

Finance Committee

FIN(4) 06–12 – Paper 1

National Assembly for Wales Finance Committee Evidence from Scottish Futures Trust

1. Introduction

The committee has asked for evidence on the experience of Scotland in innovative financing of infrastructure through the Scottish Futures Trust. The paper presents an overview of our current work streams

Scottish Futures Trust (SFT) is an independent company established in 2008 by the Scottish Government with a responsibility to deliver value-for-money across public infrastructure investment in Scotland. SFT's five-year Corporate Plan, published in October 2009, committed SFT to deliver an initial £7 of benefits and savings for every £1 spent on the organisation. During 2010/11 SFT surpassed this by delivering £129m savings and benefits from its work which were net of SFT's £4m operating costs and were within the £100m-150m per annum target of benefits originally anticipated to be achieved once SFT had become fully operational.

SFT has the following five approaches through which it delivers benefits and savings for the taxpayer:

Delivery – what began with hub and Scotland's Schools for the Future programmes, SFT's role has grown as new projects such as NHT, TIF and asset management have been identified where SFT can lend its expertise and add value

Collaboration – bringing new approaches to collaboration on projects across sectors and regions, such as the Schools pilot project

Funding and Financing – innovating and improving funding structures which put SFT in a strong position to respond to investment opportunities including for pension funds, and maximise value for the public sector – clear examples of this are the £2.5bn NPD programme, NHT and TIF

Validation – applying stringent due diligence to infrastructure investment deals, which has often in the past been the preserve of private funders

Centre of Expertise – working with others to develop new and better forms of appraisal, execution and delivery. Using knowledge transfer and applying the lessons learnt, SFT will not be bound by existing structures or methodologies

The fall in the capital budget available to the Scottish Government, by more than 40 per cent in real terms from its peak of almost £4bn in 2009/10, reinforces the need to achieve improved value-for-money and develop innovative financing methods for additional investment. Delivering additional investment over and above capital budgets is important, not only to create the necessary infrastructure to support future economic growth, but also to help support the efficient delivery of public services. SFT has increased its work in infrastructure investment which now totals £3bn above traditional capital budgets, which over the next four years is predicted to support thousands of jobs in the construction sector in Scotland.

2. Additional Investment

This infrastructure is ultimately to be funded through payments as it is used, and requires a form of financing to pay for the construction work up-front. The varying forms of funding and financing that SFT uses across its programmes, are shown below:

Programme	Funding	Financing
NPD	Scottish Government revenue budgets over a 25-30 year contract	Capped-return risk capital investment by private provider and long-term finance from banks or capital markets
TIF	Future incremental non-domestic rates	Local authority borrowing from the Public Works Loan Board (PWLB)
NHT	Mid-market rent paid by property occupiers and eventual sale value	Local authority borrowing from the PWLB with a Scottish Government guarantee and capped-return equity from the private developer

3. Non-Profit Distributing Structure

In relative terms, SFT is managing one of the largest Public Private Partnership infrastructure investment programmes anywhere in Europe. The 2011/12 Scottish Budget gave SFT responsibility to deliver an additional £2.5bn pipeline of projects – to be paid for as they are used from future revenue budgets – in partnership with the Scottish Government, local government, NHS boards and other public bodies. SFT’s role is to manage the pipeline of projects in the programme; present a properly coordinated position to the market across all investment sectors; challenge procurers and share best practice to maximise value-for-money, and simplify contracts and processes to save time and cost in procurement and delivery.

Scotland has pioneered capped private sector profits so that profits properly reflect risks taken and deliver better value for the taxpayer. The £2.5bn project pipeline will be delivered under the Non-Profit Distributing (NPD) structure with delivery risks transferred to private partners under capped profit arrangements.

Paying for infrastructure from future revenue budgets, rather than from increasingly constrained capital funds, means that construction can start now instead of being postponed until capital budgets become available. In essence this means buildings are built, jobs protected and in many cases new jobs created. 2011 marked the start of the first flow of deals through the £2.5bn programme, with six projects, including the recently launched procurement of City of Glasgow College (valued at £200m) and Inverness College (valued at £50m), in the early stages of procurement or development with hub partners.

These initial projects alone will deliver over £260m of infrastructure investment. Importantly, SFT has been working hand-in-hand with all parties concerned to ensure projects and project teams are well-structured and well-resourced. Additionally, by applying a challenge to projects at Business Case stage, SFT has encouraged organisations to think about their ‘needs’ not their ‘wants’ so that available budgets are used fairly and wisely to deliver value and benefit.

In its delivery, SFT is supporting both the public and private sectors by simplifying contracts, shortening the procurement processes and publishing a clear project pipeline to allow businesses

plan ahead and resource accordingly, thereby minimising the cost and time involved in getting projects into the ground.

Steps already taken include simplifying contracts and clarifying risk positions which will assist in attracting pension fund investment. SFT is continuing to work actively to bring pension funds and other long-term investors in to NPD projects.

4. TIF

Scotland leads the way across the UK in the use of Tax Incremental Financing (TIF) to attract further additional investment. Working with seven Scottish councils, SFT will continue to develop the Tax Incremental Financing initiative across a range of industry sectors including retail, tourism, manufacturing and renewables. Whilst public sector investment in TIF is expected to reach c.£500m, such is the ability of TIF to unlock additional investment that over £2.5bn is expected to be invested by the private sector.

TIF can be described as ‘paying for growth with growth’. Business Cases seek to identify opportunities where some public sector infrastructure investment will lead to an opportunity for private sector development. This could for example be where a new business park could be built but access is required. SFT assess the proposal and if the business case is good then the relevant local authority can borrow the money required to construct the access road. The nondomestic rates raised from the occupants of the business park will provide the revenue to repay the loan and, in due course, an ongoing income stream. Examples of where SFT is working with local authorities to introduce TIF include the Waterfront in Leith, Ravenscraig in North Lanarkshire and the Buchanan Quarter in Glasgow.

5. National Housing Trust

SFT developed the National Housing Trust (NHT) from a zero base starting in 2009. The structure was developed reflecting current market conditions through evolving offers made by various private developers into a single approach that could be adopted and tendered in partnership with Local Authorities across Scotland. NHT combines private sector equity (from a developer) and local authority borrowing with a Scottish Government guarantee. It delivers affordable housing at approximately 80% of the local private market rent for a period between 5 and 10 years after which the houses are sold on the open market. It was intended to both address the serious shortage of affordable homes, and to kick-start house building. IOt has had the added benefit of showing that different delivery structures are possible thereby opening minds in the sector to further alternative approaches. During 2011/12, SFT worked with a number of local authorities as well as the Scottish Government to agree contracts for over 600 affordable homes for rent through the National Housing Trust (NHT) initiative – homes that otherwise would not have been built – which attracted £100m of additional investment and protected hundreds of construction jobs in Scotland. As a result of the success of NHT which now has tenants in its first houses, phase 2 has been launched, with procurement well underway with the aim in 2012/13 to increase the number of NHT affordable homes in Scotland to over 1,000.

Taken together, NPD, TIF and NHT represent an extra £3bn of investment into Scotland in addition to existing capital budgets, which enables vital investment in infrastructure to continue and protect many construction jobs across Scotland. Public spending on construction activities helps maintain employment, principally in private sector businesses, in a sector where the Gross Value Add per employee is significantly higher than the national average. Given the significant downturn in private

sector construction in recent years, industry commentators have observed that maintaining public investment is needed to retain a regional skilled workforce in the sector. All of SFT's procurements include a strong focus on community benefits, primarily delivering training and employment opportunities for local people

6. Asset Management

Recognising the economic challenges and the growing need to deliver further savings, SFT was asked by the Scottish Government to undertake a review of public sector property asset management, with SFT publishing two reports in September 2011. The reports identified opportunities for improving property asset management within the Scottish public sector and the potential to realise cost efficiencies of over £500m as a result of a five year programme of proposed change. SFT has been asked by the Scottish Government to champion a strategic approach and take forward a programme management role for improving property asset management across the Scottish public sector. Work has commenced and this major work stream will be expanded upon during 2012/13.

7. Hub

Across Scotland, the £1.4bn hub programme is gathering momentum. In the past eighteen months, hub has moved from a much debated and analysed concept through to delivering tangible outcomes with three joint venture partnerships up and running. The preferred bidder has also been announced for the West hub territory and the South West hub area is in the final stages of procurement. By October 2012 all five joint venture partnerships will be operational. Each hub covers a population of around 1m and sees a public private partnership established with all the Local Authorities and Health Boards in the area as well as blue-light and other public services joining together to select a private sector delivery partner. The joint venture will deliver community infrastructure and create local construction work. The first completed hub development at Drumbrae in Edinburgh opened to the public in February and a further three community projects are on site. The first hub project has successfully demonstrated hub's approach to delivering work to local firms.

8. Schools

Along with hub, the £1.25bn Scotland's Schools for the Future programme is meeting key milestones. The first primary school to be built opened in West Lothian in February 2012 and a further eight schools are being built (five of which will be open by March 2013). Construction of an additional 10 schools will start later this year. SFT's work in managing the programme has enabled an additional 12 schools to be delivered within the existing programme budget, rising from the originally anticipated 55 schools, to 67. The schools programme is a good example of SFT's work in challenging public bodies to ensure that they are procuring to address "needs not wants". This has been a growing theme in SFT and led to the development for the first time in Scotland of benchmark metrics to efficient, sustainable and high-quality schools. The benchmarks cover space per pupil and cost per square metre and form the basis of central funding allocation. SFT has just completed exemplar primary school design work, building on an earlier handbook for secondary schools to show what can be delivered within the benchmark space and cost metrics.

9. Waste

By 2020, approximately £1bn of waste treatment infrastructure will be required across Scotland and SFT will provide support and maintain its position as a centre of expertise for waste procurement amongst stakeholder groups. SFT's expertise is evident through the work it delivered during

2011/12 by working with Glasgow City Council in its appointment of Viridor as the preferred bidder for Glasgow's £150m residual waste treatment project.

10. Low Carbon

One new initiative SFT is taking forward is the development of options on how the public sector can reduce their street lighting energy and maintenance costs. SFT is working on a pilot project to assess the potential benefits of modern technology relating to more efficient lamps and central management systems.

11. Conclusions

Recommendations from Audit Scotland, the National Audit Office and other organisations in 2008 emphasised the importance of commercial skills as well as strong capital project and programme management expertise within the public sector; skills and expertise that SFT is providing. At the heart of SFT is a highly professional team with experience gained from working on numerous national and international infrastructure programmes. The team, working collaboratively with many public sector bodies including every health board and local authority in Scotland, has leant their financial, technical and legal expertise to help positively shape all SFT's programmes to date. This provides a strong basis upon which SFT can build but there is still much to do and therefore improving value-for-money and developing innovative ways to finance future infrastructure are still very much at the heart of SFT, as is delivering high-quality sustainable infrastructure and helping protect jobs across Scotland.