FINANCE COMMITTEE

Tuesday 20 May 2008

Session 3

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FINANCE COMMITTEE
14th 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 GAVE EVIDENCE:

Michael Gerrard (Partnerships UK)
Stephen Gibson (Cordale Housing Association)
Robert McDowall (DTZ)
Fred Maroudas (Network Rail)
Ron McAulay (Network Rail)
Dougald Middleton (Ernst and Young)
Bryan Smail (Falkirk Council)
Martin Spollen (Strategic Investment Board Ltd)
Ray Stephenson (Department of Health)
Ian Wall (EDI Group Ltd)
Bruce West (Argyll and Bute Council)

CLERK TO THE COMMITTEE

Susan Duffy

SENIOR ASSISTANT CLERK

Mark Brough

ASSISTANT CLERK

Allan Campbell

LOCATION

Committee Room 2

Scottish Parliament

Finance Committee

Tuesday 20 May 2008

[THE CONVENER *opened the meeting at 14:01*]

Methods of Funding Capital Investment Projects Inquiry

The Convener (Andrew Welsh): Good afternoon and welcome to the Finance Committee's 14th meeting in 2008, in the Scottish Parliament's third session. I ask members, witnesses and the public kindly to turn off mobile phones or pagers, as they interfere with the broadcasting system. We have received apologies from Tom McCabe.

This is our sixth evidence session for the methods of funding capital investment projects inquiry. Today's session will be split into two parts. The first part will concentrate on the non-profit-distributing organisation model of funding capital investment. The second part will be a round-table discussion of other innovative approaches that have been used to fund capital investment.

I welcome Bryan Smail from Falkirk Council, Bruce West from Argyll and Bute Council, and Dougald Middleton from Ernst and Young. I ask our witnesses to make brief opening statements.

Bryan Smail (Falkirk Council): I will say a few words of introduction and give an overview of my submission to the committee. It is helpful to make the point that Falkirk Council was keen from the outset to evolve the model that was used in our initial pilot scheme in 1998, which delivered schools in 2000. My project team had a clear mandate to come up with a model that had the attributes that are set out on the first page of my paper, including more community involvement and more transparency. We ploughed our own furrow while, unbeknown to us, Argyll and Bute Council was working on a pilot of the NPDO model. What we were doing eventually coalesced in our using broadly similar models.

Although a few matters were NPDO specific and proved challenging to agree—such as refinancing and the requirement to ensure that, in the absence of equity, the NPDO model delivered efficiency—overall, the challenges that we faced would also be incurred and confronted using a conventional model.

Falkirk Council has concluded financial closure on the project on the back of strong competition, and the schools are being built.

Bruce West (Argyll and Bute Council): I will highlight a few key issues. It is worth noting that the five schools that were procured under the Argyll and Bute NPDO are now fully built and operational.

Again, like Mr Smail, as our project progressed over the procurement phase, there was not an overabundance of NPDO issues. As one of the first NPDOs, we were struck by having to progress the project in a way that made the proposal marketable and bankable. In other words, we had to make it attractive to the market so that consortia would be willing to take it forward.

In some ways, our project was similar to a traditional public-private partnership project. We followed the traditional procurement route and complied with the Scottish schools standard contract, which was a funding condition. The key NPDO issues for us were how to achieve a balance between risk and return in respect of the subordinated, or junior, debt and how to build the right sort of incentivisation into the management arrangements, given the lack of equity investment and return. Another issue was the role of the independent director.

Although the NPDO model is a good and useful option for local authorities, it is only one of a number of capital expenditure options. Authorities provide a range of different services and have a range of different assets. Consortia have different construction methods and cost profiles and are based in different areas. Authorities need to think carefully about the whole process from having in place the right policy, service delivery agenda and asset management to the procurement and funding stage. When authorities are thinking about procuring and funding capital investment, it is important that they do so from the right end of the spectrum. They should not jump immediately to asking questions such as, "Is it PPP or NPDO or funding through borrowing?"

Dougald Middleton (Ernst and Young): I am the partner who is responsible for Ernst and Young's government practice in Scotland. We were heavily involved in some of the initial thinking in the development of the NPDO model, along with Michael Gerrard of Partnerships UK, from whom the committee will hear later today.

We see the NPDO model as being the logical progression from the PPP and private finance initiative structures that had gone before it. From our perspective, the thinking behind the NPDO model at the strategic level was to improve the efficiency of the PFI/PPP model and create greater community involvement to deliver wider ownership of the outputs. We went on to advise Falkirk Council and Argyll and Bute Council on implementation of their NPDO projects. We have gained a real insight into the practical issues of the

NPDO model and how they relate to issues in previous forms of procurement.

My key message on the NPDO model is that it should be seen as a logical progression from PFI and PPP, and as one that builds on their strengths. I am thinking of the discipline that that procurement methodology has brought to the local government sector, particularly in terms of procurement of capital assets.

The Convener: You have experience of using an NPDO model to fit particular local circumstances and projects. Does the model have the potential to be expanded and adopted more widely for a wide range of projects in different sectors? Will it travel?

Dougald Middleton: I think that it will travel to different sectors. The NPD principles can be framed pretty widely. Just now, the Argyll and Bute and Falkirk projects are an evolution of the standard form of PPP contract. If you are going to take the model into other sectors, you have to recognise that there are different risk profiles in those sectors and different capabilities in terms of delivery, and that financing of projects might also be different. A simple "have model, will travel" approach will probably not work, although the NPD principles can be transferred to projects in other sectors.

Bryan Smail: I concur with those comments. Another important aspect is the fact that the stakeholders will differ in the various sectors.

Elaine Murray (Dumfries) (Lab): Previous witnesses were concerned about the capability of a board to decide to refinance the junior debt at a time when doing so might not suit the investor. They were also concerned about the possibility that that might make the NPD model less attractive to pension funds and people who want long-term investments. The submission from Falkirk Council says:

> "The Scottish Government's Financial Partnerships Unit and the Council's advisors were most helpful in helping find a way through this issue to a satisfactory conclusion."

Could you say a little more about how you were able to overcome problems that might make the model less attractive to investors than a conventional PPP would be?

Bryan Smail: It is fair to say that that was an issue that came to the table late in the negotiations, which reflected the fact that people on the consortium side realised what the real issues were. They were concerned about, for example, when the start point would be, compared to a conventional deal. They were also concerned that the independent director controls refinancing in the NPD model, whereas in the conventional model, people in the consortium have the wherewithal to decide whether to refinance or not.

That latter issue caused them concern because of the capacity for the public sector side to trigger—through the independent director—what might be categorised as a fake refinancing that would, in effect, freeze the consortium out, and then to undertake a real refinancing further downstream, which would enable us to capture more of the refinancing gain. That concern was dealt with, in part, by having a period—one year in our case, although it varies among projects—after such refinancing in which the original debt holders would be entitled to share in the gain. With that solution, we managed to get the consortium back on side.

There was also a concern that the independent director might not seek to maximise gain—there were shades of the fake-refinancing point in that. Again, largely through the device of a letter of comfort, we managed to get the consortium on side. We also made the rational argument that we would be unlikely to do anything other than seek to maximise gain because it would be in our interest as well, as long as the fake-refinancing point was covered.

14:15

The people in the consortium were concerned about liquidity and an exit strategy. Again, that links with the fact that the independent director, rather than they, would control refinancing. There were three strands to our response to that. One was that they would have the option to conduct an exempt refinancing—I think, from memory, that that is the term that is used in the contract—which would basically mean that they could sell their debt. If they did so, they might not get as much back as they would from a refinancing, but it gave them an option if their primary concern at any point was liquidity and an exit strategy. The second strand involved the fact that, in a deal like the one we were involved in, there is an expectation that a refinancing would take place early and that, in any case, they would still gain from that early refinancing if they so wished. The final strand involved the possibility that the people in the consortium might feel that the independent director was not functioning in the best interests of the company—for example, by not pursuing refinancing when they thought it should take place. To deal with that concern, we allowed them the capacity to lobby the nominator of the independent director, which is Partnership UK, for a termination of the contract of the independent director.

I am not saying that the people on the consortium side were 100 per cent happy as a result of each of those responses, but we were able to get them onside, and the deal was signed on that basis.

Derek Brownlee (South of Scotland) (Con): One of the other interesting aspects of the NPD model is the role of the charity. For the record, could you say why the charity is in the NPD structure, and talk about some of the issues that led to the development in the structure as it is in the schemes that you have given evidence on today?

Bryan Smail: In the NPDO model, we are looking to cap private sector return and to gain, on the back of that, greater benefit for the community.

When we arranged our deals, there was a series of rules and constraints within which we needed to operate. The most critical one was that the deal had to remain off balance sheet in order to meet the eligibility criteria. Any funds coming back to the council from the surpluses that are generated will go to the charity. If the council accessed those funds directly—or, indeed, controlled the charity to which the funds are being channelled—the status of the deal would be jeopardised. We had to route those anticipated surpluses through the vehicle of a charity, which was set up for the benefit of the community.

We are in the process of setting up our charity. It is properly registered, but it is a work in progress. There will be a range of stakeholders on the charity, involving pupils in the relevant schools, parents, community groups and so on. It is a necessary device that allows us to recycle the benefit to the public sector.

The committee might be aware that proposed changes in accounting rules will negate the need for a charity device to be set up, and will enable the public sector organisation to take the gain back itself. Of course, however, if they want to, organisations will still be able to use the charity and have funds distributed in that manner.

Dougald Middleton: There is another practical reason for having a charity, which is that the special purpose vehicle—the company that sits in the middle of the contract—can distribute surpluses to the charity gross of tax. That means that there is no tax leakage from the vehicle through making the contribution rather than paying a dividend.

Alex Neil: If you did a comparator analysis between the Argyll and Bute model and the Falkirk model, and also contrasted the funding of your schools with the benefits of a traditional PFI model vis-à-vis prudential borrowing, how big a difference would there be, in terms of value for money, between the three models?

Secondly, now that the rules are being changed from next year and all the PFI or NPDO contracts are going to be put on the public sector's books, would you still go down that route, or would you just use prudential borrowing in the future?

The Convener: Who would like to answer that one?

Bruce West: I am happy to take that question first.

On the comparison between the traditional approach, an NPDO and the traditional PPP, as it was, as part of the sign-off of our business case, we carried out a value-for-money analysis to compare the public sector comparator, which, in effect, is traditional procurement, with the NPDO approach. That approach showed that it would have quite a significant value-for-money benefit to the council compared with the traditional approach, otherwise we would not have taken the NPDO approach.

In terms of the comparison between an NPDO and a PPP, in our case, the net cost using the Treasury green book analysis is similar across the 30 years of the contract. There might be issues with ours being the first NPDO to be taken to the market: because it is new, there might be perceived risks. As the model becomes embedded, some NPDO costs might come down a bit. However, in our experience, the costs of an NPDO and a PPP are similar, but the NPDO is certainly showing a benefit to the council when compared with traditional procurement.

Alex Neil: I am sorry to interrupt. Would it be possible for the committee to get a copy of that analysis?

Bruce West: I would need to check its commercial confidentiality, but I am more than happy to do that and provide the information if I can.

Alex Neil: That would be very helpful.

The Convener: Any witnesses who have additional information should feel free to submit it to us in writing. Does anyone else wish to continue?

Alex Neil: I asked a second question about the contracts going on the books.

Bruce West: Accounting treatment should not stand in the way of a proper assessment of value for money. Whichever one of traditional procurement, PPP-type procurement, or leasing is the best value-for-money option should be used. As a procurer, we need to deal with the accounting consequences.

Bryan Smail: I broadly agree with Mr West, although another dimension needs to be factored in. Turning it on its head, all relevant factors would need to be taken on board to determine the optimum value-for-money option. The availability of grant or otherwise through one option or another might be a material factor.

The Convener: James McArthur.

Liam McArthur (Orkney) (LD): Take your pick, convener.

Mr Middleton talked about the NPDO approach being a logical progression from PPP, and Mr West has alluded to Argyll and Bute Council's voyage of discovery. Without washing any dirty linen in public, and referring to how the model evolved, can lessons be learned from the processes that Argyll and Bute Council has gone through that would help the further development of the NPDO model?

Bruce West: No specific instances immediately come to mind in which we definitely got something wrong and would need to change it in another procurement. As Mr Middleton said, it is a case of evolution. Traditional PPP procurement has evolved quite a bit since the mid-1990s and there will be an element of evolution in the NPDO approach from now on, partly on the public sector procurer side and partly on the private sector side—the funders, construction companies and facilities management providers—as folk become more used to working through that type of model, gain greater experience and become more comfortable with it.

Bryan Smail: I agree that it is a matter of evolution. There are always lessons to be learned, but I would not suggest that Falkirk Council's experience provides any pronounced lessons for developing the NPDO model. As Mr Middleton mentioned earlier, the challenge lies more in taking its evolution forward in other sectors.

Dougald Middleton: Two things are required to further the use of NPDOs. The first is a more sophisticated analysis of the value-for-money argument. The issue is not simply the cost of borrowing in whatever form of procurement is used, whether under the prudential code or PFI/PPP. We must begin to consider where the risks are in delivery of a project and perhaps tune the financing more finely to fit those risks as the project evolves. The first requirement is for more sophisticated risk analysis.

The committee will hear later this afternoon from Network Rail, which is a massive NPDO, and a housing association, which is much smaller and more community based. The second point is that those models have the potential to be much more widely applicable to infrastructure and accommodation projects in Scotland, but they require a different approach to be taken to asset ownership and procurement than the one that is currently available. It is necessary to think more widely about how those other models could be applied. I encourage the committee to do that, because there is a lot be learned from them.

Liam McArthur: I am conscious that I am speaking to project managers; project management was highlighted in previous evidence as being crucial to achieving value for money in NPDOs. Is there a skills deficiency in NPDO procurement? Does more need to be done to share best practice in project management or create more capability across council groups and the wider public sector?

Bryan Smail: When the PPP process started, there was unquestionably a material skills deficit within public sector organisations. There may still be one, but it is certainly of far smaller magnitude. Virtually every public sector organisation has pursued such a deal—the one on which Falkirk Council is well advanced is its second—so there is much greater currency of knowledge. I would not pretend or argue that the skill level is now entirely fit for purpose, but it is vastly greater than it once was.

On communications and networking, a range of forums exists to share knowledge. One example is the Scottish schools PPP group, of which virtually every local authority is a member. It meets periodically and serves the purpose of cross-fertilisation and sharing knowledge.

Bruce West: The barriers to the evolution of the NPDO approach, as Mr Middleton outlined, are not necessarily down to a lack of project management skills on either the public or the private sector side. The debate is more about—as was outlined—what assets are required, who should own them, and other such issues.

14:30

Dougald Middleton: It is about policy rather than about project management, although that is a key issue.

The Convener: The correct James is of course James Kelly—my apologies to him.

James Kelly (Glasgow Rutherglen) (Lab): Thank you, convener.

The submission from Argyll and Bute Council deals with the financing of these projects. You mentioned the concept of senior and junior debt and you say that 90 per cent of the debt is senior debt, which comes in at a rate of interest similar to PPP projects, while the other 10 per cent is junior debt, which has greater risk and a higher level of interest attached to it. What was the thinking behind deriving the 90:10 split? Would that vary across projects? If you went on to do more projects, would you reconsider how you split the senior and junior debt?

Bruce West: Mr Middleton will correct me if I get this wrong. Historically, the split within PPP projects has been about 90 per cent senior debt and about 10 per cent equity investment. All that has happened in the Argyll and Bute model is that the equity investment has, in effect, been replaced by junior debt that is taking a bit more risk than the senior debt.

The Convener: That being so, does the NPD model work better for lower-risk projects? In what ways does it create greater transparency and community involvement compared with the standard PPP model?

Dougald Middleton: In its current form, the NPD model lends itself to lower-risk and relatively standardised projects such as schools and community health care projects. If you were to move the NPD model into riskier areas, particularly in the procurement period, a higher level of subordinated debt would be required in the project capital structure in order to absorb that risk. You might require a different approach to liquidated damages and quasi-equity from contractors and the supply chain.

On the community involvement aspect, if you want to move to a greater level of community involvement, you would have to consider doing something about the structural governance of the NPD companies. This example would not apply across the board, but the structure of housing associations, in which there is tenant and independent representation on the board, informs the debate about community involvement. That puts you into a different position when you are considering procurement, because you would essentially be procuring through the NPD body and not through the local authority, to use the schools analogy. That is one of the structural things that you would have to deal with if you wanted to change the levels of community involvement and representation on NPD projects.

The Convener: With regard to procurement, is the panel comfortable with the procurement costs for NPDOs?

Bruce West: In the case of our project, I do not believe that the NPDO procurement costs were significantly higher than the cost of a traditional PPP.

Liam McArthur: You suggest that NPDOs might be more applicable to lower-risk projects. In previous evidence sessions it was suggested to us that the private sector's agitation about technology risk might have curtailed the inclusion in projects of more innovative technologies, for example to do with energy efficiency and energy generation in schools. Was that the experience in the Argyll and Bute or Falkirk projects?

Bryan Smail: In our project, Falkirk Council is responsible for the provision of information and communications technology. The contractor will hard-wire the school and provide the ICT infrastructure, but everything after the point in the wall is our responsibility.

Liam McArthur: I was thinking more about innovative technologies that increase a building's energy efficiency or generate energy on site. We have been told that the private sector is less keen on such technologies than it is on more traditional means of energy generation.

Bryan Smail: In the specification for the Falkirk project, which bidders were required to meet, we gave great attention to optimising environmental considerations in a range of areas, including energy efficiency. We required bidders to meet the criteria in the Building Research Establishment environmental assessment method, which is a recognised standard, at a high level. A range of components can be factored in to help achieve such objectives and our project contained an inherent driver in that regard. For example, there was a specification for rainwater harvesting.

Dougald Middleton: We advised on the Perth schools project, which included a requirement for biomass boilers that would burn woodchips. It would be fair to say that discussing that requirement and its payment and performance mechanisms probably took up a disproportionate amount of time. However, such elements can be included in projects if it is clear from the outset that they are required and if the performance penalties are not disproportionate to the overall size of the project if the innovative technology does not work. You cannot spend £1 million in a £100 million project and then find that you do not get paid for the whole £101 million because one part of the technology does not work. It is about striking a balance. If that happens, people will deliver.

James Kelly: According to the submission from Falkirk Council, the

"tax efficient treatment of surpluses"

is a main feature of the NPD model. Do you have more information on that?

Bryan Smail: That relates to the point that Mr Middleton made about how charities are set up. The flow to the charity is optimised so that there is no haemorrhage of a tax element.

Liam McArthur: An issue that has cropped up in previous evidence sessions is the problem that is created when projects are bundled together. Do witnesses have observations on the extent to which NPD projects can and should be bundled? A project to build four or five schools does not seem awfully large, but in an ideal world would such a project be scaled up or down?

Bruce West: The bundled schools project that we put together was about the minimum size that would be needed to make using the NPD or PPP-type model worth while. If you are bundling assets or services that have a similar or the same risk profile there is no issue, but if you start mixing apples and pears the situation becomes more difficult.

Dougald Middleton: I agree with Bruce West—bundled projects are scaleable if similar assets are being considered. However, the larger a project gets, the further it gets from the community objective, so a balance must be struck. The project must not be so small that the fixed costs of putting the contract in place cannot be carried, but it must not be so large that wider social objectives are blunted.

The Convener: Are the features of NPDOs sufficiently appealing to attract adequate competition and value for money?

Bryan Smail: In our project, which was the second one after Argyll and Bute, we had five expressions of interest, which converted at tender stage into three strong bidders and concluded successfully with a signed deal. To play it with a straight bat, we need to recognise that our deal was attractive to the market because it was in the central belt, because of the scale of the project and because it was all new-build schools as opposed to refurbishment or a mix thereof. From the Falkirk perspective, bidder interest was strong.

The Convener: Is that your feeling, Mr West?

Bruce West: I agree with that. There is market interest out there, but it depends on what we bundle into the project. If we make it unattractive to the market, we will get no interest. It is more likely to make for a stable marketplace if the flow of projects coming to the market is properly controlled and managed so that it is steady, even and predictable and gives bidders something to aim at. An uneven or unpredictable flow, in which half a dozen projects are up for consideration at once, followed by nothing for a fairly long period, results in bidders having to manage peaks and troughs, which may make the market unattractive.

The Convener: How do you achieve such a flow?

Bruce West: There is not much that individual councils can do. It may be an issue that needs to be considered at a national level, perhaps in the context of the infrastructure investment plan and so on.

Dougald Middleton: I agree with Bruce West that the flow of projects is important. It is really governed by the grant that is available from central Government to finance the project, and the role of achieving that sits squarely with the Parliament. We are currently advising on Tayside, which is the first NPD project in the health sector. We have three bidders, so there is interest in the project.

There is a lot of debate about the mandatory refinancing provisions. We have to think about that quite carefully. Private sector bidders feel that although they take all the risk on the construction fees, they do not get any return because the project does not pay out any interest during the construction phase. The project then gets refinanced out very quickly, after the original bidders have taken the risk and not earned any of the return. We need balance in that debate, in order that we make projects attractive to as wide a pool of investors as possible.

The Convener: If our witnesses have no further comments, I thank them for their evidence.

14:44

Meeting suspended.

14:49

On resuming—

The Convener: We now have a round-table discussion on different approaches to capital investment. This is a discussion rather than a formal question-and-answer session. All members and witnesses are free to ask questions of one another and to make general contributions rather than ask questions. All contributions should be made one at a time through me. Members and witnesses should indicate to me or to the clerks that they wish to speak. Should witnesses wish to add further evidence afterwards, I ask them to do so in writing. The discussion will be most useful if everyone has plenty of opportunities to take part, so I encourage everyone to keep their contributions short, although they should feel free to make those contributions.

At the table are our independent advisers for the inquiry—Nathan Goode from Grant Thornton and his colleague Marianne Burgoyne—our clerks, and official report and broadcasting staff.

I will now go round the table and invite our witnesses to introduce themselves and make a very short statement, perhaps outlining two or three key features of the approaches to capital investment that they have taken. We will want to explore everything in detail during the meeting, so I encourage everyone to keep their opening comments as brief as possible. Once we have done that, I will open up the general discussion, looking at various methods that have been used, finding out why they have been used for particular projects, and examining what strengths and weaknesses exist in the various approaches. We will start with Mr Ian Wall.

Ian Wall (EDI Group Ltd): My proposal relies on breaking things down. One of the problems of PFI is that it involves too big and unwieldy a package.

The proposal is that a public body—a health trust or education authority, for example—sets up its own company and grants it a lease for whatever facility it wants. The company then goes to the private market, employs consultants and borrows money, either from the private market and secured against the lease, which will get it the cheapest private money available, or from prudential borrowing. That is the company's choice. It then employs private consultants, builders and so on, and it builds the building. The public body occupies the building for the length of the lease, at the end of which it becomes the public body's property.

That is a simple system. It uses leases—existing structures that are well understood after hundreds of years' experience—and it gives clarity. The system can be run as not-for-profit or with profit going back to the public body. It gives much greater flexibility and allows better competition—one difficulty of PFIs is that they create little or even reduce competition, particularly for Scotland-based firms. In our experience, the system that I described produces better buildings. Its other great strength is that it is immediate. It does not require changes in law, different structures or complicated, expensive arrangements. It can run projects from the very small to the national or even a series of national projects.

The Convener: Thank you for that succinct synopsis.

Ray Stephenson (Department of Health): I represent the ProCure21 programme, which is a national framework, using publicly-funded capital, based in England. We have been going since September 2003, so we are five years into the programme. It revolves exclusively around public funding—there is no element of private financing in the ProCure21 programme.

We have eight of the largest construction companies in England on the national framework. National health service trusts and organisations can call up companies from the framework without the need to go through a tender exercise, as the companies were pre-tendered to join the framework. That cuts down the pre-construction time—it is typically between six and nine months before construction starts on site.

The programme aims to give the NHS trusts and organisations certainty about build quality and delivery on time and within budget. Figures for completed schemes for the past four years, which are in our written submission, demonstrate that, by and large, we are performing quite well in the key objectives.

The Convener: I like the phrase "on time and within budget".

Martin Spollen (Strategic Investment Board Ltd): I represent the Strategic Investment Board, which is a small company owned by the Office of the First Minister and Deputy First Minister in Northern Ireland.

Our remit is, first, to deliver a long-term tenure investment strategy for Northern Ireland, working with Government departments and their agencies to test their long-term plans, to articulate those plans, particularly to the market and the wider range of stakeholders in Northern Ireland, and to drive contestability and delivery on time and to budget.

Secondly, we work with those Government departments through complex procurement processes to help accelerate delivery of the projects and to drive value for money. Our chairman describes us as greasy-handed mechanics. That is our approach.

Thirdly, we use quite a large capital programme to reform the way in which we deliver services—to increase value for money in the resource impact of our public services and to improve service performance. We have been working across the Government to upskill the civil service by driving key skills in procurement, programme management and delivery into departments to help them, through a knowledge transfer process, deliver their long-term programmes. We have also been working with the construction and finance markets to get the best deals for projects in Northern Ireland and the evidence shows that we have done quite well on that in terms of some of our recent hospital programmes, for example. We are getting quite a degree of market interest.

Fourthly, we look at the capital assets that we already have and how we can reuse them to ensure that we are getting excellent asset management into our programme. Our programme is funded largely through exchequer funding. Although a proportion of it will be PFI, it will be largely on balance sheet, so it will need exchequer funding cover anyway. We also have access to what, in Scotland, you call prudential borrowing from the national loans fund. We have some knowledge of the non-profit-distributing model through our recent work with Northern Ireland Energy Holdings, but that has largely involved extant assets being transferred over to that model rather than a model that has been crafted specifically to address our forward investment requirements. Given the fact that our neighbouring jurisdiction is developing in that field, perhaps we will wait and see how you get on before we jump in after you.

The Convener: Thank you. From Network Rail we have Ron McAulay and Fred Maroudas. Who would like to be the spokesman?

Fred Maroudas (Network Rail): I will take that on, convener. Network Rail owns and operates the railway infrastructure in Scotland and the rest of

Great Britain. Many committee members will know my colleague, Ron McAulay, who is our director in Scotland. I am the director of funding in Network Rail and I was one of the small team that, six years ago, established Network Rail as a non-profit-distributing organisation.

The question that one might start with is, "Why did we choose the NPD model and has it been a success?" NPD has allowed us to harness private sector management and drive while reinvesting all our profits in the railway. It has allowed us to take a long-term view of infrastructure investment without, on the one hand, being shackled by the exigencies of defending a share price and, on the other hand, without the difficulties of an annual spending round.

So, has it worked? We are pretty proud of the achievements that Network Rail has been able to deliver to the railway over a comparatively short time. In a little under five years, we will have cut costs on the railway by almost 30 per cent at the same time as driving train performance, safety and asset condition to record levels. Use of the railway has also increased rather than decreased, so we now have more people and freight using the railway than at any time since the second world war.

To do all that, among other things, we have driven a significant capital investment programme of between £3 billion and £5 billion per annum over the past five years. We have financed that entirely through senior debt—we have no junior debt or equity. That means that all our profits have been reinvested in the network. When we established Network Rail, the position of the railway was so bad that we needed a package of guarantees from the UK Government to allow us to raise debt. However, progress has been so considerable over the past five years that we are now in discussions with the Scottish Government, the Department for Transport in London and our regulator with a view to raising future debt without a Government guarantee. We believe that that will help to reinforce and institutionalise the good management practices that we have brought to bear over the past five years.

15:00

The Convener: We have Stephen Gibson of Cordale Housing Association, and Robert McDowall of DTZ. Who would like to be the spokesperson?

Stephen Gibson (Cordale Housing Association): I will be the spokesperson. Good afternoon. I work for and represent Cordale Housing Association, which is based in the village of Renton in Dunbartonshire. I will go back a little just to say that the housing association was established in 1993 with some of the worst stock of the former Dumbarton District Council. A phrase was coined at the time: "We won't build a better standard of housing for people to enjoy their poverty in." That idea still holds because, although our primary focus is on building, managing and maintaining high-quality and affordable housing, if that is all that we do, and if we ignore education, health, addiction and unemployment issues, we will not create sustainable regeneration and we will not do anything to improve local economic development. We work very hard in those fields, and there is tangible evidence that we have succeeded.

We are an entrepreneurial housing association. We established two subsidiary companies in 2003, although I will not give their names because they are so long. One is a property development company and the other is a service delivery company. In 2003, we built our first supermarket, and we made a substantial profit in our first year of trading. We then covenanted that back to the housing association using the tax efficiency models that were discussed earlier and we used the money to help fund the building of Scotland's only housing association-owned healthy living centre in Scotland.

We used tax efficiency models and we reinvested profits in order to allow us to reduce public sector investment. We wanted to develop something that is very much akin to what the Scottish futures trust hopes to do now—a not-for-profit organisation that reinvests in the local community.

We have talked a lot this afternoon about the next step forward and about logical progression, building on the strengths of PPP and NPDOs. I hope to argue the case for a new model called public community partnership, which can build on those strengths but can take a logical step that really involves local people—not only in the building of houses, but in the building of communities.

Michael Gerrard (Partnerships UK): For those who do not know, Partnerships UK is a public procurement delivery organisation. The theme that I wanted to introduce to this discussion is one that I hope will find common ground with all the speakers here. Each sector may have a preferred procurement delivery model for a particular project, but I want to consider the additional thinking that is required when there is a programme.

The particular circumstances of an individual procurement may dictate a certain solution, and the best value-for-money methodology may be specific to those circumstances. However, over and above that, if there is a programme of individual projects that add up to something much bigger, you will miss out on an additional element of value for money unless you analyse the programme as a whole. Although it is true that diversity can be a good thing, and that we can allow each individual project to progress in a slightly different way, we lose something tangible and valuable if we do not accept that all the individual procurements belong to a programme.

Partnerships UK has spent a lot of time developing a methodology on programme-based management—considering the relationship between the public sector, as a purchaser, and the market, and considering how to build confidence and capacity. That can lead to a virtuous spiral in which increased competition drives increased value for money. It is about quality control methodology and about standardised processes and contracts. Elements such as ProCure21 are relevant in this context, in terms of the public sector's bulk purchasing power. That allows the capacity to build cost benchmark databases that give real joined-up government clout that measures up to what the private sector can do.

We have to use the different tools to ensure that we get value for money not just at the level of an individual procurement, but at the level of the programme.

The Convener: Thank you for those opening remarks. We have round the table people with great expertise in a wide range of activities. The idea behind this session, in which we will examine the merits or otherwise of the different models, is that, instead of dividing things into different sections, we will have a continuous discussion.

What is the most pressing issue in the public sector's approach to capital investment?

Ray Stephenson: As I believe was highlighted in an earlier session, we have found not only with the ProCure21 capital procurement programme but with other forms of procurement that the key issue is getting the NHS client to understand just what is involved in capital procurement and to have the skills and expertise to programme manage it effectively. Last year, when we carried out an MOT process in more than 35 NHS trusts, we found that project managers were trying to take on £10 million, £20 million or £30 million projects in addition to their day jobs. That is not the way forward if they want to manage capital procurement effectively.

Robert McDowall (DTZ): The most pressing issue is what has been termed the credit crunch. As individuals or organisations, we are all operating in a financial climate that might be described as unprecedented, and no one has any idea when things might change. As a result, with regard to engaging with the private sector in the continued delivery of public assets or, indeed, in anything to do with senior debt, junior debt, subordinated debt or equity, we must ensure that in the next wave of public procurement the private sector has the appetite for the debt required.

Martin Spollen: In Northern Ireland, the key issue is to scale up from £1.5 billion a year to about £2 billion a year. If we are to deliver that increase, we have to, as Mr Stephenson pointed out, develop the skills base in the procuring authorities. Moreover, we must ensure that we do not find ourselves at the end of the year with a capital underspend because, under Her Majesty's Treasury new end-year flexibility rules, we will be unable to access it. Key to that will be not only developing skills but knowing exactly where we are with our myriad capital investments, all of which are at different procurement points.

As a result, we are working with the Office of Government Commerce on a secure internet-enabled monitoring system that will be able to track all public sector capital projects at each of the gateway stages to ensure that, at any point, we will be able to see whether certain projects are slipping in timescale or budget or, conversely, whether other projects can be accelerated. Although the system is being delivered in Northern Ireland, I am sure that it is scaleable to other regions. Taking what we hope will prove to be a macro-programme approach to all of Government's forward capital investments will be a big step forward, and I am happy to provide more information on it to the committee.

The Convener: You are doing more, more efficiently.

Martin Spollen: I hope so.

Ron McAulay (Network Rail): I want to reinforce Ray Stephenson's comments about project management. I have already said on record to the Transport, Infrastructure and Climate Change Committee that if you want major projects to be delivered on time and on budget—and that is extremely important to us all—you need the clear governance and monitoring processes that go with them; you also need people with the right expertise and project management skills, who have experience in delivering such projects in that particular sector.

Ian Wall: You also need some damn good contractors. Sometimes I think that we are a bit short in that respect. After all, it is the building that counts; the money is simply froth. Good consultants and project managers are critical to the process, but it does not matter how good they are if the contractor is bad.

I disagree with Robert McDowall's comments on the credit crunch. My recent commercial experience bears out my view that this is a moveable feast and that the current climate will put the public sector in a much more powerful position. Contractors and consultants are very keen to work for—and bankers are desperate to lend to—the public sector, because it never lets them down. There is a flight to quality, and the tightest possible deals can be cut. There is no risk in lending to the public sector because it never lets the private sector down.

A point that we might be missing is the quality of the buildings that are constructed. I accept that it might be more difficult to put a finger on that than on issues such as cost or time, but I believe that civic quality is just as important a consideration for buildings that are meant to last for a long time. Given that our hospitals, schools and town halls represent our best civic aspirations and a collective commitment to and involvement in our future, they should express as much. I find it very depressing to walk into a school that looks no better—and indeed can look worse—than a third-rate office block.

Such considerations are often left out of technical discussions. One of the problems with the PFI, PPP and NPDO models is that everything starts with the funding method. In the private sector, no one discusses how a building will be funded; finance is obviously one factor in the discussions but the fact is that, when one considers the costs of a project, how it is financed is not really that important. Instead, the private sector begins by wanting a good school, hospital, railway line, railway station, refurbishment or whatever and then seeks to balance the various staffing, procurement, in-house and out-house requirements to match the project. By beginning with the financing method, we are simply taking things back to front; we need to begin with the project and then find the appropriate funding method. In the current climate, things will be so easy, it will just not be true.

The Convener: If the public sector is a safer haven in troubled times, will that allow it to drive a harder bargain?

Ian Wall: Of course.

Fred Maroudas: Mr Wall is being a little hard on the public sector. As the previous witnesses made clear, finance is not and should not be the key consideration; value for money should be.

In a previous life, I worked in an outfit called the Treasury task force, which was a predecessor to Mike Gerrard's Partnerships UK, and spent an awful lot of time encouraging public sector officials to be very clear about what they wanted from the school service, hospital service or railway that they were looking for. Most of them were very good at doing so, although sometimes their intentions were not translated as well as they might have been into the initial offering to the private sector. There was a feeling that the private sector could do everything, and it could not. In any case, it is a little unfair to say that this is all about financing, because it quite clearly is not.

I think that there will be some disjunction or divergence between direct borrowing by the Government and the public sector and the terms of lending to PPP, PFI and non-profit-distributing-type structures. However, like Mr Wall, I do not believe that the credit crunch will impact hugely on this sector. It is one of the safest areas.

Martin Spollen: I agree with the previous two speakers.

We are trying to join up Government's infrastructure plans across the different sectors to ensure that, instead of their being distributed across different facilities that might be under development at different times, public services have a focus and locus in communities. By doing so, we might within a short time be able to get a critical mass of developments in communities in order to prompt regeneration. Certainly the opportunities for taking such an approach in Scotland's broader infrastructure plans should, if possible, be maximised.

Stephen Gibson: I am glad that Martin Spollen mentioned the word "communities", because we were starting to lose it from the discussion.

A key issue is the involvement of and transfer of assets to communities. Over the past 20 years, the housing association movement has demonstrated that transferring public assets can make a real, life-changing difference. For example, innovative organisations such as Cordale, which has introduced subsidiary companies that trade for profit and reinvest any money that they make in the local community, can make—indeed, have made—a huge difference in those communities. Public community partnerships are a step forward—and possibly represent a logical progression—from the NPDO model.

If we take that step forward, an organisation such as a housing association can establish a subsidiary company to build a school. In simple terms, as Ian Wall said, that school could be leased to a local authority for 25 years and the company could make a profit over that time. Such an arrangement does not involve shareholder requirements or the private sector's huge overheads, so it can be more efficient. The benefit relates to the surpluses—we are not worried about using that word, because without profits, we could not afford to operate. What we did with the profits would be different—we would reinvest them in communities and use them to offset housing association grant, to avoid benefit dependency and to make ourselves financially independent instead of grant dependent.

The PCP is a transferable model. It can be used in West Dunbartonshire and rolled out. The model is simple. It would introduce community ownership and make a real difference.

15:15

Michael Gerrard: In the past 10 years of public procurement in this country, the one aspect that I would describe as a revolution is the translation from an input-based to an output-based procurement philosophy, which Mr Maroudas touched on. The holy grail remains outcome-based procurement, under which the public client is expected to pay only for a delivered service that is closer to the social goal that it is trying to achieve—a high-level social outcome such as improved health in the community or increased offender rehabilitation in the community. We are not there yet. We are at an intermediate stage that is well up from the granularity of inputs and which we refer to as outputs, or service delivery concepts.

That transition in the past 10 years has been a revolution. The challenge now is to learn from that, to take the best parts of that and to see whether we can push that envelope further to get a little closer to outcome-based procurement.

Robert McDowall: I will pick up on Mr Gibson's point about the structure of housing associations. The move from PPP to NPDO has been mentioned. Cordale's proposal has merit and it might overcome some of the governance issues to which the previous witnesses referred, such as the independence of directors. In the housing association model, the stakeholders are around the table and act in the interests of that body rather than of the organisation that they might be seen to represent. A long-standing relationship exists between good governance and the progression of organisations in the housing association sector and therefore in subsidiary companies as part of groups.

Stephen Gibson: I like talking about inputs, outputs and outcomes, which we have measured for a while. The input is investment and the output is housing, but what is the outcome of that housing? We have measured that. Crime has reduced, so the management of crime has reduced. We have built a health centre to tackle health inequalities, and we expect that to reduce the cost of managing health issues. Educational attainment has increased.

We reckon that we have developed a framework that can measure financially not only outputs, but outcomes and which shows that we might break even in the future. Rather than considering a housing association such as Cordale to have received housing association grant of, say, £35 million, we can think of that as investment. In the future, because of the savings that we will make to the public purse on crime, health, addiction and so on, we will repay that money and break even. Housing associations should strive to achieve that outcome.

The Convener: Gentlemen, you have achieved something remarkable—committee members have been silent. However, that cannot last for ever.

Alex Neil: With the exception of yourself, convener.

At least four innovative and interesting ways of providing funding have been described and I am interested in having more information on and more explanation of them. I will start with Network Rail. The funding model for the new Borders railway will be similar to that for Network Rail. Issues and accusations have arisen about the funding for the new Borders railway and how it could be raised—for example, about whether the model is right. I would like to hear more about the application of the Network Rail model; if possible, I would like to hear how it could be applied to the Borders railway project, which is extremely important for Scotland. I am interested in what Network Rail says on page 3 of its submission regarding its "Regulated Asset Base", although I assume that the £28 billion figure for the value of fixed assets is for United Kingdom and not Scotland-based assets. Could a similar model be applied to the road network, if it was run along similar lines to those of the railways?

I am interested in where and how Cordale raised its money. Perhaps Stephen Gibson will tell us more about that. Did Cordale go out to competitive tender? Did it borrow all the money? If so, who did it borrow from, what rate of interest is it paying and is the rate competitive?

I am keen to hear more about ProCure21 and EDI. We are all familiar with the Gyle shopping centre and other projects in which EDI was involved. However, it is clear that application of funding models differs between panel members—after all, we are talking about railway infrastructure, housing and associated services, commercial activity and the health service. Given that we are trying to cover all those areas, I am interested to learn lessons from each experience, as they all offer something different.

The Convener: There are a few things to play with there. Who would like to start?

Fred Maroudas: I guess it is up to me.

I will address the way in which Network Rail is financed before talking about the Borders rail project. We finance ourselves in a way that is similar to other regulated utilities in England and

Wales. We do that through an asset base that represents the value of our investments—not the value of our assets, which is significantly higher. When we put a new investment into the railway, it increases our regulatory asset base and, when we come to the five-yearly review by our regulator, it is the RAB that drives our revenues. The regulator looks at what it thinks is a proper rate of return for Network Rail as a regulated utility, given the investments that we have made and our efficiency. In itself, that drives back into charges to our customers. That is the model.

You asked whether the model could be used outside rail. Certainly, it is used extensively in the water industry, our airports, electricity and gas transmission and so on. I am not an expert on roads; others understand the issues far better than I do. In principle, however, there is no reason why the model should not be used, although I am sure that there are differences in the road system, which has its own peculiarities.

The answer to the question whether the RAB-based model is suitable for an individual project is perhaps less clear cut. That is not to say that the NPDO model is not suitable, as that may well be the case. The RAB-based model is much more suited to a programme of procurement or capital works, or utility-style procurement. I am thinking of the issues that Mike Gerrard spoke about. It is less easy to see how the RAB-based model would work for a single project, albeit one that an individual corporate body may procure, deliver and operate over the long term.

There are many other possible models, whether they have been used in housing or school projects or on procurements that transfer to a utility, as in the case of Network Rail. Aspects of our model are suitable, but it would not be possible to take the Network Rail model and use it for an individual project.

Stephen Gibson: Cordale Housing Association is a charitable housing association. In 2003, it established two subsidiary companies, which we are talking about today. One is a property-based subsidiary that has built supermarkets, chemists and post offices and has plans to build schools at some point in the future, we hope. The subsidiaries are completely firewalled from the charitable housing association. If anything goes wrong with them, there is no financial or legal risk to the parent company.

The financing is 100 per cent private finance. Alex Neil asked about rates of interest. In the past, the trend has been for us to obtain preferential private finance rates, and I hope that that will be the trend in the future. The subsidiaries have obtained similar rates to those of the housing association.

Alex Neil: Has that all been loan finance?

Stephen Gibson: Yes. We have many mottoes, one of which is, "We want to be financially independent, not grant dependent." Therefore, we do not do anything unless we think that we can make money from it. Using the principles of tax efficiency, the subsidiary companies make a profit and covenant the gross profits back to the housing association, which thereafter reinvests in the local community. The example that I used previously helped us to build Scotland's only housing association health centre.

Ron McAulay: I would like to expand on something that my colleague Fred Maroudas said. He talked about an RAB being set up for an individual project or a programme of work. I should point out that, through using its RAB, Network Rail has been able to finance three rail projects in Scotland: the Airdrie to Bathgate rail project, the Glasgow airport rail link and the Kilmarnock to Lugton loop project. That has just kicked in in this financial year.

The Convener: Various models have been mentioned. Is EDI's approach restricted to the development model, or is it possible to apply it to social infrastructure projects, such as schools and hospitals?

Ian Wall: It is applicable to schools and hospitals. Although EDI is probably best known for its major commercial work, we have built three schools, and we are going to build a health centre in North Ayrshire—the document for that has not been signed yet, but I am reasonably hopeful that it will be; we have certainly put a lot of effort into the project. Our schools came in on time, on target and on budget. The first two have just been finished; the first has won international recognition and an enormous range of awards. The point is that such an approach is applicable to such things. A private sector approach and a private sector style are used. We break things up so that risks can be managed. The risks need to be recognised. The more things are packaged up, the more difficulties there will be with averages, lack of clarity and so on. Of course, we cannot get rid of risk; rather, we must decide whether to accept it or pay someone else to accept it. It will not go away.

With long-term complex projects in particular, I am a strong believer in clients on the private and public side—I have operated on both sides as a property developer—fundamentally retaining as much control as they can, because compromises will inevitably need to be made. If we could tell what the future will be with respect to construction procurements and the nature of the world, none of us would be sitting around this table now—we would be sitting on a beach in the Bahamas; we would have sold up and left about nine months ago. Clients may have to decide whether to put more money into a project—that might be the best solution, although it may not be the solution that is wanted—to cut back the specification, to delay the project or to mix and match. Such judgments must ultimately be client judgments, particularly in the public sector, because doctors, nurses and health managers, for example, will best understand how to do things.

None of us can foretell the future—doing so is impossible—and I would be surprised if anyone around this table really thought that a contract could be written that explains and covers every eventuality. That cannot be done. People get lawyers to write long documents—for which the lawyers sometimes charge millions of pounds—but those documents never actually work. Any of us who has been involved in a project that has gone wrong will have pulled down legal documents in which lawyers have written lots of stuff that is meant to protect people in every circumstance, but of course it does not do so. The one thing that the lawyers will not have thought about will be the one thing that went wrong, and we simply have to get on with things. When you reach the stage of pulling down legal documents, you know that the whole project has gone down the Swanee big time. Of course there will be problems, but they get sorted out in good projects. The client should take good advice from contractors, professionals, consultants, financiers and so on, but they must make the ultimate judgment.

Ron McAulay: Perhaps I am changing the subject, but the issue of the consistency of the workload in the contracting world has been raised. I do not know whether you want to return to that issue later, but I see it as a huge issue in Scotland. A lot of investment is being made. We need to ensure that we do not overheat the market and that there are no peaks and troughs in construction activity. The contracting fraternity would be extremely happy if a magic wand could be waved that resulted in a consistent approach being taken. I think that such an approach would drive in huge efficiencies and better value for money in the delivery of the programme of work. Boom and bust simply does not work.

15:30

The Convener: How do you prevent overheating of the market? For example, the Commonwealth games, the Olympic games and other events will take a great chunk out of the construction industry as attention is directed there.

Ron McAulay: I was going to say that you need a magic wand, but I think that Fred Maroudas has a better idea.

Fred Maroudas: It is difficult to prevent overheating by cutting off demand. What we can do—and what people are beginning to try to do—links into what Michael Gerrard said about programmes. We can put projects into programmes to ensure that they are not all put out at the same time and to ensure that we get proper focus and do not end up with one project for every contractor, because that will lead to poor value. What that generally means is creating procurement programmes that transcend individual authorities, health boards and so on. The great prize from doing that is that it deals with some of the skills shortages on the public sector side and with some of the capacity issues on the private sector side. However, there is no magic answer to prevent people from asking for what they want when they think that they can afford it.

Ray Stephenson: With regard to large capital procurement programmes in England, the Office of Government Commerce tries to manage some of the projects across the big spending departments and agencies, such as the Department of Health, the Department for Children, Schools and Families, and the Highways Agency, but it struggles to get a handle on what may be coming up in the next year, 18 months or three years, apart from some of the big projects such as crossrail and the Olympics. It is difficult to address some of those problems.

Martin Spollen: That goes to the heart of what I said earlier about the monitoring system that we are developing and are just about to roll out. That is intended to address that exact issue—we have not hitherto had good information about when projects were likely to come to market. Different procuring authorities operate individually to their own timescales and reflect externalities that affect the transit of the project through the early stages of procurement. There is a prize if one can capture that information, and that is what we are trying to do. We now have what we believe is the right platform to do that. It is scaleable and it will apply as a mandatory system across all our public services and procuring authorities. If we meet again in a year’s time, we will be able to reflect on how well it has performed.

A key issue is that the construction sector wants to have access to the system, where that is appropriate and where projects have passed a certain stage and there is a degree of assurance that they are going forward. Construction firms view that as important in giving them the confidence to invest in our region. It gives them the confidence to build and maintain the capacity to deliver and to manage the peaks and troughs. Those affect not just the construction industry and its ability to respond; they have an impact on the capacity of the public sector officials who are taking projects through from the client side, and on our ability to afford projects from our departmental expenditure limits in the year when the funding is required.

The Convener: Do you have some special insight into Government, or would the information that you have been able to gather be available to everybody and if so, how?

Martin Spollen: Our statutory role is to work with all public sector bodies to articulate their capital programme, and to co-ordinate the management and roll-out of that on behalf of the Government to achieve best value for money and to accelerate delivery. We wanted to access that information—which can be very remote in some cases, because although some Government departments are procuring authorities in themselves, a voluntary aided school, for example, could be carrying out the procurement itself.

There are a number of tiers of public sector interfaces. The remote internet-enabled system will allow the procuring authorities to enter the information directly and to update it monthly to say where a project is at any point in time, as set against defined milestones, and against the original budget and variance to budget. It will be a snapshot, updated monthly, of where we are with all the projects.

Ron McAulay: It sounds like Martin Spollen is slightly ahead of us. In Scotland, Transport Scotland and Network Rail share information on roads programmes and rail programmes to try to identify where peaks and troughs might come in a programme. It would not be too much of a leap of faith to try to involve other organisations in that discussion, such as Scottish Water, which has another major investment programme. That might be a step towards what Martin Spollen is already involved in.

Fred Maroudas might want to add a Great Britain perspective.

Fred Maroudas: As is often the case, Scotland is ahead of the rest of Great Britain in sharing information across bits of government and trying to make it work as a whole. It is easier to provide and manage a constant flow to the supply side by taking a utility approach rather than dealing with individual projects.

That is a natural point for Network Rail to make. We are just settling our next five years' investment programme now and have done a lot of work, not only with Transport Scotland but with the Department for Transport and our regulator, to ensure that the delivery capability exists. Until recently, one of the difficulties on the railways was a shortage of signalling engineers, and the problems with overhead line engineers were highlighted over the new year period. It is critical to be able to look across the piece in those specialist areas so that we do not bite off more than we can chew. Only so many people in the country can do that work and, if we have more projects than they can do, it will lead to difficulties.

The Convener: Mr Gerrard will be followed by the very patient Mr McDowall.

Michael Gerrard: This morning's announcement about the design of the Scottish futures trust contained a lot that relates to the programme management issues that we have just been hearing about. I will bring the matter close to home by giving an example of a programme to which that might be applicable: the waste investment programme. To achieve the European Union landfill diversion targets, there are to be at least half a dozen—possibly more—major procurements of fixed assets in Scotland. Collectively, those will represent several hundred million pounds of investment. The worst possible outcome would be if all six or eight were to launch into the market at the same time. If we want the market to overprice those procurements, we should allow them to be bunched. The challenge is somehow to manage the presentation of that investment pipeline to the market in a way that achieves better value for money.

The Convener: In this age of communication, one would think that that would be feasible.

Robert McDowall: As I understand it, there has been a dip in the number of projects that are coming through PPP and NPDO models in Scotland. That dip comes at a price, so we need to get the Scottish futures trust and/or whatever else back out in the market with a list of projects to be delivered as soon as possible so that we can retain the collective expertise around this table and more widely. We need to get on with that.

The committee heard in earlier evidence as well as from us about the positive aspects associated with best practice to come out of the PPP and NPDO models. We must pick up recognised best practice in whatever vehicle we are talking about using in future.

With regard to Ray Stephenson's comments on ProCure21, I was interested in what he said about public funding and the national framework. I am not sure that we have such a framework in Scotland. Perhaps we do not have the scale that would enable us to do some pre-qualification for projects that are recognised as national and, one hopes, cut down on the timeframe to which Ray Stephenson referred.

The Convener: The communications that we have in Scotland do not help the process that you are talking about.

Robert McDowall: Perhaps that is the case. Another pipeline of projects is to come through and we need to consider the best way to procure them. There are a number of issues that we need to get right and I think that there is enough collective will around the table to try to ensure that we do.

The Convener: You are really asking for a better flow of projects with better matching of available resources.

Robert McDowall: That is correct.

The Convener: Fundamentally, it is quite simple.

Robert McDowall: I agree with that, but there is many a slip between cup and lip.

The Convener: Yes, indeed.

Liam McArthur: I want to pick up a point that Mr Maroudas made about the utility approach being able to smooth out the process. Mr Gerrard has just talked about the waste projects that come with the need to divert from landfill. I suspect that the number of local authorities that will be champing at the bit to get in on those projects may be limited. However, in the case of the building of schools, I suspect that the hierarchy of who comes first is more politically sensitive. Is there any experience in Northern Ireland of managing that flow effectively?

Martin Spollen: Each of our departments effectively sets its own priorities for the projects that it wants to see within the programme of investment and within the total investment package of funding that is earmarked for it in the investment strategy. So, in a way, the departments manage their own stakeholders. However, we have a role in signing off the business cases for the larger procurements of the type that Mike Gerrard mentioned. That is another function of the Strategic Investment Board, as a kind of co-ordinator across Government. If we felt that those projects were proposed to come to market in a way that compromised value for money, we would suggest to the originating department that they be rescheduled to drive better contestability into the procurement of the projects.

We have recently had the opportunity to do that anyway with the publication in January of the revised investment strategy for Northern Ireland. Below that, we now have a set of operational programmes that set out—particularly over the first five years—a degree of granularity at the level of major projects and programmes as aggregations of smaller projects. It is important to flag up to the market the likely timescales according to which the projects will come through the procurement process. The real-time information with which we are going to back that information up will give the market a degree of confidence that it is not relying on a document that is becoming increasingly out of date but has up-to-date information about when the projects will come forward.

We therefore exercise a degree of influence over departments, including our Department of Finance and Personnel, which ultimately signs off the business cases and provides the checks and balances that we apply. I would recommend that approach to other jurisdictions.

The Convener: It is a question of lines of communication. In a small country, everybody knows one another, and that can go in one of two directions. Seeing a pal out can be the road to perdition, but having immediate connections can lead to things getting done. Is that what is happening in Northern Ireland? You all know one another, so the chances are that you will know the organisations and be able to communicate pretty quickly. Is that a factor in what has been going on?

Martin Spollen: Yes, that is a fair point. Our size plays to our advantage in some areas. Also, our familiarity with the totality of the programmes that we are taking forward means that our organisation, small though it is, is able to provide an effective bridge between the public sector clients and the private sector markets. We are finding that we are able to have that conversation with the markets as well as with the clients and can manage the interface in a way that has been productive over the five years for which we have had that role.

The Convener: All the organisations that are represented here have created success stories in finance and delivery. What is the secret of your success? Is it just about doing things better, or is there some other ingredient that is crucial to what you do and what you have achieved?

Ian Wall: You have beaten me to it, convener. I was just thinking about that. The organisations for which those of us here who are deliverers—Ron McAulay, me and Stephen Gibson—work are motivated by more than just the desire to make money. Stephen Gibson spoke eloquently about the need for cost effectiveness, profitability, ring fencing and all the rest of it, but I am not sure that he, his board or the people who work for his firm are trying to do anything other than make the world a better place. That is also true of the rail industry. One of the weaknesses in the interregnum was the loss of pride in a public service, which Network Rail is trying to rebuild. That is certainly true of the companies for which I have been responsible.

It all comes back to the question of civic-ness and what the public estate is being provided for. It is not being provided to create jobs for private contractors, although that is not unimportant; it is being provided to improve the quality of our lives in Scotland. If that becomes the driving force, whether it is Network Rail, Cordale, EDI or others, other things will start to fall into place, and there will be commitment, enthusiasm and a determination to make something work for its own sake.

15:45

The Convener: Motivation, in other words.

Ron McAulay: The short answer to your question is a lot of hard work. There is no doubt that Network Rail has been able to attract a very strong senior leadership team, which has introduced clear direction and focus, and strong governance over how projects are managed. There is a clear focus on delivering and taking cost out of the business while improving performance and the condition of the asset. That is down to a lot of hard work and motivation.

Ian Wall made the point about people going the extra mile. In industries such as the railway, we get a level of commitment that we see in the other utility industries. The likes of Mr Stephen Gibson show a huge level of commitment and I suggest that that is seen throughout organisations such as the rail and water industries and other public service industries.

Stephen Gibson: Not surprisingly, I agree with Ian Wall. We have been successful because Cordale is a genuinely community-based organisation. We do not pay lip service to working with the public; we work for and with the public and we are community controlled. Cordale is promoting a model of public community partnership that is, we believe, a logical extension to the NPDO model that can make a tangible difference; in our model the community owns the asset and leases it to the local authority. Because Cordale is a stakeholder in the community, we care about quality. The school will be the best at the most affordable level, and it will be an all-singing, all-dancing school. It will not just do education; it will look at lifelong learning and educational attainment—you name it, it will do it.

We are also interested in focusing on excellence. We want to reduce costs. Cordale is one of the smaller housing associations, but it is the only one that owns supermarkets and chemists. We have one of the biggest development programmes in Scotland.

I should also point out that Cordale Housing Association has only seven members of staff—Glasgow Housing Association has an awful lot of staff—but Cordale sells out services to other housing associations. We have a keen eye to keeping costs as low as possible as well as providing excellence and being innovative.

The Convener: You obviously have a great mixture of people who are keen on what they do and very good at it in a specific location. How transferable is all that? Is it all down to what you have managed to achieve with the people who have gathered around the concept?

Stephen Gibson: It is transferable to anywhere. It is about community development, which is a principle that can work anywhere in the country.

The Convener: But it would be down to having the right mix of people and skills. That might not always happen.

Stephen Gibson: No. It is down to the realisation that, if the community is given responsibility, it can make a difference, take control and do things efficiently and effectively.

I read the Convention of Scottish Local Authorities consultation response. Part of it said that the Scottish futures trust

"would need to be a private sector vehicle with public sector ethos."

I would like to turn that on its head and say that it should be a public sector or community-owned organisation with private sector principles and entrepreneurial flair. That can happen. The social economy in Scotland is thriving and there is no reason why we cannot have asset transfer into entrepreneurial community-based housing associations or social enterprises that can look at building Scotland's infrastructure in the future.

The Convener: I recognise drive, skill and enthusiasm when I see them.

Fred Maroudas: At the margins, there is probably little difference between the public sector drive that you talk about, and the private sector company with a public mission that we talk about. Individuals will make a difference to the organisation, but the organisational model is hugely important.

I spend a huge amount of time talking to our debt investors and lenders. They will generally ask one of two questions. They will ask, "Are you really just waiting to become a private sector public limited company and the present state is a halfway house?" or they will ask, "Aren't you really in the public sector and just masquerading to stay off the Government's books?" We firmly believe that the answer to both those questions is no. The non-profit-distributing model, with a company limited by guarantee, is fundamental to the success that we have had on the railway. The model has enabled us to attract the right management and, crucially, it has enabled the management to operate outside the constraints that everyone knows arise from being too closely linked to Government departments. The model has enabled us to do the difficult things that are really tough for an organisation that is shackled to ministerial commitments.

On the other hand, the model means that we can take a long view, which the private sector finds increasingly difficult, and we can consider the public mission. In the railways, perhaps more than in any other utility, we are proud of the infrastructure. When we make a profit—we are not worried about that word—we can reinvest it back into the railway, so staff at all levels see that they are making a difference, because we can do the upgrades that are needed. The non-profit-distributing model is key to our success, and it is not a halfway house to anywhere; it stands on its own.

Elaine Murray: My question is for Mr Spollen. I have not yet had time to read in detail the Government's proposals for the Scottish futures trust, but aspects of it seem to be similar to the Strategic Investment Board in Northern Ireland. I wonder about the board's decision-making process in setting priorities. Local authorities or health boards will have priorities, such as refurbishing or rebuilding schools or investing in hospital facilities, and will then take decisions on how to finance them. Is it your role to decide between those priorities? Do you decide in a top-down way that investment is needed in hospital facilities in one area or in schools in another area and that those projects are more important than the school projects that somebody else wants to bid for in another area? Do you take such decisions, or is it your role to bring the projects together and say which projects can be matched to gain financing? What is your role in determining priorities in Northern Ireland?

Martin Spollen: I am not sure that we determine priorities, but we have a role in both those areas. Our role is to develop and maintain a long-term investment strategy for Northern Ireland. Translated, that means that our role is to advise the Northern Ireland Executive on the most appropriate balance of investment between sectors. To clarify the sectors, both within and outside Northern Ireland, we have disaggregated our 11 Government departments for the purposes of capital investment into 23 separate operational programmes, with a three-year budget and a 10-year indicative budget for each of them. When we went through that process, which was part of the comprehensive spending review, we were fortunate in that we had just got our devolved Assembly back, in May last year. Individually, each of the departments gave us a long list of proposals on what they wanted, based on their priorities. The cost of the proposals would have totalled £28 billion over a 10-year period, but our Department of Finance and Personnel advised us that the long-term envelope of affordability was an investment package of about £18 billion.

It fell to the Strategic Investment Board to work with the departments collaboratively to sift out the projects to which they were already committed—projects that were on-going and which had to be finalised—and that therefore had a prior call on future capital. We also separated out projects that were driven by the need to comply with EU directives, such as those on waste management or the water framework. Those projects took the next chunk of available funding. Then there were projects that had been announced either by direct rule ministers or ministers in the previous Administration, prior to 2002. They were dealt with next. Finally, we were left with a small slice of the pie, which was made up of the residual projects, about which we could make decisions.

We focused on the likely return on investment from different sectors, and were driven by the guidance of our ministers with regard to the priorities in their programme for government, of which this investment strategy was a supporting aspect. The fact that the aim of growing a dynamic and innovative economy was placed at the centre of the programme for government directed us towards certain types of projects. For example, we have more roads projects and network-type projects in the second investment strategy than in the first, with a similar scale of investment in schools and hospitals but more investment in the environment and our productive sectors.

We put those options before ministers in the executive format, and they decided that they were happy with the proposals, which were published, with minimum changes to them, as our long-term investment strategy. It is largely for departments to determine how that disaggregates into individual projects and the timing of individual projects. Within the investment strategy, we name, value and set a timeline for the delivery of what we call milestone projects, which are the more publicly visible projects, but we do not do that with the 400-odd other projects in the programme, as we recognise that there should be room for manoeuvre.

You asked about our role in the approvals process. I mentioned earlier that we have a role in determining the value-for-money aspects of all of the business cases that are passed to us from our Department of Finance and Personnel. All departments, including the DFP have a legal duty to have regard to our advice, which means that they can either take our advice or move at variance to it, if they feel that they can defend their position. That arrangement provides us with a reasonably central position in determining the nature and roll-out of capital investment. Ultimately, however, it is for ministers and their departments to manage the capital investment in their portfolio.

Elaine Murray: Are the decisions that you mention about the investment in schools and hospitals taken by ministers, local authorities or other levels of government?

Martin Spollen: The local authorities in Northern Ireland have a localised remit; they do not have responsibility for schools investment or the management of schools, social housing or health care. Clearly, that makes central Government departments much bigger players in those areas than you would find in other parts of the UK.

The Convener: It is important to match like with like.

Robert McDowall: I do not want to challenge Dr Murray, but I would like to turn her question round and consider it in a Scottish context. From DTZ's point of view, there is an opportunity to link up strands of policy in relation to future capital investment. For example, if we are going to make progress in the areas of the regeneration agenda, firm foundations, indices of multiple deprivation, NHS Scotland's priorities and so on, we should perhaps be aligning all of those policies and then determining our priorities. That would link in with Stephen Gibson's point, which was that, if we identify a level of investment into an area, we might, through a robust evaluation framework, identify the benefits that accrue from that.

For example, I know that Argyll and Bute is consulting on its next wave of school investment, and the situation is similar in West Dunbartonshire. Perhaps we could say that, within such particular locations in Scotland, we should be determining priorities by linking policy initiatives together and ensuring that anything that is invested is tracked through an evaluation framework that will enable us to measure the difference that is made.

16:00

Liam McArthur: We have heard consistent evidence about the evolutionary process from PFI to PPP and then NPD. We heard in the first evidence session this afternoon that the NPD model is itself in the process of evolutionary change. Judging from the experience of the EDI Group and from that of Mr Gibson, I wonder whether there is a feeling that a combination of NPD and more traditional PPP is crowding out the other models that are being developed. What is required to give the right market signals about growing your models without frightening off investment in Scotland across the board?

Ian Wall: Banks and contractors look to see where they can make a profit with a reasonably reliable measure of risk, in whatever form. I do not see any of the models that have been discussed scaring off investors. I do not believe that getting money is ever a difficult problem—it has not been for a very long period of my career. That does not mean that there is no need to have sophisticated skills and so on, but that fact is there.

Whether or not the other things are crowding out the proposals that Stephen Gibson and I are making, part of the problem has been exemplified here today. On the one hand, there is a limited series of procurements in the rail industry, which is a large national industry. At the other extreme, Stephen Gibson lives in a community with some houses for social use, a small supermarket and a health centre. There are very different requirements and specialities. In between, a whole range of other things is going on in the country. We then add in geographical differences. The procurement of buildings in Liam McArthur's constituency of Orkney is very different from that in Falkirk, for instance. We have to take all those differences on board.

I would argue—I do not doubt that Stephen Gibson will have a broadly similar view—that recognition is required for the models that we are proposing, together with some encouragement for people to take them up. It is partly about releasing the enthusiasm and the skills base that exist in Scotland, in both the private and public sectors, at a medium-sized level. Most stuff is of a medium size. Network Rail and Scottish Water are exceptional cases. A lot of the health stuff is medium sized. The big hospitals dominate the headlines, but it is health centres and various small-scale improvements and changes that are required. It is in that area where the proposals that Stephen Gibson and I are making would have enormous power and weight.

Stephen Gibson: We have spoken about logical progression and evolution. We have gone from PFI to PPP to NPDO. I think that there is more evolution to come, and that public community partnerships provide a way forward. We have spoken about the strengths of NPDO—improved efficiency, improved community ownership and the ability to be tax efficient. All those things can be done through public community partnerships. We can get communities more involved. Assets can be owned by the community, and surpluses could go back into the community. The community could use the profits to do whatever it feels that it needs to do.

For example, to reduce Cordale's requirement on housing association grant, we would use surpluses generated through public community partnership to reduce public sector investment going into Renton. That would mean that scarce resources could be used elsewhere. I do not feel that public community partnership is being crowded out. However, I would like pathfinder status to test it. I believe that it is a way forward.

The Convener: Does it matter whether small to medium-sized contractors are included in bidding for projects? If it does, how best could that be done?

Ian Wall: That is important, in the sense that I want a decent range of competition when I am procuring a building. The difficulty with the bigger projects is that very few firms are capable of taking them on. There can be a problem with capacity, too. If there are one, two or three big firms, one or two of them will write themselves out of the process before they have even started. There is therefore no, or very limited, competition in such instances. Part of the trick of procuring lies in matching the packages to where the market is at any one time. Sometimes, a big package is the way to go forward; sometimes, it needs to be broken up. I mentioned flexibility earlier.

I wish to reinforce an important point that Ron McAulay or his colleague, Fred Maroudas, made about how NPDO allowed Network Rail to attract a certain quality of staff. We must not underestimate this. Unless we have the right people in the right places, all the formulas and sophisticated presentations in the world will not make a monkey's difference. There needs to be someone with genuine knowledge and skill sorting the problem out and managing it. Those people are in the public and private sectors. They are around. They need to be found, and they need to be excited and given something worth while to do. Then, they will deliver for Scotland in spades.

Michael Gerrard: I will follow straight on from Mr Wall's comments, with which I agree. I will jump back to an earlier question about key success factors in investment management, which I did not answer at the time. I would cite two in particular. One is good governance at the level of investment programmes or procurement management. The second one—this is effectively jumping from 30,000ft to 1,000ft—is relentless attention to detail. If I had to cite two success factors, it would be those.

The Convener: This market day is wearing late, and I will bring this evidence session to a close, but not without offering the witnesses the chance to make some final comments. Nobody wishes to do so. Thank you for the valuable insights that you have given us in your evidence today. You have covered a whole range of activities and organisations. I thank everyone for that evidence, which is greatly appreciated and which will be very helpful to the committee in its deliberations.

16:06

Meeting suspended.

16:09

On resuming—

Financial Memoranda

The Convener: As members will recall, we have heard concerns about the quality of financial memoranda, the most recent example being the memorandum accompanying the Creative Scotland Bill. Members indicated that I should write to the Standards and Public Appointments Committee taking forward suggestions made by the previous Finance Committee for a mechanism to be introduced whereby a revised financial memorandum would need to be produced if the original was judged to be inadequate. Are members happy with the letter that I intend to send to the Standards, Procedures and Public Appointments Committee?

Members *indicated agreement.*

The Convener: As the committee has previously agreed, we now go into private session to consider the evidence that we heard today for our inquiry into methods of funding capital investment projects.

16:10

Meeting continued in private until 16:28.

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