help reviewing performance reports.
- Check that PFI Co applies the payment mechanism correctly in its reporting and invoicing, including deductions for availability and service failures.
- Review invoice calculations periodically for accuracy, including indexation, abatements, and pass-through costs, against the contract and financial model.
- Document any discrepancies and their resolution, maintaining a clear audit trail.



Breaking the mechanism into its constituent parts (e.g. availability deductions, KPI failure points, indexation, pass-throughs) can make checks more manageable.

Foundations for Contract Managers

Section 6.2 continued

Use contractual information rights

PFI contracts provide the contracting authority with rights to access information beyond routine monthly reports. Ideally these rights should allow access to verifiable source data and information that allows the contracting authority to assure itself of compliance. This is essential for maintaining oversight and protecting public services and value for money. These rights should be exercised proportionately and in line with the contract to support (amongst other things):

- Meeting legal obligations as the ultimate asset owner (e.g. health and safety compliance).
- Verifying reported performance and lifecycle delivery.
- Confirming the PFI Co's financial soundness.
- Supporting commercial discussions and statutory audits.
- Preparing for expiry by checking asset condition and maintenance records.

Contract managers should:

- Check what the contract provides for information access, including scope, level of detail and frequency.
- Use these rights to obtain supporting evidence where

needed, such as maintenance records, lifecycle plans, condition surveys and financial information (including the financial model where permitted).

- Document all requests and responses to maintain transparency and enforceability.
- Identify and address gaps in information early; where contractual rights are insufficient, negotiate additional data provision to address specific risks or issues.



Requests should always be proportionate and clearly linked to a specific need, such as verifying reported performance, checking compliance or preparing for expiry.

Escalate issues early and involve stakeholders

Delays in addressing problems can increase risk and cost. PFI contracts set out formal escalation routes to resolve issues while maintaining service continuity. Using these routes promptly helps prevent disputes from escalating and ensures that contractual remedies remain enforceable.

Foundations for Contract Managers

Section 6.2 continued

- Follow the contractual escalation processes for unresolved issues, starting with operational meetings and moving through to formal notice where required.
- Engage the PFI Co board when problems persist or require decisions beyond day-to-day management.
- Involve senior lenders while they remain engaged, as their oversight and financial leverage can incentivise compliance, particularly before the debt tail period ends.
- Keep a clear record of all steps taken, including notices, meeting minutes and correspondence, to support enforceability and future dispute resolution if needed.



Escalation is about solving problems quickly and protecting public value, not about being adversarial. Frame escalation as a means to restore compliance and maintain service standards.

Maintain effective day-to-day routines

Strong day-to-day routines are essential for preventing issues from escalating and ensuring the contract operates as intended.

- Maintain a structured governance calendar, including monthly operational meetings and periodic contract board reviews.
- Use meetings to review performance reports, planned maintenance and lifecycle works, ensuring these align with contractual obligations.
- Keep live issue and risk logs, updating actions and responsibilities after each meeting.
- Plan for operational constraints, such as scheduling lifecycle works around service delivery (e.g. school holidays, hospital downtime).
- Record decisions and agreements clearly, so they are auditable and enforceable if needed.

Foundations for Contract Managers

6.3 Illustrative examples

NAO reviews and Public Accounts Committee reports show the real-world consequences of weak monitoring in PFI contracts:

Authorities failing to track lifecycle delivery. Contracting authorities that did not monitor lifecycle investment found assets in poor condition at expiry, leading to costly remedial works.

Missed deductions for service failures. In some cases, authorities accepted self-reported performance without verification, resulting in significant value loss over the contract term.

Limited engagement with senior lenders during the debt tail. Contracting authorities that failed to involve lenders early in resolving issues lost the leverage that lender oversight can provide before debt is fully repaid.

The National Audit Office and Public Accounts Committee⁴ have reported that

“4 out of 9 authorities, which took ownership of PFI assets at expiry, were not satisfied with the asset’s condition. Any mismanagement of the expiry process could result in large sums of taxpayer’s money being wasted. A lack of attention from the public authorities running these contracts could also leave the public sector footing large bills for rectification work which the PFI company has already been paid to do.”

⁴ <https://committees.parliament.uk/publications/5144/documents/50775/default/>

Foundations for Contract Managers

7. Knowledge and skills for PFI contract management

Managing a PFI contract effectively requires both capacity and capability. Allocating sufficient people to manage a PFI contract can be a challenge in resource-constrained contracting authorities, but given the value of these contracts, the benefits of doing so are considerable. It is equally important that those managing PFI contracts have the necessary knowledge and skills.

Contract management and commercial skills are central to the contracting authority's Intelligent Client Function. These should be supported by technical, legal and financial expertise to ensure effective oversight. This section sets out the PFI-specific knowledge and skills required for day-to-day contract management.

7.1 Essential knowledge for contract managers

At a minimum, day-to-day management of a PFI project requires understanding of: The project agreement, including:

- The obligations that govern the provision of services by the PFI Co.
- The rights to information.
- Rights to access the asset.
- The output specification and performance regime.
- The financial model sufficiently to identify the planned maintenance and lifecycle spend and the agreed unitary charge.
- The payment mechanism to enable deductions to be made if services are not delivered to the agreed specification.
- Contract management manuals and best practice guidance, including any authority-specific processes.



Refresh this knowledge regularly and ensure new team members are briefed early.

Foundations for Contract Managers

7.2 Skills required for effective PFI management

PFI contract managers need a blend of technical and interpersonal skills to manage complex, long-term relationships and enforce contractual obligations. Key skills include:

Analyse and interpret data

PFI contract managers monitor performance through a wide range of reports and data sources. They must be able to:

- Absorb and interpret information from multiple systems and reports.
- Identify trends, anomalies and risks in performance data.
- Translate raw data into meaningful insights that can be discussed with stakeholders and used to drive action.

This skill is essential because contract managers are responsible for ensuring that performance issues are identified early and addressed effectively.

Collaborate effectively

PFI contracts touch many business areas, so collaboration is critical. Contract managers must be able to:

- Work with internal teams (finance, legal, estates) and external parties (PFI Co, service providers) to resolve issues.
- Build constructive relationships that support problem-solving and delivery.
- Apply understanding of the original procurement intent to support collaborative problem-solving and ensure operational delivery aligns with contractual scope.

Collaboration underpins effective contract management because no single team holds all the expertise needed to manage a PFI contract.

Manage stakeholders

Contract managers engage with a wide range of stakeholders, often with competing priorities. They must be able to:

- Identify key stakeholders and understand their interests.
- Manage expectations and maintain trust, even when delivering difficult messages.

Foundations for Contract Managers

Section 7.2 continued

- Influence outcomes through engagement and negotiation, even without formal authority.

This skill ensures that decisions are informed, risks are managed and relationships remain constructive over the long term.

Communicate and influence

Clear and timely communication is essential for effective contract management. Contract managers must be able to:

- Explain complex contractual and performance issues in plain language.
- Communicate clearly and professionally with PFI Co and internal stakeholders.
- Use influencing skills to secure cooperation and resolve issues without escalation where possible.

Strong communication and influencing skills help maintain constructive relationships and ensure that obligations and expectations are understood by all parties.

Resolve issues and coordinate activities

PFI contracts involve multiple moving parts, and issues often arise that require prompt action. Contract managers must be able to:

- Organise and prioritise multiple tasks, often under time pressure.
- Follow up on issues, monitor progress, and ensure timely resolution.
- Apply initiative to resolve problems, knowing when to escalate or seek specialist input.
- Coordinate activities such as site visits, audits and planned maintenance, ensuring minimal disruption to services.

This skill ensures that operational challenges are managed effectively, and contractual obligations are met.

Interpret contracts and apply critical thinking

Critical thinking is a core capability that supports all aspects of contract management. It is particularly important when interpreting complex contractual documents and making decisions that balance compliance, risk and operational realities. Contract managers must be able to:

Foundations for Contract Managers

Section 7.2 continued

- Navigate and interpret contractual documents, including schedules and technical specifications.
- Understand the implications of contractual provisions for operational decisions.
- Apply critical thinking to assess whether current practices align with contractual obligations and to evaluate the wider impact of decisions.
- Consider the original procurement intent when interpreting contractual provisions and assessing operational practices.
- Identify gaps, ambiguities and risks in documentation and advise on appropriate actions.

This skill is essential for ensuring compliance while enabling informed, balanced decision-making.

Maintain risk awareness and problem-solving

PFI contracts carry long-term risks that need proactive management. Contract managers must be able to:

- Anticipate potential risks to service delivery, compliance or value for money before they materialise
- Monitor early warning indicators and take preventive action.
- Analyse root causes of recurring issues and embed long-term mitigation strategies.
- Promote a proactive approach to risk management, making it part of day-to-day practice rather than a reactive response.

This skill helps prevent issues from escalating and ensures that risks are managed effectively throughout the contract lifecycle.

Foundations for Contract Managers



Annex A: Key contractual documents

Contract	Detail
Project agreement	<p>Who is involved: The contracting authority and the PFI Co.</p> <p>What is its purpose: It is the main agreement for the PFI project and it:</p> <ul style="list-style-type: none"> • Governs the relationship between the contracting authority and PFI Co. • Sets out the rights and obligations for service delivery by the PFI Co. • Defines payment mechanisms and risk allocation.
	Subcontracts
Construction agreement	<p>Who is involved: The PFI Co and construction contractor.</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • The project agreement sets out the PFI Co's obligations for building or refurbishing the asset. The construction contract passes down design and build obligations from the project agreement. • Typically, a turnkey contract where the contractor takes risk for completion on time and to specification (subject to any provisions where completion can be postponed or where additional costs are met).
Service agreement	<p>Who is involved: The PFI Co and service provider(s).</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Sets out the obligations for delivering services such as facilities management and lifecycle maintenance. • Applies primarily during the operational phase, but service providers may also support commissioning.

Foundations for Contract Managers

Contract	Detail
Management services agreement	<p>Who is involved: The management services company and the PFI Co</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Defines scope of management services, including company secretarial, financial administration, reporting and technical support (e.g. lifecycle planning, performance monitoring). • Provides the PFI Co with the necessary skills and capacity to deliver the project.
	Finance documents
Credit agreement	<p>Who is involved: The senior lenders and the PFI Co.</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Sets out the terms for senior debt financing, including: <ul style="list-style-type: none"> • Loan terms, repayment schedule, and covenants. • Conditions on use of funds and security package. • Establishes project bank accounts for all cashflows.
Lenders direct agreement	<p>Who is involved: The senior lenders, the contracting authority and the PFI Co.</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Provides lenders with notice of termination and step-in rights if the PFI Co defaults. • Protects lenders by allowing time to remedy defaults before termination.
Lenders direct agreement	<p>Who is involved: The senior lenders, the contracting authority and the PFI Co.</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Provides lenders with notice of termination and step-in rights if the PFI Co defaults. • Protects lenders by allowing time to remedy defaults before termination.

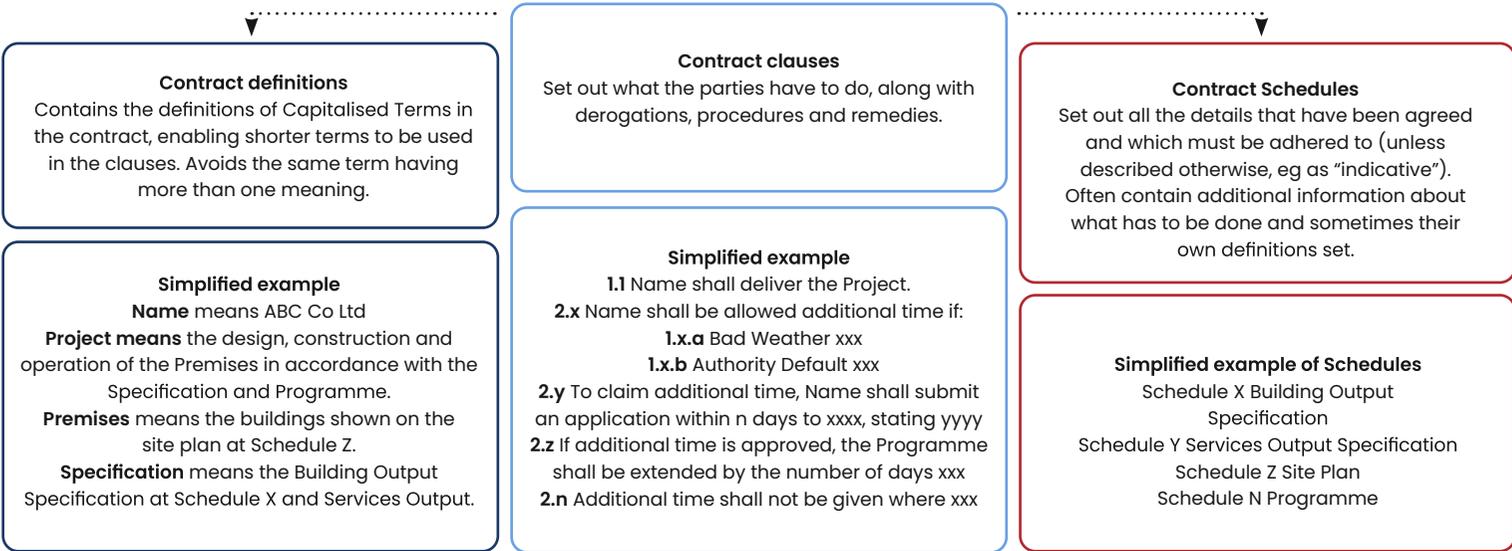
Foundations for Contract Managers

Contract	Detail
Hedging document	<p>Who is involved: The swap provider (which is often part of the lender group) and the PFI Co.</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Manage interest rate risk (and in some early PFIs, inflation risk) through hedging arrangements. • Typically involves swapping variable interest for fixed. See Section 3 for more detail.
Collateral warranties	<p>Who is involved: Senior lenders and the PFI Co's technical supply chain including architect, surveyors and engineers.</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Extend duty of care from key consultants to senior lenders. • Provide lenders with rights to take legal action against consultants if needed.
Performance bonds	<p>Who is involved: Senior lenders with subcontractors and service providers.</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Provide a performance bond from a bank or insurance company as security for the lenders in the case of default to provide further funding for the project. • May be replaced by a parent company guarantee if the contract has a strong balance sheet.
Shareholder agreement	<p>Who is involved: Equity investors only</p> <p>What is its purpose:</p> <ul style="list-style-type: none"> • Regulates how the equity investors manage the PFI Co, including: <ul style="list-style-type: none"> • Processes for providing equity investment. • Voting rights, dispute resolution and dividend policy. • Share disposal process and rights of first refusal on share sales. <p>See Section 3 for more detail.</p>

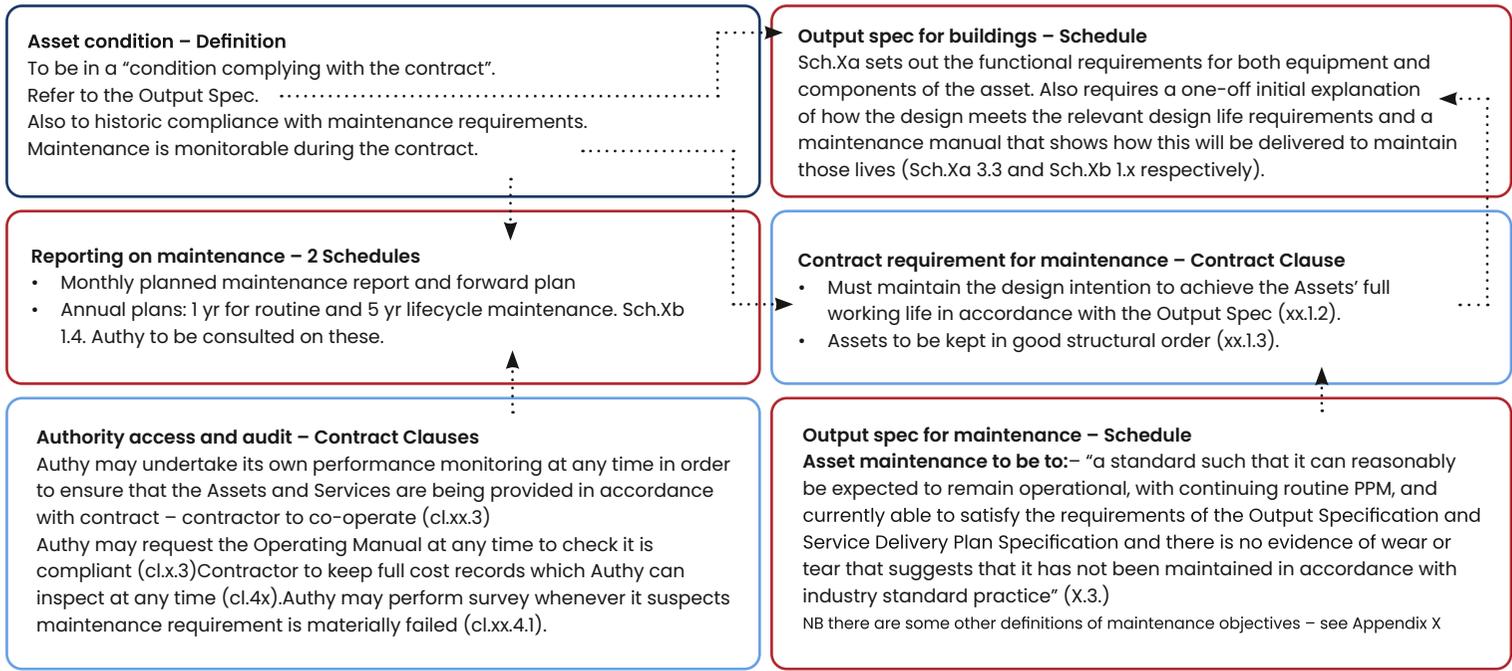
Foundations for Contract Managers

Annex B: Illustration of PFI contract structure

The diagram below shows three of the main elements of a PFI contract structure. The diagram is illustrative, and the structure of your contract may vary. Given the size and complexity of the contract, the contract will set out the relative priority ('precedence') of each element in the case of conflicting terms.



The provisions can also be spread across these provisions. The diagram below provides an illustrative example of this for asset condition and maintenance.



Key

- Contract Causes
- Contract Definitions
- Contract Schedules