FINANCE COMMITTEE

Tuesday 15 April 2008

Session 3

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FINANCE COMMITTEE
9th Meeting 2008, Session 3

CONVENER

*Andrew Welsh (Angus) (SNP)

DEPUTY CONVENER

*Elaine Murray (Dumfries) (Lab)

COMMITTEE MEMBERS

*Derek Brownlee (South of Scotland) (Con)
*Joe FitzPatrick (Dundee West) (SNP)
*James Kelly (Glasgow Rutherglen) (Lab)
*Liam McArthur (Orkney) (LD)
*Tom McCabe (Hamilton South) (Lab)
*Alex Neil (Central Scotland) (SNP)

COMMITTEE SUBSTITUTES

Roseanna Cunningham (Perth) (SNP)
Ross Finnie (West of Scotland) (LD)
Murdo Fraser (Mid Scotland and Fife) (Con)
Peter Peacock (Highlands and Islands) (Lab)

*attended

THE FOLLOWING ALSO ATTENDED:

Nathan Goode (Adviser)

THE FOLLOWING GAVE EVIDENCE:

Riona Bell (Scottish Further and Higher Education Funding Council)
Lynn Brown (Glasgow City Council)
Douglas Griffin (NHS Greater Glasgow and Clyde)
Peter Haggarty (Health Facilities Scotland)
Guy Houston (Transport Scotland)
Donald McGougan (City of Edinburgh Council)
Douglas Millican (Scottish Water)

CLERK TO THE COMMITTEE

Susan Duffy

SENIOR ASSISTANT CLERK

Mark Brough

ASSISTANT CLERK

Allan Campbell

LOCATION

Committee Room 2

Scottish Parliament

Finance Committee

Tuesday 15 April 2008

[THE CONVENER *opened the meeting at 14:06*]

Decisions on Taking Business in Private

The Convener (Andrew Welsh): Good afternoon and welcome to the Finance Committee's ninth meeting in 2008, in the Scottish Parliament's third session. I ask everyone to turn off mobile phones and pagers—they interfere with the broadcasting system, so leaving them on is a capital offence around here.

Agenda item 1 is to decide whether to take in private item 6, which will allow members to have a short discussion about the evidence that we hear today, to assist us in working towards conclusions in due course. Is the committee content to take that item in private?

Members *indicated agreement*.

The Convener: Do we agree to take in private similar discussions in subsequent weeks throughout the inquiry?

Members *indicated agreement*.

Methods of Funding Capital Investment Projects Inquiry

14:07

The Convener: Item 2 is the first evidence session for the committee's inquiry into the methods of funding capital investment projects. We are using a round-table discussion format today. We hope to have a good introduction to the inquiry by exploring the view from the public sector and thereby eliciting and clarifying the interests and concerns of those who commission and purchase capital investment projects.

The round-table discussion format is new to the committee. It may be useful to introduce all who are present and who are participating. At the table are our independent advisers for the inquiry—Nathan Goode of Grant Thornton and his colleague Marianne Burgoyne—our clerks, and the official report and broadcasting staff.

I will invite members and witnesses to introduce themselves in turn. I ask committee members to say which party and area they represent and witnesses to identify their organisation and role. I start with myself: I am the committee's convener and I am the member of the Scottish Parliament for Angus.

James Kelly (Glasgow Rutherglen) (Lab): I am a member of the Scottish Labour Party and I represent Glasgow Rutherglen.

Lynn Brown (Glasgow City Council): I am the executive director of financial services at Glasgow City Council.

Joe FitzPatrick (Dundee West) (SNP): I am the Scottish National Party member for Dundee West.

Peter Haggarty (Health Facilities Scotland): I am an assistant director at health facilities Scotland, which is an operating division of NHS National Services Scotland.

Derek Brownlee (South of Scotland) (Con): I am the Conservative member for the South of Scotland.

Guy Houston (Transport Scotland): I am the director of finance and corporate services for Transport Scotland, which is an agency of the Scottish Government.

Douglas Griffin (NHS Greater Glasgow and Clyde): I am the director of finance for NHS Greater Glasgow and Clyde.

Liam McArthur (Orkney) (LD): I am the Liberal Democrat MSP for Orkney.

Riona Bell (Scottish Further and Higher Education Funding Council): I am the director of funding at the Scottish Further and Higher Education Funding Council, which is a non-departmental public body that funds universities and colleges.

Tom McCabe (Hamilton South) (Lab): I am the Labour MSP for Hamilton South.

Douglas Millican (Scottish Water): I am the finance and regulation director for Scottish Water.

Alex Neil (Central Scotland) (SNP): I am an SNP member for Central Scotland.

Donald McGougan (City of Edinburgh Council): I am the director of finance at the City of Edinburgh Council.

Elaine Murray (Dumfries) (Lab): I am the committee's deputy convener. I am the Labour member for Dumfries, which just happens to be the home town of Queen of the South Football Club.

The Convener: This could take a while, if you continue in that vein.

I welcome everybody to committee. We have an excellent cross-section around the table—our witnesses represent all aspects of the issue that we are considering. I will try to structure the discussion under the four themes, spending roughly half an hour on each. I will introduce the theme and allow open discussion before asking our adviser to sum up what we have heard under the theme. Everyone will be pleased to hear that we will have a short break in the middle of the session. We will conclude at approximately 4.30 pm.

I will make clear the ground rules. Our aim is to have a discussion, rather than a formal question-and-answer session. All members and witnesses are free to ask questions of one another or the whole meeting and make general contributions, but all contributions should be made one at a time and through me. I ask members and witnesses to indicate when they wish to speak. The discussion will be most useful if everyone gets plenty of opportunity to take part. I encourage everyone to keep their contributions short, sharp and to the point.

The committee has received written evidence on the circumstances in which different funding approaches have been used, on the types of project for which different methods are most suitable, and on a range of policy, service planning and financial issues and constraints that public bodies face in selecting between methods. For the first part of the discussion, we will focus on the different funding methods that are available to you and the factors that determine which are most suitable in different circumstances. It would also be useful for the committee to understand the differences between the parts of the public sector that you represent. What are the key factors that influence your approach to capital investment decisions? Who will pick up that one and run with it? No one? This used to happen when I was a teacher.

Donald McGougan: I will start off.

The City of Edinburgh Council approaches capital expenditure decisions from the viewpoint of asset-based management information. We examine our present infrastructure and see what needs to be done to put it into a proper state to deliver services for a period of time in the future. There is a huge infrastructure backlog across the whole public sector, as a result of decades of underinvestment. In any given situation, the infrastructure investment that is required goes way beyond affordability constraints—certainly, that is the case for my council and, I expect, for all others.

Affordability is a factor. The main plank is the support that authorities expect to receive from central Government. We get a certain amount on an on-going basis through the general grant system for supported borrowing. Nowadays, through the three-year financial settlement, authorities also get Government grants to support capital expenditure and for specific projects. At the moment, the biggest grant that the City of Edinburgh Council is receiving is the £500 million from Transport Scotland for the tram project.

Authorities can supplement grants and supported borrowing through capital receipts from asset disposals. The City of Edinburgh Council has tried to maximise that income stream. Beyond that, over the past four or five years, councils have been given the capacity to borrow under the prudential framework for local authority capital investment. Basically, if the borrowing costs are affordable, we are allowed to proceed with the investment without seeking Scottish Government approval.

That has opened up investment areas, particularly where savings can be made, for example by closing two facilities, disposing of them, generating capital receipts, making revenue savings and investing them in other schemes for better service delivery. If there is an income generation line, measures can qualify under the prudential framework. Further investment through the prudential framework can be supported if the council determines that it can afford it within its forecast medium-term expenditure plans through setting council tax levels or making efficiency savings in other areas, above and beyond the Government target. Every £10 million of borrowing would cost us about £800,000 per annum over a 20-year period. Given that we estimate that the council's infrastructure backlog amounts to about £500 million, it would be unaffordable to tackle it all over a short period. As far as the City of Edinburgh Council is concerned—I believe that the situation is the same for most local authorities—continued Scottish Government support for revenue borrowing costs will be essential in tackling the infrastructure backlog.

14:15

The Convener: You have raised some fundamental topics, such as the management information that is available, the backlog of infrastructure problems, central Government assistance, capital receipts, and prudential borrowing and the means of obtaining it. Are those issues shared by you all? Does anyone else have comments?

Lynn Brown: In a local authority context, obviously it is the same for Glasgow. The main sources of funding are capital receipts, borrowing and grants.

The one point that I will add to Donald McGougan's comments is the policy perspective on decisions. Let us take as an example Glasgow City Council's pre-12 strategy, which deals with school-age children before they go to high school. We had a backlog of repairs in our schools, but there was also a policy objective to improve education, so we moved to campuses for pre-12 education. For example, Haghill, on the road out of Glasgow, has a primary, a nursery and a community aspect. The policy and service imperatives must be considered, as well as the basic asset.

We are moving to the policy of keeping older people in their own home for longer, and ensuring that when they move into care homes those care homes are fit for purpose for the 21st century. There are different aspects. It is about not only the asset and its valuation but how you want to deliver the service.

The Convener: Quality is involved.

Lynn Brown: Yes.

The Convener: We have heard from two local authorities. Does anyone else want to comment?

Guy Houston: I will pick up on a point about asset management and backlogs. We manage the trunk road network, which is the biggest asset on the Scottish Government's books—it is valued at about £13 billion, so it is a sizeable asset to look after. We developed an asset management plan and published what we will do through to 2009. That formed the basis of what we applied for and gained in the latest spending review. We mapped our plan against overseas examples in places such as New Zealand and Scandinavian countries. We have worked up our asset management plan. It all relates to identifying our biggest priorities, be they safety issues or reducing a backlog. A number of issues impact on how we take our plans forward.

The Convener: Have you always had an asset management plan? How new is it?

Guy Houston: It is a revamped version, or a more up-to-date version, of what we had previously. It has involved a lot of work on our part and we have had external help. We have worked with other authorities, for example other United Kingdom bodies and overseas bodies. We are also involved in the world road congress. We aim to be at the forefront.

Peter Haggarty: We are working closely with the Scottish Government health directorate and national health service boards in Scotland to develop a specification for a national asset management system, which will allow us to view and interrogate the NHS property portfolio nationally. Previously, each NHS board and organisation was responsible for holding asset management details, and the extent and quality of the information that was held locally varied. The project will create a consistent, national base for the collection of information and, we hope, will assist with the development of national service strategies and the holding of information centrally in the directorate.

The Convener: What stage is the work at? What problems have you found in creating what appears to be a fundamental necessity?

Peter Haggarty: The asset management advisory group was established towards the end of last year. It is chaired by the health directorate and a number of NHS boards are represented on it. A system specification is being developed and we hope to go to the market in the next few months, through the *Official Journal of the European Union*, to identify a system that will meet the national need.

As I said, there has been an inconsistent approach to the development and handling of asset management locally. In some boards there was a good approach and much detailed information; in others—perhaps those with fewer resources—such detail was not available.

Riona Bell: In our planning in the further and higher education sectors we use the national estate management statistics systems, which are internal benchmarking systems and are not public. We are starting work on a set of core indicators for asset management, which we intend to publish.

We are a buffer body, so we do not deliver; we make decisions on the balance between specific project funding and funding to everyone for core maintenance and investment, and on the balance between direct grant and support for borrowing. To help us to make such decisions, we use the estate management statistics systems and we buy in consultants to help us with interpretation. Every couple of years we have a formal report produced on the investment needs for each sector.

Alex Neil: Do all the public sector organisations that are represented here have a comprehensive asset register? Do you know how much land you own? The local authorities in my area own a lot of land, but they do not know how much they own or its location, let alone its market value.

Whatever the capital investment project, land is usually a significant element of the cost, although it is not usually the major element. In its submission, the City of Edinburgh Council made a point that has been made to me many times, which is that the rule that sites must be sold at market value is a constraint on investing in certain types of infrastructure. Organisations that are involved in social housing tell me that if authorities were allowed to use their judgment and sell sites at less than market value, there could be investment in housing projects that would meet social and economic need, given the housing shortage throughout Scotland.

The Convener: Do you want to respond, Mr McGougan?

Donald McGougan: The member's comments were partly relevant to Edinburgh, so I am happy to do so.

We have asset registers that we hope are comprehensive, but we cannot know whether they are until we find assets that they do not include. The registers should include the land that the council owns. Since 1996, the council has generated almost £300 million in capital receipts. It is planning to generate another £115 million over the next four years, mostly for specific projects. For example, we will ring fence the capital receipts from schools to develop the school estate and infrastructure.

We have been able to work with registered social landlords to make land available in return for nomination rights and partnership approaches to social housing. However, our land holding—other than land in the green belt, development of which is contentious—is not sufficient to meet needs. I have not yet spoken about the need to develop social housing and other infrastructure for the city and its economy.

Alex Neil: Do we need a rule change to allow local authorities not always to sell at market value?

Donald McGougan: I do not think so. At the moment, we are allowed to dispose of land at below market value with the consent of the Scottish ministers. That consent has never yet been withheld. The rule is more of an issue for the rest of the public sector. For eight to 10 years, we have been working with Lothian NHS Board to find a new site for Boroughmuir high school. The board is constrained by the rule, which has not helped the council to meet its development aspirations.

The Convener: Does the problem extend beyond local government? Do our other witnesses have evidence on the matter?

Douglas Griffin: At the moment, NHS Greater Glasgow and Clyde is working closely with Lynn Brown. We have reached the stage of introducing joint management organisations to take responsibility for managing services in our community and to produce strategies for developing their services over time. Increasingly, those organisations are beginning to identify the need to co-locate services or to provide joint premises and facilities for health and local authority services—usually social work, but sometimes education services.

Navigating between two different sets of provisions and regulations to provide capital funding for such developments can be tricky. Just as there are issues associated with how we use and transfer land assets between us, there are issues associated with how we tap into funding sources to finance joint developments. Because we have been doing such work for only a short time, to some extent we are making it up as we go along. We have to navigate between two different regimes.

The Convener: What is Scottish Water's view on the matter?

Douglas Millican: My comments relate to asset information. We have a huge stock of assets throughout Scotland. No water company in the world can claim that it has located every one of its assets. We have about 96,000km of pipes underneath the ground. I do not pretend for a minute that we know precisely where every element of that pipework is located. The challenge for us—which plays through capital investment—is continually to try to understand not just where our assets are but what performance they are capable of delivering, and to identify risks to future performance. We invest about £200 million a year just in replacing asset stock. It is important for us to become ever more efficient in how we target maintenance investment, to prevent a backlog appearing and to keep our asset stock in a steady state. The key to that is good information, especially about performance and risks to performance.

14:30

Guy Houston: On the asset side of things, Transport Scotland holds a very detailed asset register for the trunk road network. Our job is slightly easier than that of Scottish Water, in that we have 3,500km of roads that we can identify fairly easily.

We do not hold surplus land that has a market value. Two elements might make the land that we hold surplus. First, we hold quite a lot of land for potential road schemes, which we therefore need to hold on to. For example, some road schemes are being developed now that have been on the drawing board for quite a while, so we are now able to use the land. Once we complete such schemes, we normally sell off any excess land. Secondly, we have the bits of land at the side of the road. Unfortunately, those are 5m wide and 132km long, and they do not really have a market value.

As well as being pretty sure about what assets we hold, another important aspect is knowing the condition of the assets. We know the condition of the current trunk road network down to quite a detailed level.

Peter Haggarty: On asset management information and valuation, within the past two years the Scottish Executive Health Department commissioned the Valuation Office Agency to carry out a full asset valuation of the entire NHS property portfolio. I believe that the conclusion was that the property should be valued at £3.93 billion or thereabouts—the figure is mentioned in one of the committee's papers. Each NHS organisation will know the value of its own property, but information on an all-Scotland basis sits within the Scottish Government health directorate. That information is very recent.

Liam McArthur: Mr McGougan talked about the need to play catch-up because of the backlog of investment that is required in the City of Edinburgh and, no doubt, other council areas. Will the release of capital through receipts from the sale of assets—for example, in order to bring together different bodies on a single site to release space—be increasingly difficult for councils to achieve? Presumably, assets that are sold off cannot be sold off again. Will the process of managing the assets over a period of 25, 30 or 40 years enable successor councils—elected members and officials—to continue to maintain or improve the assets through capital receipts?

Donald McGougan: The current perspective is that that will become more difficult over time. We have started with the more readily identifiable surplus assets, so the job will get harder because we will have to work harder at our asset base to make better use of those assets, either on our own or in conjunction with public sector partners. That will certainly become more difficult over time.

On capital receipts, I think that the City of Edinburgh Council has been in a favourable position, compared with many other councils, because of the value of the assets that we disposed of. However, looking beyond the current three-year planning horizon, we cannot see any other big receipts that we could use to fund major projects.

The Convener: Does that apply to Glasgow City Council, too?

Lynn Brown: I think that the issue needs to be considered in terms of what the assets are for. Like City of Edinburgh Council, we have been very successful in realising capital receipts. On our balance sheet, we have about £100 million of surplus assets that are waiting to be disposed of. Although there is an issue that we cannot sell the family silver twice—as people say—we still need to look at what the assets are for. For example, we need to consider whether we need all our office accommodation going forward, given modern ways of working. We have many people who work in the community most of the time, yet an office and desk are kept warm for them while they are out on the street. We are starting to look at how we want to deliver such services, given that such receipts will not be available in the future. The issue is also about how we have a modern service going forward.

Liam McArthur: From earlier evidence, I know that there was a backlog to be made up in regard to the funding council; there is now more of a ring-fencing approach to the maintenance of assets. Are you confident that there is now a culture of maintenance and servicing that will enable us, once some of that backlog has been caught up, to avoid slipping back to the levels of backlog that have traditionally occurred?

Lynn Brown: Local authorities have not dealt with the life-cycle maintenance issue particularly well. We tend to build the assets rather than invest in the long term, but there is now greater recognition that we should be doing that instead. The question that we are asking in Glasgow is whether the council should be in a particular building in the first place. Do we need it? If we need it, we will maintain it, but if we do not, what will we do instead? It is about not just accepting that we must keep such assets.

Riona Bell: The funding council has addressed life-cycle maintenance, and working towards a steady state of sustainable reinvestment is a specific aim in our corporate plan. We are not there yet; we are still working through the backlog, but as we do that we are trying to phase into an on-going sustainable reinvestment mindset, which needs to be backed up by funding to make it affordable.

The Convener: Are there any other ways of using surplus assets to finance investment, rather than just disposing of them?

Donald McGougan: Yes. The City of Edinburgh Council has put land into joint ventures; we have done that with the private sector in relation to Edinburgh Park, where there is a joint venture with the Miller Group, and through our own waterfront company, which is a joint venture with Scottish Enterprise. The intention behind both those joint ventures was to use the council assets and private sector assets on the one hand, and Scottish Enterprise cash on the other, to help to develop the area and to build an asset base. That will allow us to take advantage of the asset base in west Edinburgh through the business park at the appropriate time in the future. The waterfront company is a help to the regeneration of the whole of north Edinburgh and the provision of up to 30,000 new houses, which is a key element in the growth of the city and the Scottish economy.

The Convener: Are there any examples of that being done elsewhere?

Lynn Brown: Glasgow City Council has done that with the Commonwealth games, and the games village. The city is putting the land into that equation to unlock the potential for the developers to build the village; that is the same as Edinburgh has been doing.

The Convener: Those examples are both from local government. Would the method be applicable elsewhere?

Douglas Griffin: I can give two examples. The health board is quite closely involved with East Dunbartonshire Council in the regeneration and redevelopment of Kirkintilloch, and both agencies have played in some capital receipts to support a number of regeneration projects, including a leisure centre, a new local health centre and the like. Another example, from mainstream Glasgow, is our plan to provide a new hospital on the Southern general site, which will be the major new hospital for acute services for NHS Greater Glasgow and Clyde in the future. Part of our plan is to play in up to around £130 million to £140 million of capital receipts to contribute to that.

To return to the original question, we are playing in a one-off receipt to cover a one-off cost. I am sure that there would be ways in which one could take a one-off receipt and play it in to cover the on-going annual recurring costs that would come with a new investment. However, it is difficult to do that because historically, in selling off a piece of land, the requirement is to generate the best possible return. Handing across the piece of land to the developer would mean that you could not be sure of getting the best value from its disposal, which you might have got if you had done the deal yourself. I am talking about putting a capital receipt into a development proposition so that it could be played back to you in the form of reduced operating costs over several years, although the situation is trickier because you would lose transparency. I hope that that was clear.

James Kelly: A point was raised about the policy priorities that underpin capital investment work. Lynn Brown gave a good example from Glasgow when she spoke about the capital expenditure programme for schools, its objective of improving education in the city and how it tied in with the pre-12 strategy. Are there any practical examples of how the success of the policy objective is measured once such investments are completed? The measure of success in the Glasgow example would be whether the education of the children has been improved by the capital investment decisions that have been implemented.

Lynn Brown: The main assessment method in Glasgow is attainment and the expectation is that our children's attainment will increase. Attainment is closely monitored and it is improving.

The Convener: Elaine Murray has a question. She has been very patient.

Elaine Murray: You described the variety of funding methods. Does anybody want to volunteer information about how you choose which funding mechanism is suitable for which project? For example, Transport Scotland has changed the mechanism for the funding of Borders rail. It would be interesting to know what was behind that decision.

Do you feel constrained by politicians' views, which might be true in councils as well, that certain types of funding mechanism are particularly popular or unpopular with the local council and that a political bias guides you? I have heard councils say in the past, "There is only one train leaving the station and we have to go down that route whether we like it or not."

How do you make decisions about funding mechanisms? At what stage in the process do you evaluate success or otherwise? That is a bit like James Kelly's question. At what point do you decide that you need to go back to square one or change the funding mechanism?

Guy Houston: We go through a number of stages before we reach the point at which we decide on the funding mechanism. At the start of the process, we use standard appraisal guidance to decide whether various schemes meet whatever our objective might be. That is a value-for-money assessment in terms of the cost benefit ratio—assuming that the assessment beats a ratio of 1, it will deliver more benefit than costs.

We then consider the procurement side of things. Taking roads as an example, we do a public sector comparison on a value-for-money basis. If we were to grant fund a project by ourselves, we find out how that would compare with taking out private finance with all the risks passed over.

The decision comes down to which is the cheapest option overall. We decide whether to grant fund a project ourselves and carry all the risk or whether to transfer the risk to the private financer—in other words, the private financer maintains the asset over a longer period and keeps it to a specific level of service and deliverability. There are various stages in between before we reach that position. We very much look to the value-for-money guidance that we live within and the public sector comparator to assess what level of funding we use.

Elaine Murray: In the case of Borders rail, where a decision was made to change the funding mechanism, what information determined that you would select a new funding mechanism for that project?

Guy Houston: The basis of that decision was to come up with a cheaper form of finance, which is what the not-for-profit model aims to do. The decision was based on value for money—on whether there was a better option out there or a cheaper option, and how it compared with what we could get elsewhere. That is what it came down to.

Elaine Murray: What in particular would direct you towards a not-for-profit model rather than the conventional private finance initiative model? Both models are forms of public-private partnership.

14:45

Guy Houston: Within the not-for-profit model, the private sector is not able to take the large dividends from refinancing that might occur under a traditional PPP scheme.

Liam McArthur: It is interesting that during that exchange you referred to non-profit-distributing models as not-for-profit models. Transport Scotland's submission to the committee states:

"NPDs are not 'not for profit'—normal profits and returns are taken by contractors and funders in all such procurements."

During this inquiry, we have found that language is extremely important. There can be nuanced differences between policy provisions. I was slightly surprised by the assertion in the submission that

"The Scottish Futures Trust is the Government's alternative funding mechanism to the costly standard form PFI which has been used throughout the UK."

Will you elaborate on that?

Guy Houston: I should say that the NPD models are non-profit-distributing models, rather than not-for-profit models. You are right: the standard terminology is "not for profit", but we should say "non-profit distributing". I apologise. We should be clear about that.

Mr Swinney will appear before you in due course. The Scottish futures trust is not our area of policy. We, like everyone else, are awaiting the outcome of the consultation. We are aware that there might be an even better option out there in the form of the Scottish futures trust.

Elaine Murray: There have been two different Governments in Scotland, which have had different views on the way in which public sector investment can be financed. How constrained are you? Are you saying that you rely on what the Cabinet Secretary for Finance and Sustainable Growth thinks is the best model? How much are politicians directing you to make decisions?

Guy Houston: I would not say that we were led directly by politicians in our choice. We must follow clear, transparent guidance to ensure that we come up with the right value-for-money assessment.

Alex Neil: In the submissions that we received, only the Scottish funding council mentioned the use of a bond to raise funding. In the United Kingdom in the past, the municipal bond was a fairly standard method of funding capital investment, particularly at municipal level. In the United States, particularly at city and county level, but also at state level, the bond is used as a mechanism—it is probably used more than any other mechanism—for funding capital investment. I ask the Scottish funding council to explain the pros and cons of the bond model. Have the other witnesses considered the bond model? Would they consider it? If not, why not?

Riona Bell: The bond that we mentioned in our submission was taken out by the University of Edinburgh, which is the biggest institution that we fund. The university was able to do that, because it is a large business in its own right and was able to satisfy the potential lenders that it was a good lending risk. It has a well-defined programme of works to which it would apply the bond.

The rest of the sector is generally smaller scale. The challenge for us is that issuing a bond to a much smaller organisation would not be attractive to lenders. That is why we are working on a group borrowing facility. The Scottish funding council is not allowed to borrow. We cannot issue a bond, but we can arrange a central facility on which individual institutions can draw. We have decided to go ahead with that and have just started the process of procuring it.

Alex Neil: Is that based on the bond principle?

Riona Bell: The type of finance that will be used is yet to be decided.

Donald McGougan: Local authorities have powers to issue bonds. I can remember local bonds being issued to local citizens in my working lifetime. However, the administration of that scheme was very expensive and, for the past 15 years, local authorities have been able to access significant and sufficient sums for their capital borrowing requirements through the Public Works Loan Board at lower rates than those that would be available on the bond market. Basically, that gives us a source of finance that is cheaper than bond finance. The market conditions and the borrowing instruments that are available to us in bond finance are not the most attractive option, but we have powers to raise bonds if required.

Alex Neil: Have the national bodies, such as the NHS and Transport Scotland, considered bonds? Although they might be dearer than finance through the Public Works Loan Board, are they not cheaper than the traditional PFI method?

The Convener: We will consider individual investment methods later, but Mr Haggarty wants to say something.

Peter Haggarty: I must say that finance, bonds and financial models are way beyond my knowledge and expertise and those of my department. I do not wish to seem to be ducking the question, but I do not have the background to answer it. I am sorry.

The Convener: Among politicians, honesty is refreshing.

Are the witnesses' organisations satisfied with the borrowing powers that they have? Should more flexibility be introduced and, if so, how?

Douglas Millican: Scottish Water is probably unique in the public sector in that the way that it is financed is the same as any other utility in the UK, which is across regulatory periods. In our case, it is a four-year regulatory period. In effect, we have objectives and a level of financing—the limits to the prices that we can charge customers and to borrowing from Government—set for four years. In the six years that we have been in existence, we have benefited enormously from the flexibility to borrow across the regulatory period. We are not confined to an annual limit but, subject to forecasting, we are able to flex when we borrow across the four years. That has assisted enormously in making capital investment delivery more efficient and enabling us to plan to deliver a programme of thousands of projects across four years rather than sticking with an annual borrowing budget.

The Convener: So rather than having an annual cap, you may wish to go above the cap in some years.

Douglas Millican: We can never go above it, but we can delay drawing down the borrowing into the subsequent year. That has assisted enormously.

Douglas Griffin: In answer to Mr Neil's question, I do not think that the NHS is able to borrow on its own account, because the funding comes directly from the Treasury. I think that the only other source of finance that is open to us is a PFI/PPP contract arrangement.

Alex Neil: If that rule was changed so that you were in the same position as local authorities and were able to consider the bond method for raising funding, would you find it attractive? Have you not considered that?

Douglas Griffin: I have not considered it personally. The proof of the pudding would be in the eating. We are back to some of the points that Mr Houston made earlier. We would have a wider range of options to assess and work within.

Donald McGougan: I will make one simple comment on borrowing powers. The prudential framework has been a great enhancement to local authorities' ability to invest sustainably and properly. We can all see the economic clouds gathering nationally and it is clear that there could be a constraint on the prudential framework in the future, but I hope that that will not happen, because the framework has opened up other avenues to local authorities and has generally been used wisely.

Riona Bell: The funding council operates something similar to the prudential framework. Colleges and universities are allowed to borrow up to certain delegated limits. If they wish to go beyond those, they have to come to the funding council for consent. In granting consent, we always check the affordability of the repayments.

The Convener: We have considered the different funding methods that are suitable for different sectors of activity. I invite our adviser, Nathan Goode, to sum up the evidence that we have heard so far. We will then move on to our next theme.

Nathan Goode (Adviser): That was a fairly wide-ranging discussion and a considerable number of points were made, so it is quite difficult to pull it all together. We started with the point that understanding the current asset position of public sector bodies seems to be the bedrock of investment decision making in most cases. There is a lot of commonality on that.

We talked about joint working between authorities, to which Douglas Griffin alluded, and I would be interested to hear more about that. It emerged during the session that there are many similarities and common themes and objectives between public sector bodies, but that there are also many differences. That showed up in our discussion about the flexibility of borrowing and the different approaches—the prudential code in local authority terms, the limited borrowing powers of the NHS, and the different prudential code of the Scottish funding council.

Along the way, we need to remember the backlog, which continues to be addressed notwithstanding the investment that has taken place in recent years, and the need to emphasise service delivery. The other main point is that surplus assets and sites can play a role in the overall funding mix for public sector bodies.

The Convener: Thank you.

In the next part of the discussion, we will focus on how the various investment models actually work. I seek thoughts about—and experiences of—how they work in practice. What are their implications for public bodies, both financially and in relation to service delivery? How do you ensure that they represent value for money?

Who would like to start? What is your experience of the different investment models? Would you like to change the one that you have?

Alex Neil: Why do we not ask Glasgow City Council? It has the Glasgow Housing Association model, which is completely different from the PFI model for schools, and both those models are different from the other things that have been mentioned. Glasgow might be a good example with which to start.

Lynn Brown: We have a range of models, and our written submission includes some case studies. One of the key things is the level of support that we get from the Scottish Government. For example, the attraction of PPP was that 80 per cent of the capital was funded by the Scottish Executive, as it was at the time. The attraction of the GHA model was that the Executive paid off the housing debt, which was about £900 million, I think. Future investment was enabled because that debt was paid off.

When it came to the pre-12 strategy in Glasgow, primary schools were considered to be different from the high schools that were built under PPP. By then, the prudential code had come in. It was not in existence in 2000; it came in only in 2003. As Donald McGougan said, the flexibility that it allows is crucial. For the first time, capital receipts could be used and we could borrow against savings. It gave us much more flexibility. The pre-12 programme could not have happened in 2000 because we did not have the ability to introduce it at that time.

15:00

Going forward, we are spending about £70 million building care homes. Much of that is predicated on savings that we will make on our current stock.

The issues for us are what is permissible under the guidance and whether funding is available to us from elsewhere. Each project is considered on its merits—it is horses for courses.

The Convener: How do your existing models work? Are you satisfied with them?

Douglas Millican: I am not sure whether the question is about finance or investment delivery, but I can answer the question in relation to investment delivery. We are a big investor—we invest about £600 million a year—and we have gone through quite an evolution in our approach. Back in the days of the water authorities, in the mid to late 1990s, quite a lot was done through PFI. We have nine PFI schemes that have brought in about £600 million to £700 million of investment. We have also had a range of traditional investment delivery. More recently, over the past four or five years, we have gone on to much more of a partnership model whereby we have been looking to be in long-term investment partnerships with clear incentives to deliver—particularly, to outperform across the programme as a whole, not just in individual projects.

On the journey that we have gone through, we have gained a lot of experience as we have gone forward. Things have worked well where there has been a clear specification of what has needed to be delivered and an aligning of incentives—both positive and negative—around that. Therefore, we have used pain-gain mechanisms—pain mechanisms backed up by parent company guarantees—and, ideally, we have tried to give as much predictability to the market as possible to avoid boom and bust in any element of the delivery chain while trying to get consistency of workload into the design community and the construction community. The more certainty that we can provide in the marketplace, the more we will see such huge benefits as we have seen in terms of improved efficiency and delivery.

Guy Houston: The discussion assumes that we have lots of contractors out there and lots of people who are interested in doing business in Scotland. Although it is only one part of looking at which investment models work, we must be conscious of the current workload not only across the UK but globally. An increasingly important aspect to us is how we can get enough contractors into the market. If we do not, it does not matter what the funding model is because the cost will still be high. That is something that we are conscious of and are working hard on.

Douglas Millican: In our experience, the question is increasingly how we can become an attractive client. Typically, in the public sector, the margins may not be as great as in other parts of the market. How does the public sector become an attractive client? In our case, a lot of it comes by giving forward visibility of workload to the marketplace, so that contractors know that they can invest in Scotland and in skills and can see a continuity of workload two, five and 10 years out.

Tom McCabe: The previous Administration published an infrastructure investment plan that tried to give a 10-year horizon of potential investments that would come to market. I assume from the comments that I have heard that people feel that that approach complements the considerations around what kind of financial model would make the projects happen.

Alex Neil: A new plan has just been published.

My question is for Transport Scotland, Guy—not the Transport Scotland guy, but Guy Houston. The NPD model has been used for the Borders railway. Would you be able to use that model for investment in the roads network? The difference between rail and road is that there is no revenue stream for roads as there is for railways. Would the NPD model, in principle, be applicable to the roads investment programme as well as the rail investment programme?

Guy Houston: There is maintenance to be done for the next 30 years so, yes, the NPD model is just as applicable. It is a new version of PFI.

Riona Bell: I want to pick up on the issue of the impact on service delivery. Tertiary education is a dynamic service, and demand for certain subjects changes through time. That makes it difficult to get a firm specification at the outset of a 30-year period and to say that that is what we want to operate for 30 years. We have found that the concession-type contracts in PFI and NPD projects do not work in a sector in which there is dynamic in the specification.

Secondly, I want to pick up on Mr McCabe's point. The forward indication of investment is useful to the market, but it is a challenge to provide the information for the infrastructure investment plan because we are still working within three-year spending review periods. In its recent report on higher education infrastructure, Audit Scotland picked up that a longer planning horizon would be helpful.

The Convener: How attractive is investment in proposals by public authorities? You are in competition with all sorts of other investment. What can you offer that would encourage folk to invest more in public projects?

Donald McGougan: The attraction is the covenant, and the security of the investment in infrastructure over a period. Strangely enough, now that there is less development risk in PPP projects, the pension funds are buying the projects on a secondary basis because of their sustained guaranteed return over a long period. The public sector covenant is an attraction for investors.

The Convener: Given the burning that has taken place with certain investment vehicles, that solidity might be attractive.

PFI and other partnership models are based on the principle of risk transfer. Is risk transfer achievable in practice?

Douglas Griffin: The succinct answer is yes, but there is a price to pay, and it comes down to how we negotiate the amount that we pay. There is no such thing as a free lunch, and if there is a transfer of responsibility, there must be a payment for that. That payment is down to negotiation. We get what we pay for.

The Convener: In fact, you are in a position of strength rather than weakness.

Douglas Griffin: It depends on how we manage the contract once it is in place. We have to be careful to ensure that the right management infrastructure is in place to engage with the contractor and the facilities provider and to ensure that we get what we are paying for. We have to work through that discipline very carefully.

Elaine Murray: My question builds on the back of the service delivery issue, which Lynn Brown talked about. I will illustrate it using a local example. Dumfries and Galloway Council is rebuilding some schools using a PPP model and some schools using the conventional model. The council felt constrained by commercial confidentiality on the PPP model. It is unable to consult local stakeholders in the same way that it can with the conventional model. Has that been your experience, particularly in Glasgow, which has used that model? Has the financing model that you were using constrained your ability to consult service users?

Lynn Brown: The PPP at Glasgow City Council finished before I started working there. I was not around when the council was doing the consultation so I cannot really comment on it. There is consultation on the pre-12 strategy. Parents of primary school children are very vocal—they want to influence what happens. It becomes a balance between what is needed in service terms, what we can afford and what the needs of parents and children are. A lot of consultation takes place, but my understanding is that, if we want to close a school, for example, consultation is statutory under education legislation. In Glasgow, we have closed a number of schools for pre-12s. There was some opposition to those closures, but it was not significant; the consultation was quite successful. I cannot answer on the position as regards the PPP projects, as I was not in post at that time.

Elaine Murray: My question was more about design issues. As you say, there is a statutory requirement to consult on school closures. The experience of Dumfries and Galloway Council was that consultation with service users about the design of facilities was difficult because of the constraints of commercial confidentiality.

Lynn Brown: I cannot comment on the situation in Dumfries and Galloway because I do not know the detail of that, but my view is that PPPs allow as much consultation to be carried out as is desired. The cost attached to that might have been the issue.

As part of the pre-12 programme in Glasgow, we have just completed a high-spec special needs school in Bellahouston, which is wonderful. Parents and students were heavily involved in the project. I am sure that sufficient consultation can be carried out under PFI projects; it is just a question of the cost that is attached to that.

Douglas Griffin: I can offer another perspective. I have been closely involved in two reasonably small PFI projects that have come to fruition in the past five years. My experience was that our private sector partners were extremely keen for our nurses, doctors, clinical staff and service users to be right at the heart of the process so that they got those projects right.

As has been said, an issue arises once the spec has been agreed, the contract has been signed and what was asked for has been provided. Over the succeeding 30 years, it becomes much more difficult to put through some form of variation. That is why, as another witness mentioned, getting the spec right is so important. Such funding arrangements can be quite inflexible. They are workable, but once a facility has been put in place a lot of effort is required to make changes.

Liam McArthur: I echo what Mr Griffin said. There has been significant consultation with users on the NPD school estate project in Orkney. I do not think that users have felt constrained in any way.

Mr Millican spoke about the attractiveness of such investments and the visibility and predictability of the contracts involved. However, there is the issue of scale; in that regard, it is slightly disappointing that Western Isles Council is not represented at the meeting. I know that Orkney Islands Council wrestled with that issue in the context of the school estate. I do not know which small-scale PFI projects Mr Griffin was referring to. It is difficult to attract any sort of response from the market when one is dealing with projects that are not on as significant a scale as those that have been progressed in Glasgow and Edinburgh. It would be interesting to know what views our guests have on the role that scale plays in deciding projects.

Guy Houston: From our point of view, large-scale projects are those that are most likely to attract PFI investment because of scalability and the efficiencies that can be gained from the maintenance of a piece of network for up to 30 years. I will give the example of the M74 extension, which is a short piece of infrastructure, for which we can transfer the risk in other ways without the need for PFI. We are talking about a fixed-price lump sum for the construction of the new motorway, after which it is up to us to maintain it. For us, the risk transfers to the maintenance side. It was said earlier that an intelligent client is an attractive client. The risk depends very much on whether the piece of infrastructure is in a fit state when it is passed over to us, such that it will last for a considerable period of time.

There is another side to risk transfer. I will give two examples of large schemes. The M77, which runs down to Ayrshire, has been operating for five years and no claims have been made. It was a fixed-price project. The road is a good piece of network, as is the M74 down to the border, which has been going for even longer. Again, the risk has been transferred and it was a fixed-price project. We know that we are getting a suitable service. The outputs are there—in other words, the road is open.

15:15

Joe FitzPatrick: I will follow up Elaine Murray's point. I have been involved in Dundee's on-going school building programme, which uses PPP and conventional methods. The public's perception was of more consultation on schools that were not being funded via the standard PPP, but I am not sure whether that was a result of the funding methods. Great effort was made to involve the public as much as possible in both sets of contracts, but the size of the PPP part might have been a factor. So many schools were involved that a level of confidentiality had to be maintained. I am not sure whether changing the methods would make a difference to consultation. People in Dundee saw a difference between the consultation on PPP schools and the one on non-PPP schools, but I am not sure whether that related to the funding method or to the scale of the projects.

Tom McCabe: Consulting the public can be a difficult job, as people know, and sometimes we need to be careful that people or organisations do not hide behind the funding model when they consult the public.

I was interested in the comments about the difficulty or cost of making alterations once a client has a set scheme. It is true that, in any construction project, the minute that an architect's instruction is issued, a big cheque is being written. That applies to PPP and to conventional procurement. I am interested in the panel's views on whether, under conventional procurement before PPP, if a client had not set a scheme and an expensive flow of alterations continued, that expense was much less transparent than it would be under PPP or PFI.

Donald McGougan: That has happened—in the past, hospitals and major local authority projects have greatly exceeded their budgets.

Alex Neil: You are sitting in one example of that.

Donald McGougan: So I am—I was too polite to say.

Tom McCabe: This is a classic example of an architect's instruction.

Donald McGougan: Of course it is.

The difference with a PPP scheme is that the issue still applies in the period post-development, when services are run for 25 or 30 years. The contract might lock the client into going to the initial provider to make a change rather than having further competition to make adjustments. That is one drawback of PPP schemes. However, that has to be balanced against other advantages, such as the encouragement for lifetime maintenance arrangements, which local authorities were not good at when they were obliged to maintain their own assets, as I have shown.

Tom McCabe: Does that issue reflect the need to build experience in the construction of such contracts? Surely experience would allow a contract to be compiled that built in more of a facility to test the market after a period had passed. That was not built into early contracts. West Lothian College provides a classic example of a dynamic service to which any alterations became extremely expensive because the contractor had the client in a grip, in effect. However, through experience, contracts can be written differently to provide for such alterations.

Donald McGougan: I accept that.

Riona Bell: I agree that, with lessons learned, newer contracts can provide for future changes, but the scale still has a limit, beyond which extra cost starts to be incurred, because the financing for the alterations must have some headroom. The other extra piece of process is that operating the change mechanism means going through the service provider, which adds time to the responsiveness for a change.

Douglas Millican: Contracts can become more sophisticated, but how easy it is to make changes competitively probably depends greatly on the nature of the asset. For example, if we have a PFI contract for a sewage treatment works and we want to bring in an additional community by pipeline, it is not always easy to secure competitive tension for the expansion works when we are dealing with a single special purpose vehicle.

Guy Houston: Our PPP models are not fundamentally different. We have contracts to design, build, finance and maintain—the PFI option—and we have big design and build stand-alone contracts, in which we go for a fixed-price lump sum. We do not think that such an approach is more costly. We get a fixed price and delivery on time and on budget—within 3 per cent on the roads during the past 20 years. The key point is to ensure that we get the specification right from the outset, so that we do not change our minds mid-contract. That is basic project management.

The Convener: I draw this part of the discussion to a close and I ask our adviser to sum up the evidence that we have heard.

Nathan Goode: We started this part of the discussion by saying that there is a range of models, the drivers for which are funding and service delivery. We talked about pain-gain mechanisms and how we make the public sector client attractive to the market and create an intelligent client. Of course, the flip side of that is the need for sufficient availability of contractors in the marketplace to deliver the service effectively.

Another line of discussion was the relative flexibility of different contractual models and the dynamic nature of service delivery. I guess that the interesting point, on which the panel touched, is that it is horses for courses—if you will excuse the cliché. One model works for projects that are predictable and that can be preset and determined for a long period from the outset, such as roads projects; another model works for assets that are likely to change in future, such as dynamic educational establishments.

We touched on the importance of scale in determining attractiveness. I add that scale is important because there are fixed costs of delivery. It will always cost a certain amount of money to procure a project, whether it is in the public or the private sector, and if the overhead is high relative to the project's size, there will be challenges. That is fundamentally a financial point.

We talked about the life-cycle approach. Interesting comments were made about the need to stick to what you said that you would do at the outset and about the need to ensure a consistent approach in a number of ways, to get the best out of the market.

The Convener: We have covered a fair amount of ground. All contributions were much appreciated. I am pleased to say that we will have a short break and reconvene at about 3.35 pm.

15:23

Meeting suspended.

15:39

On resuming—

The Convener: I hope that members and witnesses are suitably refreshed.

A great deal of the written evidence that we have received describes different models and approaches to investment that have developed over recent years in response to perceived problems in previous experience. In the next part of the discussion, I would like to focus on what those innovations have achieved, what problems persist and what improvements are still needed.

Alex Neil: I suggest that we also ask about the new situation that has arisen since we started our inquiry—the credit crunch, which is bound to have some impact on organisations' ability to raise funds.

The Convener: That is a good point. We will raise that issue with dread and trepidation. What have the different models and approaches achieved? Have the new models failed? Have the old models failed?

Donald McGougan: I will offer one or two starting points. A recent report by Audit Scotland indicates that about £5 billion has been invested in schools infrastructure in Scotland under the new models of financing, especially PFI. It is argued that that money would not have been invested if PFI had not been introduced, because the main point of the model was to take investment off the public sector balance sheet. When the new accounting standards are introduced, the issue will need to be revisited. Local authorities received 80 per cent support for borrowing costs, as Lynn Brown mentioned, and a major programme of works was undertaken throughout Scotland. There has been a significant improvement in the schools infrastructure in Scotland, although Audit Scotland recognises that more needs to be done. Earlier, I spoke about the backlog that exists: at least we were able to start eating into that backlog under the new model that took investment off the public sector balance sheet.

The Convener: Have you any thoughts on whether the new accounting standards that are to be introduced will affect PFI schemes?

Donald McGougan: It appears that such schemes will have to come on to the public sector balance sheet. It will be for the Treasury and central Government to determine how funding can be released in the future.

The Convener: What effects is the change likely to have?

Alex Neil: I know that it is supposed to take place in 2009-10.

The Convener: It has been held back for a year.

Alex Neil: Obviously, from 2009 new projects will have to be on the public sector balance sheet. Does anyone know what will happen to old schemes—will they stay off the balance sheet? The decision on that will make a huge difference.

Douglas Griffin: I will try to answer the question. One or two of my colleagues may be able to add to what I have to say.

I understand that all the schemes in which we have invested to date will go on to the balance sheet and will be counted as if they were public sector capital expenditure. At some point, reporting will have to be adjusted to reflect that. For a number of years, we have been able to finance PFI-type schemes from our revenue funding envelope, rather than our capital funding envelope. As Lynn Brown indicated, that has enabled us to implement more capital schemes than we were able to implement previously.

The bottom line is that the change will not result in any more cash going out of the door. It will have no impact on cash flow—it is a technical adjustment. My colleagues and I hope that someone will work out a way of ensuring that the change, which is a non-cash item, has no impact on our ability to provide services. We will have to wait and see.

Alex Neil: There is a problem. One reason why PFI was so popular was that it allowed the Chancellor of the Exchequer to meet the golden rule of not allowing national debt to exceed 40 per cent of gross domestic product, and to maintain an annual borrowing requirement of no more than 3 per cent of GDP, as specified by the Maastricht treaty. If you add in even the new schemes, the chances of staying within the fiscal rules are zilch, particularly given the Northern Rock situation and the outstanding guarantee to Network Rail.

15:45

Douglas Griffin: It does not matter whether a scheme is publicly or privately funded—the disciplines are the same. The question is whether the scheme is affordable. Can you live within your revenue envelope? In embarking on a scheme through either funding route, you would want to make absolutely sure that you could pay the bill.

As we heard earlier, the PFI option enabled us to widen the range of funding envelopes that were open to us to deliver capital projects. We could use our revenue funding envelope by converting an up-front capital payment and spreading it over a number of years. We would try not to go into such an arrangement with our eyes shut to the on-going financial consequences. It is always more difficult to look to the longer term. We need assurances on future revenue funding levels that will enable us to deal with on-going financial bills.

Alex Neil: I accept all that for individual organisational or project level. The problem is that projects will have to be on the balance sheet and the Chancellor of the Exchequer can approve only up to the level of his fiscal rule. There will be an impact on the number and value of approved projects—I expect that they will be curtailed substantially. I think that Derek Brownlee agrees with me on that.

Tom McCabe: Just tell that to Derek Brownlee. Alex Neil was not looking for a friend or anything.

The Convener: The committee will look further into the issue next week.

Lynn Brown: I have come from a meeting of the United Kingdom local authority statement of recommended accounting practice—SORP—board, on which I sit. We discussed the issue this morning. There will be an impact: assets will have to come on to the balance sheet, as will liabilities. At the moment, the unitary charge goes through revenue, but in the future it will be split—there will be a revenue and capital element—and the capital element will have to hit loans charges. The bottom line for local authorities is that the Scottish Government will need to regulate so that the change does not impact on council tax. The situation is a bit like charged pension costs under financial reporting standard 17. This morning, the board agreed to write to the devolved Administrations to say that that is what will happen.

Given that the International Financial Reporting Interpretations Committee's interpretation 12 on service concession arrangements will be introduced in 2009, everything has to be sorted out this year. There will be a real impact, including on the bottom line.

The Convener: Thank you for taking us into those deep waters.

Peter Haggarty: My comment is on lessons learned. PFI and PPP have allowed us to become more focused, informed and intelligent clients. As we discussed earlier, that is the case particularly around our understanding of life-cycle costs. Elaine Murray touched on the importance of design. We have a better understanding of how design specification impacts on life-cycle costs.

The Convener: Do you wish to come in, Mr Houston?

Guy Houston: My point is on accounting treatment, which was raised earlier. My finance colleagues in the Scottish Government are still awaiting Treasury guidance on how all this will be dealt with. As we said, this is a technical adjustment that is not to do with cash. The Treasury took on the new accounting standard with great enthusiasm, but having realised the consequences, it has delayed its introduction by a year. We should fully expect a resolution—

Alex Neil: After the election.

The Convener: Behave yourself, Alex.

Guy Houston: We should also remember that other countries—Ireland is one—continue to use a PFI model that is on balance sheet. We should not simply be saying, "Oh, we will not do PFI in the future, because it will have to be on balance sheet." There are benefits to be had from PFI. I would not want anyone to go away thinking that we do PFIs only to keep things off our books.

Tom McCabe: The rules that chancellors set vary depending on economic circumstances. That is why we now own Northern Rock.

The Convener: Alex Neil mentioned the credit crunch. Do any of the witnesses wish to comment on how it would affect them?

Lynn Brown: The credit crunch will simply mean that borrowing will become more expensive because the banks will put their rates up. The public sector is well placed because of the covenant that Donald McGougan mentioned earlier—we are seen as a safe investment because we will repay our debts—although I think that there will be an overall increase in interest charges.

Peter Haggarty: I said that finance was not my background, but we could benefit from the public sector becoming an attractive area for investment, given the volatility in the markets.

The Convener: So, it is about strength, stability, reliability and dependability.

As there are no other comments, I will draw the questions on that theme to a close, if our adviser is ready. Would you like to sum up before we move on to the next theme?

Nathan Goode: Yes. There are two main strands to the section. One concerns the accounting treatment, on which we had some helpful clarification from Lynn Brown. We must watch this space but, equally, the general trend is towards on-balance-sheet treatment. The point was made that that is not the sole reason for doing PFI projects; there are a number of other reasons, including the life-cycle costing approach and the importance of designed development. The interesting point in all that is the suggestion that, because of how PFI is structured, it is possible to learn things from that process that may be applicable to other forms of procurement in the future. Perhaps that is one way of seeing PFI in context.

We touched on the credit crunch. Notwithstanding the fact that most of the bodies that are represented around the table source their funding primarily through public sector sources, any projects that involve surplus assets may or may not be influenced by the cost of borrowing in the marketplace. Who knows?

The Convener: We now move to the final part of our discussion. In this section, we will focus on skills. The Scottish funding council's submission states that a major capital investment is a once-in-a-career event for many public sector managers. In that case, how can the public sector develop and retain procurement skills and support to ensure that it is effective and able to negotiate the best possible deals in capital investment? How can best delivery and best practice be ensured?

Douglas Millican: In Scottish Water, we may be in a unique position in that, as a business, we spend £2 on capital investment for each £1 that we spend on running costs every year, so capital investment is a core business for us. Procurement skills are one thing, but contract management skills are crucial. The public sector needs to be able to manage contracts as effectively as the private sector. That is particularly relevant to claim management and performance management over the life of a contract. In Scottish Water, we have addressed that need through a combination of recruiting people—typically from the private sector—who have procurement or contract management skills, and developing our own capability in-house.

The Convener: You said you make £2 capital investment for every £1 of revenue. You may just have induced some envy.

Guy Houston: I echo Douglas Millican's comments. The entire purpose of Transport Scotland's being set up was to bring the ethos of a centre of excellence into transport project management and our large-scheme projects.

We have had guys working on major roads projects. There have been a number of major roads projects over the past 10 or 20 years, so they are not a new phenomenon for us and we are learning all the time. We have oversight from various independents all the way through the financing side and through our colleagues in central Government, but also through Partnerships UK. There are also gateway reviews. We also have health checks and our internal investment decision-making process. Audit Scotland comes in regularly and there is also an internal audit department that we use within the Scottish Government. In summary various bodies ensure that we do what we say we are doing.

On training and procurement, all our engineers on the roads side are qualified chartered engineers. They are all trained in the latest technical aspects in addition to being trained in contract maintenance, project delivery and project management. We bring in technical advisers from beyond the financial or legal spheres for areas in which we may be weak within the team. We have, on every one of our major projects, a rounded team that considers all aspects.

The Convener: Is that generally the case?

Riona Bell: There is not a one-size-fits-all solution, because the descriptions that we have just heard relate to a situation in which a centralised body is responsible for delivery. In the Scottish funding council's case, separate autonomous bodies are responsible for delivery. The funding council's submission sets out the structure that we have had to put in place to support them and ensure that they get adequate training and support so that they are as skilled as they can be when it comes to delivering individual projects.

Peter Haggarty: We have done quite a lot of work to try to develop procurement skills, contract management skills, project management skills, risk management skills and so on in all the NHS boards in Scotland. In PFI projects in NHS boards we have often found that once we have trained people up their skills are better valued in the private sector than they are in the public sector, so they move over the horizon. As we move forward with workforce planning, against the background of an ageing population, we must recognise that once we train people up we have to pay them accordingly in order that we can compete with the private sector and retain their knowledge, skills and corporate memory. We are losing ground in that area and will continue to do so if we do not pay such people appropriately.

Donald McGougan: It is certainly an issue for the City of Edinburgh Council. We are obviously a relatively big local authority with a number of major projects on the go. We are trying to develop project management, contract management and procurement skills in-house, so that at the least we can act as an informed client.

On the very big projects, we continue to need consultancy support and have to buy in specific skills from outside. Waste-treatment development is an example of an area into which we needed to bring outside experience. For the trams project, a separate council company has been set up that has contract management, project management and procurement expertise. To be honest, it can pay salaries that are outwith the gift of the city council on a direct basis because of the requirement for us to make comparisons in relation to staff value across the whole organisation. We certainly need on-going outside assistance for projects above a certain size. It is early days, but the committee might be aware of initiatives to join up procurement across the Scottish public sector and Scottish local government. It is also early days in relation to Scotland Excel, which is bringing together procurement across the local authority sector.

On construction, the City of Edinburgh Council is looking to see whether improvements in the process of procuring capital projects can be shared with councils such as Fife Council and Scottish Borders Council so that they can develop best practice. There is a lot still to be done in that regard.

16:00

Lynn Brown: I echo what Donald McGougan said: we have project managers, surveyors and so on, but we go out to the market for specialist advice. The refurbishment of Kelvingrove museum, which could have been a very difficult project, given that the building is old, was on budget and on time. We had private sector project managers working on that project and we have them working on the new museum. We have just sought private sector advice on our procurement strategy for the Commonwealth games, given all the competing major capital projects in the east end of the city. We would not necessarily gear ourselves up for a seven-year timeframe with developed teams, but it is helpful to go out to the private sector to buy in expertise as we need it in the timeframe that we have.

Peter Haggarty: I acknowledge that there is a need for private sector involvement on occasion, but there is also sometimes overdependence on the private sector for knowledge and expertise. There are good, well-experienced individuals working in the public sector, but we are not investing enough in them, nor are we doing enough to retain them.

The McClelland report on the review of public procurement, which the previous Scottish Executive commissioned, referred to a number of deficiencies in procurement skills and expertise. The committee might want to refer to that report for further information.

The Convener: Is there any opportunity for different organisations to share experience? Audit Scotland is now a major national institution with a wide range of expertise. Has it been of any help to you in your practical work?

Peter Haggarty: When we were sitting in the anteroom waiting to come into the committee room, I had a discussion with Douglas Millican about his experience of procurement in Scottish Water. We have agreed to follow up that discussion. I am not sure whether Audit Scotland is the best body to co-ordinate such information.

Alex Neil: Would it be helpful if there was a unit in the Scottish Government that had information about best practice across the public sector in Scotland that you could access, so that you could learn about best practice in Scottish Water, the health service and local authorities?

Peter Haggarty: Yes. I believe that such a unit might already exist, but I do not know how effective it is at communicating such information to the various public bodies. Does such a unit not exist in the procurement directorate of the Scottish Government?

Alex Neil: I do not know.

The Convener: Perhaps we could find out. Thank you for raising the matter.

Guy Houston: We have Office of Government Commerce gateway reviews and health checks across the whole UK, not just Scotland. There are mechanisms and processes in place to keep an eye on things and spread best practice.

Douglas Griffin: If we are to take that initiative, it is important that we are able to tap into practical experience and knowledge, rather than just sets of guidance and rules. Whatever source of advice was available centrally would have to have credibility with the services in order for it to be effective. There is a danger sometimes that we end up with a booklet full of best practice, when people really want to know how organisations dealt with a particular situation and what they should think about when they engage with a contractor or service provider.

Douglas Millican: I think that we should look way beyond Scotland and way beyond the public sector. When we were developing our approach to partnering, we looked at how the oil and gas sector coped when it had to deliver capital investment much more effectively after the oil price collapse of 10 or 15 years ago. I would encourage people to broaden their horizons by looking at what can be learned from elsewhere in the world and from the private as well as the public sector.

The Convener: Does anyone have any comments on the role of the gateway reviews?

Donald McGougan: The process for the tram project required us to go through a gateway review, which was a robust and useful step in the process. On 1 May, a report will go to the City of Edinburgh Council that will recommend that any project of more than £10 million should be classified as a major project. We will introduce a gateway review process for all such projects, following on from our experience with the tram project.

The Convener: Obviously, there is an agenda for public bodies to work together in delivering services. How is such working together affected by the fact that different Government sectors have different accounting rules and different options for capital investment? For example, local authorities have access to the Public Works Loan Board, which provides funds at very competitive rates, but the health and central Government sectors do not have access to that. What problems does that pose?

Douglas Griffin: As I introduced the topic earlier, I feel duty bound to make the first comment.

Our experience to date has been that, for schemes of several million pounds, we can use existing mechanisms such as capital grants or resource transfers between organisations to make available the partner's share that is needed by the other organisation. We have used that approach with Glasgow City Council in the recent past. Where things become more difficult is where bigger schemes are involved that require larger amounts of money. The difficulty is in trying to synchronise the bidding so that the resources are obtained at the same time to provide the total funding. That becomes difficult because of the need to operate with two different funding sources.

Lynn Brown: One difficulty is the different VAT regimes. For example, local authorities can reclaim VAT on capital projects but, as health boards cannot do that to the same extent, it can be more expensive for the health board to build something. If the health board wants to build an asset that will be run by the health board, the new rules on capital—this issue could be looked at—require Glasgow City Council, because we do not own the asset, to treat our contribution as revenue funding. Therefore, our funding for such projects needs to come out of capital funding or from revenue funding and we cannot borrow the money to help to fund the facility. That accounting rule seems a bit strange and it hampers the ability of the public sector to work together. That is the main thing.

Douglas Griffin: We have more flexibility than our council colleagues because we can feed money across through the mechanism of a capital grant to transfer capital resources or through a resource transfer or revenue transfer if the scheme does not involve the creation of a capital asset.

The Convener: Let me bring this section to a close with a final question. Aside from the specifics of the proposed Scottish futures trust, what principles should be enshrined as a priority in future policy on capital investment?

I hope that that question tempts people. Who would like to have a go at that one?

Douglas Griffin: I am doing too much talking now—

The Convener: No, feel free.

Douglas Griffin: I commented earlier that the most significant issue is for capital investment to be connected up front with clarity about what revenue funding is available to meet the on-going consequences of the asset over a longer period. Sometimes, there is too much focus on the availability of capital to get a project established and less clarity about the certainty of the on-going revenue funding that pays for the maintenance, capital charges, rates, electricity and gas that are associated with improving and creating an asset over a number of years. It would be good to have the assurance that one was in a position in which that significant additional cost could be covered on an on-going basis. There is not always that certainty.

The Convener: That is a complete view of the process.

Douglas Griffin: Yes.

Riona Bell: I agree that an emphasis on estate strategies and whole-life costing is important to ensure that we do not get back into another cycle of neglect that leads to another problem of backlog for future generations to deal with.

Donald McGougan: I am not sure whether it is a principle, convener, but I would like a greater recognition of the importance of investment and infrastructure to the Government's main aim of economic development within Scotland. In areas in which growth is possible and needs to take place, there is a need to invest in infrastructure—in public sector infrastructure first of all, in order to generate private sector investment, which would come afterwards.

I perhaps missed my chance, when we were talking about other models of capital financing, to say that we have set out in our evidence the issues surrounding the tax increment financing scheme, which relates only to local authorities, not to other parts of the public sector. One of the principles is that there is no incentivisation in the system at the moment, in terms of the product of the non-domestic rate or of council tax.

The case has been proven, in America and elsewhere, that investing in infrastructure leads to an increase in the product of non-domestic rates and council tax. That investment could be in transport or affordable housing—or coastal protection, for example, so that the waterfront can be developed—but at the moment the increase in non-domestic rates and council tax that such investment brings is swallowed up by the local government finance system and diverted elsewhere within the Scottish Government settlement. If local authorities were allowed to keep at least a proportion of that increase, they could finance, through the prudential framework, the investment in infrastructure. A good case can be made that that would create a virtuous circle: the investment in infrastructure would lead to growth, which would increase the product and return, and we could then recycle that into future infrastructure. Compared with European competitors, Scottish cities lag behind in relation to public sector infrastructure investment.

The Convener: Infrastructure investment is a lesson that the Victorians taught us. Therefore, a Glasgow view might be appropriate.

Lynn Brown: The prudential code, and the flexibility that it gives us, needs to be maintained in any future way of dealing with capital. We touched earlier on the fact that the rules for different organisations—which you mentioned in the previous question, convener—need to be sorted out so that we can work together to create infrastructure.

The Convener: This market day is wearing late, so we will conclude this section, but I leave the option open for any final comments.

Peter Haggarty: I will move away from the finance side and consider the people side. We have an ageing workforce and if we do not examine the workforce and invest in workforce planning, we are in danger of losing our corporate memory, which will lead to overdependence on the private sector to buy that knowledge and expertise back.

The Convener: I now bring this section to a conclusion with our adviser's summary.

16:15

Nathan Goode: Thank you for an interesting afternoon. The key points coming out of the final section were that skills in procurement and contract management are key to the delivery of investment across the public sector. It is fair to say that there is still work to be done in training and retaining staff within the public sector to deliver procurement and contract management effectively. There was talk of a mixed economy and the use of private sector resource, as well as training people up within the public sector, and of getting the right balance between the two.

We discussed the role of guidance and best practice. There were some positive views of the role that gateway reviews and external scrutiny can play in the process. There was an emphasis on the need for practical experience as well as guidance or theory on paper; it is also important to focus on the realities of delivery.

We talked a bit about the differences in accounting and tax treatment between public sector bodies. That seems to be an area that the Government should address to ensure that those differences do not prevent joint working.

Different people expressed aspirations for Government policy in this area. Whole-life costing was very much a theme of the afternoon: the whole life of projects needs to be considered. The capital and revenue implications of the project need to be linked effectively and the project needs to be seen as an integrated whole. That has come out quite strongly from the discussions.

We also discussed the importance of investment in infrastructure on a general economic level, and then, finally, the maintenance of the prudential code as a key area of flexibility for investment for local authorities.

The Convener: Thank you. I thank all the witnesses for their assistance in what has been a very useful and informative session. We appreciate your expertise, knowledge and presence today. It will all help the committee to produce its report.

We will reflect on what we have heard and take further evidence during the next few weeks. We look forward to sharing our conclusions with you in due course.

We will suspend briefly to allow our witnesses to leave. The committee will then reconvene to deal with the remaining agenda items.

16:17

Meeting suspended.

16:19

On resuming—

Scottish Register of Tartans Bill: Financial Memorandum

The Convener: Item 3 is consideration of our approach to the financial memorandum to the Scottish Register of Tartans Bill, which was introduced on 25 March. As members will see from the clerk's paper, it is suggested that we adopt level 1 scrutiny of the bill, which will involve our seeking written evidence from the National Archives of Scotland. Do members agree to that approach?

Liam McArthur: I agree. However, when I read the briefing paper, a thought occurred to me on the range of the fees. The textile industry supports the general thrust of the bill, but as we know from the Licensing (Scotland) Act 2005, the way in which a fee structure is introduced can create difficulties. I wonder whether it would be helpful to ask for written evidence from those who are likely to be paying the fees.

The Convener: Are there any other comments?

Alex Neil: In the previous session I was convener of the Enterprise and Culture Committee, which considered the Scottish Register of Tartans Bill. At that time, for various reasons, it did not progress. On Liam McArthur's point, if we refer to the evidence that potential users gave that committee in the previous session, we will get a list of people to whom to write for information.

The Convener: Would such a list be reasonably accessible?

Alex Neil: It is just a question of checking who gave evidence last time.

The Convener: By the way, perhaps I should declare an interest, since I am convener of the cross-party group on tartan day. However, I give an assurance that I have no pecuniary interest—only the wish to encourage tartan day events.

The suggestion is that we seek written evidence on fees. Does the committee agree?

Members *indicated agreement*.

The Convener: We will adopt level 1 scrutiny.

Subordinate Legislation

Public Contracts and Utilities Contracts (Scotland) Amendment Regulations 2008 (SSI 2008/94)

16:21

The Convener: Item 4 is consideration of a Scottish statutory instrument under the negative procedure. Members have a note from the clerk, which explains the negative procedure, covers the policy effect of the regulations and includes an extract from the Subordinate Legislation Committee's report.

Do members have any comments on the regulations?

Members: No.

The Convener: Are members content to make no recommendation to the Parliament on the regulations?

Members *indicated agreement*.

Judiciary and Courts (Scotland) Bill: Financial Memorandum

16:22

The Convener: Item 5 is consideration of the financial memorandum to the Judiciary and Courts (Scotland) Bill. At our meeting on 11 March, the committee considered the submissions that had been received and raised a number of concerns. The committee agreed to write to the bill team to ask for clarification on a number of points. A response has been received and is included in the papers. The response addresses the concerns that were raised, and I thank the respondents for the clarification.

I recommend that the committee agrees to forward the submissions and the response to the lead committee for its consideration. The lead committee has completed its oral evidence-taking sessions and will shortly consider its report. Do members agree to that approach?

Members *indicated agreement*.

16:23

Meeting continued in private until 16:38.

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