How to get better private finance deals for infrastructure

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About this report

This report is based on: a detailed review of the literature on financing infrastructure in the UK and internationally; in-depth interviews with more than 20 individuals involved in financing infrastructure; and a round table that brought together leading finance experts from government, academia and the private sector.

This report is the fifth in a series of reports on infrastructure. Our previous reports are:

- *What's Wrong with Infrastructure Decision Making? Conclusions from six UK case studies*
- *How to Value Infrastructure: Improving cost benefit analysis*
- *Public versus Private: How to pick the best infrastructure finance option*
- *How to Design an Infrastructure Strategy for the UK.*

A final report will draw together the evidence we have gathered throughout this programme of work to make final recommendations on how to improve infrastructure decision making in the UK.

Find out more:
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List of abbreviations

IPA	Infrastructure and Projects Authority
NICP	National Infrastructure and Construction Pipeline
PFI	Private Finance Initiative
PF2	Private Finance 2
PiP	Pensions Infrastructure Platform
PPP	Public–private partnership

Summary

This report is the second of two reports on infrastructure finance from the Institute for Government. In the first, *Public versus Private: how to pick the best infrastructure finance option*,[1] we looked at how accounting, appraisal and budgeting can bias governments in favour of private finance, and against public spending and risk-sharing options. We argued that private finance should be used only when there is reasonable evidence that it will provide better value than public spending. That is the starting point for this report.

The current Government has repeatedly said it wants to secure more private investment in UK infrastructure,[2] at a good price. However, our research shows it is failing to take the necessary steps to meet these twin objectives.

This failure is not primarily due to a lack of knowledge in the civil service. Civil service commercial specialists understand that increasing the volume of private investment requires publishing a clear pipeline of forthcoming projects and addressing investors' concern about who the Government ultimately wants to fund specific infrastructure projects. Rather, it is ministers – perhaps worried about the political toxicity of private finance – who have failed to take the decisions needed to increase private investment in infrastructure.

The Government has got better at negotiating private finance deals for infrastructure in recent years – the private finance contract for Thames Tideway Tunnel being a good example. But if ministers are serious about meeting their objective of increasing private investment in UK infrastructure on commercially advantageous terms, they need to address three key barriers:

- limitations in civil service commercial capability
- their own understanding of investor perspectives
- the quality of the infrastructure project pipeline.

Ensuring the civil service can draw on in-house commercial skills

The public sector has not always negotiated good infrastructure finance deals. Concerns have been expressed in Parliament and the media about excessive returns accruing to investors – particularly in relation to the early Private Finance Initiative (PFI)* deals. The civil service's in-house commercial and financial skills have improved

* The PFI was a standardised project finance contract, used extensively to procure social and economic infrastructure in the early 2000s.

but weaknesses remain, especially in contract management.[3] To secure private investment at a good price, the Government must address these shortcomings.

Once contracts have been signed, the public sector has sometimes renegotiated and taken on more cost or risk than was originally agreed.[4] To ensure that the Government negotiates realistic contracts and subsequently holds investors accountable for delivery, the civil service must ensure that departments and public bodies negotiating and managing private finance contracts can draw on sufficient in-house commercial expertise.

Given the Government's objective of substantially increasing private investment in infrastructure, the project finance* specialism in the Infrastructure and Projects Authority (IPA)** should increase the number of specialists available to manage private finance-specific contractual issues.

Improving ministerial understanding of investor perspectives

Civil servants with commercial expertise, particularly those in the IPA who engage regularly with investors, understand their needs. However, this understanding has not translated into better policies. The problem lies with ministers, who have developed and implemented policies to encourage private infrastructure investment without adequately consulting private investors.

Several policies announced to encourage private infrastructure investment – including pension fund pooling – have glossed over underlying barriers to investment, particularly identifying who will ultimately fund new infrastructure. If the Government wants to increase private investment in infrastructure, ministers must consult more often with investors and ensure that policies address these underlying barriers.

Outlining a clear pipeline

Ministers need to recognise that one of the most critical barriers to increasing private investment in infrastructure is the absence of a detailed project pipeline. Currently, the number and scope of projects which might require private finance are opaque to investors. This uncertainty limits the number of potential investors and thereby reduces competitive tension. Persistent uncertainty erodes investor confidence in the Government, leading to inferior contractual terms and higher costs for taxpayers or consumers, as the market shrinks and investors 'price in' uncertainty.[5]

A clearer pipeline of projects, based on information standards agreed between government, industry and investors, would increase confidence and encourage competition. It would create a better basis for constructive dialogue between government, industry and investors that would help both industry and investors understand what government wants. Moreover, it would help government understand what the private sector can deliver, improving both how government contracts and how the private sector delivers.

* Project finance entails the creation of specific companies – special purpose vehicles – to finance, design, build, operate and maintain an infrastructure project, such as road, power plant or sewage facility.

** The joint Cabinet Office and Treasury executive agency supporting delivery of the Government's major projects, focused on assuring policy, initiation and finance.

The Government must act urgently to make clear how it, and regulated companies,* intend to finance projects. In the 2016 Autumn Statement the Government announced that it would publish a list of new private finance projects – the Private Finance 2 (PF2)** pipeline – in early 2017.[6] Over a year later it has failed to do so. The Government must publish the PF2 pipeline, and it must integrate it with the existing National Infrastructure and Construction Pipeline (NICP).*** This would entail the IPA improving the NICP, with additional information provided on proposed funding and contract structures for private finance projects. In doing so they should draw on best practice from Norway and the Netherlands.

* Regulated companies own and operate infrastructure assets in the privatised sectors, such as water and energy transmission. They typically raise finance from private investors, and recover their costs by charging consumers. See: Atkins G, Davies N and Kidney Bishop T (2017) *Public versus Private: How to pick the best infrastructure finance option*, p. 9, Institute for Government, https://www.instituteforgovernment.org.uk/publications/public-private-infrastructure-finance

** PF2 is the Government's replacement for PFI: a standardised project finance contract designed to address the shortcomings of PFI.

*** The Government's list of planned public and private infrastructure projects, published annually.

1. The Government must develop the civil service's in-house commercial skills

The Government's objective of negotiating a greater volume of good private finance deals for taxpayers and consumers will only be met if it further develops the civil service's commercial skills.

Historically, the public sector has not negotiated good private finance deals. Numerous National Audit Office[1] and Public Accounts Committee[2] reports have detailed contract shortcomings that emerged when public bodies lacked the necessary skills, or did not involve public sector commercial specialists early enough,[3] to challenge their external advisers and contractors. Contractual shortcomings are likely to have left taxpayers and consumers paying more for new infrastructure than they would have under different financing arrangements.[4] In some cases, the Government has been unable to exit inflexible private finance contracts without paying significant penalties, even where those projects are no longer required.[5]

Commercial capability in the public sector can be improved

If the Government is to secure good-value private finance deals, the civil service must have the commercial skills to negotiate new contracts and manage existing ones effectively. Civil servants need to be able to draw on in-house expertise to:

- agree finance contracts
- challenge whether proposed investors' returns are reasonable
- monitor contracts once established
- communicate this in language that generalists can understand.

Some interviewees thought that this problem could be overcome by hiring more external advisers for major commercial and financial deals; however, this is only a partial solution. While hiring external advisers can help smooth out the peaks of government workload, doing this for individual projects is costly,[6] and can create conflict of interest unless the public sector establishes protections regarding advisers who rotate between the public and private sectors.[7,8] Moreover, if there is insufficient in-house capacity, there is no way for the Government to act as an intelligent client and challenge the advice that it is receiving.[9] Therefore, investing in in-house expertise is essential.

The civil service has made improvements. The main reforms have been creating the commercial specialism, which supports contract agreement and management; the finance specialism, which supports financial management; and the project finance specialism, which focuses on agreeing and managing private finance contracts specifically. All three have helped agree and manage better deals.* There are more commercial staff within government, and recruitment has been overhauled to bring in more senior staff whom otherwise might not have considered a career in the public sector.[10] In *Professionalising Whitehall*, the Institute for Government concluded that the commercial specialism was the most mature among the various cross-departmental specialisms.[11]

Successive governments have bolstered the civil service's private finance expertise, specifically to help secure private investment in infrastructure. The civil service has a project finance specialism that is part of the larger finance specialism, but this was only established in November 2016.[12] Before this, the Treasury was responsible for hiring commercial and financial staff with private finance expertise.

Initially, private finance was split between policy, which the Treasury developed, and agreeing deals, which was the responsibility of individual public authorities, departments, public bodies and local authorities. Within this split, individual public authorities were supported by a Treasury task force set up in 1997;[13] some departments and public bodies also had Private Finance Initiative (PFI) units. In 2000, the Treasury task force was replaced by Partnerships UK – a public–private joint venture to help develop, procure and implement UK private finance projects. Following the financial crash in 2008 and the declining availability of bank finance for infrastructure, the Treasury set up an infrastructure finance unit to lend to PFI projects where private investment was not forthcoming.[14]

In 2009, the tangled responsibilities for policy, delivery and finance were consolidated in Infrastructure UK. Announced in the 2010 Budget, it had a remit to increase private investment in infrastructure,[15] and improve government planning and delivery of infrastructure. Infrastructure UK worked alongside the then Major Projects Authority, which provided assurance and support on major government projects. The two bodies were merged into the Infrastructure and Projects Authority (IPA) in January 2016, in order to concentrate government infrastructure and major project expertise in one place.[16]

In our interviews we were told that the IPA's expanded Finance and International and Infrastructure Delivery teams[17] had improved the Government's ability to strike good deals. The fruits of these reforms can be seen in the low cost of finance that the Government secured for the Thames Tideway Tunnel.**[18]

Improving commercial practice: the Thames Tideway Tunnel

The financial deal for the Thames Tideway Tunnel – the underground tunnel that is being built to deal with sewer overflow in the Thames – illustrates how the IPA has helped the Government strike better deals.

* This report refers to specialisms (also known as functions and professions) to denote the organisational structures set up to ensure that specialist tasks are performed properly. Where discussing general civil service capacity, this report uses 'expertise' instead.

** Some interviewees contested whether government took on too much risk, and argued that some investors might have been willing to take additional risk at a higher premium, in a way that would have improved value for money overall.

Starting in 2010,[19] Infrastructure UK (later the IPA) helped the Department for Environment, Food & Rural Affairs (Defra) consult with private investors and agree an appropriate contract that distributed risks to those most able to bear them.

In our interviews, investors said that the IPA had "improved the quality of the conversation" when discussing the project with Defra.[20] This view is shared by Gavin Tait of Amber Infrastructure, one of the equity investors in Thames Tideway,[21] who has stated that Defra and the IPA took:

> "an active and pragmatic approach to potential investors [which] was key to the success of getting this project financed… private/public engagement on this project sets a benchmark for the development of all future major UK infrastructure projects."[22]
>
> Infrastructure and Projects Authority, 2016, p. 13

A government support package[23] – financial support that government will provide if specific low-probability, but high-impact, risks occur[*24] – to enhance Tideway's credit profile was particularly important.[25] These are risks that the project-specific company responsible for designing, constructing, financing and maintaining the tunnel (Bazalgette) is unable to assume itself at a reasonable cost to customers. These include public liability claims in excess of available commercial insurance, and extreme increases in construction costs.

This helped Bazalgette maintain a high credit rating and secure a low cost of capital. The final cost of capital for Tideway was less than 2.5%, which the National Audit Office estimates will reduce the projected annual impact on household water bills from £70–80 to £20–25.[26]

The civil service has come a long way. However, if the Government is to secure more private investment in infrastructure successfully, it needs the skills to negotiate good deals. These specialists could be based in departments, akin to the corporate finance team at the Department for Transport, or centrally based and deployed where appropriate.[27] Basing specialists within departments is likely to be most appropriate for those with high infrastructure spend, including the Department for Business, Energy and Industrial Strategy, Defra and the Department for Transport.

Contract management is critical, but often neglected

The story does not end once contracts have been agreed. Previous Institute for Government[28,29] and National Audit Office[30] research suggests that government does not always invest adequately in managing contracts – particularly monitoring and challenging supplier performance. This has been the case in many government projects, but the impact of poor contract management in infrastructure is well illustrated by the case of Metronet (see Box 1).

* Similar to a government guarantee, but differs insofar as it offers contingent financial support. It also requires Bazalgette to take certain steps before government steps in. In general, government guarantees to transfer project risks from private owners to the Government, by promising investors in infrastructure projects that they will be repaid, even if the project company operating the asset is unable to make repayments.

Box 1: Contract management at Metronet

In the case of Metronet, a public–private partnership (PPP)* contract designed to maintain and renew London Underground's track, trains and stations, the Government did not manage the contract effectively.

The public sector contracting authority, London Underground, had repeated disputes with the companies with which it contracted. Ambiguous phrases in the contracts, such as 'replace/renew', created tension between London Underground and the Metronet contractors over project scope. London Underground had neither the contractual levers nor access to data[31] that would have allowed it to challenge Metronet's performance effectively.

The Department for Transport – the organisation with overarching responsibility for the contract – did not manage the contract, because monitoring was devolved to London Underground and Transport for London. The department also expected Metronet's shareholders and lenders to challenge and improve performance, but as the shareholders were also suppliers, and the lenders had 95% of their borrowing underwritten by a government guarantee,[32] they had limited incentives to put pressure on contractors to deliver efficiently.

Reviewing the project, Professor Anthony King and Professor Sir Ivor Crewe simply concluded that 'it was not clear that anyone was managing the contracts at all'.[33]

Public sector interviewees told us that contract management still plays a secondary role compared with agreeing contracts,** [34] despite its importance for ensuring long-term value. They said that local authorities lacked staff with experience of dealing with contractors and investors, meaning that they risked making changes without understanding the contractual implications, potentially incurring large additional costs. We were told that the small size of local authorities made it difficult to justify expenditure on commercial specialists. As one interviewee said:

> "A lot of our deals are done by local authorities who do not have the same capability in contract management as the people who sit across the table with them. A local authority may have one, maybe two PFIs, so they've got someone that basically administers the contract; but when you get into difficulties, [that person] is sat across the table from someone who has a portfolio of contracts, is paid significantly more, and is experienced [solely] in contract management. [In comparison] in most local authorities these individuals sit within finance and come from a finance background, rather than a pure contract management background."
>
> Institute for Government Infrastructure Project interview, 2017

* An arrangement where a third party runs a contracted-out service. In infrastructure, typically used as a catch-all term for project finance contracts.

** The National Audit Office also found that two out of four underlying causes of poor contract management related to lack of senior engagement.

Some departments have models to help local authorities access commercial expertise. Defra offers an example. The department works jointly with Local Partnerships, a company wholly owned by the Local Government Association and the Treasury,[35] to ensure that local authorities managing waste private finance contracts have access to necessary contract negotiation and management expertise. Local Partnerships has provided support to local authorities on procurement, town planning, construction, commissioning, contract management, contract variations and expiry.

Local Partnerships has supported local authorities in 46 private finance projects collectively worth more than £30 billion (bn). It has strengthened the Government's position when negotiating private finance deals, reflected in faster progress from negotiations to financial close. Projects have reached financial close at five times the rate prior to Local Partnerships' involvement. Defra argues that this support has delivered better value for money from operational contracts, improved project monitoring and grant management.[36]

To ensure that private finance contracts are effectively managed once they are agreed, we recommend that the Government commercial specialism continues to deploy commercial specialists to priority projects. There is scope for improvement by spreading best practice.

However, given the Government's objective of substantially increasing private investment in infrastructure, the project finance specialism in the IPA should increase the number of specialists available to manage private finance-specific contractual issues.

2. Ministers must understand investor perspectives when making policy

If the Government wants to increase private investment in infrastructure, and get better private finance deals, then ministers need a better understanding of investor perspectives. This would increase the likelihood that policies designed to unlock private investment actually do so.

Effective policymaking requires effective engagement

Effective policymaking requires thinking through implementation, and seeking rigorous challenge for ideas as early as possible. Robust stress-testing leads to better policy: challenge should be invited from practitioners and 'external stakeholders who have the ability to make or break a policy'.[1] This includes consulting early with those whom policies are designed to affect. As we noted in *Better Budgets: Making tax policy better*,[2] lack of challenge increases the risk of poor decisions, whereas engagement typically improves decisions.[3] Governments must be careful to avoid capture from self-interested actors,[4] but when a policy is designed to effect change, it is worth consulting those whose behaviours one is trying to change.

Unfortunately, investors told us that ministerial engagement had been superficial and infrequent, and tended to occur only when new chancellors came to office.[5] While officials, particularly those in the Infrastructure and Projects Authority (IPA), have engaged extensively with investors, their insights are not always heeded by ministers.

> Investors told us that ministerial engagement had been superficial

Pension fund pooling did not address the key barriers to private investment

Due to a lack of ministerial understanding, policies designed – or at least announced – to encourage private investment in infrastructure have not been as effective as they could have been. Pension fund pooling offers a clear example.

As bank finance for infrastructure declined after the global financial crisis in 2008,[6] the Coalition Government and its successors have attempted to attract new investors with 'longer-term horizons'[7] (mainly pension funds and insurers) to invest in infrastructure.

In 2011, then Chancellor of the Exchequer George Osborne argued that British pension funds should be investing in British projects and announced that, to deliver more infrastructure investment, "the Government negotiated an agreement with two groups of British pension funds, to unlock an additional £20bn of private investment in modern infrastructure over the next decade".[8] Osborne then announced the Pensions Infrastructure Platform (PiP) – an investment vehicle to make it easier for pension funds to pool their money and invest in infrastructure without having to pay expensive advisory fees individually.[9,10]

In October 2015, Osborne announced that a separate policy – local authority pension fund pooling – would encourage pension funds to invest in infrastructure.[11] Although local authority pension fund pooling was designed as a cost-saving initiative to reduce 89 separate pensions to eight 'British Wealth Funds' (and was not a new proposal),[12] government rhetoric at the time of the announcement implied that pooling local authority pension funds was an intervention in the infrastructure finance market.

According to Osborne, these interventions had two infrastructure-related aims. First, to increase the number of new infrastructure projects being built, by getting private investors to provide the upfront money for new project construction. Second, to give pension funds and insurers another safe, long-term investment option as an alternative to increasingly low-yield gilts.

The second point is laudable, and has been somewhat successful. An increasing number of investors, from the Greater Manchester Pension Fund and the London Pensions Fund Authority[13] to insurers such as Aviva[14] and Legal & General,[15] have stated that they intend to invest more in UK infrastructure. GLIL Infrastructure – the London, Manchester, Merseyside, West Yorkshire and Lancashire pooled pension fund – financed new South Western trains earlier this year;[16] and PiP recently acquired £400 million (m) of existing UK public–private partnership (PPP) projects,[17] although it is hard to attribute these promises and investments to the specific initiatives above.

However, on the first point, these interventions have not been as successful as ministers had hoped. Despite Osborne's £20bn by 2021 infrastructure target for pension fund pooling, the actual amount invested has been far less. In 2017, the *Financial Times* reported that the total amount that the PiP had raised and invested was £1bn.[18] Data from Preqin, an alternative investment data provider, suggests that UK pension funds are not meeting their infrastructure investment target allocations,[19] and have not substantially increased their infrastructure allocations since 2012. This may, however, be due to legal restrictions meaning that most pooled local government pension fund platforms will not be able to start investing until they go live in April 2018.

In any case, these targets are lower than leading institutional investors in Australia and Canada.[20] Moreover, most of the money invested through PiP has been in shares in companies that own projects which have been built already, rather than in constructing new infrastructure.

This was predictable. The ministerial announcements around PiP and local authority pension fund pooling assumed that the main factors deterring these bodies from investing in UK infrastructure were a lack of in-house expertise and a reluctance to pay expensive advisory fees. All else being equal, removing these barriers would stimulate more investment in UK infrastructure.

However, the key problem was not a lack of ability to invest, but an unwillingness to invest in what appeared to be risky investments where payback was not clear.* If ministers had focused on the underlying factors driving investors' behaviour, they may not have pursued pooling policies so vigorously – or at least reduced their expectations.[21]

This is not a novel conclusion. Investors' responsibilities to their shareholders and clients mean that they will only invest in infrastructure if it meets their risk and return requirements, not if politicians pressure them to do so.[22] Incremental changes such as pooling and new investment vehicles may increase investment at the margin; but importantly, they will not fundamentally change whether an infrastructure investment looks like a good bet.

In addition, pension funds were starting from a low base in terms of their total capital available to invest in infrastructure.[23] Therefore, a sizeable increase in UK pension fund investment in infrastructure would not make a huge difference. Even if all UK pension funds were to invest all their alternative asset capital in UK infrastructure, it would represent only a drop in the ocean, given interest from international sovereign wealth funds and pension funds.

It is not surprising that pooling policies has not been the success that ministers had hoped for. Without clarifying a future revenue stream and underwriting the riskiest aspects of projects, governments cannot expect to increase private investment in infrastructure. If the aim is increasing private investment in infrastructure, then successive governments have spent too long trying to increase the number of investors, when the bigger problem is a lack of suitable investment opportunities. Of more concern is that there is little to suggest that the current government has learned from pension fund pooling, or indeed listened to investors.

Instead, there have been hints of reinventing the same policy with a different name.[24] In their 2017 manifesto, the Conservatives proposed 'Future Britain Funds'[25] – effectively sovereign wealth funds that would invest in British infrastructure, which pension funds would be encouraged to join. It is not clear how these are materially different from the existing PiP, or the proposed 2015 public sector pension fund pooling into 'British Wealth Funds'.

Future policies must address key barriers to private investment

If the Government is truly committed to securing more private investment in UK infrastructure, at a good price, then ministers must enable and take account of challenge from those that the policies are designed to affect, early in the policymaking process. This will require greater consultation. This consultation must have balanced representation of incumbents and emerging companies, and maintain focus on a small set of issues, drawing on the principles we set out in *Creating and Sustaining an Effective Strategic Dialogue with Business*.[26,27]

* Correspondingly, our interviewees stressed the attractiveness of investing in the privatised regulated sectors (energy, water) because of: comparative policy stability of regulators compared with government; lower demand risk; and the attractiveness of a portfolio of investments which balanced any project-specific demand risks. There is also a secondary issue: that defined contribution pension funds require a high degree of liquidity, which infrastructure investment often does not provide.

3. The Government must outline a clear infrastructure pipeline

A clear pipeline is critical for attracting private investment in UK infrastructure. Currently, there are meant to be two infrastructure pipelines – lists of planned infrastructure projects – in the UK, but only one has been published.

The existing National Infrastructure and Construction Pipeline (NICP), first published in 2013, provides greater certainty for construction firms and helps government plan for future skills needs.[1] The proposed Private Finance 2 (PF2) pipeline should set out projects suitable for delivery through PF2, the Government's replacement for the Private Finance Initiative (PFI).[*] [2] The latter was announced in the 2016 Autumn Statement, but has yet to be published.[3] The Government will struggle to meet its goal of increasing private investment in UK infrastructure unless it provides clarity and more detail on upcoming projects.

Lack of upcoming private finance projects is pushing investors towards other markets

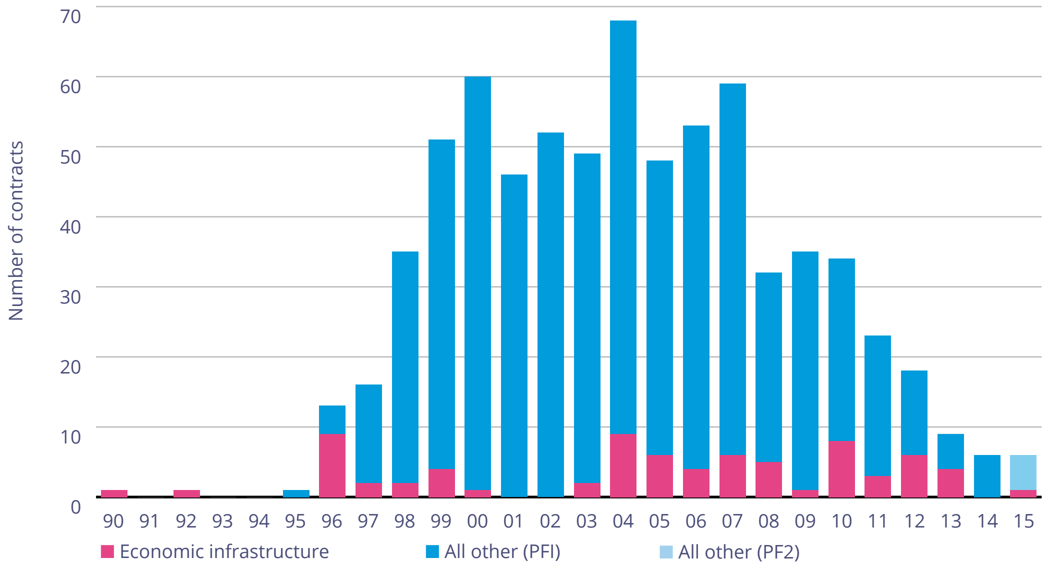
For the investors we spoke to, the main problem with the Government's current approach is the dearth of upcoming bankable projects: projects that are well defined and attractive enough for them to finance.[4]

Investors were keen to stress that the UK has not always lacked an infrastructure pipeline. The current situation contrasts starkly with the early 2000s, when there was a flow of similar infrastructure projects delivered using a standard project finance contract: PFI.[5] Investors said that they built up their in-house specialists to bid for the large stream of private finance projects at that time. However, following the decline of PFI projects after 2007,[6] this private sector infrastructure finance expertise shifted to focus on other countries.

John Laing Group plc, a UK infrastructure investor, provides an illustrative example. In the early to mid-2000s, its investments consisted entirely of UK-based public–private partnership (PPP) projects. Now, consumer-funded renewable energy generation projects make up around 25% of its investments and most of its future planned investments are outside the UK.[7] Other investors told us that they had let go of specialist staff and that to hire infrastructure specialists, they needed the security of a future pipeline.[8]

* PFI was a standardised project finance contract used to procure social and economic infrastructure. PF2 is its replacement, designed to address some of the shortcomings of PFIs.

Figure 1: Number of PFI and PF2 contracts signed annually, 1990–2015



Source: Institute for Government analysis of HM Treasury and Infrastructure and Projects Authority (2016) 'Private Finance Initiative and Private Finance 2 Projects: 2016 summary data', GOV.UK, retrieved 3 November 2017, www.gov.uk/government/publications/private-finance-initiative-and-private-finance-2-projects-2016-summary-data

If the Government does not provide clarity on upcoming opportunities, investors will not prioritise UK projects. This would not be a problem if the Government had decided there is no role for private finance in infrastructure. However, given the Government's aim to increase private investment, there is a real risk of reduced competition creating unnecessarily high costs for taxpayers and consumers. In 2013, the Treasury Select Committee concluded that only a large number of competing investors would drive the cost of private finance down, and only a clear pipeline would attract a large number of investors.[9]

Competition to finance and deliver infrastructure reduces costs for consumers and taxpayers.[10] For example, in clean energy infrastructure, the Competition and Markets Authority estimates that replacing the administratively set Renewables Obligation with competitive bidding to set strike prices[*] has reduced costs by 25%. It estimates that this has saved energy customers around £110m annually over the contract lifetimes.[11]

Lack of standardisation in similar projects is also a concern. Standardised contracts make it easier for investors to finance similar projects,[**] and build trust between government and investors.[12] A standardised contract will not work across all projects: clearly, projects with major risks are different. For example, the scale of the construction risks on the Thames Tideway Tunnel made a standard PF2 contract inappropriate. However, smaller projects with manageable risks do not need

* A 'strike price' is the pre-agreed price that the Government guarantees electricity-generating companies will receive for the low-carbon electricity produced for the duration of a contract. When the wholesale price is less than the strike price, electricity-generating companies receive a top-up from the consumer. When the wholesale price is greater than the strike price, the electricity-generating companies pay back the difference.

** However, this does not mean that government should uncritically endorse a standardised contract for different projects. A standardised contract should be used only if it would consistently provide value for money compared with other options.

government guarantees to encourage private investment, and projects with similar risks do not require bespoke contracts.

Infrastructure finance contracts should be structured to provide best value to the public sector. Given that standardised contracts create certainty, which in turn can introduce further competition, the Government should avoid outlining bespoke contracts – contracts with unique clauses or novel ways of sharing risks – unless there is a compelling argument that doing so would increase value for money.

The quality of information in the current pipeline is inadequate

As well as clarity on upcoming opportunities, the Government must provide more detail on projects in the pipeline. Although the Government has improved the quality of pipeline information, it remains insufficient if the Government is to meet its objective of increasing the volume of private infrastructure investment.

In 2010, Infrastructure UK published a national infrastructure plan, subsequently updated annually, which outlined how it intended to meet its infrastructure goals.[13] From 2013 it published an annually updated list of planned infrastructure projects: the NICP. Alongside the plan and pipeline, the Infrastructure and Projects Authority (IPA) publishes supplementary delivery and finance updates to publicise progress and investment opportunities, respectively.

> The information in the pipeline does not provide a basis for a constructive dialogue between government and investors

The Government announced in Autumn 2016 that a new pipeline of PF2 projects would be published. However, this new pipeline is yet to be released, and investors told us that, in its absence, the NICP is inadequate. From an investor perspective, the NICP has three problems.

- It combines projects financed through public spending and private finance, and is not clear on underlying funding[14] – who will pay for the project (and therefore how investors will make a return). This means that it is difficult for investors to determine which projects represent viable investment opportunities. Without knowing who will pay for a project, investors cannot evaluate how risky the investment is.

- It is not clear on the timelines for projects going ahead. This makes it challenging for investors to plan their investment strategy. Of projects in the NICP, 23% are in the 'scoping' stage, with little information on the next steps.

- It includes projects which are no longer investment opportunities. Some projects – such as the Thames Tideway Tunnel and Hinkley Point C – are included, although private finance has been arranged already. There is no information in the pipeline documentation to indicate this.

The information in the pipeline does not provide a basis for a constructive dialogue between government and investors. Yet this does not have to be the case. Our analysis of pipelines in other countries shows that it is possible to be clearer about opportunities, timelines, contractual details, location and the objective of projects.

We were told that providing these details would improve dialogue between governments and potential investors.

Norway and the Netherlands both illustrate better ways to communicate private finance opportunities to potential investors. Table 1 shows how the current UK pipeline compares with the private finance pipelines of Germany,[15] the Netherlands[16] and Norway[17] in five key areas. For investors, a clear timeline and contract structure are particularly important.

Table 1: Information provided in project pipelines

	UK	Germany	Netherlands	Norway
Project stage and next steps clearly outlined?	Unclear	Yes	Unclear	Yes
Contract structure?	No	No	Yes	Yes
Regularly updated?	Yes	No	No	Unclear
Objective?	Yes	No	Yes	Yes
Location?	Yes	Yes	Yes	Yes

Key: Yes | Unclear | No

Source: Institute for Government analysis of PPP project pipelines

Interviewees particularly praised the Netherlands' approach because of its clear pipeline, standardised processes for assessing private finance options and clarifying revenue sources, and quick progress to financial close.[18]

The project pipeline must be improved

If the Government wants to realise its ambition of increasing private investment in UK infrastructure then ministers must prioritise publishing the proposed PF2 pipeline. Announced over a year ago and promised for early 2017,[19] its failure to make an appearance sends a negative signal to investors.

The Government should integrate the planned PF2 pipeline with the existing NICP, publishing an integrated pipeline. Having a private finance pipeline independent of the existing pipeline is odd. It artificially divorces the financing and construction of projects, which are closely bound together in private finance projects. Providing information for investors and construction contractors in a single place would promote dialogue based on a common understanding shared between government, industry and investors.

To integrate the pipelines, we recommend expanding the NICP to include information on:

- where a project is in the approvals and planning process, an indicative timeline for when any finance will be sought, and anticipated date of financial close
- whether the public or private asset owners are seeking private finance to deliver the project
- the anticipated source of funding – taxes, consumers, or attempts to capture rents[20]
- the balance between the different funding sources and, if taxes, whether funding will be hypothecated
- the proposed contract structure for private finance – that is, corporate finance or project finance, and who the existing company and/or project-specific company will be
- whether private finance has been secured – and if not, information on who to contact to discuss.

4. Recommendations

The Government has consistently stated that it wants to secure more private investment in UK infrastructure, at a good price. To date, ministers have failed to address the barriers that are preventing this from happening. If the Government is serious about achieving this objective it needs to take action in three areas.

If the Government decides that there is reasonable evidence that private finance will provide better value than public spending, it must up its game to get better deals. The Government should do the following.

Ensure the civil service has access to sufficient in-house commercial skills

Better private finance deals – deals with appropriate risk transfers, which will deliver better value for taxpayers and consumers – require civil servants to have the commercial skills to negotiate and manage deals effectively. The public sector has not always negotiated good deals. While the civil service's in-house commercial skills have improved, weaknesses remain, especially in contract management.[1]

To ensure the civil service can agree and manage a greater volume of good private finance deals:

- the Government commercial specialism must ensure that public bodies have adequate access to in-house commercial and contract management specialists
- these specialists could be based in departments, or centrally based and deployed where appropriate – the former will be appropriate only for departments with high infrastructure spends.

As private finance contracts entail specific issues beyond generic contracting issues, the Infrastructure and Projects Authority (IPA) – where the project finance specialism sits – should:

- continue to deploy specialists to priority projects
- increase the number of private finance specialists.

Ensure ministers understand investor perspectives

Ministers have designed and implemented policies to encourage private infrastructure investment without adequately understanding the needs of private investors. Several policies announced to encourage private infrastructure investment have failed to have the impact desired.

To ensure that policies designed to encourage private infrastructure investment are effective:

- ministers must consult earlier, and more frequently, with investors when making policy designed to effect change in the infrastructure finance market
- this consultation must have balanced representation of incumbents and emerging companies, and maintain focus on a small set of issues, drawing on the principles we set out in *Creating and Sustaining an Effective Strategic Dialogue with Business.*[2]

Outline a clear infrastructure pipeline

The Government will not be able to significantly increase private investment in UK infrastructure unless it improves the project pipeline. Currently, the private finance pipeline is opaque to potential investors. Uncertainty reduces the number of investors and therefore competitive tension, leading to higher costs for taxpayers or consumers.[3]

> The Government must publish the PF2 pipeline

A clearer pipeline of projects to promote a common understanding between government, industry and investors would promote competition and create a better basis for dialogue. Constructive dialogue between government, industry and investors would help industry and investors understand what the Government wants, and help government understand what the private sector can deliver, improving how government contracts and the private sector delivers.

To address this, the Government must publish the PF2 pipeline originally announced in the 2016 Autumn Statement.[4]

This should be integrated with the existing NICP. The NICP could be made relevant for both investors and the supply chain, by including data on:

- where a project is in the approvals and planning process, and an indicative timeline for when any finance will be sought, alongside anticipated financial close
- whether the public or private asset owners are seeking private finance to deliver the project
- the anticipated source of funding – taxes, consumers, or attempts to capture rents[5]
- the balance of funding and, if taxes, whether funding will be hypothecated
- the proposed contract structure for private finance
- whether private finance has been secured and, if not, information on who to contact to discuss.

When deciding how to finance infrastructure, governments must rigorously appraise different options, as we set out in *Public versus Private: How to pick the best finance infrastructure option.*[6]

But, once the decision has been made, there is still room for improvement. Taken together, the reforms we outline – building the Government's commercial capability, understanding investor perspectives in policymaking, and ensuring the pipeline promotes competition – would help the Government to achieve its objective of increasing private investment in UK infrastructure on commercially advantageous terms.

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