OFFICIAL REPORT
AITHISG OIFIGEIL

Economy, Energy and Fair Work Committee

Tuesday 26 March 2019

The Scottish Parliament
Pàrlamaid na h-Alba

Session 5

Tuesday 26 March 2019

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ECONOMY, ENERGY AND FAIR WORK COMMITTEE
11th Meeting 2019, Session 5

CONVENER

*Gordon Lindhurst (Lothian) (Con)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Jackie Baillie (Dumbarton) (Lab)
*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Angela Constance (Almond Valley) (SNP)
*Jamie Halcro Johnston (Highlands and Islands) (Con)
*Dean Lockhart (Mid Scotland and Fife) (Con)
Gordon MacDonald (Edinburgh Pentlands) (SNP)
*Andy Wightman (Lothian) (Green)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Mark Dickson (Scottish Water)
Graeme Dodds (Jacobs)
Shona Frame (CMS Cameron McKenna Nabarro Olswang LLP)
Søren Kirk Jensen (CoST—the Infrastructure Transparency Initiative)
Gavin Paton (Burness Paull LLP)
Peter Reekie (Scottish Futures Trust)
Stephen Slessor (Morrison Construction)
David Stewart (Scottish Federation of Housing Associations)

CLERK TO THE COMMITTEE

Alison Walker

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Economy, Energy and Fair Work Committee

Tuesday 26 March 2019

[The Convener opened the meeting at 09:46]

Decision on Taking Business in Private

The Convener (Gordon Lindhurst): Good morning and welcome to the 11th meeting in 2019 of the Economy, Energy and Fair Work Committee. I ask everyone present to turn their electronic devices to silent to ensure that they do not interfere with proceedings. We have received apologies from committee member Gordon MacDonald.

Agenda item 1 is a decision on taking business in private. Does the committee agree to take items 4 and 5 in private?

Members *indicated agreement.*

Construction and Scotland's Economy

09:46

The Convener: Agenda item 2 is evidence taking from a number of witnesses for our inquiry into construction and Scotland's economy. I advise our witnesses that there is no need to press any buttons, because the microphones are operated from the sound desk. If you want to come into the discussion, please indicate as much by raising your hand.

I welcome to the meeting Graeme Dodds, director of operations, Jacobs; David Stewart, policy lead, Scottish Federation of Housing Associations; Mark Dickson, director of capital investment, Scottish Water; Peter Reekie, chief executive, Scottish Futures Trust; and Søren Kirk Jensen, senior policy and research adviser, CoST—the Infrastructure Transparency Initiative.

The deputy convener, John Mason, will start our questions.

John Mason (Glasgow Shettleston) (SNP): The first area that I want to touch on is the project pipeline. As I understand it, the Government is giving an overview of the amount of money that is available and the number of projects that it is expecting in the coming years. How useful is that approach? Are there any gaps? Would you like that overview to go further ahead? Would you like more detail? Would you like other sectors to be covered that are not already being covered? Does anyone have any strong thoughts on that and want to start us off? I see that Mr Stewart looks interested.

David Stewart (Scottish Federation of Housing Associations): I am happy to start off, but I should probably begin by saying that I am not an expert on infrastructure. I propose to talk more about planning programmes for housing, although I realise that infrastructure has a role to play in that.

We very much welcome the target of 50,000 affordable homes, and I would also note that grant planning targets have been set out for three years. I would therefore say that, as far as clients and contractors being able to plan out work is concerned, we are in a good situation over the current parliamentary session. That is extremely welcome, because we have not always been in that position.

John Mason: Am I right in saying that housing is not included in the project pipeline that is produced by the Government, because the detail of that is decided by other bodies?

David Stewart: I believe that that is the case.

John Mason: But we still have a pretty clear target for housing.

David Stewart: Yes.

Peter Reekie (Scottish Futures Trust): The Scottish Government last published the infrastructure investment plan in 2015, with an update in April 2018. It included nearly £1 billion of project opportunities—high-value projects across all sectors that have Government involvement—that had not started construction at that stage. However, most infrastructure investment is done by local authorities and other bodies such as housing associations, as you have alluded to. The Government's page has a click-through to the SFT's pipeline; we publish the pipeline that looks ahead to the hub programme that we manage, which also does not cover everything that is being done by local authorities and others.

In 2016, Audit Scotland identified in its follow-up report on "Major capital investment in councils" that a third of local authorities published forward-looking investment plans—I do not know whether the proportion has changed since then—and it recommended that more information should be published by local authorities.

In summary, high-level plans are published by Government and different bodies publish their plans, but I agree with your premise that there is no single place to look for all investment across every body that procures infrastructure in the public sector across Scotland.

John Mason: I suppose that not having a single place does not matter as long as everybody has access to all the information.

Peter Reekie: That is right.

John Mason: Does the SFT have access to all the information that it needs? You are obviously closer to Government than some of the witnesses.

Peter Reekie: The plans that are published give a good look ahead, but many people in the industry have said that more pipeline information would be more useful. People will always want to be able to look further ahead to plan their resources. Industry witnesses will be better placed than I am on this point, but it is one thing to know what is coming but quite another to know that your organisation is going to be part of what is coming and win tenders and so on. There is good information on the overall volume of activity and pretty good information on which sectors it will come in, but organisations then have to start looking in different places for individual projects.

A tension that arises is that although, if all that information were published in a central place, every contractor from anywhere would be able to click on it and see what work was coming in every area of the country, if local authorities publish their own information, that arguably makes it easier for local contractors to view what is coming locally, which they might see as a good thing. Therefore, everyone would like to see more information published—with the challenge about how far ahead because of budgets and so forth—but there will be different views on where the best place is for it to be published and whether it should all be centralised.

Søren Kirk Jensen (CoST—the Infrastructure Transparency Initiative): I provide an outsider's perspective here. From the international point of view, I agree with Peter Reekie about the different ways to make things transparent. Our case study on Scotland, which was published last year, found that it has a high level of infrastructure transparency for data that is disclosed throughout project delivery, in comparison with the United Kingdom and internationally. For large projects above £20 million, the level of transparency was 95 per cent when measured against the infrastructure data standard, and for projects between £4.5 million and £20 million, transparency was 70 per cent of the standard.

However, the drawback is that the information is fragmented and scattered across websites and reports, so considerable time is needed to find it, which lowers the value for contractors and for citizens who are interested.

Graeme Dodds (Jacobs): As Peter Reekie mentioned, industry will always want the pipeline to be as detailed and as long as possible, because that gives us surety in our investments in our people. However, we understand that there is a practical limit as to how far that can go.

The existing pipeline is relatively good at telling us what is being constructed and what is about to be constructed, but it is less good at pointing out forthcoming construction, although there is a certain degree of probability about those projects, because some require funding decisions that still have to be made. There is tension between what can be said definitively and the advice that can be given to the industry on what may be coming up to allow it to make judgments. The industry understands that probability factor. Peter Reekie referred to the fact that we do not win everything, but we look at our forward order book all the time and at probabilities of what we might win.

Other speakers were right about the fragmentation that exists once we move away from the infrastructure plan. Relative accuracy is important for industry. Therefore, we would not want to see an expansion of the plan that degrades that accuracy. It is important that there is either a degree of governance of what goes into any published plan—which we have with the current infrastructure plan—or an understanding of a threshold of certainty that agencies at national or local level need to meet, in order to give the industry surety about what is coming forward.

John Mason: To take the A9, which is quite a long-term plan, you could sit down on day 1 and say, “This is what we are going to do this year, and in years 2, 3 and 20,” but year 20 would change in all likelihood. I am struggling to understand. Should we be trying to plan further ahead, even if we are uncertain about something?

Graeme Dodds: I declare an interest in the A9, because we are involved in it.

The diagram for the process would feature a cone, in which the certainty decreases as one moves further out. However, it is also a conveyor belt in which, as we move forward in time, the certainty about where certain elements of a project lie increases. It would be useful for the industry to reflect on that. It would be difficult to say with any degree of accuracy what is going to happen in five years time on a project or to say that something is going to happen on April 14 2025—the only thing that we can say about that is that it is wrong. However, some indication of what is coming forward further out would be of use to the industry.

Mark Dickson (Scottish Water): A forward pipeline of work is crucial. We are not included in the specific infrastructure plan that you referred to, but we work within a regulatory cycle that allows us to have a long-term, medium-term and short-term view of the work that is coming. We endeavour to share that as widely as we can with our whole supply chain to allow sufficient planning, first, to get the projects delivered efficiently and effectively, and secondly, to understand the capacity and capability that we might need in the medium to longer-term future.

John Mason: How certain can you be? How far ahead can you be certain as to Scottish Water’s investments?

Mark Dickson: At the moment, we are in year 4 of a six-year plan, so we have reasonable certainty looking forward to 2021. As we go into the next regulatory cycle, we will have an understanding of the next two years of work in place by the back of this year, and will move into a rolling two-year plan thereafter.

To build on Graeme Dodds’s point, we can see out to 2021 with reasonable accuracy, but we can also understand the nature of the project work that is coming up in the following period, and some of the capacity and capability for which we need support from the industry. That allows us to talk to our supply chain extensively about the investment that is needed to grow that capacity and capability. The whole notion of a forward-looking pipeline that is as accurate as possible is very useful.

John Mason: Thank you. I could ask more questions, but I think that that is enough.

10:00

Andy Wightman (Lothian) (Green): I have a follow-up question for David Stewart. Would you agree that housing is infrastructure?

David Stewart: We would certainly argue that it is.

Andy Wightman: So you would say that both public housing and private housing are infrastructure.

David Stewart: Yes.

Andy Wightman: Right—I must have misunderstood something that you said earlier.

What more could be done to make the infrastructure investment plans useful beyond what you have already hinted at in relation to further forecasting?

David Stewart: I appreciate that it is difficult. Although there is a great deal of clarity about current funding—there is more than £3 billion in public money to support affordable housing, which will be match funded by investment by landlords—in the past, housing has suffered from changes over electoral cycles because there has not been long-term agreement on how much affordable housing or housing in general we need and how we can deliver that. I appreciate that there is not a lot of point in having a 20-year plan for the A9 because it will change, but if there could be consensus broadly about how we arrive at the level of housing need and how we will deliver housing through planning, infrastructure and land release, it would help the industry to invest in apprentices and move to digital and off-site delivery, so that it can attract different people into housing, such as more young people and women. Even if we accept that things change because of economics or political cycles, any horizon scan that looked to a longer-term target would be very helpful.

Peter Reekie: In the broadest sense, the industry is building construction, civil engineering and house building. Then there are the geographies in which people operate and scales of projects that different organisations get involved in and work on. It would be interesting if the Scottish Futures Trust or the Government could provide information that breaks things down into those broad categories—whether projects are in construction, civils or house building, the scale of the projects and where they are going to happen—so that they are of interest to different firms. We could create a perfect world in our minds where we can look at areas of the country, scales of projects and the nature of activity that will be going on, and then work back to what is possible and see which organisations own bits of data beyond that.

Graeme Dodds: I echo most of what was just said. It is useful to understand whether something is a programme or a project within a programme. That is helpful for small and medium-sized enterprises when they engage with tier 1 contractors on programmes, so that they have an idea of what they need to do, how they need to get engaged and whether there are elements within programmes that will be split into projects that they could take on themselves.

The Australian and New Zealand system has six classifications, running from prospective to closed out. The ability to have such a classification system is useful in understanding the overall picture. That approach would not focus just on work that has all its permissions in place and is shovel ready but would also give the industry an indication of the types of projects that are coming up and therefore the kinds of skills that the industry will need to mobilise at that time to meet that need.

Søren Kirk Jensen: The question is whether it is possible to move from an infrastructure investment plan to a broader, overarching strategy. That is not our thinking, but it is something that was recommended by Audit Scotland in 2011. The infrastructure investment plan should be upgraded to become an overarching strategy, to identify some of

"the long-term investment needs and constraints for capital investment in Scotland."

At that time, it was found that the IIP did not strategically assess

"the complex interrelationship between needs, affordability, political priorities and implementation capacity."

It is quite encouraging that, since we concluded our research, the Government has created the infrastructure commission for Scotland, which will support the development of the next infrastructure investment plan. Our advice here would be that the Government goes back to the Audit Scotland recommendation and instructs the commission to work on something that is more strategic and visionary for the country, in order to guide priorities and decision making, which would also add value to the work of the infrastructure investment board.

Andy Wightman: I think that the Government is consulting on the infrastructure commission right now. Are all the panel members responding to the consultation?

Peter Reekie: I can help with the timescale for that. I wrote down the infrastructure commission's remit before I came to the meeting. The commission has been asked to

"provide independent, informed advice on the vision, ambition and priorities for a long-term, 30-year, strategy for infrastructure in Scotland to meet our future economic growth and societal needs."

I understand that the consultation is out at the minute. I clicked on the website last night, and the consultation closes on 3 May, if anyone is interested.

Andy Wightman: I think that someone else will cover the infrastructure commission.

I will ask about the Government's plans to increase investment by £1.5 billion per year by 2025-26. Is that realistic? What should we be prioritising?

Graeme Dodds: The question of realism is probably one for the Government. From an industry perspective, we will respond to whatever is required—industry will ramp up as necessary to meet that need.

However, I will make two points. First, we should not see concrete, steel and black top for roads as the first priority for the increased investment or for our infrastructure spend. We need to step back and look at emerging solutions. We are on the cusp of fourth industrial revolution digital solutions. We need to think better about how we address infrastructure, and when we do concrete and steel, which we will still do, we need to make sure that we have chosen the best schemes to take forward—schemes that are cross cutting and which deliver not only for single parts of the economy, but across the board.

My second point is also about how the investment is prioritised. At the moment, we have the Treasury rule book and we look at 60-year return periods on investment, but I am certainly not going to sit in front of the committee and tell you what the transport network will look like in 60 years. Not far from here, we have the legacy of a bridge that has been there for almost 120 years and is still performing an important role in getting trains across the Forth. The way in which we examine and test infrastructure has to take into account a lot more dimensions than simply the economic rate of return. It needs to reflect what we want infrastructure to do. We do not build infrastructure for infrastructure's sake; we build it to allow our economy and our country to flourish.

Andy Wightman: Would one of the things that we need to do differently be to think about low carbon, for example?

Graeme Dodds: Absolutely. Infrastructure is a means of tackling a number of issues, and we need to ask how it is doing that in relation to health, social inequality, carbon and sustainability—and we can add to that list.

Andy Wightman: No one else has thoughts on the Government's planned £1.5 billion a year increase, so I will move on.

We will look at finance with the next panel, but it is an issue that comes up with the Scottish Futures Trust. There seems to be alchemy involved in the funding of public infrastructure in particular. Can Peter Reekie give us a flavour of where the Scottish Futures Trust is going with the question of financing infrastructure?

Peter Reekie: The ambition to increase infrastructure investment by £1.5 billion a year by 2025-26 will not be deliverable from within capital budgets as they are currently set, so there will need to be an element of financing to deliver that increase. I think that there should be public financing where that is possible, and the approach may include private financing if we still need increased activity to get to the infrastructure investment levels that we need.

Last year, we were asked to look at possible profit-sharing approaches to the financing of future infrastructure investment. We are currently doing that. The other panellists and members of the committee might know that the Welsh Government is using a mutual investment model arrangement, which is similar to the non-profit-distributing model that we used in Scotland in the past. However, the mutual investment model has a profit-sharing approach rather than the profit-capping approach that we had with NPD. It is a very similar overall arrangement that involves the public sector taking a stake of around 20 per cent in the projects and investing up to around 20 per cent in them. We are looking at such options, should they need to be used to deliver the national infrastructure mission.

Andy Wightman: What kind of projects is such a model anticipated for?

Peter Reekie: That is currently in the too-early-to-say bucket. If we can use public forms of financing, we would go to them first. It depends on the nature of the investment projects that come forward in a future infrastructure investment plan and what would be suitable for such investment.

Andy Wightman: A lot of infrastructure—for private housing, broadband and some utilities, for example—is now privately financed.

Peter Reekie: Yes.

Andy Wightman: Is there a suggestion that the increased stake for the public sector should apply to private housing, digital and energy infrastructure?

Peter Reekie: I am sorry; I was talking about projects that are ultimately paid for or funded by Government budgets. The private sector will have to finance its own infrastructure in the way that it needs to in order to deliver—

Andy Wightman: Is there any merit in thinking about giving the public sector more of a role? It is just as important to have electricity grids, digital grids and private housing—

Peter Reekie: We have not considered public financing interventions in private infrastructure markets.

Andy Wightman: Okay. Thanks very much.

Søren Kirk Jensen: I agree with that. There is also an international dimension to the discussion about attracting private finance to public infrastructure. There are many reasons for and against that. In general, it is even more important that there is increased transparency in some of the public-private partnership-type arrangements, because they include a different type of risk, which quite often falls more on the Government even if private finance is involved, in line with what Peter Reekie said.

Another view that does not contradict the idea of attracting private finance to public investment is that we should look at how to obtain better value from the money that is already invested or available and how to close efficiency gaps. The International Monetary Fund has estimated that, in all types of countries, there are efficiency gaps in public investments that range from 10 to 30 per cent. It quantifies the gap as 13 per cent for advanced economies, although each country will, of course, have different, specific losses from efficiency gaps in public investment.

There is growing consensus that one of the ways of mitigating, addressing or closing the efficiency gap is to improve infrastructure governance and to try to avoid some of the pitfalls with public infrastructure that are all too well known with regard to things running over time and over budget or not delivering within the expected costs. That is why we promote the idea of more transparency and accountability in infrastructure investments in general.

Andy Wightman: You are sitting in one of those projects.

Søren Kirk Jensen: I am well aware of that.

10:15

The Convener: Do you think that private sector contractors should be included on the infrastructure investment board?

Søren Kirk Jensen: Thank you for asking for clarification on that issue. We generally recommend more structured and systematic stakeholder engagement in infrastructure governance, including the possibility of discussing policy options.

One of our core features is multistakeholder working. Perhaps I should explain that a bit more. Our approach brings Government, industry and civil society together to pursue the goal of improving transparency and accountability in public infrastructure. In our member countries, what are called multistakeholder working groups are formed to oversee the implementation of programmes. When we were developing the Scotland case study, we started to look at how our core features could be adapted to a high-income country or advanced economy, but we found that our usual model did not appear to be the most constructive way forward.

As a result, we were very keen to look at existing institutional set-ups that could adopt features such as multistakeholder working. Interestingly, we found that in Scotland there was quite an advanced level of strategic planning as well as an institutional set-up to oversee its implementation, and we believe that such institutions can increase their legitimacy and credibility if they are constituted in a manner that is representative of different sectors of society. We therefore suggest not that contractors as such should be on the infrastructure investment board, but that it should be possible for representative bodies and associations to be included.

The Convener: You said that such an approach would increase legitimacy, but would it increase effectiveness? There is a difference between people saying, “This is a great idea,” and the idea actually working. What if people buy into something at a high level, so to speak, but it does not actually accomplish the goal that you set out at the beginning of your answer? Is that not the question?

Søren Kirk Jensen: That is very true, and I know that there is a history of attempts to improve the efficiency of the body in Scotland. In our experience, multistakeholder working helps build trust and enables different sectors to understand one another’s points of view earlier. There is a minister in one country who has said that, because of the multistakeholder working group, things can be discussed that would otherwise end up on the front pages of the next day’s newspapers.

Jackie Baillie (Dumbarton) (Lab): That is not a good thing!

Søren Kirk Jensen: The question is whether efficiency gains can be found at the beginning of the process.

The Convener: My question is not about something ending up on the front page of the newspaper the next day; it is about whether the approach actually works. Obviously there must be transparency and public accountability, too—it is not a matter of brushing things away or discussing them privately without anything being worked out. Do you agree?

Søren Kirk Jensen: Yes.

The Convener: I know that other committee members have questions to ask and other panellists want to comment. I believe that Dean Lockhart has a follow-up question.

Dean Lockhart (Mid Scotland and Fife) (Con): It is a brief follow-up question on sources of investment. As the panel will be aware, legislation is being introduced to establish the Scottish national investment bank, one of the main missions of which will be infrastructure development. Could the panel members explain briefly the role of the investment bank in infrastructure development? What discussions have you had with the Scottish Government about how it will affect the work of your organisations?

Mr Reekie, I guess we should start with you because the Scottish Futures Trust will obviously have a close working relationship with the new bank.

The Convener: I think that Peter Reekie wanted to reply to my point so perhaps he can give a dual answer.

Peter Reekie: I will try my best.

I was involved in some of the early work on the SNIB but I have not been involved in that for some time now. The SNIB will be a source of public funding, so it will be able to provide finance to projects that are ultimately in the private sector but in relation to which there is a policy interest in taking them forward. For example, we might think of renewable energy projects that will ultimately be part of the energy system, or increasing the energy efficiency of buildings, which ultimately will be paid for by the occupiers.

The structure under which the SNIB will provide a source of public finance means that it will not be able to fund things such as schools, hospitals and roads because of the rules about balance sheet treatment—it would just be seen as public capital funding and would not deliver any additionality. The SNIB has a role to play in the infrastructure sector, possibly in new areas or low-carbon areas—it rather depends on the mission that it is set during the period before it is set up. We will certainly be keeping close to the SNIB and working closely with it.

Should I come back on the IIB point, convener?

The Convener: If you want to, but briefly please.

Peter Reekie: I should probably say that I am a member of the infrastructure investment board, which functions as an internal governance system for projects and programmes. I am really pleased that the Government set up the infrastructure commission for Scotland to look at longer-term plans for infrastructure, and that sitting on that is a set of stakeholders from across industry and academia and from other interested bodies. It is particularly important that all those stakeholders are involved in looking to the future and helping us to set good priorities for Scotland.

David Stewart: On what the bank might fund, there are a couple of major challenges in housing. First, although land might be available, it is often difficult to fund the infrastructure that is necessary to develop sites. If the bank could help with enabling the development of large sites by putting infrastructure in up-front, that would be extremely helpful and a more effective way to fund development.

The second challenge goes back to Peter Reekie's point. There is a great need to increase the energy efficiency of existing housing to address fuel poverty and meet climate change targets. There is a need to switch to low-carbon energy, particularly low-carbon heating. If the bank could help to fund that for all tenures of housing, it would extremely helpful.

Colin Beattie (Midlothian North and Musselburgh) (SNP): During the inquiry, the committee has heard various views on whether the construction sector has the capacity to deliver the country's infrastructure needs. What are your views on whether the appropriate skills and capacity exist in the industry?

Mark Dickson: It is critical to be mindful, in working with the industry, of the required capacity and capability for the future, in order to make sure that skills are introduced. Our experience is that the industry will grow in order to deliver what we need it to deliver, but we also have to work closely with the industry to facilitate that by promoting intake of graduates and apprentices, and attracting different types of people into the industry. We have to work with the industry to understand the different mix of work that is coming in the future.

We heard earlier about the impact of digital and the need to focus on low carbon. One of the challenges that we face is that we will be moving increasingly towards investment in maintaining the existing asset stock. There will be a lot more mechanical and electrical work, as well as civils work.

Colin Beattie has asked a key question. I summarise by saying that we think that the capacity and capability exist, but we recognise that they have to grow, and that we need to work closely with all our suppliers on a long-term basis, if we can, to facilitate that.

Colin Beattie: I will come to David Stewart in a second. Is there capacity to deliver what is in the pipeline?

Mark Dickson: Looking ahead to the next 10 years or so, I suggest that we will have to grow capability and capacity for certain types of work over two, three or four years. From talking to many people who work in the industry, we get no sense that it cannot be done. That is linked to forward planning of the pipeline. The capacity and capability will be there if we move gradually into the new types of work that are coming down the pipeline. The core skill sets are certainly there.

David Stewart: In the SFHA's understanding, there is a challenge with capacity. There is, for example, an ageing workforce, certainly in housing construction. The sector can be quite reliant on European Union migrants, so there is a potential challenge coming in that respect.

We have entered a partnership with the Construction Scotland innovation centre to promote the potential of off-site construction and use of digital technology. That is partly to increase capacity and partly to increase the quality of the buildings that are produced. It is also based on our understanding that we need to attract new—and different—entrants to the industry. At the moment, the profile is very much of an ageing and largely male workforce, so a real effort to modernise and make construction a more attractive career for a wider range of people is needed.

Colin Beattie: Am I correct to take from what you are saying that although capacity does not exist at the moment to deliver what is in the pipeline, it is hoped that it will be?

David Stewart: It is more the case that capacity might be just about there. However, we have received anecdotal feedback from our members who are working to increase delivery of affordable housing, that the step change from the 30,000 units target in the previous session of Parliament to 50,000 in this session of Parliament has led to difficulty in attracting enough workers to some trades, including bricklaying, and that there is a premium in certain trades. In the medium to long term, action needs be taken to remedy that.

Colin Beattie: Is that any different from what the situation was previously? Historically, there have always been periodic shortages in certain trades, but they correct themselves. Are we not just in such a situation at the moment?

David Stewart: The difference at the moment might be due to the fact that the workforce is ageing. It is not just that there is a shortage; there is the question of what happens when so many people retire.

Colin Beattie: I remember people talking years ago about the ageing workforce, but it always seems to adjust itself as time goes on. In the natural course of time, people retire and a fairly high percentage of people at any time will be over 50, let us say.

David Stewart: I do not know about the period that you are referring to, but if the workforce's profile is very top heavy, there is a need to ensure that new entrants and apprentices are coming in and that the industry is seen as attractive to people.

10:30

Colin Beattie: I have a simple question, in that case. Are enough apprentices coming in, at the moment?

David Stewart: There is a challenge in that respect.

Colin Beattie: We hear the word "challenge" a lot. What does that mean?

The Convener: I think that we would like a yes or no answer. Are there enough apprentices coming in?

David Stewart: No, arguably, there are not. There certainly needs to be something that is more attractive to women, for example.

Graeme Dodds: I have a few brief points to make. We should remember that the industry largely reacts to client needs: that is what we are good at doing. When client requirements need us to ramp up, we do it. We have done that for a long time, and I think that we will continue to do it, because we are market driven.

We need to look at the issue of capacity through a couple of lenses. From the national and international perspective, we know that Ireland is very hot at the moment in infrastructure terms. A great deal is going on there and there is great demand for skills. There are also major projects here, such as high speed 2, that soak up capacity. We cannot see Scotland in isolation when we think about capacity, because projects elsewhere impact on the available skills and people. Tier 1 projects in Scotland will always get the high level of skills that they require, just because of their profile and what they are. However, when we have pressure on skills and resources, the danger is that the tier 2 projects will suffer as a result. That is the global and national lens.

There is also a local lens. When we are constructing or designing, we can max out the supply-chain base pretty quickly in particular parts of Scotland. It is therefore really important for consultants and contractors that we have a wide supply-chain base across Scotland.

We need to understand that the infrastructure of tomorrow will not need exactly the same skills base as the infrastructure of yesterday and today. For example, we have developed a whole new digital solutions division. That has been a significant investment, but we see it as a major area of growth.

For Jacobs, Scotland is one of our global design centres, so we have major skills and resources here. Actually, in balancing demand locally in Scotland, we have teams operating on an international front. For example, my rail-signalling group was working on Australian stuff the other month. There are people sitting in Scotland working on international projects.

Mark Dickson: I want to bring the issue to life and link it back to planning. Colleagues have talked about bringing in apprentices and graduates. That is a live issue for us all; we are working hard to bring in lots of new people. In terms of planning, we know that over the next five to 10 years we will probably need to double the level of investment in maintaining existing assets, and we know that in order to do that, we will probably need to double the amount of work that we do on mechanical and electrical installations. We are working with our supply chain to build that capacity.

The key is planning. We cannot switch on that capacity overnight, but if we plan we can build capacity, especially if we have good long-term relationships with the supply chain. The key is understanding what is coming and ramping up capacity. Clearly, if we were to double investment in a certain type of work tomorrow we would not have sufficient capacity, but if we know that it is coming down the line two or three years in advance, we can work with the supply chain and ramp up capacity.

We recognise that it is not just about capacity; it is also about capability. It is a live issue and we have to tie it back to how we plan for what is coming down the line.

Colin Beattie: You have raised a good point—on which we have not put much emphasis—about maintaining the infrastructure that is already built. I presume that that will take resources away from new infrastructure. How well has that been factored in?

Mark Dickson: We have certainly put a lot of time into and paid a lot of attention to that. More and more investment in the future will go towards maintaining existing assets: ergo, the nature of projects will be different and we will have to grow skills in that space, as well as in the new-build space. That will be true for all types of infrastructure. As Graeme Dodds said, as we maintain the infrastructure, we will have to grow additional skills, including digital, as well as traditional civils skills. We are alive to that and are putting a lot of time and effort into it, at the moment.

Peter Reekie: Investment in infrastructure equals investment in new infrastructure plus investment in maintaining the infrastructure that we already have. It is all part of the same overall picture.

At the risk of oversimplifying, I say that if we are going to increase our investment levels by £1.5 billion a year in six or seven years' time, we will need investment by the industry in its people and productivity, because we do not have much spare capacity hanging on pegs in the industry now. We will probably need more people and more output per person—productivity—in the digital arena and manufacturing, whether it is off-site or on-site manufacturing.

The public sector has the responsibility to help the industry to invest in its people and productivity in order to ensure that the industry has visibility of the pipeline and the procurement approaches that will allow it to invest. Setting that as a long-term ambition is the right thing to do. Over the next five or six years, there is work for the industry to do and for the public sector to do to allow the industry to do that.

Jackie Baillie: Before I proceed to my question on procurement, I want to return to Scottish Water and to probe something that Mark Dickson said. Scottish Water is planning increased capital spend to protect the existing infrastructure. Of what order of magnitude will that be compared with current expenditure? I am interested to know who will pay for it and whether there will be an increase in people's water bills as a consequence.

Mark Dickson: Ultimately, the investment that is undertaken by Scottish Water is funded through customer charges and supplemented by borrowing, which is why I did not answer the earlier question about the SNIB.

With regard to what is coming down the line, there is probably a need to increase investment in maintenance. We are going through a planning cycle just now: investment is currently about 50:50 between maintaining existing infrastructure and building new infrastructure. However, we are probably moving more towards 70:30. Please do not take that as gospel, because it is just going through the planning cycle at the moment. It will probably be 70 per cent of investment for maintaining existing asset stock and 30 per cent for new asset stock.

What that will mean for total levels of investment is still being worked on by a multi-stakeholder group. I cannot really comment on how it will be paid for.

Most of our water pipes and infrastructure were built post-war, and many of our non-infrastructure components—water and waste-water treatment works—were built in the early 80s. By the time when water and waste-water treatment works are 25 or 30 years old, many of the components are starting to come to the end of their lives. The post-war pipelines are starting to come to the end of their lives, so we will have to refurbish and maintain a lot of our asset stock.

Jackie Baillie: If it helps, I am making no criticism of the maintenance of our existing infrastructure; I am interested in how we pay for it. There used to be a principle that repayment of investment in water infrastructure was done over generations because it impacts on more than just the current generation. I am not sure whether that principle still exists or whether the current bill payers will pay the cost of the substantial increase in spending that is associated with all the infrastructure.

Mark Dickson: I am probably not best equipped to answer that question right now. However, ultimately, in our sector it is the customers who pay, whether through charges in the short term or through repayment of borrowing in the long term.

Jackie Baillie: You spoke about external capacity of contractors, and, naturally, you are working with your supply chain. What about internal capacity? Does Scottish Water use a lot of agency workers to supplement its staff?

Mark Dickson: We use agency workers, but most of our staff are Scottish Water employees. We use agency workers to deal with peaks and troughs in our workload, and when we need a certain skill set for a period of time that might not be long enough to justify employing other people—

Jackie Baillie: What percentage of the overall Scottish Water staff are agency workers?

Mark Dickson: I could not tell you that.

Jackie Baillie: It has been suggested to me that it might be about 20 per cent. Do you recognise that figure?

Mark Dickson: I would need to check. In my part of the business—the capital investment part—it flexes between 15 per cent and 20 per cent. Most of that is because of the need to bring in particular skills for particular types of work. I do not have the information to hand for the company as a whole, but I can certainly supply it to the committee.

Jackie Baillie: That would be helpful. I will now move on to the question that I was supposed to ask.

The committee has received evidence that suggests that procurement hurdles act as a disincentive to firms that are bidding for public sector contracts. Do current procurement arrangements act as a barrier for firms? If so, what improvements would make it easier for firms—in particular, small and local firms—to tender to access the supply chain opportunities? Peter Reekie might want to answer first.

Peter Reekie: The first thing to say is that it would be entirely wrong for me to disagree, given the evidence that the committee has received during its inquiry.

However, it is also true to say that public procurement is difficult to do well. Compared with procurement of construction works in the private sector, we in the public sector are required to work in accordance with a significant volume of public regulation and guidance to ensure fair play and that everything is transparent. That is not wrong—it is right—but it adds to the complexity of what we do.

We also have to deliver on a lot of agendas, aside from building the new asset. We must work on community engagement and training opportunities, and we must work with small and medium-sized enterprises. Again, that is not wrong—it is entirely right—but it gives procurers a lot to do other than focusing on the asset that they are going to buy.

As Jackie Baillie alluded slightly to, we also have competing priorities, which I think you have heard evidence on already. Some elements of the industry that supply to us say that, if we bring demand together and create framework opportunities and long-term opportunities for them, they will be able to invest in productivity and in people in a way that will enable them to deliver better for us.

There is another subset of people with whom we work who say that it would be better if we reviewed everything individually and at local level so that smaller firms could access the top level in supply chains in delivery of projects, rather than have access only lower down the supply chains. We have to ensure that the right kinds of projects appeal to the right sorts of contractors, so that there is a good fit between those operations. We cannot go all one way, and we cannot go all the other way.

10:45

The skills base in public procurement can always do with more investment. Wherever the SFT, as a central body, can help people, we do that. However, most of the procurement activity for social infrastructure is done in health boards and local authorities, and it is a challenging thing for people to do well.

Everyone is doing the best that they can, but there is always more that we can do with regard to the two things that are needed: provision of longer-term opportunities in some areas, to allow people to invest; and keeping some things small and local, to allow SME contractors to get in at tier 1 stage delivery and—I hope—grow to become the next generation of larger contractors.

Far from saying that we have got everything right in that regard, my organisation is trying to do better. We have just restructured, such that one of my directors is looking explicitly at the interaction between the public sector and industry in order to try to improve things over time.

David Stewart: I largely agree with what Peter Reekie just said. I cannot disagree with the suggestion that public procurement rules can be complex and challenging and therefore can put SMEs off bidding.

In our sector, we have found that where the public procurement rules apply, they can be a challenge for housing associations. The average housing association in Scotland has fewer than 1,000 units and does not have the same capacity—in terms of procurement teams or expertise—as a national health service trust or Police Scotland.

On the other hand, the procurement rules are in place for a good reason. It is public money that is being spent, and it is right that community benefits and value for money are sought and that fair work practices are encouraged.

I cannot provide a magic solution. I can say a little about what my sector has done to help to engage SMEs, and other practices that I am aware of in that regard. We have provided training to our members to increase capacity, which is about helping people to not just comply with procurement rules but engage with SMEs and help them to understand what housing associations are looking for, and deliver better community benefits from spend.

We have also worked with the supplier development programme, whose mission is to engage with suppliers, particularly small and medium-sized enterprises, to enable them to do what they have to do to comply with rules and succeed in bids.

Finally, it is often possible for contracts to be broken up into smaller lots, so that it is not just very large contractors and multinationals that can bid, and so that there is scope for local companies to bid and to bring in their local expertise and provide local employment.

The Convener: If the witnesses want to make further comments in writing after today's meeting, including on points that we have covered, they should feel free to do so. We have limited time, so I will bring in Graeme Dodds and then we will move on to questions from Jamie Halcro Johnston.

Graeme Dodds: I will make a few brief points. On procurement at the start of a project and deciding what projects should be, quite often when we look at something that comes out, we think, "Well, if you had asked the question slightly differently, you would probably have ended up with a slightly different answer—or a better-framed infrastructure solution." The scenarios in which we have had industry engagement, such as industry days, in the lead-in to procurement, have been valuable in enabling conversations and providing feedback to agencies that has enabled them to frame the question that they want answered.

I know that the committee has taken evidence on how procurement processes can drive—or not drive—innovation. One issue is that industry largely reflects the procurement process that it stands alongside. If we want innovation, the procurement process needs to be driven by that rather than by cost as the biggest element. The committee will take evidence from contractors on the next panel, so I will not comment further on that area.

The public contracts Scotland system is working to improve things. Particularly for SMEs, throughout the year it is valuable to be able to upload, or to have one hit of, information that changes only on an annual basis, such as accounts and the hygiene stuff that goes with bidding. To some extent, that issue is fine for companies such as mine, because we have dedicated teams that operate on that side of things. However, making the process more effective for SMEs would be useful.

Jamie Halcro Johnston (Highlands and Islands) (Con): In my region, the Highlands and Islands, there are a number of companies of different sizes, and a lot of smaller local companies have been involved in larger projects that have been going on in the area. Some witnesses to the committee have said that frameworks can be a positive way of managing procurement. How do such frameworks impact on the ability of local companies to access larger contracts?

Mark Dickson: As well as frameworks, we have a series of rural contractors. We have some larger alliances, some tier 1 contractors and 50-odd rural contractors, a number of which are in the Highlands and Islands. We endeavour to support them through complex procurement exercises. Three times a year, we run rural roadshows, which involves going round and meeting rural contractors and doing what we can to connect them with larger organisations that are using frameworks, through which there might be opportunities for them. We also connect rural contractors to our organisation and assist them with direct procurement opportunities.

We need the support of local organisations for a lot of the stuff that we deliver in rural areas, and many of our frameworks and larger contractors need the support of local organisations. The key point is to recognise that and to ensure that all the connections between the relevant organisations are in place.

We give support not just with procurement, but with health and safety and training, and we try to take that support out to local organisations as much as we can.

David Stewart: On the housing side, the issue is about frameworks being developed appropriately, bearing in mind the range of geographies and different projects in Scotland. For example, a framework that originated in England had a housing framework with only one Scottish contractor, which was not ideal.

Perhaps we should talk about some of the players in the housing landscape. We work quite closely with Scotland Excel, and the majority of its business goes to SMEs. The Scottish procurement alliance has set up new-build housing frameworks for different geographic areas, in acknowledgement of the need for different contractors to do jobs of different scales, from very rural projects to larger development in Glasgow or Edinburgh, for example.

Finally, hub West Scotland, which is a mix of the public and private sector, has recently developed a two-scale housing offer covering both larger developments and the kind of smaller developments that allow SMEs to be part of the framework. It is about setting up and using these things appropriately, not just to respond to different clients' different needs but to allow SMEs to take part.

Angela Constance (Almond Valley) (SNP): How does Scotland compare with the rest of the UK with regard to the level of information available on public sector infrastructure and the construction sector's ability to engage in infrastructure projects? Are there other lessons that we should be learning from international experience?

Søren Kirk Jensen: Interestingly, research that we have carried out at the UK level shows that the level of transparency in Scotland is not only higher but significantly higher than it is in the UK. I said earlier that the figures for transparency when measured against the CoST infrastructure data standard are 95 per cent for larger projects and 70 per cent for medium-sized projects; in the UK, the equivalent figures are only 60 per cent for larger projects and 35 per cent for medium-sized projects. I do not have time to explain the infrastructure data standard in detail, but I am happy to submit that information subsequently.

It would also be possible to strengthen that position even more by, as we said in our initial conversation, avoiding having the data scattered over different websites and reports. It would be quite easy to create a single online platform that connects the locations of the different data points, and that would make Scotland a real international leader in infrastructure transparency.

Angela Constance: Mr Reekie, do you have anything to add about how Scotland compares to the UK or, indeed, what is happening further afield with regard to the level of information on infrastructure projects that is available and the construction sector's ability to engage with infrastructure projects?

Peter Reekie: I think that Søren Kirk Jensen will have more of an international focus than we do, but I will say that we are always trying to do more on engagement. That said, we have a pretty good network with contractors, and we in the SFT are now involved in a structured and regular set of discussions with the Government and the contracting community on what needs to change in the future. We engage on specific projects and programmes before they kick off to ensure that the industry has a good sense of what is coming, and, with individual projects, we are increasingly involving contractors early and bringing them in at development stage. I would say that there is a pretty good level of understanding between the private sector delivery organisations and the public sector, but it can always be better, and more work can always be done on the matter.

On your question about international comparisons, we are certainly keen to learn about best practice from around the world. When the New Zealand infrastructure group came over, they learned something from us and we learned something from them, and I also spoke at their infrastructure conference—by videoconference, I should point out. We have done all sorts of different things at an international level. For example, we are a member of some of the European Investment Bank groupings in order to share experience across Europe, and the Organisation for Economic Co-operation and Development has some good infrastructure networks, too. I should point out that we also interact with our colleagues in the other nations of the UK.

We are always keen to do more, but we have a fairly good working relationship with the industry in Scotland, which is helped by our scale, and we learn from what is going on internationally and take an outward-looking approach.

Angela Constance: Thank you. I will leave it there, convener, because I am conscious of the time.

The Convener: I thank our panel for coming in today. As I have said, if you wish to add anything to what you have said, please feel free to write to the committee.

I suspend the meeting for a changeover of witnesses.

10:59

Meeting suspended.

11:03

On resuming—

The Convener: I welcome our second panel of witnesses: Stephen Slessor, operations director, infrastructure Scotland, Morrison Construction; Shona Frame, partner, CMS Cameron McKenna Nabarro Olswang LLP; and Gavin Paton, partner, Burness Paull LLP. Len Bunton was meant to be here but, unfortunately, he is not able to attend today.

I will start with a question on finance. What are your views on whether financial institutions are properly engaged with the construction industry and companies?

Stephen Slessor (Morrison Construction): Since the recent demise of Carillion, the business environment has been quite challenging for construction companies. Traditionally, banks have supported the businesses and although mainstream lenders are still engaged with the sector, there is a trend away from that—we can see that in the way that Interserve and Kier have been treated by the markets.

Average debt has risen significantly because, over the years, cheap funding has been available, and some companies have used that to capitalise to fund growth. However, in some instances that is changing rather dramatically, and that is one of the reasons why the market is currently quite challenging.

The other issue is that construction is quite cash intensive. Liquidity is really important. In 2016, net debt levels across the industry were 10.5 times the combined UK income of the top 10 contractors—that is compared to 6.5 times that income in 2009. That shows that there has been a real move towards debt.

On a smaller level, SMEs are struggling to obtain accessible and reasonable finance.

The Convener: I do not know whether Shona Frame and Gavin Paton are involved in the acquisition of finance or work more on the setting up of finance that has already been agreed with clients. Do either of you have any comments on how financial institutions currently relate to the construction industry?

Gavin Paton (Burness Paull LLP): I am principally involved in implementing arrangements, rather than negotiating them. However, the feedback that we get is that a combination of low margins, high-risk projects and recent insolvencies, in particular, means that the construction sector is viewed with caution by lenders. Where there are high risks and low margins, difficulties can arise quite suddenly, as we have seen in some recent high-profile cases. That model and recent high-profile cases have had an impact.

The Convener: Do you have anything to add, Shona?

Shona Frame (CMS Cameron McKenna Nabarro Olswang LLP): No. My expertise is on the other end of construction projects.

Andy Wightman: Recently, we carried out an inquiry into the business gateway support provided by local authorities to businesses and my question follows on from that. In general terms, looking across business support—business gateway, Scottish Enterprise and so on—does the construction sector get the same level of support from public sector bodies, including financial support, as other sectors, or is it treated somewhat differently?

Stephen Slessor: It has been the case that, because of the thin margins that we operate and the procurement models that work is based on, we effectively fund public and private sector contracts for the first 30 days. We get paid 60 days after we first start on site, but there is an expectation that cash will immediately flow down our supply chain from day 31. On top of that, getting access to finance can be difficult, depending on some of the terms and conditions that certain local authorities or procurement authorities put in place. In some instances, we take the decision not to pursue projects because of that.

Most of the Scottish Enterprise and business gateway support is targeted at the Scottish SME sector, so for us as a tier 1 contractor, a great deal of that is not visible.

Andy Wightman: If you were contemplating tendering to build a hospital, let us say, how would you fund the first 30 days?

Stephen Slessor: That would be funded from our net cash reserves. We use a mixture of cash reserves, trade credit, bank borrowing and private equity finance to do that. One of the attractions of using a major contractor is that they have a strong balance sheet, and strong balance sheets are really important.

Andy Wightman: Does any of the panel members have experience of alternative sources of finance in the construction industry? Obviously, we have had recent experience of PPP and private finance initiative projects, and the Scottish Futures Trust has made attempts to generate new models of funding. Do you have any comments on different ways of funding construction?

Gavin Paton: My practice is focused on mainstream construction and development in the public and private sectors, and on project finance. In the 20-odd years that I have been in the profession, the availability of project finance models and the pipeline associated with them has certainly been quite spiky, and that has an impact on the market. We have a strong core of expertise in project finance in Scotland, but it waxes and wanes depending on what models are available. At the moment, we have the hub DBFM—design, build, finance, maintain—model, which is a project finance model within the hub framework that is delivering a lot of fantastic projects. Obviously, NPD projects have not been proceeding recently because of accounting treatment issues, but the market would certainly welcome further development of NPD and of new project finance models to deliver big infrastructure projects.

The Convener: Shona Frame deals with the disputes that arise when things fall apart, so to speak. Which finance models tend to work rather than not work in that regard?

Shona Frame: The disputes that I deal with are focused around time, money and defects—those are the constant themes that we see across all the methods of procurement. With the different standard forms and, increasingly in recent years, PFI/PPP models, the exact same issues are coming through. At the moment, with PFI contracts, we are seeing a large increase in the number of disputes concerning performance deduction payment mechanisms.

The Convener: You would not single out any particular procurement or finance model as better than another in that sense.

Shona Frame: We are starting to see a trend towards more partnering and alliancing forms of contract, but I have dealt with many disputes under those forms of contract. The way to deal with dispute management and avoidance is to live those contracts rather than just enter into them. If disputes are to be avoided, it is not enough for the parties just to use the terminology and the sorts of clauses that we see in NEC contracts about acting with good faith and mutual trust and co-operation;

that has to actually mean something in the way that the contract is operated. It is not necessarily about the contract model; it is about parties' behaviours and how the contract is operated.

Angela Constance: Does the panel have any views on whether the building Scotland fund has helped to improve the availability of funding for the sector? Mr Slessor might have views on that.

Stephen Slessor: I had a look at the figures and found that, up to the end of the current financial year, about £51 million has been allocated from the £150 million that was set aside, around half of which is for one project, the Winchburgh development. The fund is helpful for the sector. It has helped that project come to market much more quickly than it might have done in the past. However, there is a challenge with transparency around how to access the fund, and there are a number of constraints that prevent many developers from accessing it.

The fund is a good idea. It helps to bring more projects to market and is a useful step towards understanding how the Scottish national investment bank will be able to support construction infrastructure in Scotland in the next 10 to 15 years.

11:15

Angela Constance: Given that the building Scotland fund was launched as a precursor to the national investment bank, how do you expect the bank to improve the sector's access to finance?

Stephen Slessor: The biggest challenge will be in replacing the European Investment Bank if it decides not to invest heavily in Scotland post-Brexit. Over the past 10 or 15 years, it has invested in the region of £3 billion in Scotland, which has delivered some of the largest infrastructure projects around. There is a £2 billion pot for the Scottish national investment bank, which leaves a gap against what we would have hoped for.

The other issue will be the constraints that are placed around the funding to satisfy accounting regulations as to whether it should be on or off the Government's books. We are in the early stages of trying to understand what that will mean. Our hope is that it will continue, in some way, shape or form, to fill the gap that will be left by the European Investment Bank.

Angela Constance: We have heard that the national investment bank will take quite a mission-orientated approach. Is it your hope and expectation that there will be a specific mission around construction?

Stephen Slessor: That is certainly my hope, though not necessarily my expectation. The national investment bank has to cover lots of things, but it could add real value to the renewables sector and the low-carbon economy. There is a lot of opportunity in Scotland to explore those areas, and I would like the investment bank to push in that direction.

John Mason: Quite a lot of people who responded to the committee's consultation have commented on retentions. What do the witnesses think about retentions? I ask you to paint us a picture of how common they are and of what percentages we are talking about. A long time ago, when I was an auditor, retentions were pretty standard and people just accepted that they happened. Has the situation changed?

Shona Frame: Retention is typical in almost every project. The usual percentage is between 3 and 5 per cent, although I have recently heard of projects in which it has been as high as 10 per cent, which seems particularly onerous. As you are probably aware, the usual mechanism is that half of the retention is released on practical completion and the other half is released at the end of the defect liability period.

John Mason: If retention of 10 per cent is a bit unusual, what do you think happened there? I presume that the contractor signed an agreement about it.

Shona Frame: I do not know whether that retention was agreed to. Contractors would assess any retention clause in assessing the risk profile of the contract and whether they were prepared to take it on, given their working capital and cash flow requirements. Such a retention would take out any profit from the job and withhold it until a later stage, which could make it very difficult for the contract to be viable.

John Mason: I always thought that there was a certain logic to a retention, because, if work is not done properly or if odds and ends need to be tied up at the end, it gives the main organisation, be it private or public, a hold over the contractor. Is that not accepted as much as it used to be?

Shona Frame: That logic still applies; the question mark is over the fact that it is a relatively small pot. If the work is properly managed and inspected as it proceeds, there should not be an enormous number of defects left at practical completion, and contracts provide for people to come back for snagging works.

A relatively small pot is left, but it has become a very big hot potato with regard to headlines about retention amounts. That is brought to bear when there is an insolvency and the retention fund is lost. However, I am not convinced that the Construction (Retention Deposit Schemes) Bill is the way forward, because it addresses the problem from one perspective and does not look at the issue in the round.

John Mason: Is that a Westminster bill?

Shona Frame: Yes—it is a private member's bill that is being considered at Westminster.

John Mason: Would it apply to the whole UK or just to England?

Shona Frame: I do not know.

John Mason: Would either of the other witnesses like to comment?

Gavin Paton: The example that Shona Frame gave was interesting. On all the projects that I am involved in, there will be a retention, which is normally 3 per cent. Recently, requests have been made for higher retentions. That seems to be being driven partly by—we discussed this earlier—anxiety among lenders to the construction sector and bond providers. Some contractors at a lower level are having difficulty in obtaining performance bonds, which are typically for 10 per cent of the contract. Performance bonds provide an element of performance security. If the contractor is unable to obtain a performance bond, the client's next step might be to ask for a higher retention.

John Mason: For those of us who are not terribly technical, is a performance bond an alternative to retention? Is it a sort of insurance policy? Is that how it works?

Gavin Paton: It is provided by a bank or a specialist bond provider. Essentially, it is a pot of cash that can be claimed if there is any default under the contract. On the projects that we are involved in, there would normally be a 3 per cent retention and a 10 per cent performance bond. If the contractor is unable to obtain a performance bond, the client might seek to increase the retention to compensate for the lack of a performance bond.

John Mason: Has it become more difficult to get a performance bond in recent years?

Gavin Paton: Anecdotally, I would say that it has become more difficult for contractors at SME level to get a performance bond, which simply compounds the issue. Stephen Slessor might be able to comment on that. If retentions of 3 per cent are a challenge from the point of view of cash flow, a retention of 10 per cent is obviously more problematic.

If retentions were to be done away with, the client would be left unprotected, but there are alternatives. A more measured response would be to find an alternative or to challenge bad practice. Retention serves a purpose. If it is properly used, it is legitimate; however, if it is used abusively, a more focused response might be to target the abuse.

John Mason: I might come back to that point after we have heard from Mr Slessor.

Stephen Slessor: I support some of the points that have been made. I will put my cards on the table: I am definitely pro the abolition of retention, which I think is a product of a yesteryear industry. As we move to a more digital age in which we can embrace technology such as blockchain technology and artificial intelligence, that will help to remove clients' concerns about quality and defects.

In reality, we often have to provide a performance bond and a parent company guarantee, as well as having some retention taken from us, in order to undertake some contracts—that is the case with public sector contracts as well as with private sector contracts. Three or four different methods of obtaining financial security are available to clients if they wish to use them, and they do not necessarily impact on people's cash flow. Cash is really important for all areas of the business, not just tier 1s.

The vast majority of defects that the pot of money is supposed to be held for are latent—we are talking about things that might happen five, 10, 15 or 20 years down the line. On some large projects, significant sums of money can be held. In better times—although not so much in recent times—some nice interest could be made on that pot. In addition, some unscrupulous employers will use that money as an advantage in agreeing final account sums.

Generally speaking, I am definitely pro-abolition.

John Mason: Is everybody else in favour of the abolition of retentions? Is that the general feeling?

Shona Frame: Retention gives rise to disputes about when the money should be released and the securing of its release—particularly the release of the second tranche of retention, which comes at the end of the defect liability period. For main contractors, we see disputes about whether the conditions to allow that release are in place, such as the rectification of any snagging works. However, for subcontractors or tier 2 contractors, the retention release is often linked to certifications further up the line to the main contractor.

Individually, retentions are relatively small amounts of project money, but, if there are a lot of projects on the subcontractor's books, they can add up to a large amount of cash. Accessing a dispute mechanism that allows that cash to be released is also not economic, because the cost of pursuing those small debts outweighs the sums involved. It is a real issue for contractors' bottom line to get cash in the bank once it has been withheld during a project.

John Mason: If a retention is not released without good reason, what are the options for the person who is seeking to release that retention? Is it court or an arbitration system?

Shona Frame: Adjudication is an option. That is the fast-track 28-day process. If the amount is small enough, there is the court procedure for smaller debts—it is not called small claims any more. However, that applies only for amounts under £5,000.

It is tricky, because there is a cost to adjudication. The parties fund the process themselves—there is no recovery of cost—and they have to pay for the adjudicator. It is difficult to recover money when someone has a list of retentions on their books, particularly when those retentions are linked to certification further up the line. They have no control over it. The defects in a very early subcontract might have been dealt with long ago, but, if the main contractor's retention has not been released, it is very difficult for the subcontractors to get their retention released.

John Mason: Somebody suggested to the committee that, even though there is an adjudication process and even after a positive decision, the payment is sometimes still not made and has to be chased in court. Does that happen?

Shona Frame: That can happen. My experience is that most adjudication decisions are implemented. A small number go to court for enforcement procedures, but those tend to involve larger amounts and cases in which there is a real issue with the process or the jurisdiction of the adjudicator. The courts have set out their stall: they will enforce adjudication decisions unless there is very good reason not to.

John Mason: Mr Paton, you mentioned abuse of the retention system. Can you expand on that?

Gavin Paton: Coming back to my original comment, pressure on cash flow, low margins and high risk can lead to poor behaviour from some contractors in order to keep their own business afloat; retention can be a means of making it to the end of the week. I suspect that there is poor practice among a minority rather than a majority of contractors and that, to some extent, it is driven by financial necessity.

The Construction (Retention Deposit Schemes) Bill creates an interesting issue—although the detail of it is not particularly well developed, because it anticipates that there will be detailed statutory instruments to cover its implementation in the various territories. Retentions, as a concept, can exist in the form of cash retentions or retention deposit schemes, but there is a very big difference for clients, in that with a retention deposit scheme, they will have to draw down the cash to put it into the deposit scheme. Therefore, if a developer is taking bank funding, for example, they will have to draw down the bank funding sooner and ring fence it by placing it in the deposit scheme, which will add to the overall cost of the project. I can understand why contractors would say that that should be the client's issue and that contractors should not be funding the project.

11:30

John Mason: So in one sense, it makes it safer, but it could push up the overall cost of the project.

Gavin Paton: Yes. If a developer is taking funding, they will draw it down sooner and the interest costs will run from an earlier date, but I can see why, from a contractor perspective, that is perhaps a fairer outcome than the contractor funding the 3 per cent for the duration of the project.

John Mason: Okay, thanks.

The Convener: I have one follow-up point on that, which is the abolitionist position, as it were: getting rid of retentions altogether. Mr Slessor, could that not go against smaller firms? Presumably, the client has to have some security for seeing the project completed and smaller firms might be less well placed to get the required bond, or the cost of their doing so would be prohibitive.

Stephen Slessor: In order to get past that issue, we need to take a more long-term, wider view of the sector. It comes down to how we procure things. If we are looking to engage with SMEs and the supply chain across Scotland and we want to be fair to them—which, in my mind, includes abolishing retentions, which was part of your question—we need to have a framework; we need a way of working with SMEs that allows them to grow, to build resources and capability and to bid for work and we need to take a more mature approach to procurement to facilitate that. In order to ensure that clients still get protection from SMEs in such instances, bonds are available—they do not necessarily need to be performance bonds; retention bonds are available and can be procured.

If we still have retentions, in some instances, having a fiduciary trust, which the Construction (Retention Deposit Schemes) Bill talks about, might help. One of the biggest issues is insolvency, especially for those who are subcontracted to a tier 1. Carillion was an example of a tier 1, and a lot of subcontractors would have been in a much better place if the money had been held in a trust that they would have been able to access. For me, that is the only real benefit of such an arrangement.

If we want a mature industry that will develop and deliver the infrastructure needs of Scotland in the next 25 years, we need to start having a more mature discussion about how we treat our supply chain, and the expectation that those in the chain will not come back to rectify a defect is part of the discussion. A local SME that is here for the long term will, of course, come back to repair the defect.

Colin Beattie: How prevalent are late payments in the sector? How much of a problem are they?

Shona Frame: I deal with construction disputes and a lot of the cases that I deal with are to do with payment—I do not know about late payment; the ones that I see are more around disputed levels of payment. Payment procedures in the industry are very heavily regulated through the Housing Grants, Construction and Regeneration Act 1996, and that flows through to the standard forms of contract. However, what I see is more around disputed values, rather than timing.

Colin Beattie: Do any of the other panel members have a view?

Gavin Paton: Disputes are generally around values, but delayed payment can be used up the contractual chain as a means of improving cash flow. If there is a 30-day payment period at one level and a longer payment period at another, that has a cash-flow benefit.

Colin Beattie: We have been advised that delayed payments are a problem in the industry, particularly larger contractors delaying payments to subcontractors, who are maybe less able to absorb the delay. Is there an effective and accessible adjudication process to deal with the problem?

Stephen Slessor: You raise some legitimate points and it would be wrong of me to sit here and say that there are not payment problems in the industry—there are problems, but that is not to say that things are not being done to address them.

I agree with Shona Frame that most adjudications relate to disputes about the value of the payment rather than whether the payment has been made. Adjudications are one way of dealing with a difficulty in getting paid on time, but in my view—I mean no disrespect to my learned legal colleagues—in general, solicitors seem to have hijacked the adjudication process in the past 10 years, and what should have been a relatively simple, short and sharp way of obtaining cash, or getting it to the person who believes that they are owed it, has become a drawn-out affair that can cost significant amounts of money because of representation at adjudications and adjudication fees that go through the roof. These days, adjudication is not a viable alternative for those chasing cash. While adjudication has a purpose and is a perfectly excellent way of resolving some disputes, it is not suitable for payment and getting cash earlier.

Colin Beattie: And yet Mr Bunton, in his submission, states:

> “the issues I am dealing with are the worst I have experienced in 20 years.”

That would imply that adjudications are going up fairly significantly.

Stephen Slessor: I read Mr Bunton’s paper with some interest and have a couple of observations on it. The payment disputes that he refers to are on the sums due and are largely down to two things: first, that contractors are no longer willing to take the types of risk that they were once willing to take and are managing those risks; and, secondly, that the initial budgets were wrong. Contractors, being the way they are, will always try to get to the lowest price, because that is how procurement in Scotland is driven. I think that are the conclusions about the root causes that you can draw from Mr Bunton’s report, in as far as it goes. However, I do not believe that in the adjudications that Mr Bunton refers to the issue is the speed of payment; it is more the quantum—what the payment should be.

Colin Beattie: Over the weeks of our inquiry, quite a number of witnesses have referred to late payments as being an issue, especially for smaller contractors. How much leverage does a small contractor have to extract payment from the main contractor?

Stephen Slessor: Generally speaking, in my experience, quite a lot. Especially in Scotland, we rely on our regional supply chain to be able to deliver works for us. If we are working in some of the more rural parts of Scotland, if we did not pay on time or could not work with the local supply chain, there would be no chance of keeping our credibility in relation to delivery or of doing repeat business. The relationship is symbiotic; there is a lot of mutual respect.

In the part of the business that I work in, we self-deliver a lot of our work, so we do not use a great many subcontractors. When we do use subcontractors, it is on a specialist, regional basis. My experience has been that smaller contractors have a lot of leverage.

Colin Beattie: And still we hear that getting payment is a problem for them. I am not saying that that is across the board.

Stephen Slessor: I totally accept that; I am just telling you what my experience has been. In terms of the wider supply chain and SMEs, there are contractors out there that somehow finance schemes but which are unscrupulous or treat the supply chain with disdain. I am not saying that everybody has the same principles as us—there is a challenge there that needs to be addressed.

Colin Beattie: I do not get the feeling from the panel that there is a general concern about late payments.

Stephen Slessor: There is a concern about late payments, even in our sector. Some of the payments that we get from public sector clients are late, which puts pressure on our cash flow, because we are still expected to pay our supply chain within 30 days. When we are working on large projects, we are generally able to do that, but there are times when there are disagreements over the value of payments. Sometimes SMEs feel that disagreements over the value are related to the speed of payment. We need to distinguish between the true value of the work and how quickly it should be paid for.

Colin Beattie: Does the public sector act fairly in how it schedules its payments?

Stephen Slessor: Generally, yes, but there are specific instances in which elements of the public sector seem to treat construction companies as an additional revenue stream.

Colin Beattie: Can you say which parts of the public sector you mean?

Stephen Slessor: There is nothing specific, but we have to finance projects for certain amounts of time. As we discussed earlier, in effect, we finance projects for 60 to 90 days, in some instances.

Colin Beattie: In a public sector contract, the sum of money can be fairly large.

Stephen Slessor: It can be.

Colin Beattie: Are there particular areas of the public sector that are—

Stephen Slessor: There is no particular area that I can give you observations on. We work collaboratively with the hub and Scottish Water, for example, and we find that we have a really good relationship with them and that payment is not a problem. They have some great practices and there is a lot that others could learn from them.

Colin Beattie: I will let you off the hook on that.

Stephen Slessor: Thank you very much, Mr Beattie.

The Convener: I want to ask a slightly different question along the same lines. What reasons are given for late payments when the public sector is involved? Are there legitimate reasons why late payments sometimes occur?

Stephen Slessor: Generally speaking, there are usually reasons behind late payments. Often the reason is that there has been a funding decision when a contract has been entered into and people are waiting for the funding to come through, or people have to spend a certain amount of money within the financial year. In my view, there is no set trend.

Shona Frame: In addition to the relationship points that Stephen Slessor mentioned, there is a legal framework for protection for contractors and subcontractors. There has been an enormous amount of innovation in the industry in implying terms and forcing terms into construction contracts—we saw that from 1998 through the application of the Housing Grants, Construction and Regeneration Act 1996, which was tightened up in 2011 through the Local Democracy, Economic Development and Construction Act 2009. They apply equally in Scotland.

Regulation is in place that deals with the structure of payments, payment notices, pay-less notices and certainty over payments, and that is backed up by adjudication, which is at least a cheaper and quicker dispute-resolution method than the alternatives.

I am not convinced that more regulation is the way forward. To pick up on Stephen Slessor's point, the way in which people work together, with leadership from the Government and public sector bodies in not just talking about better payment practices but putting them in place, will be more of a way forward than more legal and contractual remedies.

Gavin Paton: Our experience is that there can be payment issues at every step in the chain. In some instances, they arise at the client or public sector level. Sometimes, I think, they are a consequence of a lack of skills or resourcing to properly manage and administer the contracts. The contracts that are put in place for high-value projects are generally quite detailed and complex and require a reasonable amount of management and administration. We talk about skills at the apprentice level, but if the skills and resources are not available at the client level to properly manage and implement the contracts, for example, that can lead to payment issues.

Jackie Baillie: On project bank accounts, it is fair to say that the majority of the submissions that the committee has received question their effectiveness in improving cash flow and payment issues. What are the panel's views on project bank accounts? I am conscious that the threshold was £4 million—although I do not think that one project bank account was used when that was the threshold—and is now £2 million. Will that help?

11:45

Gavin Paton: Certainly, what we have experienced, even prior to the reduction in the threshold, was relatively new to the Scottish market. There is still quite a lot of work being done, on all sides, by parties that are wrestling with the implementation of the project bank accounts. That is not a comment on whether they are a good thing or a bad thing; it simply reflects the fact that the practicalities of them are still being wrestled with.

Obviously, there is a cost associated with setting up and implementing a project bank account that would not exist if they were not being used. Also, the introduction of project bank accounts has an impact on cash flow, as you do not have a large chunk of cash passing down through the supply chain, because it has to go around the main contractor and the second-tier contractors. The previous model involved the cash flowing through the main contractor. If you take that cash flow away, and you get a low margin, that has an impact on people’s business. That is not a criticism; it is just reality—if the cash is no longer flowing through, that has an impact. The issue is whether it is recognised that that cash-flow disbenefit to the main contractor should be reflected in the pricing of the job.

If the guidance is complied with, the reduction in the threshold will lead to the greater use of project bank accounts. However, the set-up and operating costs of project bank accounts do not relate directly to the scale of the project. Therefore, to some extent, reducing the threshold compounds the issue of the cost of setting up and operating a project bank account, because a lower-value project is less able to sustain the costs that are associated with setting up and operating one.

Jackie Baillie: What percentage of a contract would setting up a project bank account normally represent?

Gavin Paton: I could not comment on the percentage.

Jackie Baillie: So, you do not know what the relative cost would be.

Gavin Paton: That is correct.

Shona Frame: I would make three points on project bank accounts. First, to echo Gavin Paton, there is an increased level of administrative burden on the people who operate them. Ensuring that the correct amount of money flows to the correct people at the right time is probably more complex than is appreciated.

The second point concerns the interaction of timescales. The Housing Grants, Construction and Regeneration Act 1996, the Scheme for Construction Contracts (Scotland) Regulations 1998 and the standard form building contracts have specified timescales for payments; for the issue of payment notices, which are mandatory; and for the issue of pay-less notices in advance of the final date for payment. When you overlay those on to the drawdown dates for trying to extract money from a project bank account, the timeline becomes quite complex. When you are operating on the 17-day fair-payment guidance, it is difficult to make the timescales work properly. There is a practical consequence around the use of project bank accounts.

The third point concerns the removal of working capital from the supply chain. There tends to be a gap between payments coming in and going back out to flow down the supply chain. When the money is sitting with the party, it is being used as working capital. Removing that from the equation, in a circumstance in which people are working on extremely low margins, with low pricing, and are taking on high levels of risk, almost creates a perfect storm.

Stephen Slessor: I could not summarise it better than that, to be honest. If we have no cash buffer, the rate of failure will rise and margins will need to go up to compensate for that.

Jackie Baillie: Given that project bank accounts are not the magic bullet that some people hoped they would be, what would be your top measure to improve the financial management of construction projects? If you could tell the Government what to do to fix the problem, what would you say that it should do?

Stephen Slessor: I would advise it to set a realistic budget at the very outset instead of constantly trying to engineer savings that do not exist.

Jackie Baillie: Okay. Are you going to agree with Mr Slessor, Ms Frame?

Shona Frame: I was going to make a different point. Instead of looking at the capital costs of the build, you should look at the cost over the entire life cycle of the asset. If you do that, you will see that lowest cost for the capital expenditure of the build does not necessarily mean best value. Going for the lowest cost might also impact on quality, which might lead to things costing more over the length of the asset. I suggest, therefore, that we look more closely at the whole thing from inception right through to the asset’s end of life.

Gavin Paton: I might be taking a bit of a sideways step, but if the issue is that project bank accounts are challenging and problematic, perhaps different procurement routes should be considered. At the moment, there is a big focus on design and build, which involves main contractors and subcontractors and the cash flowing that way. However, other procurement routes are available, one of which is construction management. You cannot have the tail wagging the dog, but a construction management procurement approach would make project bank accounts a less significant issue. As I have said, though, to some extent that is the tail wagging the dog.

Dean Lockhart: We have heard about the challenges facing the sector, but what do you see as the main opportunities for growth? How can the sector in Scotland take advantage of the UK construction sector deal and the £600 billion of investment that is coming through the pipeline over the next 10 years?

Stephen Slessor: At the risk of repeating myself, I would say that digital construction and ways of operating are the one massive opportunity for the industry in Scotland. We need to be able to research, invest in and harness digital approaches such as robotics, blockchain technology and artificial intelligence if we are to deliver the kind of infrastructure that Scotland deserves in future. However, in order to make that kind of investment, we contractors need a strong pipeline of work. We are looking at the wider UK construction industry deal in some detail and, as part of our commitment to working in Scotland, are looking to deliver a number of projects featuring robotics and artificial intelligence here. We also need to move away from the fixation on the lowest price and piecemeal bidding and concentrate instead on the more qualitative aspects of construction.

Outside of digital construction, the other big win and opportunity relates to social value and community benefits. Procurement can be a really powerful tool for obtaining great social benefits, and we need to assess how we can deliver projects more widely, rather than just on the basis of lowest cost and in a way that takes those aspects into account.

Dean Lockhart: Does anyone else have any views on the UK construction sector deal?

Shona Frame: My point is not so much about the deal as about the opportunities for growth that you asked about. In research that my firm carried out, we approached 150 of the UK's main contractors. As far as the marketplace is concerned, the opportunities centre very much on the themes of innovation and technology, which are seen as a very real way of achieving benefits through cost savings, quality improvements and a better built environment—that came out strongly in the research. As for how that could be achieved across the sector, the big theme was collaboration and the need for a partnership approach in delivering projects.

Gavin Paton: The only thing to add is in relation to off-site manufacturing. We have talked today about the high risk associated with construction projects, part of which arises because they are implemented in uncontrolled environments—the weather is a particular risk. The hope is that off-site manufacturing increases productivity and quality and helps with programme certainty. To really ramp up off-site manufacturing, significant investment is required and, to achieve that, an environment that supports investment is needed.

The Convener: As there are no further questions from committee members, I thank all our witnesses for coming today. We will move straight on to another item on our agenda, so please feel free to leave us to carry on with that.

European Union (Withdrawal) Act 2018

Geo-Blocking Regulation (Revocation) (EU Exit) Regulations 2019

11:55

The Convener: The third item on the agenda is consideration of the Geo-Blocking Regulation (Revocation) (EU Exit) Regulations 2019. The committee has been asked to consider a notification from the Scottish Government relating to the geo-blocking regulation, which prohibits certain forms of discrimination that are encountered by customers buying certain goods or services from traders in the EU. It applies regardless of whether the sale is processed online or offline and whether the customer is a consumer or a business.

In the event of a no-deal exit from the EU, preserving the geo-blocking regulation would, with reference to reserved matters, mean that UK businesses would retain the same obligations to EU customers under UK law, while UK customers would have a substantial loss of protection. That is because UK customers would be outside the EU internal market and EU traders would not retain the same obligations. Repealing the geo-blocking regulation would ensure that UK businesses were not subject to non-reciprocal demands that would act as a burden without any benefit for UK businesses or customers.

At its previous meeting, the committee agreed to seek further information on the regulations, the response to which is in members' papers. Is the committee content for the issues to be dealt with by a statutory instrument that is laid at Westminster?

Members *indicated agreement.*

The Convener: As the committee is agreed, I will write to the cabinet secretary to notify him of the committee's decision. We move into private session.

11:57

Meeting continued in private until 12:14.

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