Position paper:

Public Private Partnerships and PFI Projects

April 2013

At a Glance.

Unlocking Private Sector investment will be key to creating a world-class UK infrastructure.

It has become increasingly clear that the way private finance is used to fund public infrastructure in the UK is no longer viable.

New approaches will be needed that create alternative channels for private sector infrastructure investment.

Where we Stand.

We have already invested £1.2 billion in UK recycling and waste management infrastructure. It's something that will have an enormous positive impact on the UK economy. But in our view, if the private sector is to continue financing waste infrastructure, three things will be required. Firstly, the planning system for waste must be streamlined and the regulations eased at each stage of the process to encourage investment and to recognise that many modern waste developments are similar in nature to other industrial and distribution land uses. Secondly, there needs to be a clear and consistent policy framework within which to bring projects forward and thirdly, there must be real certainty about the main drivers, irrespective of which political party is in power. Any investment for 25 years or more must present the right balance of risk and reward between the Private and Public Sectors.

The success of any new economic models will depend on how well new projects address the wider political and financial concerns that have been raised. We believe the following will be the key issues:

- Unlocking Private Sector investment.
- Creating the right conditions.
- Developing a structure and a way of funding that is workable; including the right protocols to address changes in projects.
- Creating a structure that promotes genuine partnerships.
- Establishing a culture that achieves aims, but also encourages contractors.

Turning waste into a resource

VEOLIA ENVIRONMENTAL SERVICES

The Situation.

It has become **increasingly clear** that the way private finance is used to fund public infrastructure in the UK is no longer viable.

New approaches will be needed that create the stability needed for Private Sector infrastructure investment. Only then can we look forward to a **positive impact on the UK economy.**

With the Private Finance Initiative (PFI) coming under increasing pressure, the Government has been looking at ways in which the situation can be improved.

It should not be overlooked that while the perception was that the Private Sector was making exceptional profits out of PFI, in reality many bids were being withdrawn. With no guarantees and the entire investment and planning permission risk shouldered by the Private Sector, the balance between risk and reward was simply not good enough.

In December 2012 the Government unveiled its revamped system for private finance (PF2). New contract forms will see the Government take a stake in the majority of future PFI schemes. Combined with the streamlining of the planning system, this should strike the right balance and provide the stability and reassurance that investors need. It will also ensure any excess profits are shared with the taxpayer. The system also puts a time limit of 18 months on PFI bidding processes and forces project companies to publish their revenues and profits.

Where we Stand.

Ironically Veolia believes that, by and large, Waste Projects (whether PPP or PFI) have **delivered a positive benefit.**

More importantly, they have also resulted in the recycling and diversion from landfill that are the key aims of those projects. A good example is the PFI Project for Brighton and Hove City Council and East Sussex County Council which now boasts an impressive suite of Waste, Recycling, Composting and Recovery facilities.

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The Challenges.

1. Unlocking Private Sector Investment

Many UK Waste Authorities have procured the infrastructure required to provide the treatment facilities and related infrastructure to deal with Municipal Waste. Others are already in the process of doing so as the UK does not yet have the complete infrastructure which is needed. This kind of infrastructure is critical to the wider UK's economic and social infrastructure networks. It helps economic growth, boosts exports and creates jobs, while improving the quality of life and the environment in which we live.

But the quality of our infrastructure has far wider-reaching consequences too. We know it's central to the competitiveness of the business environment that the UK can offer. The reliability of transport networks, the security and cost of energy, the quality of public services, the resilience of water and waste services, the speed of broadband connections; these are all critical factors when firms decide whether to do business in the UK.

Surveys show that the UK infrastructure compares poorly with economies that closely resemble ours. But more importantly, it's something that has not gone unnoticed. If we are to attract new business to the UK, it's vital that this perception is changed.

The nation's infrastructure networks require £200bn of investment by 2015 in economic infrastructure alone. This is essential to meet increasing demand and support long-term growth in the UK economy. It will also provide good economic returns in the short term, stimulating immediate economic growth. But with little room for manoeuvre in the Government's fiscal plans and constraints on public budgets the majority of this new investment (>70%) must come from the Private Sector.

Investing in infrastructure on the scale required presents a huge challenge. No-one knows that more than us. We've already delivered £1.2bn of infrastructure (£250m in 2012) and have programmes in place to provide £1bn more in the future.

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Privately financed infrastructure projects are already a feature of the UK economy. Since 1992, PFI/PPP have been behind economic and social infrastructure projects across the Public Sector. Hundreds of schools and hospitals have been built or modernised. Furthermore, the innovative thinking of Private Sector partners has transformed our approach to highway maintenance and waste management.

Waste PPP projects deliver more than much-needed infrastructure; they also provide key employment and training opportunities. For example, a facility that was commissioned recently created over 350 temporary construction jobs over its three year build. It also created 65 permanent positions.

That's great news all round. But to maximise the potential for private investment in UK infrastructure like this, we need to standardise how infrastructure assets are traded. New investment products will need to be developed, but the regulations that hinder investment will also need to be removed. For example, obtaining planning permission is a lengthy, time consuming and expensive process.

It can often be the subject of political whim or become the victim of political squabbles. These projects are too important to be decided by such processes. Other issues, such as energy policy, fiscal policy and general environmental regulation also need to be clear and understandable to encourage and sustain investor input.

What can we expect to happen?

The potential to increase Private Sector investment in the UK economy is significant. Investment (the Government's forward investment programme) and the way in which Regulated Asset Based models for our digital, water, waste and energy networks are governed in the future will also play a part.

We believe that this action will create the right demand for infrastructure investment. So we can look forward to the UK's infrastructure networks offering world-class opportunities for investors in an internationally-competitive market.

2 Partnerships with public authorities

Waste projects are a long term commitment. Increasingly we're seeing 25-30 year projects for treatment and disposal and 7-14 year projects for collection and recycling. As local authorities struggle with the challenges of budgetary constraints and demands for social care, waste services are going to be high on the agenda for discussion.

New thinking and innovation will be needed to maintain high service levels whilst giving best value to tax payers and rewarding private contractors fairly. But risk will be key to the success of any efforts to increase private investment. What's needed is a clear conversation between the Government and the market; one that outlines the risks involved in different types of projects and how they will appeal to different types of investor.

Since PFI was introduced, much has been learned about risk and the Private Sector. As a basic principle, whether it's operational, financial or political, risk should be borne by the party that can manage it most effectively.

There has been a trend towards certain sectors taking on greater levels of risk including insurance, IT, energy costs, interest rates, employee transfers and pensions. But this has cost implications and private investment in a project may not be viable if it is not handled appropriately. Transferring risk, effectively and economically, requires an emphasis on sharing rather than simply off-loading it from the Public to Private Sectors.

In addition, unlocking the potential of private capital demands equally urgent action on the supply side. Measures will be needed to encourage investors (including pension, insurance and private equity fund managers) to invest their capital resources in UK infrastructure. The aim should be to create a genuine, open partnership between the Public and Private Sectors. One that gives each side confidence in the long-term viability and affordability of private investment.

So what other barriers are there to increasing investment levels?

The lack of expertise in infrastructure investment in the UK pensions and insurance sector remains a significant hurdle. Stand-alone infrastructure investment funds are already active in the UK. However, an approach that builds on the Canadian experience of direct investment in infrastructure projects could be the solution. It would help to realise the full potential of private finance at the same time as creating a competitive market in infrastructure investment opportunities.

What's also needed is a change in the political debate on this issue. Effective leadership, which manages political risk and aligns the Public and Private Sectors, will be crucial. To date, private infrastructure investment has been accompanied by political hostility. Bridging the infrastructure funding gap will only be possible if we acknowledge that private capital often costs more to raise than Government borrowing. But without it, the alternative is to delay investment or ignore the current deficit reduction plan, neither of which we believe are the right way forward.

Another big issue in public projects has been the procurement processes. The introduction of the Competitive Dialogue procedure has meant a huge commitment. Not least in terms of the cost required to develop proposals to a degree that should not really be necessary. This cannot continue. Procurement processes need to be far less cumbersome and based on commercial reality. Making the early stages simpler, and taking heavy cost commitments out of the equations until the later stages of procurement, will encourage greater competition.

An improved procurement processes could also play an important role in harnessing a variety of expertise from Private Sector partners. Quicker, cheaper bidding processes will be key to attracting a wider range of small and medium sized businesses into the UK infrastructure markets.

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A final word

Whatever the future holds for public infrastructure investment, flexibility is the key. 25 years for a project should not be written in tablets of stone. We believe the length of a project should be related to the assets and services being procured to gain maximum value from depreciation and/or amortisation. And that means that some projects may be shorter and some may be longer than the 25 year norm.