



THE SCOTTISH OFFICE

National Health Service in Scotland Management Executive

Dear Colleague

PRIVATE FINANCE AND APPROVAL OF CAPITAL PROJECTS

Summary

1. On 8 November 1994 the Chancellor of the Exchequer announced that Treasury will not approve any capital projects unless private finance options have been explored. The annex to this Circular gives further guidance on the use by Health Boards and NHS Trusts of private finance for capital projects.

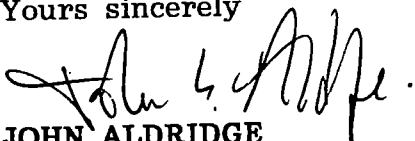
Background

2. In particular the guidance covers:
- 2.1 occasions when private finance should be considered in taking capital projects forward;
 - 2.2 details of the circumstances in which projects may proceed to procurement without a private finance option;
 - 2.3 evaluation of private finance options;
 - 2.4 details of the criteria to be applied when deciding whether to proceed using private finance; and
 - 2.5 guidelines to be applied to projects already in the pipeline.

Action

3. Please ensure that this circular is seen by all those concerned with private sector finance projects or proposals.
4. Please copy this circular to NHS Trust and Health Board Directors of Finance and Unit General Managers for information.

Yours sincerely


JOHN ALDRIDGE
Acting Director of Finance

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Addressees

For action:
Chief Executives,
NHS Trusts

General Managers
Health Boards

General Manager,
Common Services Agency

General Manager,
State Hospital

General Manager,
Health Education Board
for Scotland

To be copied to:
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Enquires to:

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PRIVATE FINANCE AND APPROVAL OF CAPITAL PROJECTS

Guidance for departments

In his speech to the CBI Annual Conference on 8 November 1994, the Chancellor of the Exchequer said:

"We need to take the private finance message to the heart of all decision-making in Government, as the Prime Minister made clear in July. So I am announcing today that, in future, the Treasury will not approve any capital projects unless private finance options have been explored. This will maximise the scope for, and use of, private finance while concentrating inevitably finite public capital provision on those areas where, for whatever reason, private finance is not possible. And it would mean that those departments who take up the challenge and use private finance will be able to deliver more projects than those who do not."

2. This note gives further guidance.

Scope.

3. This guidance applies to all parts of the public sector. The Treasury will apply the guidance in considering any projects which need Treasury approval under existing delegations. For projects within delegated limits, departments will want to discuss with the relevant Treasury expenditure division its applicability in the particular context of their programmes.

When to consider private finance

4. In considering whether a capital project should be taken forward under private finance there are two tests to apply. The final decision must rest on whether value for money can be demonstrated. But the initial test is whether, in principle, it is possible genuinely to transfer control and the associated risks to the private sector without disproportionate cost. Where this is thought to be so, a privately financed solution should be considered. This decision should be reached at the earliest possible stage. The possibility of private finance should be addressed explicitly when drawing up departmental efficiency plans: in the prior options review process, it falls to be considered once a department has concluded that privatisation is not the appropriate situation.

5. Projects may proceed to procurement without a private finance option if it is clear that transfer of control and risk is not feasible. The circumstances in which this might be so include the following:

-an overriding operational need for the public sector to provide the service; or

-no prospect, for policy or operational reasons, of transferring significant control and risk to the private sector without disproportionate cost; or

-when the project is covered by an existing contractual commitment.

Examples of the first might include certain defence systems. Examples of the second might be repairs and maintenance works on Government buildings (though not full refurbishment where occupancy risk might be transferable to the developer).

6. Ultimately, many projects across Government will be suitable for private finance. But in the short term, and particularly while this new requirement is bedding down, Department need to ensure that this guidance does not operate to hinder investment activity. Departments will need to consider, and if necessary discuss with the Treasury, how best to ensure this.

How to consider private finance

7. If transfer of control and risk to the private sector appears feasible, the next question is whether it provides value for money. This needs to be based on an investment appraisal, normally following a competitive tender, subject to the Treasury's March 1994 guidance "Competition and the Private Finance Initiative". It follows therefore that, unless excluded by the criteria in paragraph 5 above, future invitations to tender should be on the basis of private finance. Such tenders should seek the involvement of private sector management and capital in the provision of the relevant asset or service. They should indicate that adequate risk transfer will be one factor in awarding the contract, and encourage bidders to offer innovative solutions. They should be specified in terms of clearly defined outputs which the public sector is seeking to procure, leaving it to the private sector to decide the inputs required to deliver them. But, as the above guidance indicates, tender documents must make clear what are the evaluation criteria.

Decisions on private finance

8. Once bids have been received, the decision to proceed is one of value for money. That should take into account the benefits of transferring risk and responsibility under privately financed solutions. There may also be circumstances in which a decision to use private finance would create headroom within a department's public expenditure programme which allows projects to proceed which would not have done so otherwise. This may be relevant to a decision to go ahead, but does not form part of the formal investment appraisal. Guidance on appraising privately financed projects is in Annex F to the Treasury publication "Economic Appraisal in Central Government".

9. Where projects would otherwise have gone forward on a similar timescale but with public finance, departments need to satisfy themselves that private finance represents value for money relative to the publicly financed alternative. Where public capital provision is not available on a similar timescale, the comparison should not assume that it is.

10. "Public sector comparators" are not necessary for projects which involve no public money or which would not have gone ahead otherwise (whether joint ventures or the procurement of services), because public sector capital provision was not available. Separate rules apply to leasing.

**Projects already
in the pipeline**

11. It is recognised that some procurements will have been well advanced at the time of the announcement. The general presumption is that, in line with the Chancellor's announcement, such projects should consider privately financed solutions. Where procurements have previously been advertised under EC rules the admissibility of variant bids should be assessed. It would however be wrong if the policy resulted in unreasonable delay and disruption in public capital programmes. It is for departments to agree with the relevant Treasury expenditure divisions where this is so.

12. Departments should therefore approach the relevant Treasury expenditure division as soon as possible about any projects which they believe could be subject to legal challenge or would be unreasonably delayed if required to consider private finance. Any requests to exempt current projects from the requirement to test private finance should be notified to the Treasury by 31 January 1995. Departments may agree later notification dates in exceptional cases.

Contact points

13. Questions on the application of this guidance should be addressed to the relevant Treasury expenditure division, or to the Treasury Private Finance Unit (071 270 5531/5527).

Related guidance

*"Economic Appraisal in Central Government: A Technical Guide for Government Departments", HM Treasury, April 1991.

*"Leasing: Guidance for Departments", HM Treasury, May 1993 (PES(93)11).

*"Breaking New Ground", HM Treasury, November 1993.

*"Competition and the Private Finance Initiative: Guidance for Departments", HM Treasury, March 1994 (PES(94)3).

In addition, CCTA and the Private Finance Panel will shortly be issuing guidance on the Private Finance Initiative and Government IS/IT.