UK debt-free public infrastructure is available now: busting the myth

Post-budget, the HM Treasury's own Accounting, Budgeting and Fiscal regulations still permit 'UK debt-free' investments by the private sector for public infrastructure.

It is the approvals process that does not.

Misconception

It is a present-day, common misconception, from investors to the top of government, that raising private capital for UK infrastructure projects results in the recognition of debt in the National Accounts. Consequently, investment in public infrastructure has been stymied for the last seven years.

Since the abolition of PFI as a financial 'product' in 2017, any projects using private capital to fund public infrastructure failed to gain approval and are now no longer even proposed. This was a politically-driven shift to distance public spending away from some of the failed contracts associated with the product.

However, the budgeting rules have not changed. Yes, tighter accounting was brought in to control leases and income strips to the private sector, reshaping the leasing accounting standard so that even operating leases resulted in National debt, but the budgeting rules have stayed the same and been forgotten. Now, public authorities do not build, borrow or lease with private finance to bridge their critical infrastructure gap, labouring under the misapprehension that all routes lead to approval failure because of debt recognition. The truth is debt-free infrastructure is available: the approval failure is about Value.

Solution

Firstly, let's deal with the irrefutable facts about National debt. HM Treasury's Manual for Government Deficit and Debt dictates what transactions result in National debt. It states that privately financed infrastructure projects of >20 years, in exchange for regular payments, do not result in National debt where the private sector constructs and maintains the assets on behalf of authorities. Yes, there is an embedded lease implied in the contract and yes, it is a long-term commitment to pay for infrastructure over the contract term, but it does not result in National debt. Projects adopting this structure cannot be stopped because of capital or debt constraints.

> **"The only way to drive economic growth is to invest, invest, invest"**
>
> **Rt Hon Rachel Reeves** Budget speech Oct 24

Gaining approval, therefore, relies on accurately harnessing and measuring the economic and social value of a project to balance the perceived risk of long-term financial commitments, debt classified or otherwise.

This is borne out in the government's current approach the Key Worker Housing in the NHS. The *NHS Homes Alliance White Paper*[1] and resultant MHCLG/DHSC joint ministerial Task Force, currently runs a pilot scheme that provides for a future pipeline of 25,000 units of Key Woker homes on NHS Trust land. All delivered under a privately funded, UK debt-free model. This model received HM Treasury approval because it harnessed value, balanced against perceived financial risk.

Capturing value

PFI was a financial product, not an investment philosophy. Low cost, long-term annuity backed pension finance still remains one of cheapest sources of capital. Public infrastructure is its perfect partner: it is backed by a state covenant and has a lifespan that matches the horizons of the bigger funds.

[1] *A People Driven Approach: Delivering NHS Homes* The NHS Homes Alliance https://www.nhshomesalliance.co.uk

The solution is found in public authorities capturing the value within the supply chain of infrastructure, not in outlawing private funding.

Privately financed approaches now need to draw on lessons learned from historically failed-PFI schemes with fresh, innovative contractual arrangements built into the supply chain of the project that provide greater value to Government. Examples include:

- Risk transfer between the private and public sector optimised, profiteering guarded against, and the public sector having an equity stake.
- IRR Caps: the levels of profit made by the private partners capped to prevent profits well in excess of those projected at the outset.
- Shareholding: example of up to 30% infrastructure project companies can be reserved for the public sector partners to retain financial value.
- Social and community benefit clauses included to ensure local labour and services are used pre and post construction. These add monetisable benefits to the scheme's economic case to be exchanged for the approvals process.
- Tighter payment mechanisms: continually benchmarked maintenance pricing to ensure best value year-on-year and greater power to penalise non-performance.

The Right Business Case

Underlined in Rachel Reeves' budget speech, the new government's push to recognise the economic and social value embedded in delivering infrastructure as a means of decision making already exists in the HM Treasury's documented approvals process.

> **"Net financial debt recognises that government investment delivers returns for taxpayers by counting not just the liabilities on a government's balance sheet, but the financial assets too"**
>
> **Rt Hon Rachel Reeves** Budget speech Oct 24

HM Treasury's own infrastructure business case methodology contains detailed, economic indices that, used properly, demonstrate robust, measurable economic and social value net gains for the UK for most infrastructure projects.

But the decision making itself does not align with the method: insufficiency of skillsets within consultancies and government to build these economic cases, combined with an erroneous fear of private finance means that authorities fail to give a strong enough reason to win approvals. The right business case will demonstrate the urgency of the strategic need for a project and the robust measurement of economic and social value to be gained.

Call to Action

Authorities need to better understand how the UK budgeting rules apply to their infrastructure project proposals. Thereafter, the public sector needs to better leverage its proposals for projects, proving the balance of economic gain versus financing risk, where the project's UK economic £Value > £Value of the financial exposure. It needs to give politicians one choice. They can't let infrastructure fail, nor can they find all the capital to fund infrastructure, so: approve a debt-free proposal and let the private sector fund infrastructure.

Kick-starting public infrastructure relies on the re-imagining of private capital deployment in one form or other. This is underway in the NHS housing sector and UK debt-free solutions do exist. The greatest blocker to achieving progress is balancing the political gain to be realised by solving the infrastructure gap with the political pain perceived by reigniting private capital.

Managing that balance requires value-driven proposals and meaningful engagement with HM Treasury to unlock approvals for refreshed, privately funded projects that deliver robustly measured public Value, whilst capitalising on the developer/operator skillset only found in the private sector and low-cost annuity backed finance only found in the institutional funding sector.

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