

From Rt Hon Simon Burns MP Minister of State  
for Health

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The Rt Hon Danny Alexander MP  
HM Treasury  
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30 JUN 2011

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#### Deeds of Safeguard in NHS PFI schemes:

I am writing to seek the Treasury's support for the continued use of Deeds of Safeguard in NHS PFI-schemes, and the arrangements under which they should be issued.

The Settlement Letter following the 2010 Spending Review required that the policy with regard to Deeds of Safeguard in NHS PFI schemes be reviewed jointly by the DH and the Treasury, with a view to ending Deeds of Safeguard.

The factors that were to be considered in the review were:

- Strategic fit with the Government's vision of enhanced financial freedoms for provider trusts;
- The risk from Deeds of Safeguard of cost liabilities to the Government;
- The potential benefit of incentivising greater scrutiny by private sector lenders and investors of trusts' plans for affording their schemes, as part of their own due diligence; and
- The implications for priority schemes and the wider health economy.

DH officials have considered these matters carefully, and in doing so, have consulted private sector lenders and equity providers. DH officials have kept Treasury officials up to date on the conclusions as they have emerged.

In summary, the findings of DH's consideration of the four factors are as follows:

## **Strategic Fit with financial freedoms**

Foundation Trusts do already have very significant financial freedoms, in that they may retain cash for investment and borrow up to prudential borrowing limits. In practice though, investors and lenders regard lending large amounts, long-term to Foundation Trusts as significantly riskier than lending directly to central government, or to vehicles that are guaranteed either contractually or statutorily by central government. Confidence may well improve over time, but this is the view that investors and lenders take now.

## **Cost liabilities to Government:**

When PFI schemes are signed, they impose very large liabilities on the contracting authority, including servicing the underlying loan and the costs of maintaining and running the asset. The liabilities exist from the point at which the contract is signed. The key requirement is that the contracting authority can afford the payments, such that it should not become necessary for a guarantor to step in. The Department will therefore strengthen the affordability/viability tests that must be met by schemes before Deeds of Safeguard are agreed.

## **The role of investors in scrutinising schemes**

It is true that we have in the past nullified the need for private sector investors, lenders and contractors to undertake proper due diligence of trusts' plans for affording their schemes by providing guarantees, initially statutorily through the NHS Residual Liabilities act and subsequent legislation and through the issue of contractual guarantees. In this respect, we have removed an independent challenge of schemes' assumptions that exists in the commercial sector.

Our consultations with the private sector have, however, indicated consistently that financial institutions' assessments of the risks of dealing with Foundation Trusts would lead them to conclude that they could not rely on the covenant of Foundation Trusts for loans of the scale and term that are necessary for large PFI schemes.

Loans in the commercial sector tend to be for shorter terms than the 25 to 30 years that has been common in Health PFIs, smaller relative to the borrower's debt-service capacity and ultimately secured against assets.

**The implications for priority schemes:**

The implications for the trusts that are seeking to progress PFI schemes (Papworth, Alder Hey, Royal Liverpool and RNOH, which are in procurement, and Sandwell and North Tees which are seeking approval to go to market imminently), are that they would not be able to obtain funding from the market without government underwriting.

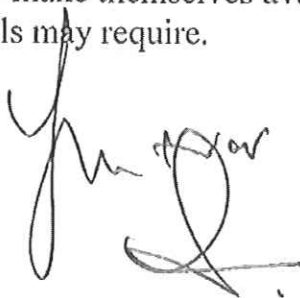
For the above reasons, I am asking for the Treasury's support for continuing to make Deeds of Safeguard available on PFI schemes.

Treasury officials have consistently made it clear to the Department that the Treasury could only support the issue of Deeds of Safeguard to the schemes that are in development, or subsequent schemes, where there are checks in place to ensure that schemes are affordable and otherwise compliant with government policy.

These checks will happen. Even where the trust proposing the scheme is a Foundation Trust, Deeds of Safeguard will only be agreed following approval of an Outline Business Case and Full Business Case (itself a two-stage approval process with the first check at appointment of Preferred Bidder). We envisage that the Treasury will be involved in approvals where the capital value of the scheme exceeds such Delegated Limits as apply to the Department at the time. Scrutiny of the business cases will be by officials in the Department's Commercial Division, who will report direct to Ministers.

I hope you can agree to the continuation of Deeds of Safeguard on this basis. I would be grateful if you could confirm this as soon as possible as there are a number of hospital PFI schemes in progress that are reaching points where they require certainty with regard to Deeds of Safeguard.

I have asked my officials to make themselves available for any discussion or further work your officials may require.

A handwritten signature in black ink, appearing to read 'Simon Burns', with a stylized flourish at the end.

**SIMON BURNS MP**