



membership resources

Briefing 08/16

March 2008

Scottish futures trust in infrastructure investment in Scotland

To: All Chief Executives, Main Contacts and Email Contacts (Scotland)

CC: All Chief Executives, Main Contacts (England, Northern Ireland and Wales)

A consultation document by the Scottish Government

Key issues

The Consultation sets out the Scottish Government's thinking on the Scottish Futures Trust.

The Scottish Government believes that there is a better way to fund all public infrastructure investment.

The briefing paper sets out the challenges and constraints facing the Scottish Government in relation to the Scottish Futures Trust proposal and the implications for local authorities of changes in accounting rules governing PFI.

1. Introduction

The Scottish Government has proposed an alternative model to fund vital public infrastructures other than by using the traditionally costly PFI (Public Finance Initiative). A consultation paper has been published that sets out the Government's plans for that better model for public procurement – a model that as a first step is intended to direct the excess profits made from traditional PFI funding back to communities and as a second will secure savings for the public purse through greater partnership, improved management and better value borrowing.

It is believed that this package could deliver clear short and long term benefits for Scottish taxpayers and for public services and it is hoped that it will secure best value and best outcomes when delivering services to the public.

The purpose of the consultation paper is to set out the Scottish Government's thinking on the role of the Scottish Futures Trust (SFT) initiative in infrastructure investment in Scotland, and to invite views on the proposals. The consultation paper seeks to:

- Clarify what the SFT concept entails
- Sets out the Scottish context against which the use of such an investment vehicle should be considered
- Describes the challenges the SFT hopes to address
- Sets out the Government's strategy
- Proposes the development of a new investment vehicle

2. Scottish Futures Trust (SFT) Proposal

The SFT is a Scottish Government initiative whose main aim is to provide an alternative means to PFI for challenging public and private capital into infrastructure investment programmes and projects in Scotland. The Government believes that it will provide a

better deal for taxpayers than that currently being provided by PFI by combining the opportunities for maximising investment levels with those for securing cheaper funding costs. However, it may also be possible to extend this base remit for SFT to include the provision of a number of other services ranging from investment planning and project delivery to asset management. All levels of government in Scotland have a duty to create and maintain the assets which underpin public services and economic activity and they have a duty to ensure value for money through the most efficient forms of delivery and to provide for the long term protection of these assets.

Around 10% (upwards of 3 billion pounds) of the Scottish Budget each year is currently devoted to capital expenditure, most of which relates to the creation, replacement or renewal of infrastructure across the range of Government responsibilities. The bulk of investment is through conventional capital procurement but some 2% (0.5 billion) of the Scottish Budget is also committed to annual revenue payments required to meet existing contractual PFI repayments.

Under UK fiscal policies, there is a cap set by Treasury on what the Scottish Government, other devolved administrations and Whitehall Departments can spend on capital projects. This is designed to meet the UK's judgment and obligations as to what level of borrowing and investment can be sustained by the UK Government as a whole.

The Scottish Government welcomes the involvement of the private sector in infrastructure investment. It recognises the benefit of partnership between the public and private sectors, the value of private sectors, the value of private sector know how and the due diligence it provides through having private capital at risk as well as additionally their investment brings on top of public sector investment. However, it does not support the use of the standard PFI model to achieve this. The Scottish Government considers the costs of projects which use the standard PFI model to be expensive and views the returns which the private sector equity, participants can realise as excessive, especially those obtained during the contract period and which have not been factored into the initial procurement and value for money process. The full document can be viewed at: www.scotland.gov.uk/consultations

3. Challenges and constraints

The Scottish Government is committed to introducing the SFT initiative. The objectives would be to:

- Provide lower cost funding for projects and programmes than PFI
- Operate on non profit distributing principles
- Continue to provide the additionality of public service facilities investment in Scottish infrastructure through private sector investment

The Government would like to see the initiative provide for individuals to make tax exempt investments in Scotland's infrastructure and for the injection of oil revenues

into this strategically important task. However, it recognises its current lack of powers to take forward these elements within the UK legislative and fiscal framework.

In taking the SFT concept forward the Government recognises that it has to operate within the constraints of a devolved administration. More specifically the Scottish Government has no borrowing powers under the terms of the Scotland Act. From April 2008 the UK Government has committed the UK as a whole to move to accounting under the International Financial Reporting Standards (IFRS). EU Member States are also committed to introducing these new standards.

The new accounting rules will change the basis on which the balance sheet position of the PFI's is assessed and hence could potentially affect the decision on whether or not a project will score as public expenditure. Hence the changeover to IFRS is likely to make more difficult the task of designing an SFT which could continue to provide the additionality of investment in public sector facilities which has been secured through private sector investment over the last 15 years. Accordingly, the SFT proposals in this paper will be developed in the light of the final IFRS outcome.

Recognising these constraints and the lead times involved in setting up any new investment vehicle, the Government views the SFT initiative as a development path moving from the present position in a series of stages to the realisation of all our objectives, rather than a big bang approach. The Government has now moved into the second phase of the development path. For all new projects where the value for money assessment of a project or programme suggests that the use of private sector finance and delivery expertise combined with risk transfer, would be beneficial, the Non-Profit Distributing (NPD) model will be used. NPD has already been extended from schools into the health sector and its use is expected to be extended to other sectors. The scope for uncapped investor returns as in the standard PFI has been discontinued and will only be considered in rare circumstances where the risks involved in a project are exceptionally high.

To secure the best borrowing rates, any SFT investment vehicle should be placed in the public sector and have clear government backing. This placement would offer the prospect of access to government funds such as those available at low rates from the Public Works Loans Board (PWL) and strengthen its credit rating when seeking to raise funds on the commercial market, for example by use of "municipal bonds".

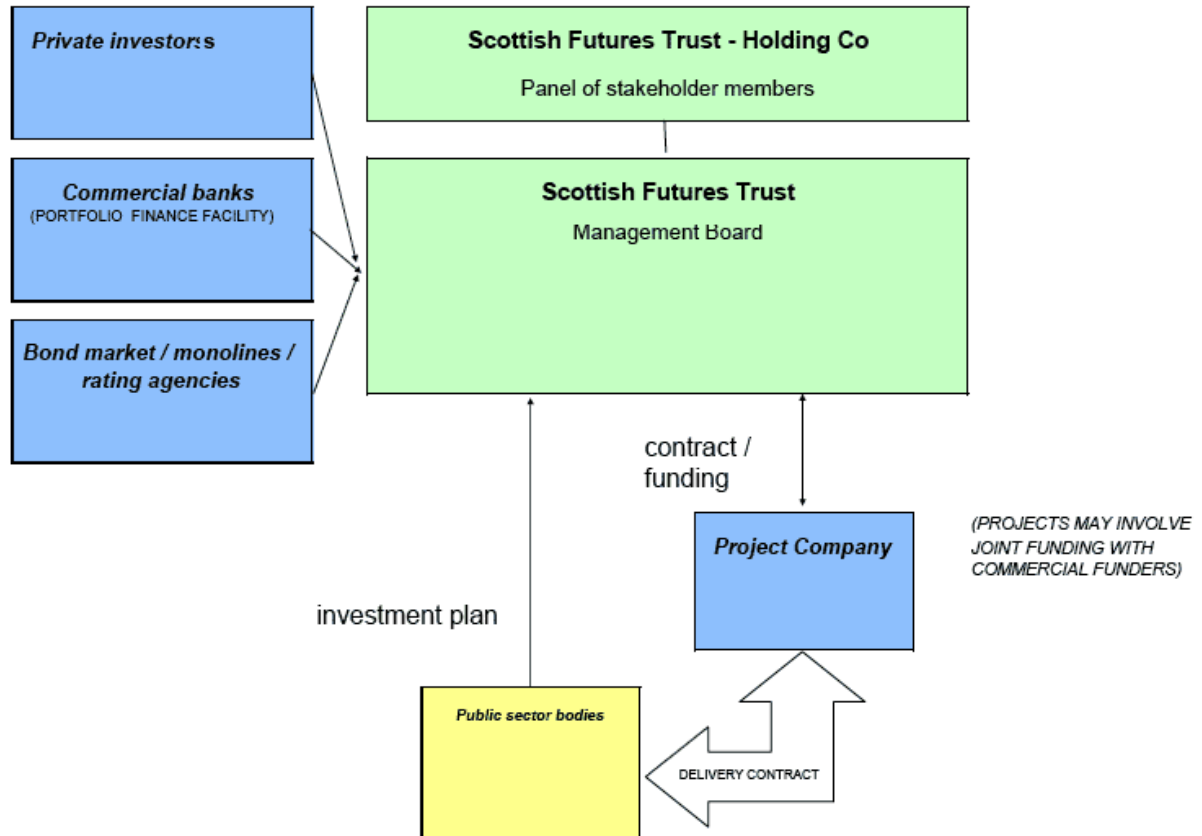
Conversely, to secure the additionality of private sector investment, the vehicle would need to be positioned in the private sector, and, drawing on a provisional interpretation of IFRS, demonstrate it was independent of the public sector and was able to control the assets it creates.

4. What would the new body look like and what would it do?

SFT is expected to be a limited company. The intended outline structure as well as the Memorandum and Articles of Association of the company would confine its activities to providing infrastructure within Scotland. In doing so, the company would be

constrained to the business of planning and supporting the delivery of national and local infrastructure plans published from time to time.

Figure 1 - structure of Scottish Futures Trust



SFT will be run on non-profit distributing principles and would obtain its funding through bonds and other appropriate commercial financial instruments at rates which would be cheaper than those involved in PFI procurements. It will undertake the following range of functions:

- Provide serviced assets to public authorities and others who provide public services
- Provide private finance to those who provide public services
- Provide other related financial services at cheaper costs
- Provide a centre of expertise for best practice advice and support to public authorities
- Provide co-ordination and support for the provision of shared infrastructure
- Provide a forum and focus for public and private sector market engagement

5. Provide cheaper private finance than PFI .

Where public authorities choose to source funding from the commercial money markets there are gains to be had from aggregation of demand and of debt management. It is proposed that the SFT might act as adviser and agent for authorities in order to optimise borrowings through the issue of municipal bonds. It could also assist in the management of existing partnership contracts and borrowings. An SFT investment vehicle would seek to co-ordinate authorities' requirements before seeking finance. The consultation paper suggests that from the market perspective, providing finance for a mixed portfolio of projects would spread the risk involved and it's likely to assist in minimising the overall costs of funds.

It is proposed that the SFT will operate across the whole public sector spectrum, but as an early focus over the next few months the Government will be exploring with the primary health care, schools, housing, higher and further education and local government sectors how, more specifically SFT can contribute to achieving the Government's objectives in these areas. The outcome of these discussions will be fed into the consultation exercise and taken into account along with the consultation responses in the final design of the SFT investment vehicle.

6. Conclusion

The Scottish Government considers that the proposals in the consultation paper are a sound basis for establishing a new infrastructure investment vehicle which will replace the choice between conventional and PFI capital financing currently available. Some aspects of the proposals for SFT set out in this paper give rise to a number of questions.

APSE welcomes investment in the public sector infrastructure in Scotland to pay for schools and hospitals etc but has long advocated that PFI does not represent the best long term value for money to the public purse. APSE has argued that changes in accounting standards and the definition of "public sector borrowing" would make conventional capital investment much more attractive than PFI for many public sector schemes. Only about 55% of the capital value of PFI schemes is deemed to be 'off balance sheet', nonetheless, experience in the local government sector is that schemes must be off balance sheet if they are to attract Central Government support in the form of PFI credits.

Nonetheless, experience in the local government sector is that schemes must be off balance sheet if they are to attract Central Government support in the form of PFI credits are the carrot that drives the local government PFI agenda forward. There may be people who will believe that a PFI will somehow magically transform the management of public sector infrastructure but for most it is the possibility that leads them to conclude that PFI = new school and no PFI = no school!

APSE has long argued that 25/30 year deals under PFI potentially lock local authorities into flexible contracts that do not reflect changing circumstances. However, there is much recognition that to date this has been one of the only means of levering in much needed capital investment in infrastructure projects. The national Government's

intention to move to International Financial Reporting Standards (IFRS) announced in the 2007 budget, should lead to most PFI's being re-categorised as public sector debt. This may result in PFI assets being re assessed and placed on the public sector balance sheet.

APSE believes that the economic impact of investment in public infrastructure is equivalent whether it is made directly by the public sector using prudential borrowing or routed through a PFI vehicle with the private sector. In terms of the level of expenditure, many would argue that the public sector route represents better value for money than PFI. Bringing those PFI assets that are currently off the public sector balance sheet on to it might well breach fiscal rules by keeping the net ratio of public sector debt to GDP. Such a move would potentially undermine the Government's hard won reputation for sound fiscal management. IFRS is supposed to create transparency and bring to an end, off balance sheet situations.

Changes to accounting rules and the definition of public sector debt, calls into question the long term viability of PFI as a vehicle for delivering infrastructure investment. APSE welcomes the debate about the best means of securing much needed investment in the public assets in the future. The consultation paper on SFT is another contribution to the debate about the best means of securing capital finance for major infrastructure investment.

APSE will be preparing a response to the Scottish Government's consultation paper and would welcome any comments which should be sent to ptaggart@apse.org.uk no later than 21 March 2008.

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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?**
2. **What are the advantages and disadvantages in setting up SFT to generate surpluses to invest in further projects?**
3. **What are the advantages and disadvantages in public authorities entering into agreements with SFT for the use of facilities?**
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?**
5. **Are there any difficulties envisaged in transferring/selling public sector owned sites to the SFT investment vehicle to use in providing the new facilities?**

NO

YES

PLEASE EXPLAIN