Finance Committee
Scottish Futures Trust/ NPD Programme

Submission from Audit Scotland

1. Audit Scotland is the public sector audit agency that undertakes the external audit of the majority of public sector bodies in Scotland. We do this on behalf of the Auditor General for Scotland (for the NHS and central government) and the Accounts Commission (for local government). We welcome the opportunity to provide written evidence to assist the Finance Committee’s inquiry into the Scottish Futures Trust (SFT), as part of its consideration of the 2016/17 budget.

2. The Scottish Ministers established the SFT as a company limited by shares in 2008 with a responsibility for delivering value for money across all public sector infrastructure investment in Scotland. As such, SFT is responsible for appointing private accountancy firms to audit its annual financial statements. The Auditor General of Scotland has powers under the Public Finance and Accountability (Scotland) Act 2000 to conduct examinations into the economy, efficiency and effectiveness with which SFT has used its resources in discharging its functions.¹

3. Audit Scotland has not previously undertaken a value for money examination of SFT, although we have published a number of reports on subject areas where SFT has had, and continues to have, some involvement. This submission highlights relevant issues raised in Audit Scotland reports, and planned audit work which will be of interest to the Committee.

Scottish Futures Trust

4. The SFT’s role has expanded since it was established in 2008. Its operational budget increased from £4.0 million in 2009/10 to £9.3 million in 2015/16. Staff numbers, which make up around 80 per cent of SFT’s spend, rose from 21 in 2010 to 68 in 2015.

5. The SFT’s aim is to “improve the effectiveness and efficiency of infrastructure investment in Scotland by working collaboratively with public bodies and industry, leading to better value for money and ultimately improved public service”. In pursuit of this, it is expected to act as a centre of expertise, providing guidance and support to public bodies in pursuit of their own capital investment plans. It also contributes to the development of innovative approaches to the design and financing of infrastructure investment.

¹ As set out in Scottish Statutory Instrument SSI 2010/389
6. For a relatively small organisation, the SFT is expected to play a pivotal role in the effective and efficient delivery of the Scottish public sector’s capital investment programme. The Scottish Government has set SFT targets to deliver benefits and savings from its activities of three per cent of the cost of the Scottish Government’s Infrastructure Investment Plan. This is the equivalent of delivering benefits and savings of around £100-150 million each year. The SFT reported achieving net benefits to infrastructure investment in Scotland of £139 million in 2013/14, and cumulative benefits and savings amounting to £640 million since it was established in 2008. The SFT uses a number of assumptions and confidence levels to estimate its benefits achieved, including efficiency gains, additional investment and avoided cost. Audit Scotland has not audited SFT’s reported benefits achieved.

7. The SFT’s business plan for 2015/16 identifies six broad headings of work and 12 key workstreams (Exhibit 1). The following paragraphs outline SFT’s work under each of these headings. They also set out the findings of relevant Audit Scotland reports, and our future audit plans in these areas.

**Exhibit 1: SFT workstreams by planned expenditure 2015/16**

Source: 2015/16 Business Plan, Scottish Futures Trust, April 2015

**SFT Invest**
8. The SFT’s work in this area focuses on the £3.5 billion Non Profit Distributing (NPD) initiative and the development of new models of financing capital investment. As at March 2015, some £1.8 billion of NPD projects were in construction, including the Aberdeen Western Peripheral Route and the new Royal Hospital for Sick Children in Edinburgh. The SFT’s role in respect of NPD projects includes:

- Developing a simplified ‘standard contract’ for NPD projects intended to reduce the time and expense of procurement negotiations.

- Undertaking Key Stage Reviews during the course of projects to ensure they are in good shape to proceed to the next phase.

- Engaging with the private sector markets to test financing options and obtain the best value for money finance.

9. The SFT is also leading on the development of Tax Incremental Financing (TIF) in Scotland and the Growth Accelerator Model (GAM). Both approaches are based on the presumption that public sector investment will unlock private sector investment, and so contribute to local economic regeneration. The intention is that this investment activity will lead to increased Non-Domestic Rate income for the investing council, enabling it to repay its borrowing. In relation to TIF, SFT formally assessed and recommended projects for SG approval. The SFT expects that public sector investment of £310 million in the six current TIF projects and the Edinburgh GAM project will result in an additional £2.2 billion private sector investment over a 10 year period.

10. Audit Scotland has produced a number of reports examining the management of capital projects, including revenue-financed projects. The Management of the Scottish Government’s capital investment programme was published on behalf of the AGS in January 2011, while Major capital investment in councils was published on behalf of the Accounts Commission in March 2013.

11. Most of the analysis of revenue-funded projects in these reports related to PFI projects, as the NPD model was only just getting off the ground. However, many of the reports’ recommendations, such as the need for councils to improve the quality of project and programme information to members, apply equally to NPD projects. We plan to publish a follow-up report to Major capital investment in councils, examining how councils have responded to the original report’s recommendations in winter 2015/16.

12. The AGS’s report Scotland’s key transport infrastructure projects, published in June 2013, considered the management of two NPD projects. The report found that both the Aberdeen Western Peripheral Route (AWPR) and M8 bundle projects were on track for being delivered against their revised budgets. Latest
estimates also suggested that the M8 bundle project would be delivered for £23 million less than the budget set out in the final business case. It was not possible to conclude on whether the AWPR was on course to be delivered on budget because the method of calculating costs differed between the final business case and later project estimates.

13. We are monitoring developments resulting from the ONS’s decision to classify the AWPR as a public sector project. This could potentially result in a charge on the Scottish Government's capital DEL budget, reducing the availability of money to take forward other capital projects. The SFT has a key role, in conjunction with the Scottish Government, in developing actions to mitigate against the ONS decision. A key interest for us is how these actions could affect the future governance of revenue-financed projects.

14. We also continue to monitor the development of alternative approaches to financing capital projects, such as TIF and GAM. We are particularly interested in these approaches from the perspective of the development of City Deals, and will consider our audit approach to this initiative in the future.

SFT Place

15. The SFT’s work in this area involves providing support to public bodies as they undergo organisational change in response to budget reductions and the need to develop new ways of providing customer-focused services. The SFT is providing support to a number of collaborative asset management initiatives across local and central government and the NHS, intended to lead to greater efficiencies in service delivery and the disposal of surplus property.

16. The SFT also undertakes a planned programme of reviews of Public Private Partnerships. These historic contracts have delivered assets valued at over £6 billion but they are often complex and need active management by the public sector. The SFT’s reviews focus on the service aspects of the project, including ensuring that the private sector fulfils its contractual responsibilities.

17. Audit Scotland published *Asset management in the NHS in Scotland* on behalf of the AGS in January 2009, and *Asset management in local government* on behalf of the Accounts Commission in May 2009. Both reports largely pre-dated SFT’s involvement in this area but commented on the variable condition of the public sector estate, the need to develop asset management strategies and the need to make better use of information on assets. We are currently considering the scope for a performance audit looking at how well public bodies are supporting transformational change to services through better management of their assets. Should we go ahead with an audit in this area, it is likely that this would include consideration of the role played by SFT.
SFT Green

18. The focus of SFT’s Low Carbon, Energy Efficiency and District Heating workstream is to support investment in the public sector estate to contribute to achieving Scotland’s climate change targets. The SFT’s recent work in this area includes the development of a toolkit providing advice to local authorities in considering the costs and benefits of investing in LED street lighting. It is also considering how best to structure the commercial propositions and the public sector’s financing of district heating schemes.

19. Audit Scotland has published a number of relevant reports in this area, although none of them involve the SFT. For example, *Improving energy efficiency* was published on behalf of the AGS and the Accounts Commission in December 2010. The Accounts Commission has also published three reports on Highland Council’s Caithness Heat and Power project, the last one in January 2014.

SFT Connect

20. The SFT’s work in this area focuses on digital connectivity. The AGS’s report *Superfast broadband for Scotland: A progress report*, published in February 2015, noted that the Scottish Government had tasked the SFT with developing a plan to achieve a world-class 2020 digital infrastructure. This was one of a number of initiatives intended to expand broadband coverage beyond what BT is expected to deliver through its two existing public sector broadband contracts. We are currently monitoring the roll-out of these contracts and will consider future reporting options, including the Scottish Government’s next steps in delivering its digital vision.

SFT Home

21. The SFT’s work in this area focuses on the development of its National Housing Trust (NHT) programme and its modified version, the NHT Council Variant. The programme is aimed at building affordable-rent homes through joint ventures involving interested councils and housing developers. The SFT is involved in the tender evaluation process and providing procurement advice for NHT projects. The SFT has reported that, since the NHT programme was introduced in 2011, 900 affordable-rent homes have been added to the national housing supply, with a further 445 in progress.

22. Audit Scotland published *Housing in Scotland* on behalf of the AGS and Accounts Commission in July 2013. The report found that housing supply was not keeping up with need, and reduced capital budgets and borrowing constraints were leading councils to consider alternative methods of financing housing supply.

SFT Build
23. The SFT’s work in this area focuses on the £1.8 billion Scotland’s Schools for the Future programme and the Scotland-wide hub programme. The SFT’s role in the Scotland’s Schools for the Future programme is to provide support to local authorities to achieve best value for money for their investment in new schools. A key part of this involved SFT creating two reference school designs with standardised cost and area metrics. It has also worked with councils to generate savings through joint procurement exercises. As at the end of March 2015, the programme had resulted in the delivery of 18 new or refurbished schools, with another 20 in construction. The SFT expects that a total of 93 new or refurbished schools will be delivered under the programme by March 2018.

24. The hub programme operates across five geographical territories in Scotland. In each territory, the participating public bodies, such as health boards, councils, police, fire and rescue services, have teamed up with a private sector development partner to form a joint venture company known as a hubCo. Each hubCo takes a strategic approach to supporting the delivery of local community services. Assets procured through the hub route can be either traditional capital financed or revenue financed using the Design, Build, Finance and Maintain (DBFM) model. They tend to be smaller in size and scope compared to NPD projects, generally not exceeding £50 million in value. The SFT’s role in the hub programme includes:

- Managing a programme office to support, encourage and share best practice in project delivery.
- Acting as an expert adviser to participants so they can maximise the benefits and value for money from individual procurements.
- Acting as an investor and shareholder in the five hub companies and all DBFM project vehicles.²
- Carrying out key stage reviews of DBFM projects.

As at the end of March 2015, hub projects valued at £1.6 billion had either been completed, were in construction or were in development.

25. Our report *Major capital investment in councils*, published in March 2013, examined a sample of 63 completed projects against their cost and time targets. Of these, 37 were school projects with a combined capital cost of £2 billion. The report found that school projects perform better to cost and time targets, perhaps

² As at 31 March 2014, the SFT has invested in four revenue-funded hubCo projects. The investments are in the form of fixed interest rate loans with interest being paid annually over the operational phase of the project. The loan principal is to be repaid in 25 years. As at 31 March 2014, the SFT’s total investment in these projects amounted to £2.3 million. It had also outstanding loans to hubCos of £0.5 million in working capital as at the same date.
because they are the most common type of capital projects councils deliver and because of the high priority they attach to them.

26. The SFT is also responsible for leading on the delivery of 29 of the 66 recommendations contained in the Review of Scottish Public Sector Procurement in Construction produced for the Scottish Government by Robin Crawford and Ken Lewandowski in October 2013. The report’s recurring themes were that construction procurement should become more collaborative, more efficient, more sustainable and more outcome focused. The need for collaborative procurement, including better sharing of knowledge and information between Scotland Excel and SFT, was a key finding in our report Procurement in councils, published on behalf of the Accounts Commission in April 2014. We are currently considering whether to conduct a follow-up to this audit.

27. Should you require any further information please contact Fraser McKinlay, Director of Performance Audit and Best Value, Audit Scotland, 18 George Street, Edinburgh, EH2 2QU, e-mail fmckinlay@audit-scotland.gov.uk.