

## **SCOTTISH FUTURES TRUST**

Submission from Edinburgh Chamber of Commerce

### **Background -**

Edinburgh Chamber of Commerce is the largest Chamber in Scotland and the fastest growing in Britain. Formed in 1786, we have represented the interests of business and commerce in Scotland's capital city for over 220 years. We now have a large and active membership of almost 2,000 businesses, from the smallest SME and sole trader to the largest corporations, plcs and institutions. We're proud of our city and proud of our members.

### **Summary of ECC response -**

The business community welcomes the opportunity to influence the debate about the future funding of infrastructure projects in Scotland. The establishment of the Scottish Futures Trust (SFT) provides the opportunity for us to re-think the way in which the private and public sectors work together in funding and managing major projects. However, we have concerns about some of the assumptions about the structure of SFT implicit in the consultation documents. These relate to:

#### **1) Equity**

It is not clear whether there is expected to be any equity in the trust. While it is not considered appropriate for equity holders in PFI to make large returns, it should be remembered that equity is often a small part of the whole package and so the total costs of capital (bonds and equity) may not be that high. If there is no equity in the proposed structure then the market may demand higher returns on the bond component so the total cost of capital may not decrease. If the assumption is that there is to be little or no equity then the projects undertaken would have to be very low risk which could mean that the public contracts for the use of the resulting infrastructure might be less favourable than could otherwise be achieved in order to effectively guarantee the bonds.

## 2) **ppp/pfi**

The paper makes a presumption that there is no future mileage in PFI / PPP structures because it is perceived to be costly. The reality is that excess cost arises mainly where there has been a failure to assess and manage risk by the public sector client. Before the concept of PFI / PPP is jettisoned, it would be appropriate to properly assess how the model can be improved from a public sector perspective. The need for better risk assessment and management will still exist under the SFT proposal so the exercise is worthwhile even if no further PFI / PPP structures are deployed. If there is a need to avoid aggregation of borrowing with public sector totals then a private sector body is needed. This will limit if not preclude any public sector support to funding provision or security. This will in turn limit the extent to which lower funding cost can be achieved. Since lower funding cost is a primary objective of the new model, early assessment of how much can be achieved would be appropriate.

## 3) **role of SFT, governance and structure**

According to the consultation document, the trust will be required to:

- a. Raise substantial funding from a variety of sources for potentially complex purposes in a form which diverges from current models
- b. Contribute to the strategic development of long-term infrastructure provision.
- c. Provide expertise on project evaluation, development, design, procurement, delivery and operation in a number of sectors

This raises issues that require to be carefully thought through in designing the structure and function of the trust. In particular:

The ambitious scale of the anticipated services to be offered by the Trust will require employment of extremely high quality people. This will of necessity need to mirror market availability and rates or contracting out to consultancy services, also at market rates. These costs effectively represent private sector returns to those employees / suppliers. Other third party services will also be market priced, which means that the only important cost that can be influenced is funding cost, where there are questions to answer. This does not negate the SFT concept, but ambitions for the outcome on cost reduction need to be realistic. Most of the benefit will probably flow from “intelligent economies of scale” rather than specific cost reduction. The governance model needs careful analysis. If it is not

well-designed, the objectives will not be achieved. Note that there will need to be demonstrable lack of control of the Trust by the public sector to take the body off the public sector balance sheet. To whom is the Trust membership accountable ? What decisions does it take relative to the Management Board ? What is the role of the “Panel”? The ability to realise “intelligent economies of scale” will depend on the quality of people employed and the authority with which they can exercise their remit.

Moreover, the SFT will need to design its protocols and agreements in accordance with EU procurement rules to ensure that the Scottish model achieves its objectives without impeding competitive bid activity; likewise State aid rules may need to be examined. And if the trust is to be given the responsibility of becoming the sole arbiter of the business case for projects, what mechanisms can be introduced to measure its effectiveness and competence in this role? Finally, The relationship with other key bodies such as Transport Scotland, Network Rail, the Scottish Funding Council, Health Boards and local authorities is not addressed. Defining the respective interests and responsibilities is another critical success factor.

A fresh look at the environment, structure and funding of major public projects in Scotland is to be welcomed and the SFT model represents the opportunity to re-design the way in which we tackle the management and funding of these projects. However, the outline model requires significant further scoping and analysis if it is to become fit for purpose and our comments in this submission are designed to inform this debate. In this context, we hope you find them useful.

Graham Birse,  
Deputy Chief Executive  
March 2008

Specific responses to questions addressed below:

## Consultation Questions

### SCOTTISH FUTURES TRUST (SFT) QUESTIONS

1. How would the availability of expertise and support from SFT change the way public bodies handle infrastructure investments?

*The provision of a centre of expertise for best practice advice and support to public authorities on the planning and delivery of infrastructure investment projects may be beneficial to public bodies and their investments where little or no in-house expertise is available to deal with this requirement. Efficiencies should be achieved for public bodies in having a central pool of experts. In addition the appointment of key advisers for technical, legal and financial services on a centralized basis may also create efficiencies. A potential concern in adopting this approach is that the procurement process for projects may lack innovation and become stilted.*

2. What are the advantages and disadvantages in setting up SFT to generate surpluses to invest in further projects?

*It is not clear from the Consultation Paper how this can be achieved. There would need to be some form of offsetting arrangement between public sector bodies to deal with potential surpluses and this may result inequality as it may be that the public bodies that are efficient continually subsidise the public bodies which are inefficient. Also, private sector funders may not be keen on the reinvesting of surpluses without a clear direction being evident and appropriate guarantees being in place.*

3. What are the advantages and disadvantages in public authorities entering into agreements with SFT for the use of facilities?

*Public authorities would lose the ability to influence the scope of the project and it is likely that you could end up with “a one size fits all” scope while also losing control of the procurement process. It is likely that the public authorities would be paying for an infrastructure solution over which they have little control.*

4. What would be the advantages and disadvantages of using a greater degree of standardisation based on exemplar, energy efficient, sustainable designs to meet public authority requirements?

*This could be an advantage in that it may better define the scope of the projects but the major downside is that it could stifle innovation while making the bidding process purely a price driven exercise rather than a “value for money” evaluation.*

5. Are there any difficulties envisaged in transferring/selling public sector owned sites to the SFT investment vehicle for use in providing the new facility?

Yes

*This potentially could weaken the public authorities control and negotiating position in creating the infrastructure assets it needs, as the whole asset would be under the control of the SFT.*

#### **GENERAL COMMENT**

*The introduction of SFT may prove difficult as the Scottish Government is restricted in its powers to borrow under the Scotland Act and the regulation likely to be imposed by the public sector's adoption of International Financial Reporting Standards from April 2008. For it to work amendments to the Scotland Act would be required.*

*As the SFT is to be structured as a private sector entity and is not be government backed, it is not clear how the SFT would attract a credit status to allow it to borrow at competitive rates.*

*It is debatable as to whether the SFT can be implemented within a reasonable timescale. There is every likelihood that while the Scottish Government ponders the future, that the private sector who invest and operate in the current PFI / PPP market will look to similar markets elsewhere rather than wait for the Scottish Government to reinvent itself. Expertise and skills which have been hard won will be lost for good. Tried and tested solutions subject to development and tweaking are often better options.*

*An SFT market may be created which has little or no interest from funders or the private sector as it may be seen as not being a large enough or profitable enough market in which to invest the intellectual capital needed to enable it to work. For SFT to work the funders and private sector need to be convinced that it is viable and there is a market for it and most importantly that it will happen quickly and certainly within the next twelve months.*

*As currently described the SFT is an attempt to restrict returns to the private sector without necessarily reducing the level of risk which the private sector is expected to assume. The reward for taking risk is being viewed as something which is unpalatable to the Scottish Government; however the risk takers do need to be rewarded and the public sector regulated bidding process ensures that the selection of provider is done on a competitive basis. PFI / PPP has delivered for the Scottish taxpayer state-of-the-art and fit for purpose schools, hospitals, prisons, and waste and clean water treatment plants which it would not otherwise have had.*

*A better plan for the Scottish Government may be to build on the PFI / PPP successes of the past and perhaps as a method of satisfying the Government's policy extend the use of the Non-Profit Distributing model ("NPD"). The NPD model involves funding projects using 100% debt and means no uncapped equity returns to the private sector. This model has already been used to procure a number of school projects and the recent Tayside Mental Health project.*

