



This month, February 2011, acumen7 member John Pilkington looks at some often innovative solutions to getting 'more for less' in the public sector. The members of acumen7 bring their skills and experience together so that they can offer innovative solutions to today's complex problems.

## Infrastructure Funding in the Age of Austerity



The UK economy is in a fragile state; financial institutions around the world are exhorting our government to spend less and tax more; already some of the bigger capital projects have been axed, and many more are under threat; the autumn spending reviews will reflect the now widely accepted mantra that 'we cannot spend what we do not have'. There is also a view, however, that the economy would benefit greatly from new public infrastructure, and from the thousands of jobs created by these projects.

So, how can we square this circle? How can we access the vast pools of private funding that is readily available for government-backed projects? How can politicians satisfy the country's need for new schools, new transport systems, and new defence equipment, and at the same time balance the UK's books?

### Introduction

Many of the tools are already in our communal kitbag. Many have been used in different circumstances, but could be refreshed and then mobilised to tackle these new challenges. All have at their heart the ideal of delivering 'more for less'; many leverage the public sector's assets to achieve - in joint venture with the private and third sectors - far more than could be managed by the public sector alone. Here are but a few of the options at our disposal:

### Better Procurement

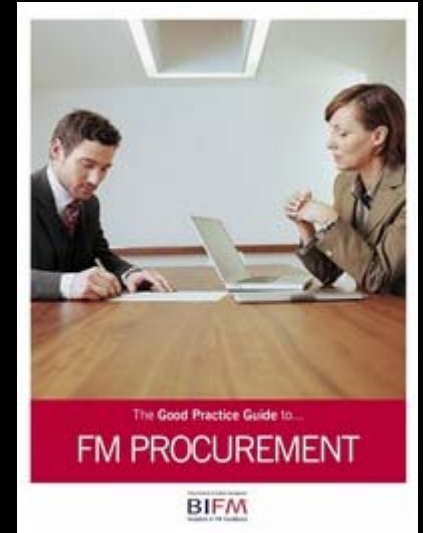
**Central procurement expertise** is essential to achieve the necessary standardisation of approach, rapid decision making, and value for money risk allocations. These teams could be area-based, and might employ incremental

partnership techniques.

There is evidence that collaborative working between public and private sectors is more effective than simple 'arms length' transactional relationships. This is best delivered through **business-like joint ventures**, where aligned objectives are an essential ingredient for success, and where private sector profit motives can sit alongside social purpose.

These '**Good Partnering**' techniques should be adopted during the tendering process, so that procurement times and costs are reduced to a minimum, the joint venture business starts as it means to proceed, and the prospects for a sustained high value relationship are high. The EU's so-called 'restricted procedure' has many merits, and could ensure the selection of the preferred partner in 3 months or less.

Area-based solutions in respect of infrastructure development might be employed more commonly. There have been instances of **joint procurement between public sector bodies**, for example, in street lighting and between the NHS and local government, but they are not yet commonplace.



### Accessing Private Sector Funding

New forms of financing will bring added value; one solution is to obtain access to **institutional funding**. In principle, there is a close match between the funding requirements for PPP and PFI schemes, where affordable long term finance is required, and the investment needs for pension funds, which want long term, low risk investments. More effort might be invested in designing and facilitating a role for institutional investors in the primary financing role in public private partnerships.

**New tax sources** might be used to provide finance. Supplementary Business Rates will be used to finance Crossrail and could be used for other projects. The use of Tax Incremental Financing has been widely discussed in connection with Accelerated Development Zones. These approaches could help kick start redevelopment schemes in some areas, albeit at the risk of more public borrowing now; this will need to be repaid from future prospective tax income which would be unguaranteed and uncertain.

In the past, enterprise zones have been established to stimulate investment in times of recession. In the case of development zones, investors were freed from paying business rates for 10 years, and tax **benefits in the** form of accelerated capital allowances and corporation tax benefits were put in place. Such schemes did create a focus for development, and the zones did achieve quicker development of areas of need. The **use of tax policies** to generate capital investment in infrastructure might therefore be considered.



Increased **charging for services** might be considered. New charges or higher charging could be introduced for a range of services. Roads and motorways appear to be the most suitable areas, where the increased use of road tolls and congestion charging (possibly linked with hypothecated spending) could provide income streams to finance new highways, motorways and river crossings. Issues of equity and economic impact would need to be taken into account when any charging was considered.

### Maximising Public Sector Funding

Public sector bodies continue to be 'asset-rich', and solutions based on accessing that wealth (subject to Treasury agreement...) to secure improved infrastructure might be sought. Precedents of successful redevelopment using asset leverage exist; however, these date back to when the market conditions were different. To have real impact

on infrastructure, the scale of redevelopment would need to be substantial, and the amount of assets transferred significant. Addressing this through area-based development companies or **local asset-backed vehicles** might be a way forward. Structuring such vehicles as real estate investment trusts or limited liability partnerships to facilitate tax relief – and thus secure outside investment – might be considered.

Public sector bodies also continue to be 'service-rich', and this affords an opportunity to **securitise multiple long-term operational and maintenance revenue streams**; both to provide initial capital injections and to service the debt repayments. The construction of new administrative offices, with modern IT systems, perhaps for two or more Local Authorities, could be the catalyst for more efficient and cost effective back-of-house operations. This was the basis of the far-sighted Northants and Milton Keynes (NMK) Strategic Partnership ten years ago, which ultimately failed owing to lack of political will.



Infrastructure provision should allow flexibility in revenue budget management. This requirement is at odds with the solutions provided by both PFI and conventional procurement, which envisage long term asset ownership, long term financing and firm commitment to asset maintenance. The current arrangements for most if not all PPP and PFI contracts inhibit future flexibility rather than support it. This arguably suggests less long term ownership of non-specialist assets, **more operating leasing**, and effectively the development of more standardised multi-use buildings. The feasibility of such radical approaches would require careful analysis of need, and consideration of the merits of alternative buildings for service delivery.

The extension of **prudential borrowing** might be considered. Local authorities throughout Great Britain have had prudential borrowing powers since 2004. These powers have been used extensively; in 2007/8 over £3bn of prudential finance was employed in England to support projects. This finance is readily available at lower rates of interest than private finance, and has been used to facilitate projects that would have otherwise been difficult to finance. The prudential borrowing regime has been extended to Foundation Hospitals from April 2009; however, this is a more restricted facility than that available to Local Authorities.

### Restructuring and Partnerships

It has been demonstrated through pilot projects promoted by OGC and the Shareholder Executive, and also by 'Total Place' initiatives in Worcestershire and Kent, that publicly-owned assets within an area or community can be easily **rationalised across a number of agencies**. The resulting cost efficiencies, sustainability improvements, and accessibility enhancements can be dramatic, and the release of locked-in capital welcomed by cash-starved Authorities.

Other forms of Partnership have been procured through Government Agencies such as Partnerships for Schools (Pfs) and Partnerships for Health (Pfh). In these arrangements, joint ventures between the public, private, and sometimes also the third sector, have committed to develop the Authority's school or health estates over a number of phases. The joint ventures are established for ten to fifteen years, and are required to demonstrate **continuous improvements in quality and price** on a year-by-year basis. Furthermore, if the 'softer' partnering behaviours fail, then the joint venture can be terminated. Despite recent criticisms, this is a very effective way of renewing the public infrastructure.



### Conclusions

**So, it can be seen there are many opportunities for the UK to build on its extensive experience in the financing, and re-financing of public infrastructure. Indeed, there are few weeks when yet another delegation from overseas is not visiting and discussing with our many experts the future of private finance, and the means of leveraging this into**



public projects. It is vitally important that we do not 'throw the baby out with the bathwater' in these times of economic constraint, and that all Authorities seize the opportunity to carry out detailed options appraisals in their continuing search for cost efficiencies.

### Postscript

This article was first published on the Public Finance blog site in autumn 2010. Since then, the recent Treasury guidelines on PFI, published on 26th January 2011, have confirmed that the UK Government is broadly content with the way PFI and PPP contracts are structured. In the detail however, the Treasury is encouraging public sector clients to stick to the original specifications, and not to 'tinker' with the desired outputs after procurement has commenced. They are also encouraging Authorities to make greater use of the value of the public estate when structuring the financial contracts.



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