ESSU **Research Report** No. 4

The £10bn Sale of Shares in PPP Companies

New source of profits for builders and banks

Dexter Whitfield

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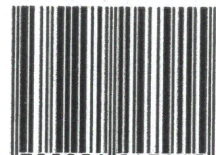


European Services Strategy Unit
(Continuing the work of the Centre for Public Services)

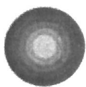
Global PPP research

This Research Report is part of a wider study of the sale of PPP equity and the growth of a secondary market focused in the UK, but also including other EU countries, US, Canada, Latin America, Australia and other countries with significant numbers of PPP projects. The final report and the Global PPP Equity Database will be published later in 2011.

PPP: Public Private Partnership

PFI: Private Finance Initiative

January 2011



European Services Strategy Unit

(Continuing the work of the Centre for Public Services)

Dexter Whitfield, Director
Adjunct Associate Professor, Australian Institute for Social Research, University of Adelaide
Mobile +44 (0)777 6370884
Tel. +353 (0)66 7130225
Email: dexter.whitfield@gmail.com
Web: www.european-services-strategy.org.uk

The **European Services Strategy Unit** is committed to social justice, through the provision of good quality public services by democratically accountable public bodies, implementing best practice management, employment, equal opportunity and sustainable development policies. The Unit continues the work of the Centre for Public Services, which began in 1973.

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Executive summary

Government monitoring of the sale of equity in PPP companies is inadequate, infrequent and under-estimates the scale of transactions. Meanwhile banks and construction companies are ratcheting up large profits extracted from what is ultimately publicly financed investment.

The sale of equity is significantly higher than that the sales identified in HM Treasury PFI equity database and estimated by the National Audit Office. This study finds:

- **240 PPP equity transactions involved 1,229 PPP projects (including multiple sales) valued at £10.0bn.**
- **Average profit was 50.6%** (compared to average operating profits in construction companies of 1.5% between 2003-09).
- £517.9m profit from a sample of 154 PPP projects.
- If the same level of profit was maintained for the 622 PPP project equity transactions **the total profit would be £2.2bn.** (This excludes the undisclosed profits obtained in the sale of secondary market infrastructure funds).
- Two sectors had higher than average profits, health (66.7%) and criminal justice (54.9%) with transport (47.1%) and education (34.1%) below average.
- The average PPP equity transaction is valued at about £10m but the actual amount varies according to the percentage of shares being sold, the capital cost of the project and other factors relating to the financing of the project.
- Sale of equity in PFI/PPP companies rose rapidly in last decade increasing rapidly from 2003 and continued largely unaffected by the global financial crisis.
- The Treasury and National Audit Office failed to identify the true scale and profitability of PPP equity transactions.
- Multiple sale of equity in many projects – HSBC acquired full ownership of Barnet Hospital through four equity transactions raising its stake from 30% to 100%. The HSBC infrastructure fund is registered in a tax haven.
- Growth of joint ventures and new secondary funds infrastructure funds to own PPP assets.
- Increased use of tax havens for UK infrastructure funds – 91 PPP projects with 50%-100% equity ownership with funds registered in tax havens.
- Equity in 7 large PPP projects in Newcastle was sold in the last five years, accounting for three-quarters of the city's operational PPP projects – three have equity owned by infrastructure funds registered in tax havens.
- At least five companies, Interserve, Amec, John Laing, Costain and Vinci, transferred PPP equity to their pension funds in lieu of cash payments or the transfer of other assets.

Recommendations

1. The standard PPP contract should be re-written to include a ceiling imposed on the level of profits that can be extracted from PPP equity together with a requirement that the public sector should have a 50% share in any profit above a specified level.
2. A new value for money methodology should be devised to take account of the profiteering in PPP equity transactions and the other flaws in the current evaluation methodology.
3. New transparency and disclosure requirements should be introduced as a matter of urgency requiring more expansive notification about equity sales.
4. The Treasury PPP equity database should be significantly extended to include all historic and future PPP equity sales. This should be publicly available and regularly updated.
5. The National Audit Office and Treasury should research the longer-term effects of the growing secondary market.
6. Ultimately, the negative effects of the PPP equity secondary market can only be solved by the termination of the PPP programme combined with new regulatory controls on existing projects.

1. Sale of PPP equity and growth of the secondary market

Each Private Finance Initiative (PFI) or Public Private Partnership (PPP) project has a Special Purpose Vehicle (SPV) or company in which the construction company, bank or financial institution and the facilities management company have an equity stake, with each companys shareholding relative to their contribution to the project. The SPV signs the contract with the public authority and finances construction by borrowing, usually bank loans or bonds, that account for between 85%–90% of the financial resources with the equity shareholding in the SPV accounting for the remaining 10%–15%. Construction companies post profits from their PPP operations in their annual accounts. Profit from the sale of equity in SPV companies is a one-off additional profit but the purchasers of the equity clearly expect to make further profits over the remainder of the contract.

This report is concerned solely with the scale of and profit from PFI and PPP equity transactions (referred to as PPP companies in this report). There are basically two types of transactions. Firstly, the direct sale of equity by the SPV shareholders, either in individual or small groups of projects. Secondly, the sale of secondary market infrastructure funds that have a portfolio of PPP equity stakes in SPVs. In both cases the partial or full ownership of equity in the SPV transfers to a new owner. PPP equity ownership also changes when a construction company is subject to a takeover or merger, however, the value of PPP assets will normally be reflected in the overall takeover price and will not be identified separately.

Once construction is completed and the building or project is operational, most of the risk has been eliminated. At this stage some PPPs are refinanced to take advantage of lower interests on bank loans available because the main construction risks are no longer applicable. In addition, the shareholders in the PPP company can choose to sell part or all of their shares in the company. The PPP contract will normally impose a restriction on the sale of equity prior to the completion of the building works and commencement of the service. Once operational, contractors can sell their equity and are only required to inform the authority within 30 days of any change of ownership. Refinancing and the sale of PPP equity comprise the secondary market.

Some PPP companies have a policy of retaining ownership of equity in SPVs whilst others recycle their investments by selling equity to help finance new PPP projects. Four trends are evident in the secondary market:

- portfolio building by some construction companies;
- recycling and profit-taking by other construction companies;
- growth of joint ventures between PPP construction companies and banks, infrastructure funds and pension funds (see page 11);
- growth of secondary market infrastructure funds (listed and unlisted).

Global Auction of Public Assets identified for the first time the scale of equity trading and highlighted some examples of high rates of profits (Whitfield, 2010). It examined the sale of equity in 618 PPP projects in the UK between 1998-2009 through individual or group transactions and the sale of secondary market infrastructure funds.

Government adopts 'hands-off' attitude

Although public sector consent and profit sharing is required when PPP projects are refinanced, there are no requirements when the equity of PPP companies is sold. The Treasury has regarded the sale of PPP equity as a transaction solely between private companies in which the government has no involvement. It argues that a change in the equity ownership of the project is part of the normal takeover or merger of companies and is different

from refinancing projects. The National Audit Office (NAO) position is summarised in their evidence to the House of Lords investigation into PFI projects and off-balance sheet finance:

> *"In general, the shareholders of a project company are allowed to trade their PFI shares freely, as they would any normal shares of a limited company. Only occasionally would a public authority have a say in such trades, such as a right to consent (not unreasonably withheld) in certain Defence contracts. The public authority is not a party to such trades and does not share in any proceeds. It is therefore important that the expected return to the shareholders over the course of the whole contract be carefully scrutinised during the contract tendering"* (House of Lords, 2010b).

This view is shared by Local Partnerships, the PFI support agency for local authorities:

> *"Holders of shares in Contractors will not want their ability to transfer their investment to be restricted. This is because allowing them to transfer their investments in Contractors extends the availability of capital for projects, makes the market more liquid and, as a consequence, can help improve value for money"* (Local Partnerships, 2004).

The NAO believes that the sale of PPP equity has, in theory, *"...had a positive effect on the availability and cost of equity capital in the primary market. The secondary market provides some confidence to primary market investors that they will have an exit opportunity and that they will not be tying up capital for the full length of the contract. This confidence could mean more investors and more capital in the market, which in turn drives competition and reduces the cost of equity finance"* (ibid).

Longer-term consequences ignored

The NAO recognises that the risk of the consolidation of PPP equity could lead to *"...disproportionate market power, and particular asymmetry of power over small public authorities tendering and managing single PFI contracts. We would be concerned if we started to see a few consolidated owners dictating contract and commercial terms. We do not have evidence that this is happening"* (ibid). It concedes that *"...the lack of visibility over the secondary market it is difficult to ascertain the effects that the secondary market has had to date"* (ibid).

They believe that changes in the share-ownership of a SPV *"...has few direct effects on the operational aspects of the project. The contractual terms are unchanged, and the organisations and people delivering the project will rarely change. The project company will remain responsible for the delivery of the project, but will seek to pass as much of the risk associated with that delivery to sub-contractors. Consequently, the key relationships between the public authority as client and the Project Companys sub-contractors will remain unchanged"* (ibid).

The NAO assumes that the growing secondary market will have little or no effect on PPP projects, services users, staff and public bodies. However, *Global Auction of Public Assets* raises a number of important issues about the potential effects of the sale of PPP equity and the growth of secondary market infrastructure funds:

- invalidation of value for money claims;
- allocation of benefits from operational efficiencies;
- privatisation of gains from publicly financed investment and development;
- erosion of democratic control;
- increasing secrecy;
- acceleration of marketisation of public services;
- longer-term implications of the growth of secondary market funds and the potential effect on the delivery of core services (Whitfield, 2010).

The Treasury and NAO are either unaware, or have decided to ignore, the excessively high profit levels obtained in PPP equity transactions.

Lack of evidence to date

The NAO's and the Treasury's ambivalent attitude underlines why they have so little information about the sale of PPP equity.

HM Treasury only began tracking changes in PFI equity ownership in 2008 and the information simply records the change in ownership and/or percentage shareholding – it does not include the value, profit/loss, date of sale, reason or any other data. The Treasury database records nearly 90 changes in equity ownership between 1 February 2008 and September 2009 (it has not been updated since then). This is only a fraction of actual equity transactions. The database records no information being available for many projects.

The Partnership UK database includes changes in ownership but there are significant gaps. There are also inconsistencies in PPP equity ownership information between the Partnerships UK and HM Treasury databases.

Companies are required to publish Regulatory Notices, Interim and Annual Reports and Corporate Press Notices geared to satisfying market information needs. The fact that virtually all PPP projects are ultimately totally reliant on public expenditure is regarded as a commercial advantage because of risk reduction, particularly in Prospectus and Offer documents of new infrastructure funds, as this reduces risk. This is not reflected in public disclosure requirements. Most company annual reports describe their commitment to Corporate Social Responsibility, but PPP equity sales provide further proof of its limited relevance and authenticity. A radical overhaul of regulatory requirements and good practice is urgently required.

The NAO claims that *"…most of what happens in the secondary market falls outside the remit of the National Audit Office. Whilst the National Audit Office has access rights to the documentation of PFI sub-contractors (where they relate to the accounts of a body we audit), we do not have access rights to documents belonging to shareholders. Our information on the secondary market is thus restricted to data collected from public authorities and contractors, as well as our general monitoring of the sector (and) has an interest in the effect of the secondary market on the value for money of PFI contracts*" (House of Lords, 2010b).

ESSU Global PPP Equity Database

The PPP Equity Database has been compiled to track the sale of equity in PPP projects and the sale of secondary market infrastructure funds. Each transaction leads to a change in partial or full ownership of the SPV company.

The Database was compiled from the following sources:

- Stock Exchange Regulatory News Service and Company Notices and Press Releases
- Company Interim and Annual Reports & Accounts
- UK Companies Houses filings
- Infrastructure fund share prospectuses
- Construction and PPP company websites
- Partnerships UK Database
- HM Treasury PFI equity holders database
- Securities & Exchange Commission 8K filings for US stock exchange companies
- Financial, construction and infrastructure journals and web sites.

The Database was developed from the evidence of PPP equity transactions in chapter 7, <u>*Global Auction of Public Assets*</u> that covered 618 PPP projects. The new database identifies a significantly larger scale of PPP equity transactions in the UK with a substantially higher level of profits. This Research Report is part of a wider study of the sale of PPP equity and the

growth of a global secondary market focused in the UK, but also including other EU members, US, Canada, Latin America, Australia and other countries with significant PPP projects. The final report and the Global PPP Equity Database will be published later in 2011.

Because of the degree of transparency of the sale of PPP equity being limited and with few disclosure requirements, there are significant problems concerning access to, and the quality, of information. Many publicly listed companies will issue a Regulatory Notice or Stock Exchange announcement disclosing the acquisition or disposal of PPP equity, but in some cases companies consider the transaction is not of material financial interest. Privately-owned companies and private equity funds have no comparable disclosure requirements.

Some companies issue press releases to announce PPP equity acquisitions/disposals but most corporate media communications focus almost exclusively on contract awards, statutory notices on share dealings and changes in company directors. A company may report the details of an equity sale or acquisition in their interim or annual report, but may not indicate the price, level of profit nor to whom they sold their shareholding. There is no common practice or standard requirement.

Obtaining information about PPP equity deals in companies subject to takeover or merger is also extremely difficult, as even annual reports and regulatory news announcements are often removed from corporate web sites shortly after acquisition. Companies may not wish the market to know they are selling a shareholding in case this is taken as a sign of financial instability and thus affect the company's share price. This further limits the information made available. Non-profit companies or social enterprises, such as care providers, release little or no information on the sale of equity in projects, presumably because this does not fit with the image they seek to portray.

Accountancy practices

Companies have a degree of flexibility and scope to manipulate how they account for income and expenditure, profits and losses and taxation between SPVs, subsidiaries and parent companies. This leads to a degree of understating and overstating profits and losses to achieve performance and taxation objectives.

Pre-emption rights

The SPV shareholders usually have pre-emption rights, which allow them the right to acquire the shares of other shareholders who want to sell their equity. For example, Macquarie agreed to sell its 50% interest in the Yorkshire Link A1-M1 PPP projects to Secondary Market Infrastructure Fund (later Trillium, then Semperian) and issued an '8K' disclosure notice to the US Securities and Exchange Commission (SEC) because of its US listing, but Balfour Beatty plc exercised its right to acquire the company at the same price.

Structure of PFI/PPP projects

There are now about 920 *Public Private Partnership* (PPP) and Private Finance Initiative (PFI) projects in the UK with a capital value of £72.3bn, of which 720 are operational. A long-term contract, between 25 – 40 years, is awarded following a procurement process. The private sector designs, builds, finances and operates the facility. The payment mechanism requires the public body to pay a unitary charge to the SPV for the availability of facilities and performance-related service provision.

The public sector pays a monthly unitary charge to the SPV that reflects the cost of using the building (including the cost of construction, maintenance and financing charges) plus the cost of facilities management (cleaning, catering, waste disposal, grounds maintenance). At the end of the contract, facilities are transferred to the public sector or new PFI/PPP contracts are procured.

PFI/PPP has accounted for about 10-15% of public sector capital investment since 1996 (International Financial Services London, 2008). Globally, PPPs account for about 4% of

public investment (Siemens, 2007). However, these figures are deceptive, because they do not take account of the increasing rate of PPPs in many countries, nor do they take account of the extensive use of PPPs in some services. PPPs accounted for 91.6% of major capital investment in the NHS between 1997-2008 – 102 projects with a capital value £11.5bn (Department of Health, 2008).

2. Growth of PPP equity sales 1998-2010

The Database records 222 UK equity transactions between 1998-2010 covering 622 PPP projects. The annual rate of PPP equity transactions, not surprisingly, increased rapidly between 2000-2004 during the formative years of the secondary market. There are inevitably variations in the number and total value of transactions on an annual basis, reflecting the completion of PPP projects, recycling decisions of PPP contractors depending on their contract win-rates and secondary market funds seeking to expand their portfolios. It is significant that the financial crisis appears to have had a minimal effect on PPP equity transactions.

Table 1: **Annual rate and value of PPP equity sales**

Year	No. of equity transactions	No. of PPP projects (includes those with multiple equity sales)	Value of equity sold (£m) (No of transactions)	Estimated total value based on average (£m)
1998	1	1	3.4 (1)	3.4
1999	1	1	n/a	n/a
2000	5	6	n/a	n/a
2001	5	15	117.4 (4)	146.7
2002	3	3	n/a	n/a
2003	16	30	135.6 (8)	271.2
2004	33	95	190.6 (14)	449.3
2005	38	59	306.3 (16)	727.5
2006	35	127	1,431.7 (24)	2,087.9
2007	21	66	401.8 (16)	527.4
2008	16	92	333.0 (8)	666.0
2009	29	60	370.4 (20)	537.1
2010	19	67	586.7 (14)	796.2
Total	**228**	**622**	**3,876.9**	**6,212.7**

Sources: ESSU Global PPP Equity Database

Sector differences

Health and Education PPP projects account for half of individual PPP equity project sales between 1998-2010 – see Table 2. Transport, primarily roads and motorways, public transport and street lighting projects account for just over ten per cent followed by criminal justice - prisons, courts, remand centres – with nine per cent.

Table 2: **Individual PPP equity transactions by sector 1998-2010**

Sector	No. of PPP projects in equity transactions	%
Health – hospitals and health centres	166	26.7
Education – schools & collages	148	23.8
Transport – public transport, roads & street lighting	65	10.5
Criminal Justice – prisons, courts, remand centres	57	9.2
Waste/Water	17	2.7
Defence	14	2.2
Housing – rehab of council estates & MoD housing	10	1.6
Leisure	10	1.6
Misc	35	5.6
Unknown	100	16.1
Total	**622**	**100.0**

Source: ESSU Global PPP Equity Database

At least 10 PPP companies have established joint ventures, usually on a 50/50 basis, with infrastructure funds so that PPP equity would transfer to the JVC once the PPP project was operational:

- John Laing – Commonwealth Bank of Australia (2004)
- Kajima Partnership (Japan) – HSBC Infrastructure (2005)
- Lend Lease (Australia) – HBOS (2006)
- Serco Group – Infrastructure Investors (now wholly owned by Barclays Private Equity) (2006)
- Hochtief (Germany) – PFI Infrastructure Co., then Infrastructure Investors and then Barclays Private Equity (2007)
- BAM (Netherlands) – Dutch Infrastructure Fund (2007)
- Amey (Ferrovial, Spain) – Dutch Infrastructure Fund (2009)
- Robertson Group – 3i (2010)
- Lend Lease (Australia) – PGGM Vermogensbeheer (Dutch pension fund) (2010)

PFI projects sold multiple times

The sale of equity in 622 PPP projects includes some projects involved in multiple transactions, ranging from 2 to 9 times (Table 3). The ESSU database records over 300 PPP projects, almost half the national total of operational projects, in which equity in the SPV has been sold. For example, the equity in the Barnet Hospital PFI project was subject to five transactions and the Calderdale Hospital PPP company was involved in nine equity transactions between 2002-2010. Further details of multiple transactions will be published in the full report.

Table 3: **PPP projects in multiple sale of equity**

No. of PPP projects	No. of transactions
267	1
59	2
24	3
10	4
4	5
3	6
1	7
1	8
1	9

Source: ESSU Global PPP Equity Database

The history of the sale of equity in the Barnet Hospital PFI Project

For example, HSBC Infrastructure had a 30% equity stake in Barnet Hospital Project Ltd at the start of the project in 2002 but within eight years had acquired 100% of the company four further equity transactions. The HSBC infrastructure fund is based in the Guernsey tax haven.

- April 2002 - Original equity ownership was Bouygues/Ecovert 30%, Siemens 30%, HSBC 30% and London Financial Group Limited 10%.
- 2006: Barnet Hospital project Ltd was one of 15 PFI assets sold for £250m by HSBC to HSBC Infrastructure Company (HICL), a new company listed on London Stock Exchange, but registered in Guernsey.
- 2006: Bouygues sells 11% stake to HSBC Infrastructure (now 41%).
- 2007: London Financial Group sells 10% stake for £3.3m to HSBC Infrastructure (now 51%).
- 2009: Siemen's sells 30% stake for £2.7m and Bouygues UK and Ecovert FM sell 19% stake for £1.7m to HSBC Infrastructure (now 100%).

3. Sale of secondary funds

There have been thirteen sales of secondary market funds with a total value of £3.1bn involving a further 607 PPP projects since 2003 (Table 4).

Table 4: **Secondary fund equity sales in UK**

Owner	Sold to	No. of PPPs	Price £m
Grosvenor House Group plc (2003)	n/a	5 (estimate)	4.0
Babcock Brown and Abbey National (2003)	Star Capital Partners, Bank of Scotland and AMP Capital Investors	23	n/a
Infrastructure Investors LP (Barclays, Societe Generale and 3i) (2005)	3i Group	31	150.0
HSBC Infrastructure Ltd and HSBC Infrastructure Fund (2006)	HSBC Infrastructure Company (HICL). PFI assets transferred to new company listed on London Stock Exchange, registered in Guernsey.	15	250.0
Investors in the Community Ltd (2007)	Trillium (Land Securities)	16	7.4
PFI Infrastructure Company (2007)	Infrastructure Investors LP (Barclays, Societe Generale and 3i)	22	156.0
Star Capital Partners, Halifax Bank of Scotland, AMP Capital Investors (2007)	Trillium (Land Securities)	79	927.0
Land Securities plc (2008)	Land Securities launches Trillium Investment Partners, a PPP Joint Venture in March 2008 with £1.1bn capital with HBOS (Uberior Infrastructure), Victorian Funds Management Corporation (Australia), Bank of Ireland, Transport for London Pension Fund.	100 (estimate)	n/a
3i Group plc (2009)	Placed in market	n/a	60.8
Land Securities (2009)	Telereal	108	750.0
Telereal (2009)	Victorian Funds Management Corporation (Australia) and Transport for London Pension Fund (now has 25.2%)	108	n/a
Infrastructure Investors LP - Barclays acquire Societe Generale (31.7%), 3i (31.7%) and Fleming (4.9%) (2009)	Barclay Private Equity Integrated Infrastructure Fund	84	558.6
John Laing (2010)	John Laing Infrastructure Fund (Laing has 23% stake)	16	242.3
Total (13 transactions)		**607**	**3,106.1** (10 transactions)

Source: ESSU Global PPP Equity Database   Note: n/a is not available

Combining the sale of equity in individual and group transactions with the sale of equity through the sale of infrastructure funds gives a total of 228 equity transactions involving 1,229 PPP projects, including multiple transactions of some projects (Table 5).

Table 5: **Total of PPP equity and secondary fund equity sales**

Year	No. of transactions	No. of PPP projects (includes multiple sales)	Value of equity sold (£m) (No of transactions)	Estimated total value based on average transaction (£m)
Sale of PPP equity	**228**	**622**	**3,876.9**	**6,212.7**
Sale of secondary funds	12	607	3,106.1	3,727.3
Total	**240**	**1,229**	**6,983.0**	**9,940.0**

Source: ESSU Global PPP Equity Database

The sale of PPP equity was generated in the main by the shareholders in the SPV, whilst the takeover/merger of companies, particularly construction firms and contract terminations also led to an equity sale or loss of assets. Joint ventures between PPP companies and infrastructure funds accounted for about 10% of equity sales. The sale of secondary funds accounted for only 5% of transactions but nearly half (49%) of PPP project equity sales.

4. Profits from PPP equity sales

This section of the database contains 154 PPP projects, where the selling price and profit from the equity transaction, have been identified from reliable sources, mainly company annual reports (Table 6).

Table 6. **PPP equity sales where profits identified**

Owner	No. of PPPs	Sold to	Value of equity (£m)	Profit £m (%)
2010				
Costain Group plc	6	Costain Pension Scheme	22.0	10.5
Carillion plc	1	HSBC Infrastructure Company	31.3	16.3
Balfour Beatty plc	2	Barclays Integrated Infrastructure Fund and Kelda Water Services	24.3	21.0
2009				
Interserve plc	13	Interserve plc Pension Scheme	61.5	33.2
Parkwood Holdings plc	5	Equitix Ltd	6.5	5.6
John Laing plc	1	Innisfree Ltd	4.8	72.9m based on original cost of assets
John Laing plc	2	John Laing plc Pension Fund	5.9	
John Laing plc	3	HSBC Infrastructure Company	8.0	
John Laing plc	1		77.3	
John Laing plc	1	Innisfree Ltd		
John Laing plc	3	Innisfree Ltd		
John Laing plc	1	Innisfree		
Galliford Try plc	1	DIF Infrastructure Fund, Holland	5.2	4.2
Galliford Try plc	1	HSBC Infrastructure	16.5 net	4.4
Kier Group plc	2	Innisfree Ltd PFI Secondary Fund	7.3	4.2
Carillion plc	1	HSBC Infrastructure Company	6.8	1.2
Carillion plc	1	Innisfree Ltd PFI Secondary Fund	7.0	
Carillion plc	2	Innisfree Ltd PFI Secondary Fund	86.9	
Interserve plc	1	Innisfree Ltd	7.2	3.4
2008				
Kier Group plc	1	Innisfree Ltd M&G PPP Fund	13.8	8.0
Carillion plc	5	Innisfree Ltd, Land Securities Trillium, Barclays European Infrastructure Fund and Robertson Capital Projects	41.9	35.6 from two transactions
Carillion plc	1	HSBC Infrastructure Company	18.0	
2007				
Kajima Partnerships	6	HSBC Infrastructure joint venture with Kajima	30.2	18.0
Carillion plc	3	Land Securities Trillium	21.5	23.6
Costain Group plc	1	John Laing plc	9.4	2.7
Costain Group plc	1	John Laing plc	5.7	3.0
MJ Gleeson Group plc	2	n/a	4.0	1.9
Allianz PFI Holdings (Jersey) Ltd,	4	HSBC Infrastructure Company	36.5	13.4
Alfred McAlpine plc	6	Infrastructure Investors	52.2	24.9
2006				
Balfour Beatty plc	3	Infrastructure Investors	13.5	6.0
PFI plc	3	Infrastructure Investors	3.2	1.1
John Laing plc	2	Secondary Market Infrastructure Fund	14.6	3.4
John Laing plc	1	n/a	1.0	0.4
Carillion plc	7	Secondary Market Infrastructure Fund	32.7	25.6 from 2 transactions
Carillion plc		Infrastructure Investors	14.0	
Serco Group plc	6	Infrastructure Investors Joint venture with SERCO	76.5	11.4
Lend Lease Corp.	11	Lend Lease joint venture with Bank of Scotland	14.7	11.5
Interserve plc	1	n/a	1.6	1.3
Skanska UK	1	Infrastructure Investors	13.7	9.1
Skanska UK	1	Innisfree Ltd	3.8	2.7
2005				
Alfred McAlpine plc	1	Secondary Market Infrastructure Fund	5.6	2.9
HSBC	1	Secondary Market Infrastructure Fund	5.6	2.9
MJ Gleeson Group plc	1	PFI Infrastructure Company	1.1	0.8

MJ Gleeson Group plc	1	Henderson Infrastructure	n/a	
WS Atkins plc	1	Secondary Market Infrastructure Fund	5.6	3.7
Kier Group plc	1	Secondary Market Infrastructure Fund	5.0	2.5
John Laing plc	1	Serco Group plc	5.9	7.9
John Laing plc	4	Allianz PFI Holdings (Jersey) Ltd,	23.1	13.0
Alfred McAlpine plc	1	Secondary Market Infrastructure Fund	7.5	4.3
WS Atkins plc	1	Secondary Market Infrastructure Fund	7.8	5.7
WS Atkins plc	1	Innisfree Ltd	1.4	0.7
2004				
Anglian Water Group	1	Henderson Private Capital	12.0	8.0
Carillion plc	1	John Laing plc plc	19.0	6.7
Carillion plc	1	John Laing plc plc	1.2	1.0
Quayle Munro Holdings PFI Fund	10	PFI Infrastructure Company	4.4	2.1
PFI Infrastructure Co.	1	Secondary Market Infrastructure Fund	0.8	0.24
John Laing plc	1	Secondary Market Infrastructure Fund	26.3	6.4 in 3 months
2003				
WS Atkins plc	3	Balfour Beatty plc	13.3	8.0
John Laing plc	1	n/a	3.4	No profit or loss
Mowlem Construction	1	Infrastructure Investors	19.4	16.0
Carillion plc	1	Barclays Infrastructure Fund	5.2	4.1
Wackenhut Corrections Corp	4	Serco Group plc	48.6	35.0
1998				
Serco Group Ltd	1	FR Aviation Ltd Bristow Helicopter	3.4	4.6
Total 63 transactions	**154**		**1,026.6**	**517.9**

Source: ESSU Global PPP Equity Database

"Over the last six years, we have sold a total of 28 investments, generating proceeds of some £279.9m and a pre-tax profit of £105.6m" (Carillion plc Annual Report, 2009).

"As a consequence of the circumstances faced by the Group, an accounting loss on disposal of £15.3 million has been recorded in the Income Statement. There was however, a substantial profit of £72.9 million on the disposals when measured against the original cost of the investment" (John Laing Annual Report & Accounts, 2009).

Profit rates in sectors

There are wide differences in the average profit rates between sectors (Table 7) with the average profit being 50.6%. The size and range of PPP projects in the sample enhances the validity of these findings.

Two sectors have higher than average profits, health (66.7%) and criminal justice (54.9%) with transport (47.1%) and education (34.1%) below average.

The 'mixed' category in Table 7 includes transactions covering a number of different types of assets and where only the total profit was stated for a group of transactions.

Table 7: **Profit on sale of PPP equity in UK (includes multiple examples)**

Sector	No. of PPP transactions	No. of PPP projects	Value of equity sold (£m)	Total Profit (£m)	Average % profit
Health	14	18	129.3	86.3	66.7
Education	6	8	47.8	16.3	34.1
Transport	8	12	101.8	48.0	47.1
Criminal Justice	6	15	122.4	67.2	54.9
Housing	1	1	5.2	4.2	80.8
Waste/Water	1	1	12.0	8.0	66.7
Leisure	1	5	6.5	5.6	86.2
Defence	2	2	9.3	12.5	134.4
Mixed	24	93	587.7	269.0	45.8
Total	**63**	**154**	**1,022.0**	**517.1**	**50.6**

Source: ESSU Global PPP Equity Database

If the same profit level of the sample of PPP projects is maintained for the 622 PPP projects involved in equity transactions, **the total profit would be £2.2bn.**

Similarly, if the same profit level was achieved in the sale of secondary funds, the profit from PPP equity sales would be a further £2.0bn, giving a total profit of **£4.2bn**

The sale of PPP equity by the major construction companies is summarised in Table 8. This Table includes only the PPP equity transactions where profit information was available (none declared a loss) and thus does not reflect the full performance of PPP equity investment by these companies. However, the rates of profit are exceedingly high with two companies achieving over 70% (Lend Lease Corporation and Balfour Beatty) and four companies over 50% (John Laing, Interserve, Kajima Partnerships and Kier Group).

Table 8: **Major sellers of PPP equity in UK between 1998-2010** (based on Table 5)

Company	No. of PPP projects	Sale value (£m)	Profit (£m)	%
Carillion plc	24	278.8	114.1	40.9
John Laing	22	170.3	100.6	59.1
Interserve plc	15	70.3	37.9	53.9
Lend Lease Corporation	11	14.7	11.5	78.2
Costain Group plc	8	37.1	16.2	42.9
Serco Group plc	7	79.9	16.0	20.0
Balfour Beatty plc	5	37.8	27.0	71.4
Kajima Partnerships	6	30.2	18.0	59.6
Kier Group plc	4	26.1	14.7	56.3

Source: ESSU Global PPP Equity Database

The profits in PPP projects contrast sharply with construction operating profit rates of the same contractors. These have remained low throughout the last decade. Table 9 is based primarily on UK construction profits and excludes profits from PPP joint ventures, although differences in corporate policies and accounting practices may result in a small margin of overlap. The average operating profit for construction companies between 2003-2009 was 1.5%.

Table 9: **Construction operating profit rates of major contractors 2003-2009 (%)**

Company	2003	2004	2005	2006	2007	2008	2009
Balfour Beatty plc	3.7	2.2	1.9	2.1	2.1	2.3	2.7
Carillion plc	0.6	1.1	1.4	1.7	0.7	1.4	1.4
Costain plc	1.3	0.0	1.3	-8.7	0.3	6.9	4.6
Kier Group plc	1.0	1.1	1.3	1.5	1.6	2.3	2.6
Average	**1.6**	**1.1**	**1.5**	**-0.8**	**1.2**	**3.2**	**2.8**

Source: Company Annual Reports & Accounts.

Notes: Based on UK construction/building activities: Carillion – 2003-06 includes international contracts whilst 2007-09 figures based on UK and Canadian building, civil engineering and development excluding Middle East Construction; Costain – 2009 and 2008 Infrastructure division, 2007-2004 building division, 2003 Group UK.

5. Changes in PFI equity in one city: Newcastle

The effect of changes in PPP equity ownership in a city is demonstrated by drawing on database evidence for Newcastle-upon-Tyne.

Equity in seven large PFI projects in Newcastle has been sold in the last five years. These projects account for about three-quarters of the city's operational PFI projects. Three of the projects have equity owned by infrastructure funds registered in tax havens.

- Newcastle City Library: Kajima sold its 50% shareholding to HSBC Infrastructure Company (HICL) for £3.0m in 2010. HICL is registered in the Guernsey tax haven.
- Newcastle and North Tyneside NHS LIFT: Robertson Capital sold 49% equity shareholding to Elgin Infrastructure Ltd, a joint venture company between Robertson and 3i Infrastructure.
- Newcastle City Council 'Building Schools for the Future': the 20% stake owned by Parsons Brinkerhoff transferred to Balfour Beatty when they acquired the US firm in 2009.
- Newcastle BSF1: Robertson Capital sold 49% equity shareholding to Elgin Infrastructure Ltd, a joint venture company between Robertson and 3i Infrastructure (registered in the Jersey tax haven).
- Newcastle City Council Grouped Schools 1: Bank of Scotland's 50% shareholding transferred to joint venture, with four pension funds in 2008, immediately prior to Lloyds Bank takeover of the bank. Lend Lease transferred its 50% shareholding to Catalyst Investment Holdings Ltd, a joint venture company between Lend Lease and the Bank of Scotland in 2006.
- Newcastle Estate Partnership - rationalisation of Department of Work and Pensions offices: Amec plc sold its 50% shareholding to the Amec Staff Pension Fund for £25m in 2006.
- Newcastle Hospitals - Refurbishment and construction at Freeman Hospital and Royal Victoria Infirmary: John Laing's 40% equity investment transfers to the ultimate ownership of Henderson Global Investors following the takeover of John Laing in 2006. It transferred again in 2010 when the John Laing Infrastructure Fund was launched as a publicly listed company, registered in the Guernsey tax haven.

6. Use of tax havens in PPP equity transactions

The equity in 91 PPP projects is owned by secondary market infrastructure funds located in tax havens (Table 10). The launch of two publicly listed infrastructure funds in 2010, the John Laing Infrastructure Fund (to which John Laing sold 19 PPP projects) and the GCP Infrastructure Fund, indicates a growing trend in the use of tax havens for PPP equity. In addition, HSBC and the other funds are constantly increasing the acquisition of equity in PPP projects, hence the number of PPP assets is set to rise.

Table 10: **PPP Infrastructure funds located in tax havens**

Company	Tax haven	No. of PPP assets	PPP projects
HSBC Infrastructure	Guernsey	33	Substantial stakes in hospitals, schools, police stations, Home Office Headquarters, London, and Dutch High Speed Rail
John Laing Infrastructure Fund	Guernsey	19	Range of schools, social housing, hospitals, courts, police stations and street lighting projects.
3i Infrastructure Fund (3i Groups owns 33.2%)	Jersey	18	Norfolk & Norwich University Hospital (26.0), Alpha Schools, Highland (50.0), 9% stake in Anglian Water owned by a private consortium, Osprey; Elgin Infrastructure Fund (joint venture with Robertson Group)
International Public Partnerships (formerly Babcock Brown Public Partnerships)	Guernsey	14	100% shareholding in schools and criminal justice PPP companies.
GCP Infrastructure Fund Ltd - Gravis Capital Partners	Jersey	7	Investments in Grosvenor PFI Holdings – South Essex Community Hospital, Stanley Primary Care Centre, Lanchester Road Childrens' Health Unit, Braintree Community Hospital): Investment in Leisure Infrastructure Investors Ltd in 3 PFI operational contracts.
Total		**91**	

Source: ESSU Global PPP Equity Database

The PPP projects where 50% - 100% of the equity is owned by infrastructure funds located in tax havens are identified in Table 11.

Table 11: **PPP equity owned by infrastructure funds based in tax havens**

Company	50% - 100% shares of PPP projects located in tax havens
HSBC	Barnet Hospital, London
	Central Middlesex Hospital
	Conwy Schools, Wales
	Exeter Crown Court
	Health & Safety Laboratory, Buxton
	Home Office Headquarters, London
	Stoke Mandeville Hospital, Aylesbury
	Sussex Custodial Services
	West Middlesex Hospital
John Laing Infrastructure Fund	Brockley Social Housing (Lewisham)
	Canning Town Social Housing (Newham)
	Kingston Hospital
	Manchester street lighting
	M40 Highway
	Newham Hospital
	Sirhowy Way Road (Wales)
	Wakefield street lighting

	Walsall street lighting
International Public Partnerships	Abingdon Police Station, Thames Valley Police
	Bootle HMRC Government Offices
	Calderdale Schools Partnership
	Derbyshire Magistrates Courts
	Derbyshire Schools I and II
	Hereford & Worcester Magistrates Courts
	Maesteg Schools, Bridgend, Wales
	Norfolk Police Headquarters
	Northampton Schools
	North Wales Police Headquarters
	St Thomas More School, West Midlands
	Strathclyde Police Training Centre, Scotland
	Tower Hamlets Schools

Source: ESSU Global PPP Equity Database

7. Other key issues

Transfer of PPP equity assets to contractor's pension funds

At least five companies, Interserve, Amec, John Laing, Costain and Vinci, transferred PPP equity to their pension funds in lieu of cash payments or the transfer of other assets. The pension funds records ownership of the asset in its accounts and receives future dividends.

Vinci plc sold a 50% stake in a Cardiff road contract to its pension fund, the Vinci Pension Scheme in 2003. Interserve transferred 13 PPP projects to its pension fund in 2008. Transfer of PFI equity assets is closely tied into the performance of the company since, at least in the case of Interserve, the company retains responsibility for operational management of the facilities. Amec transferred its 50% shareholding in the Inland Revenue Newcastle Estate Partnership to its pension fund for £25m in 2006.

Pension funds invest in PPPs and infrastructure funds in three other ways. Firstly, by direct investment in infrastructure funds: The London Borough of Enfield Pension fund has 14.5m shares (3.19%) stake in International Public Partnerships (formerly Babcock Brown Public Partnerships), the Guernsey based infrastructure fund (see Tables 10 and 11). Secondly by investment in the listed shares of construction companies and banks, and thirdly via investment in consortia that acquire privatised assets such as Associated British Ports (Whitfield, 2010).

Loss of equity in PPP contract terminations

PPP equity holders have suffered financial losses when PPP projects have been terminated or the construction company has gone bankrupt. A number of projects have been terminated – see chapter 8, *Global Auction of Public Assets.* The losses incurred in these projects are a fraction of the profits made in the sale of PPP equity.

Impact of the financial crisis

The ESSU database evidence shows that PPP equity transactions and the establishment of new secondary market infrastructure funds have continued virtually unchanged during the global financial crisis. The growth of the PPP equity market is further evidence that the claims that the financial crisis was going to lead to the demise of the PPP programme are unfounded.

8. Conclusion and recommendations

Conclusions

This report provides concrete evidence that:

- the sale of equity in PPP companies is significantly higher than the Treasury, NAO and the government have believed;
- the very high level of profits earned by construction companies and banks provides further evidence that PPP projects are little more than money-making mechanisms for the private sector;
- the level of profiteering from PPP equity transactions makes a nonsense of the original value for money assessments – if these profits had been taken into account at the evaluation stage then few PPP projects would have been approved.
- there is no accountability and no scrutiny of sale of PPP equity;
- the level of information disclosure is superficial, fragmented and unacceptable;
- the Corporate Social Responsibility (CRS) policies of construction companies and financial institutions, in parallel with the profiteering from PPP projects, indicates the CRS approach is morally and ethically bankrupt;

Recommendations

1. The standard PPP contract should be re-written to include a ceiling imposed on the level of profits that can be extracted from PPP equity together with a requirement that the public sector should have a 50% share in any profit above a specified level.
2. A new value for money methodology should be devised to take account of the profiteering in PPP equity transactions and the other flaws in the current evaluation methodology.
3. New transparency and disclosure requirements should be introduced as a matter of urgency requiring more expansive notification about equity sales.
4. The Treasury PPP equity database should be significantly extended to include all historic and future PPP equity sales. This should be publicly available and regularly updated.
5. The National Audit Office and Treasury should research the longer-term effects of the growing secondary market.
6. Ultimately, the negative effects of the PPP equity secondary market can only be solved by the termination of the PPP programme combined with new regulatory controls on existing projects.

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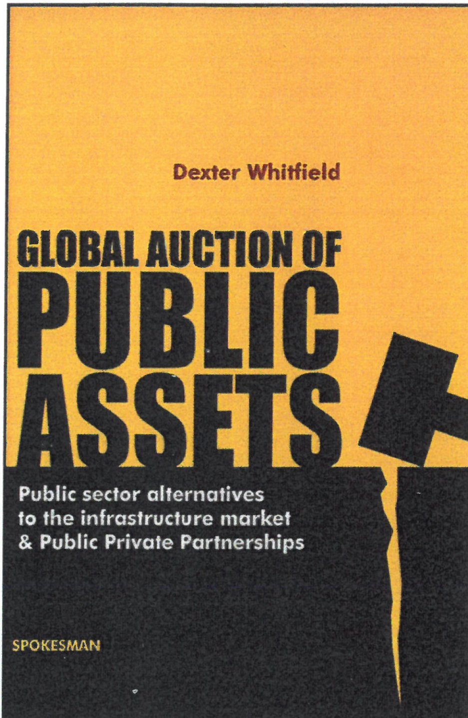

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