

# PFI Prison Case Study

DEPFA BANK plc

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## UK PFI Prisons - background

- **UK Prison Service has 137 prisons housing 74,500 prisoners (4.2.05) with spaces for 76,500**
- **PFI contracts first used for prisons in 1995**
- **Govt.'s objective was to introduce private sector design and management skills into the prison sector**
- **10 PFI contracts signed: currently 7 operational, 2 in construction**
- **Private sector operators are:**
  - **Premier Custodial Finance (Serco Group): 5**
  - **UK Detention Services: 1**
  - **Group 4: 3**
  - **Securicor: 1**

## Premier Custodial Finance Ltd

- Originally owned 50:50 by Serco (UK) and Wackenhut (USA)
- Now 100% Serco
- 5 prisons “bundled” together:

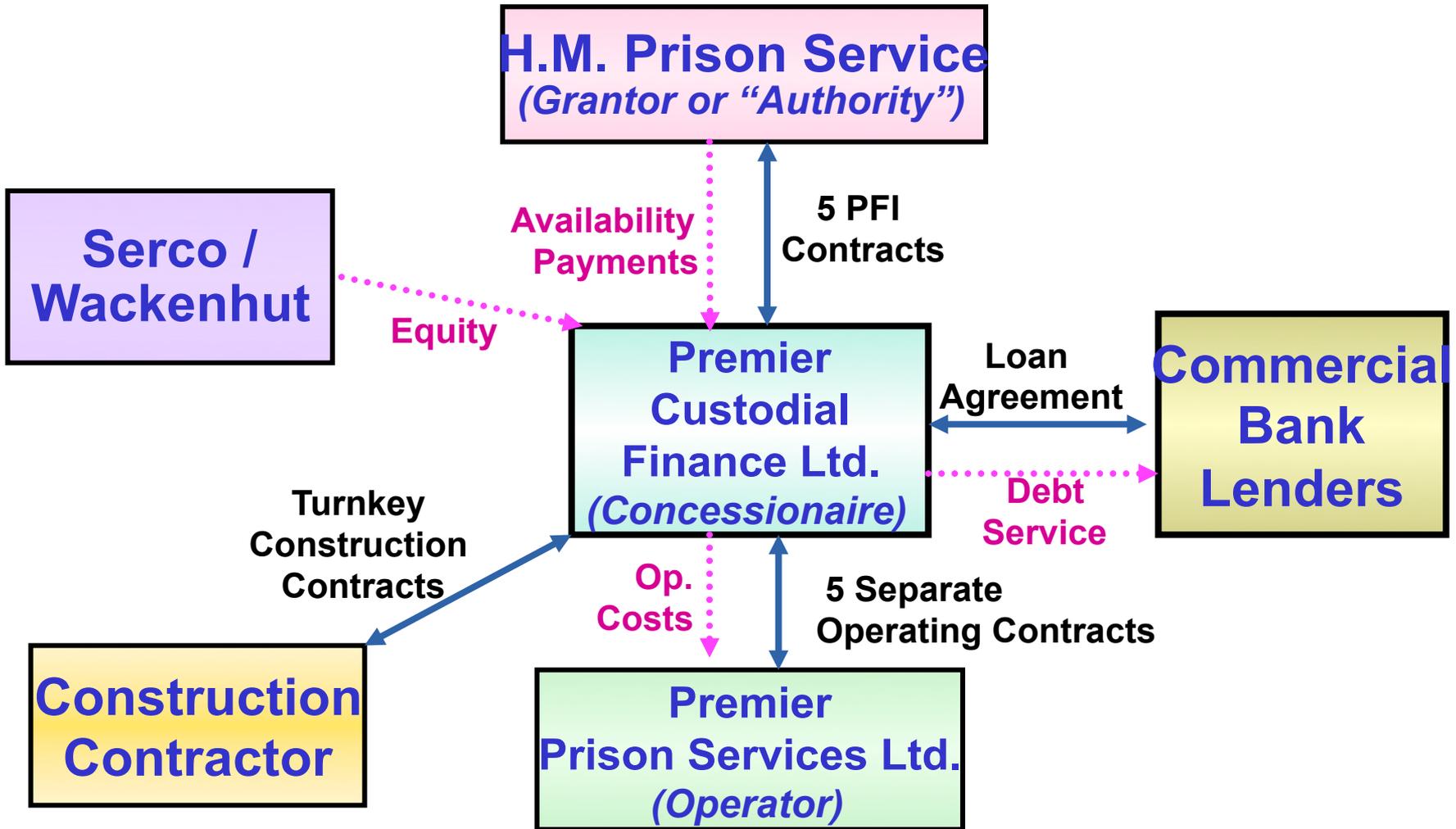
<i>Prison</i>	<i>Type</i>	<i>No.of places</i>	<i>Start Date</i>
Doncaster	Category A/B + YOI	1,080	20.6.04
Lowdham Grange	Category B (training)	840	16.2.98
Dovegate	Category B (training)	800	9.7.01
Ashfield	YOI and Juveniles	400	1.11.99
Kilmarnock	Category B	500	18.3.99
<b>TOTAL</b>		<b>3,620</b>	

YOI = Young Offender’s Institution (age 15-17)

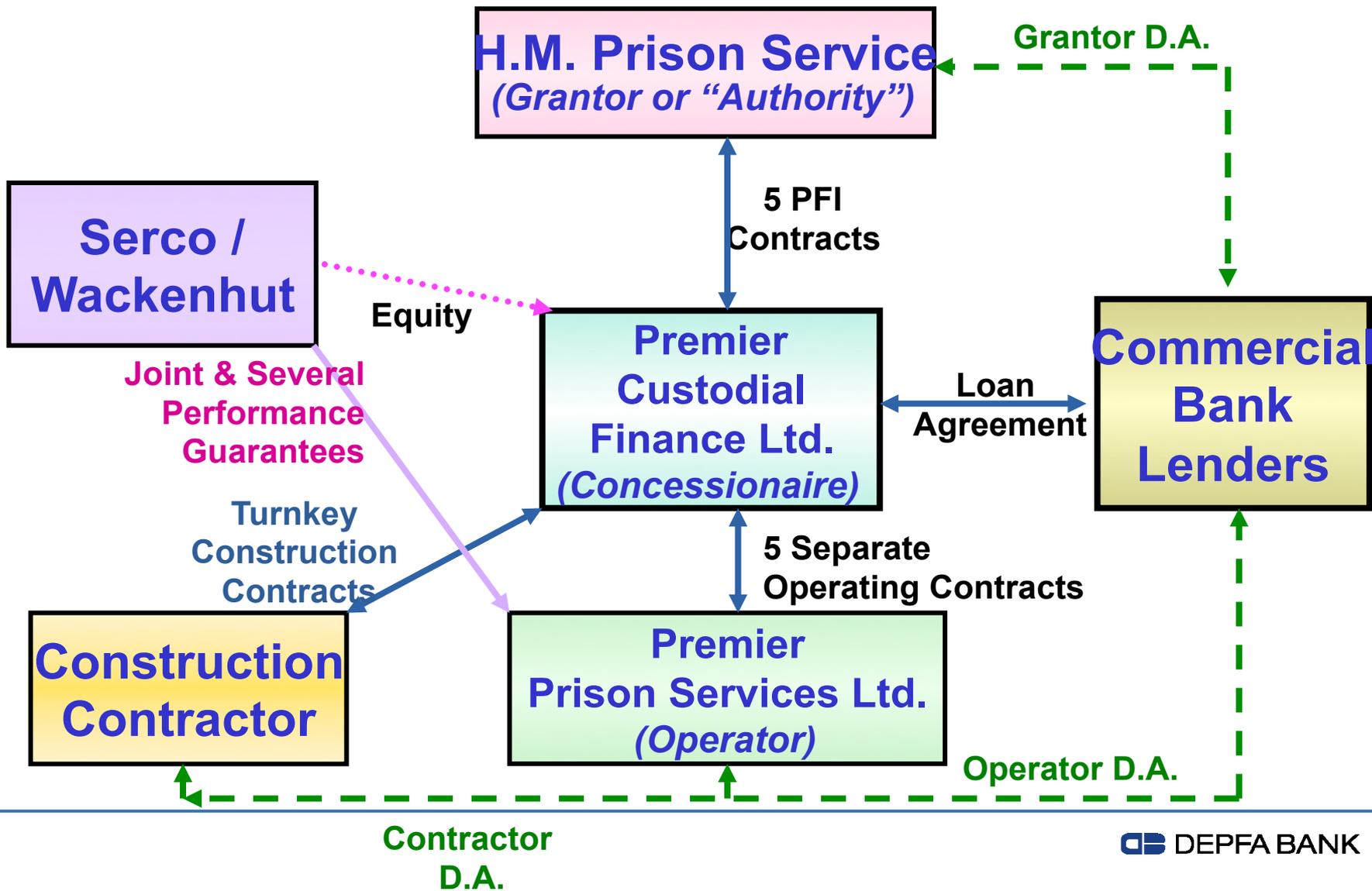
Lowdham Grange Prison



# Structure Chart: UK PFI prison project



Structure Chart: UK PFI prison project – showing Direct Agreements (D.A.)



## Scope of services

- **25 year PFI Concession to:**
  - **Design and build each prison to an agreed specification**
  - **Land is leased to Concessionaire for duration**
  - **Operations & Maintenance (at a fixed price – indexed to RPI)**
    - provide an agreed number of Available Prisoner Places ("APP") starting from a pre-agreed Contractual Opening Date
    - maintain the prison in good structural and decorative order according to pre-agreed maintenance requirements
- **Prison Operations: typically encompass 3 core aspects:**
  - **1) the “regime” which includes individual sentence planning and the provision of education, activities and real training and work opportunities (possibly in industry);**
  - **2) security and control; and**
  - **3) management and staffing.**

- ▶ **Construction Phase: Prison Service accepts the following as “Relief Events”**
  - > **If Prison Service does not comply with its obligations (in which case it must indemnify PCFL for cost of delays)**
  - > **Change in Scope of Services required by Prison Service (or change in legislation related to prisons)**
  - > **Industrial strikes by parties other than the Concessionaire or Contractor**
  - > **Civil commotion or terrorism**
  - > **Worse weather than in last 10 years**
  - > **Delays of up to 6 weeks resulting from starting construction during the winter months**
  - > **Specified perils under Construction Contract e.g. fire, flood, storm damage**

## Payment Mechanism

### Payment Mechanism:

- **The Prison Service calculates a **daily contract price** based on the number of prisoner places available (rather than occupied) – paid **monthly****
  
- **The price includes a fixed fee (non-indexed) designed to cover the Concessionaire’s financial costs, tax and shareholders’ equity return, and indexed fees designed to cover the Concessionaire’s (i.e. Operator’s) operating costs.**
  
- **Payment per Available Prisoner Place =**
  - **FIXED AVAILABILITY FEE (not indexed – to cover debt service, taxes and equity/ sub.debt return) +**
  - **INDEXED AVAILABILITY FEE (indexed to RPI – to cover non-labour related OPEX) +**
  - **INDEXED COSTS (Indexed to RPI + “X” – to cover labour related OPEX)**
  - **INDEXED UTILITY FEE (indexed to fuel and power inflation – to cover utility costs.****Adjusted every 5 years)**

## Performance Monitoring

### Performance Monitoring:

- **Prison Service “Controller”** on site – to carry out “State’s” roles e.g. disciplinary action against prisoners, investigate allegations against staff
- **Key Performance Indicators (15)** e.g. escapes, staff sickness, overcrowding, assaults, drugs
- **Key Performance Targets (48)** e.g. mandatory drug testing, completion of Offending Behaviour Programme, Security Audit Rating
- **Maintenance:** - “reactive” – respond within 48 hours max.  
- “Planned Preventative Maintenance” – prog. agreed with Prison Service setting out timing of inspections and refits

### Performance Deductions:

- If the Operator fails to meet the required standard of performance, penalty points are incurred which, if accumulated beyond a threshold, lead to financial penalties, potentially reducing the Availability Payments by up to a 5% cap.
- Persistent failure => **TERMINATION OF CONTRACT**

## Compensation for Termination

**Concessionaire default** (e.g. for not having the required no. of APP's for a continuous period of more than 30 days except for *force majeure* or where it is using “best endeavours” to correct the problem)  
**=> Authority pays Bank Debt LESS RECTIFICATION COSTS\***

\*i.e. the CAPEX required to bring the prison up to required standard under the Contract, plus increased net costs to Authority of taking over the prison, plus NPV of future INCREASED costs of a replacement private operator

**Corrupt gifts, *force majeure*, rejection by Authority of Bank's proposed replacement private operator**  
**=> Authority pays Bank Debt**

**Voluntary termination by Authority or unavailability of insurance**  
**=> Authority pays Bank Debt + Equity**

## Premier Prisons: Financing Structure

<i>Sources</i>	<i>£M</i>	<i>%</i>	<i>Uses</i>	<i>£M</i>	<i>%</i>
<b>Senior Debt (19.5 years) – lent in 5 separate tranches</b>	<b>199</b>	<b>90.9</b>	<b>Refinance of Construction Loans</b>	<b>212</b>	<b>96.8</b>
<b>Standby Facility</b>	<b>2</b>	<b>0.9</b>	<b>Available for Working Capital</b>	<b>7</b>	<b>3.2</b>
<b>Subordinated Debt</b>	<b>15</b>	<b>6.8</b>			
<b>Sponsor Equity</b>	<b>3</b>	<b>1.4</b>			
<b>Total</b>	<b>219</b>	<b>100.0</b>		<b>219</b>	<b>100.0</b>

- 1) Fixed and floating charges over Concessionaire's assets**
- 2) Assignment of benefit of all project contracts and insurances**
- 3) Charge over shares in Concessionaire (and subsidiaries)**
- 4) Direct Agreements with Authority, Construction Contractor and Operator**
  - purpose of D.A. is to give the Banks (Security Agent) time to:**
    - appoint a receiver**
    - replace the Construction Contractor or Operator**
    - novate the PFI Project Contract to a replacement Concessionaire**

## Actual Performance

- **In 1996 National Audit Office forecast 11% cost savings per prisoner from PFI**
- **In 2003 they carried out a detailed review:**
  - **- “mixed performance”**
  - **- combined availability deductions for all PFI prisons (1997-2001): £2.1m**
  - **- generally decreasing deductions over time**
- **One serious problem at Ashfield where they suspended the PFI Contract for 5 months in 2002 due to safety concerns (largely caused by staff shortages)**
- **Now operating satisfactorily**
- **PFI contracts may not be sufficiently flexible over 25 years to take account of changing needs of Prison Service**
- **PFI prisons have brought more flexible working practices and better “regimes” for prisoners with consequent cost efficiencies**

## Experience in other discipline-sector deals

### ➤ **Services Support (South East London) - 2001**

**4 new police stations; 2 admin buildings**

**Sponsored by Services Support (ultimately owned by Laing)**

**27.2 years concession**

**Debt over GBP 100 million**

### ➤ **Modern Courts (East Anglia) - 2002**

**2 new Crown courts – Cambridge and Ipswich**

**Sponsored 50/50 by Mowlem and Innisfree**

**25 year concession post-completion**

**Debt over GBP 35 million**



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