



HM TREASURY

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Impact of current funding markets on in-procurement PFI transactions

Dear colleague,

As you will be aware, the disruption in the funding markets that began last summer continues to persist. PFI projects have continued to obtain finance, although as elsewhere, the general availability of finance has led to pressure for increases in pricing. This comes after a period where market conditions and other factors led to steadily improving (lower) pricing.

At recent cross-PFU meetings (13 May and 28 July) held at HM Treasury we discussed the issue of rising bank margins in the current market and actions that the public sector could take to deal with potential additional refinancing gains that might be generated if the market were to subsequently move back to pre-credit crunch levels after a PFI contract was signed. We noted that several contracting authorities have considered increases to the public sector share of refinancing gains within the standard refinancing provisions of their PFI contracts. In many cases this will provide an appropriate protection to the taxpayer and HM Treasury will look favourably on such changes in the derogations process.

However, as you will understand the interaction of the sharing percentages and applicable discount rates within the refinancing provisions can have a significant impact on the behaviours of equity investors, both in terms of interest in the transaction itself and incentives to refinance in any particular way at a future point. Therefore, as part of their analysis of the options available to them in respect of this issue, contracting authorities should carefully consider the impact that proposed changes to the refinancing provisions might have on the incentives of the private sector parties to the contract, and thereby the likelihood of creating refinancing benefits for government in the future should market conditions improve.



While market disruption continues, for all projects we would encourage contracting authorities and departments to discuss refinancing gainshare provisions with the Refinancing Taskforce.

If you have any questions on this letter please contact either Cameron Matson in my team or the Refinancing Taskforce at Partnerships UK.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Gordon McKechnie', written in a cursive style.

Gordon McKechnie
Head of PFI Policy