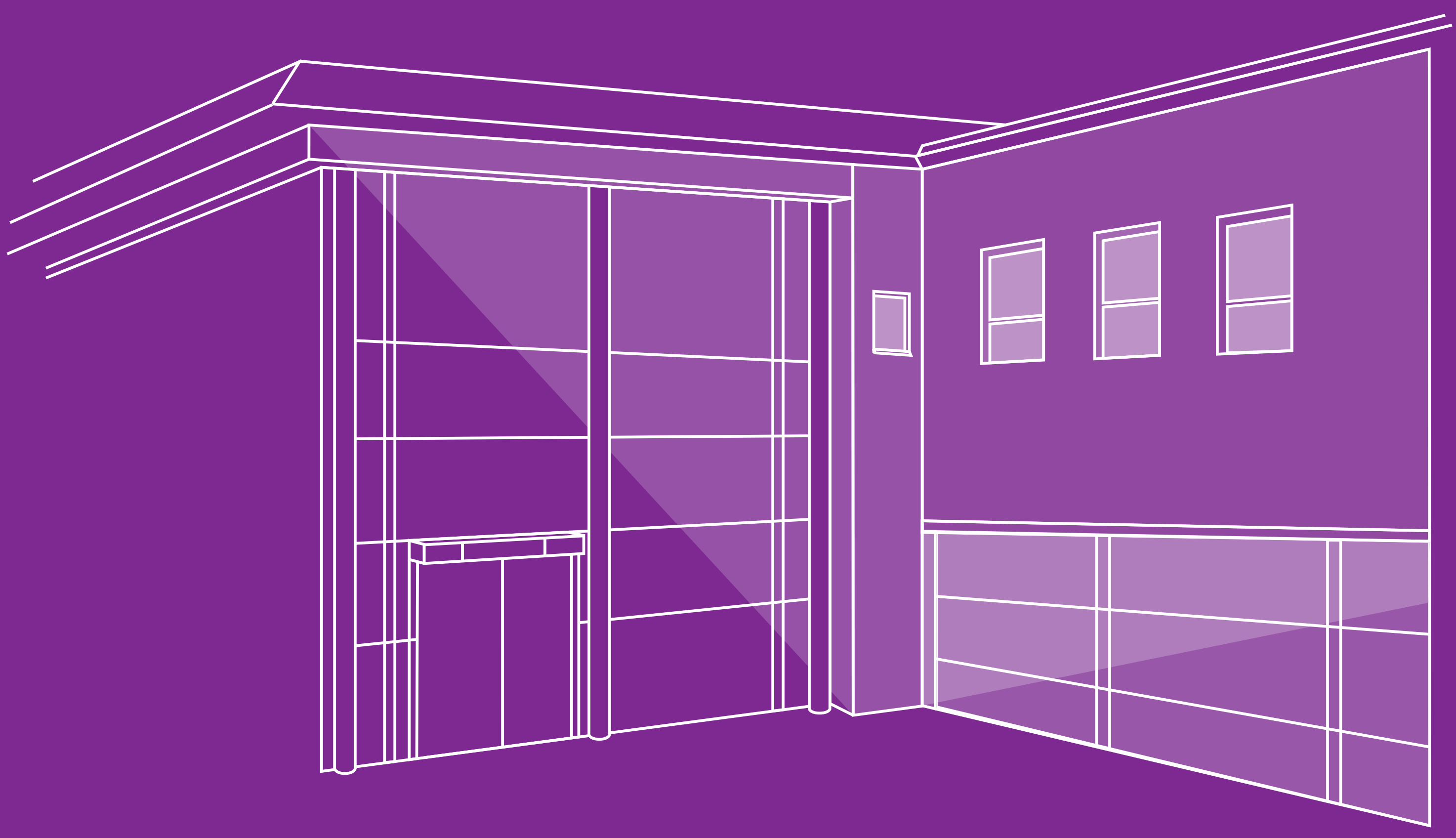
Financing Public Scotland

A Proposal for an Alternative to Public Private Partnerships



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Summary

Public Private Partnerships (PPPs) have, in all their forms, saddled the Scottish public sector with high levels of debt, poor service provision, lack of accountability, and unsafe buildings. PPPs have since the 1990s been championed as a means of securing new or maintaining existing infrastructure. However, enlisting private finance to build and maintain public projects has proven time and time again to be a costly affair. In January 2020 Audit Scotland published a review of the PPP schemes used in Scotland and found them to be expensive and in need of more oversight.[1] Despite this, PPPs continue to be a preferred model in Scotland.

We call on the Scottish Government to abolish the use of PPPs and commit to a model which has safety, quality, value for money, wellbeing and accountability to the taxpayer at its heart.

Our recommendations for moving towards an alternative to PPPs in Scotland:

- **Let public well-being drive Scottish infrastructure investment.**
- **Do not allow the Mutual Investment Model (MIM) to be put into active use in Scotland.**
- **Act on the recommendations from Audit Scotland's review of the PPP scheme.**
- **Take the best parts of LEIP and expand these across sectors.**
- **Let the planned Infrastructure Company play a key role in moving towards public ownership of infrastructure and make it a centre of local government support.**
- **Mandate SNIB to invest in public infrastructure projects.**
- **Rethink the use of prudential borrowing powers and address the budgetary incentives for using PPPs.**
- **Rebuild public sector capability and capacity for managing infrastructure.**
- **Let Net Zero be at the heart of Scottish infrastructure investment.**

The Scotland Against Public Private Partnerships (SAPPP) Task Force believes it is time for a new approach, and a break with the mistakes of the past. We need to rethink the way infrastructure is managed and financed in Scotland, and find a way forward that puts people and the planet before profits.

What are PPPs and why are they used in Scotland?

Public Private Partnerships (PPPs) are long-term contracts where the private sector designs, builds, finances and operates an infrastructure project. They are found all over the world, despite evidence of their failures.[2]

PPP is the umbrella term for all public-private partnership schemes used including PFI, NPD, Hub and MIM - which are all different forms of PPP schemes that have been in use or approved for use in Scotland since they were first introduced in the 1990s.

Scotland uses PPPs because of the budgetary advantage of these models. The Scottish Government is unable to borrow at optimal terms and its spending power is limited by the Total Management Expenditure Budget set by the UK Treasury. With these limitations, the Scottish Government's ability to cater to the needs of public infrastructure is limited. This is where private financing offers a budgetary advantage. The upfront costs of private financing have no impact on Department Expenditure Limited (DEL) capital, as only annual charges show up on DEL revenue. This has created a budgetary incentive for the use of private financing for Scottish infrastructure. The following explanation from the Scottish Futures Trust highlights the mechanisms behind the use of PPPs in Scotland, as well as the inbuilt need to keep ownership of the projects within the private sector:

> "For such investment models to work, they need to keep sufficient ownership and risk in the private sector such that projects are not 'classified' to the public sector and don't appear within the Scottish Government accounting boundary. Should that risk occur, the entire capital cost of the project is charged to the Scottish Government with immediate effect, requiring capital cover within the capital grant or capital borrowing limits available. Achieving classification to the private sector is a pre-requisite for the investment to be additional to Government grant limits. This increase is what is termed 'delivering additionality.'"[3]

In January 2020 Audit Scotland published the following key facts about the current PPP contracts of the country:[4]

Current PFI, NPD & Hub Contracts

41	Privately financed contracts via 5 hubs	**£27 billion**	Total amount of annual payments due between 2019/20 and 2047/48
15	NPD contracts	**£13.1 billion**	Total amount of annual payments already made up to 2018/19
80	Active PFI contracts in Scotland	**£9 billion**	The capital value of the assests covered by current contracts

It is worth noting that other European Countries are moving away from the use of PPPs[5], and that continued use in Scotland reflects the peculiar circumstances of the devolution settlement:

"The Scottish and Welsh Governments are proceeding with this type of investment model where borrowing is constrained, and additivity is a key factor. The UK Government which does not have the same constraints on borrowing has decided not to proceed with this type of investment model at present."[6]

As noted here by the Scottish Futures Trust, the UK Government abolished the use of PPPs.[7] This happened during the financial statement in October 2018, when the Chancellor Philip Hammond announced that private finance initiatives (PFI) would not be used for future building projects.[8]

The Treasury called the PPP model "inflexible and overly complex",[9] and the Office for Budget Responsibility called the scheme a "source of significant fiscal risk to government."[10]

This criticism supported a report from The House of Commons Public Administration and Constitutional Affairs Committee, which concluded that:

"It is unacceptable that almost 30 years since the first PFI projects were initiated, the Treasury cannot produce evidence to support its claims that PFI is worthwhile for any reason, apart from the fact that it takes debt off the balance sheet."[11]

What does the Scottish public think about PPPs?

In December 2022, Jubilee Scotland commissioned a poll[12] on the Scottish population's views on PPPs.

The results show significant support among respondents for the PPP issue to be addressed:

- **62% believe that public buildings such as schools, hospitals and community centres should be fully publicly owned.**
- **67% think that it is important to address that the Government uses a scheme where private companies can make large profits from designing, building and managing public infrastructure.**

The results also show that there is a lack of trust in the private sector among respondents:

- **Only 13% trust the private sector more than the public sector to provide good services to users.**
- **Only 16% trust the private sector more than the public sector to provide good value for money.**
- **Only 15% trust the private sector more than the public sector to offer fair working conditions and salaries to maintenance staff and cleaners.**
- **Only 15% trust the private sector more than the public sector to offer accountability and transparency.**
- **Only 12% believe that private companies should be responsible for financing infrastructure if that means higher overall costs.**

What are the problems with PPPs in Scotland?

There are four main reasons that PPPs are problematic and should be abolished.

A. PPPs are poor value for money: projects are highly lucrative for the private sector, hidden debt is accumulated for local councils and limited public finances are misused.

Enlisting private finance to build and maintain Scotland's public infrastructure has proven to be a costly affair. Audit Scotland's review of the use of the scheme concluded that "Private finance costs more than traditional forms of financing, affecting future budgets for many years".[13] In addition to the high interest costs, PPP projects also burden local councils with high fees for accountancy, legal advice and consultancy. These higher costs of PPP projects are often justified by their proponents stating that risk is 'transferred' from the public to the private sector. However, as Whitfield observes: "the public-private partnership model is high-cost and high-risk for the public sector" [14] or as Eurodad puts it: "risks are socialised and profits privatised." [15] In PPP contracts "the private sector has insisted on government guarantees which ensure all the risk is borne by the public." [16] And PPPs are highly lucrative for the private sector. These projects are initially financed with a 'risk premium' during the construction phase to offset potential losses: "Once construction is completed and construction risk evaporates, the PPP consortium refinances the project, at lower rates of interest, with ownership shares transferring to pension funds and long-term institutional investors, requiring stable low-risk returns (…) The public sector is left effectively paying high interest rates, while the companies benefit from lower interest rates following refinancing." [17]

B. PPPs lead to declining service standards: taxpayers' money is spent on assuring a profit to company shareholders rather than the best possible service for the public.

PPPs have been a major driver of outsourcing and privatisation of service provision. These outsourced services have created health hazards in prisons and hospitals and have added to the pressure on service.[18] Additionally, outsourcing is associated with lower salaries and poorer working conditions for employees.[19][20] PPP contracts are extremely difficult to renegotiate, and public authorities are therefore forced to reduce service levels and staff numbers when budgets come under pressure. Allyson Pollock suggests that the cost of PFI schemes has created an affordability gap in the NHS which among other things has resulted in "30% cuts in bed capacity and 20% reductions in staff in hospitals financed through PFI." [21] The dangers of private involvement in healthcare provision was clearly seen during the Covid-19 pandemic where countries that relied more on private financing did worse in reducing mortality.[22] When private companies are involved in providing public services, taxpayers' money is spent on assuring a profit to company shareholders, banks, bondholders and service providers, rather than ensuring that the public receives the best possible service and the workers the best possible conditions.

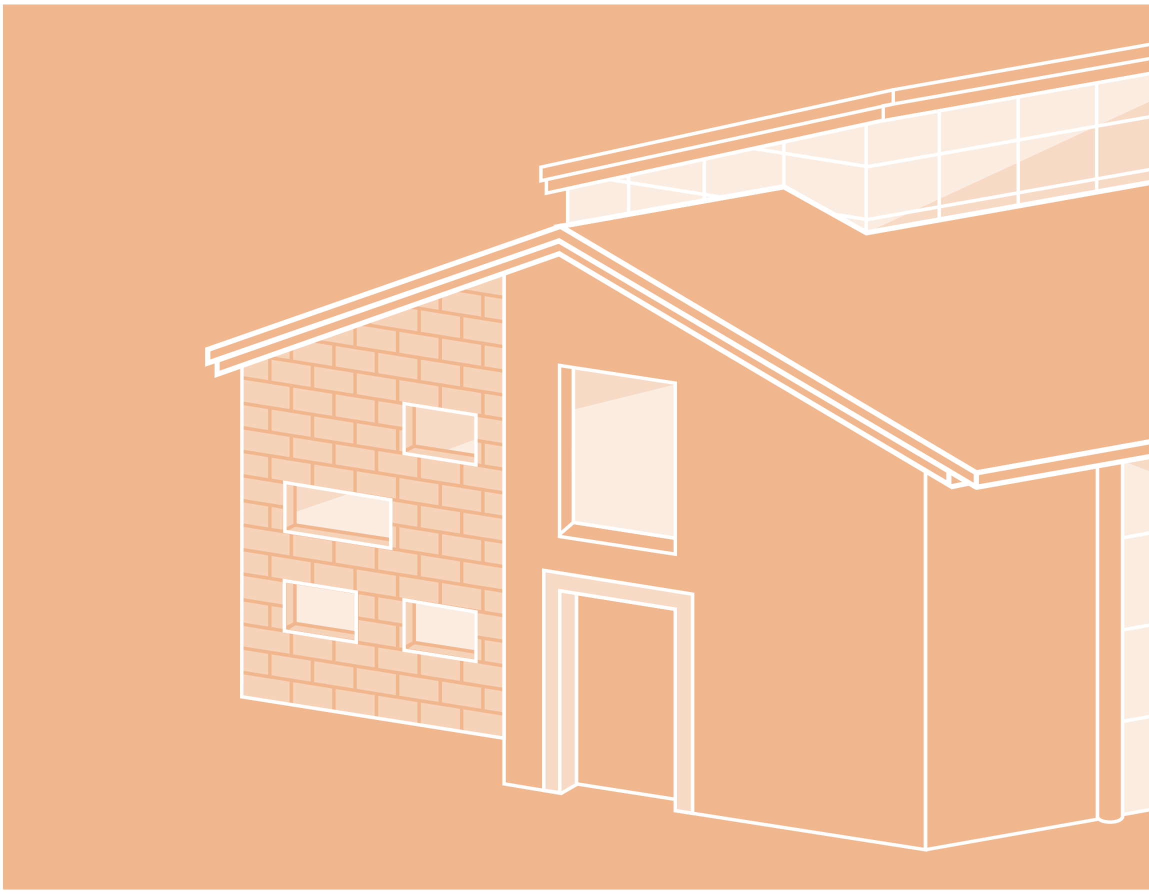
C. PPPs have meant a loss of accountability: details of PPP deals are protected by corporate confidentiality which hinders scrutiny of how corporations use taxpayers' money.

The use of PPPs has meant a loss of accountability in public services. Our public bodies, buildings and institutions are operated and monitored by the private sector for contracted periods. The financial details of the specific deals remain protected by corporate confidentiality which hinders effective scrutiny of how corporations use taxpayers' money, and the true cost of PPPs. [23] Not only does the profit of these projects go to the private sector instead of back to the government, [24] but the public does not have an overview of how big this profit is.

Another concern is that some shareholders in PPP contract companies are based in jurisdictions that Civil Society Organisations have raised strong reservations about since they are linked to international tax avoidance, for example Cayman Islands. [25] That companies based in tax secrecy jurisdictions can be involved with managing public infrastructure is unacceptable, and yet another problematic feature of PPPs.

D. PPPs give us unsafe and unusable buildings: in PPP projects infrastructure is built with profit in mind for the investor, rather than quality for the taxpayer. [26]

When infrastructure is built with profit in mind for the investor, rather than quality for the taxpayer, the Scottish public frequently ends up with unsafe and unusable buildings. In January 2016, we saw an example of this with the catastrophic failure of the gable end wall of the Oxgangs Primary School building in Edinburgh. During a storm, nine tonnes of masonry fell onto a pathway used by children and parents. The construction firm had been allowed to "self-certify" that the buildings met building safety standards, and had forgotten crucial wall ties needed for the building's structural integrity. Subsequent investigations of PPP properties found safety concerns that led to the closure of 17 schools across Edinburgh. This affected 7,600 pupils, their parents, teachers, and other schools receiving the displaced pupils. Architect Prof. John Cole concluded in an independent report that it was "a matter of timing and luck" that no children were killed or injured at Oxgangs. [27] Public services must be built on a foundation of long-term public financing, protected from profit-driven logic.



Our 9 recommendations

1. Let public well-being and good architectural design drive Scottish infrastructure investment

It is increasingly understood that our built environment is critical to our health and well-being, while the factors influencing that well-being are also becoming clearer. A return to public ownership of the procurement and commissioning of public buildings must be accompanied by evidence-based processes that put this well-being first, including our urgent responsibilities towards the climate emergency. For instance:

- In Hospitals it is known that simple measures such as sunlight falling into a room, natural ventilation and a view of nature, are not just nice but actively aid recovery – get us well, home and back to our lives sooner.[28] Speeding up our recoveries also eases pressure on the NHS so can save us vast sums of money, while the return of workers back into productive labour saves even more. The "Nightingale Wards" the Victorians built are guided by these three principles. However, despite new hospitals being defined by huge briefs nowhere are such principles made key and the resultant hospitals are often gloomy, provide views only of miserable courtyards or car parks and are ventilated by mechanical kit - whose ordinary mode is stale and whose occasional failures can kill.

- In Schools the value of full-spectrum daylight – big windows – on educational attainment is clear.[29] The value of adjacent playgrounds and a safe and, if possible, walkable route to a school that is located at the heart of its community (and is available for use by that community) is also clear. And yet, again, we have been building schools with, sometimes, small windows and even libraries with no natural light - and with locations out past the ring road, accessed by parental drop-off.

In addition, and in relation to our climate and resource emergencies:

- Sustainability – the reduction of waste and locking-up of carbon – means the best, greenest and most sustainable building is the one that already exists.[30] But we have been demonising and landfilling, or selling-on, old, well-located schools and other public buildings, with big windows and hundreds of years left in their sturdy structures, because "it will take thousands to repair the roof", then spending tens of millions on shoddy, short-term replacements. We need to pivot towards practices that prioritise repair and renewal before demolition and replacement.

- Healthy New Buildings: when we do build anew we need to, first, avoid the toxic and the plastic, but then embrace natural and carbon locking materials – noting, in particular, that heavy and engineered locally-sourced timber should be the new vernacular, as it develops local, circular economies and, when exposed and in itself, promotes healthy, calming environments.[31]

Path Forward

1. The Scottish Government should support local authorities in efforts to mend old buildings for continued public use, rather than replace them with new buildings on the advice of profit seeking companies.

2. We urge the Scottish Government to reform its Procurement Processes, such as the "Green Book", to prioritise:

a) Repair and Renewal: value the existing building (or others, empty nearby) and ascertain whether its upgrade best delivers a low-carbon, location-specific, local solution.

b) Location: value buildings at the heart of their communities – ideally walkable, with open space to complement their enclosed spaces – and ensure their facilities are open to all, out of hours.

c) Unbundle: avoid the tendency to agglomeration, noting that "centres of excellence" may be local, serving dispersed communities.

d) Materials: note the effect of the materials we build with on our health – avoid the toxic and build with the health-promoting and carbon-locking.

2. Do not allow the Mutual Investment Model (MIM) to be put into active use in Scotland

When changes to the European System of Accounts took away the budgetary incentive for the use of NPDs and Hub the Scottish Government introduced the Welsh Mutual Investment Model (MIM).[32] This is a form of private financing initiative, with few substantial differences to the old models. As Cuthbert observes, MIM "represents a retrograde move back to something which has many of the flaws of the old Private Finance Initiative, with the attendant risks of poor value for money and excess private sector profits."[33] The Scottish Futures Trust's (SFT) analysis of the model "did indeed show that the MIM approach was likely to be more expensive than funding capital through public borrowing."[34] and notes that other European Countries are moving away from PPPs.[35] Audit Scotland likewise advises that "The financing costs associated with MIM are likely to be more expensive than alternative options for capital investment, such as capital grants, borrowing and some forms of innovative financing."[36]

A Freedom of Information request (FOI) submitted by Jubilee Scotland has revealed that while the Scottish Government has adopted the model, it has yet to be put into active use. In a redacted draft update on the use of MIM (shared as a response to our FOI) SFT suggests that:

"Since the MIM options appraisal was published in May 2019, there has been a very limited number of revenue funded projects that have come to market in the UK and therefore visibility of contractor and funder views is limited. Therefore, for each project where MIM is being considered in Scotland further analysis of building/ facilities management (FM) markets and funding markets will be required before selecting MIM as a delivery route to market" [37]

The Scotland Against Public Private Partnerships Task Force welcomes the view that further analysis is needed before the Scottish Government may decide to use the delivery model. However, we are concerned about who will be consulted for this analysis. On the SFT website, they state that *"SFT will continue its engagement with public and private bodies on the development of Scottish MIM as a delivery route in the coming months,"*[38] however when we requested information about what public and private bodies this statement refers to SFT gave the following answer: "*SFT gives notice under section 17 of the Act that, (…) , it does not hold the information requested relating to SFT's engagement with private bodies regarding the development of the MIM model in Scotland since 2019. In particular, while SFT has had some engagement with private bodies as part of its general consultations on the development of the MIM model in Scotland, it does not hold any records of those consultations."*[39]

We worry that private bodies, who stand to gain extraordinary profits from the continuation of the use of Public Private Partnerships, are influencing discussions about the model and hindering an active pursuit of alternatives.

Path Forward

1. We recommend that any further analysis before selecting MIM as a delivery route is done in full public overview and broad consultation.

2. We urge the Scottish Government to not put MIM into active use in Scotland.

3. Scottish Government should learn from past failures of PPPs and explore alternatives to MIM.

3. Act on the recommendations from Audit Scotland's review of the PPP scheme

In January 2020 Audit Scotland published the review "Privately financed infrastructure investment - The Non-Profit Distributing (NPD) and hub models." The Audit shows that while the NPD and hub contracts have supported additional investment in public assets, this has come at a significant cost: "The Scottish public sector is contracted to pay a total of £40.1 billion in annual payments between 1998/99 and 2047/48 under current PFI, NPD and hub privately financed contracts. This is over four times the capital value of the assets developed." [40]

Audit Scotland furthermore concludes that the implications of entering into PPP contracts may not have been understood: "by focusing on affordability, it is not clear how public sector organisations have assessed the value for money of using private finance, or whether the implications of entering into these contracts have been fully considered" [41], and it is also not clear how projects have been selected as suitable for the PPP scheme.[42]

Based on their review of the use of PPPs in Scotland Audit Scotland has made recommendations (see full list in the Privately financed infrastructure investment - The Non-Profit Distributing (NPD) and hub models report). Among other things Audit Scotland recommend that the Scottish Government should: [43]

- "better document and report how decisions on the use of private finance are made at a programme level, and how the overall combination of programme and project funding aims to maximise investment and benefits."
- "better communicate the rationale of project financing and funding decisions to public sector organisations and Parliament."
- "develop its public reporting to provide more information on the costs and benefits of using private finance, the management of risks and outcomes delivered, and its contribution to supporting economic policies and growth."

And recommends that Councils, among other things, should: [44]

- "systematically assess the implications of participating in the financing and contract approaches led by the Scottish Government, before going ahead with individual projects"
- "clearly report current commitments under privately financed contracts, and the ongoing commitments related to these, as part of their annual budget setting"

Finally, the Audit Scotland reports suggest that the Scottish Government and councils should "continue to work together to develop arrangements for the new schools investment funding model, ensuring opportunities and risks are fully understood and properly managed." [45]

Path Forward

1. We encourage the Scottish Government to reflect on the conclusions from the Audit Scotland report regarding the lack of transparency and large costs of using PPPs, and consider this a call to action.
2. We urge the Scottish Government to act on the recommendations from Audit Scotland's review of the PPP scheme by improving documentation and reporting on the use of private finance.
3. We recommend that the Scottish Government encourage & support Councils to systematically assess the implications of using private finance ahead of new projects.
4. We recommend that the Government calls on Councils to report on current PPP commitments as part of their annual budget setting.
5. The Scottish Government should collaborate closely - and in a transparent way - with the Councils to ensure that the new schools investment funding model is properly managed.

4. Take the best parts of the Learning Estate Investment Programme (LEIP) and expand these across sectors

The Learning Estate Investment Programme (LEIP) was announced in 2019, as a replacement for the Schools for the Future programme (completed in March 2020). This is a new funding model for schools which was developed in consultation with councils (via COSLA). The first phase of LEIP consisted of 12 projects, with a second phase - comprising 25 projects - announced in December 2020. Audit Scotland notes that "The proposed model has been designed to allow additional investment in the schools estate without the use of private finance contracts. This has the potential to provide better value for money."[46]

LEIP will bring together Scottish Government and local authority funding: "Under LEIP, local authorities will be fully responsible for the costs of constructing new schools. Local authorities will need to find the money to pay for building the new schools either from their capital budgets, or by borrowing the money through the Public Works Loan Board (PWLB)."[47] The Scottish Government will cover the 'lifecycle and maintenance' costs of these new schools. Including day-to-day running costs of the buildings and the ongoing maintenance costs.[48]

The Scotland Against PPPs Task Force welcomes LEIP as a model which attempts to move away from the use of private finance, and we applaud that the Government has collaborated closely with Councils to find a new solution to the financing challenges Scotland faces.

LEIP is an example of the Scottish Government taking advantage of the powers which local authorities possess to undertake prudential borrowing, (powers which the Scottish Government itself does not possess). Since 2004, if a local authority is satisfied that it can undertake borrowing for a capital project prudentially (that is, without the resulting loan charges threatening its future revenue budgets), then it can undertake this borrowing without central government borrowing approval, and the resulting borrowing does not score against central government capital budgets. Hence the defining feature of the LEIP scheme is that the Scottish Government can get round its own borrowing restrictions by agreeing to fund the maintenance elements of schools built under the scheme.[49]

A major role has been carved out for the Scottish Futures Trust in the management of LEIP, which is to be: "led and managed by the SFT Education Team, under the direction of SFT's Leadership Team" in order to "work with local authorities and the Scottish Government to manage the programme and support the achievement of the programme objectives."[50] While SFT has served Scotland for many years, the Scotland Against PPPs Task Force suggests that Scotland is moving into a new phase and on to the use of new models which will require a different form of management. While reform and reconfiguration of SFT is one option, another could be to redirect resources from SFT to a new body more ideally suited to supporting current priorities for Scotland.

How does LEIP compare to Schools for the Future (SSF)?

	Finance Route	Construction Cost	Maintenance / Lifecycle Costs	Interest Charges
Schools for the Future (SSF)	Capital, Public Borrowing, Private Finance	Scottish Government + Local Authority	Local Authority	Scottish Government + Local Authority
Learning Estate Investment Programme (LEIP)	Capital, Public Borrowing	Local Authority	Scottish Government	Local Authority

Infographic credit: Based on infographic in SPICe Spotlight - Scotland's schools: a new LEIP forward?

LEIP remains largely untested, however it seems to be a step in the right direction. It would therefore be relevant that the Scottish Government explored options to expand the best parts of LEIP beyond the education sector. Following independent reviews and evaluations of LEIP, it should be possible to lift the best parts of the model and introduce it as a replacement for PPP schemes across sectors.

Path Forward

1. We urge the Scottish Government to review whether the Scottish Futures Trust is ideally placed and qualified to manage LEIP, and consider if SFT has played out its usefulness.

2. The Scottish Government should evaluate LEIP in an independent and transparent manner, and explore how the best parts of LEIP can be expanded across other sectors.

5. Let the planned Infrastructure Company play a key role in moving towards public ownership of infrastructure and make it a centre of local government support

In their 2021 manifesto the SNP committed to “create a National Infrastructure Company to manage and develop public assets for public good”,[51] and in the Programme for Government 2021-22 it is stated that the intention behind this is “To complement the current infrastructure planning and delivery landscape, and put the public good at the heart of management and development of public assets, we will start work to create a National Infrastructure Company. We will develop a programme of work to identify areas in which this would bring the most value to Scotland in delivering our infrastructure and a wider set of performance outcomes. Following consideration of this, we will decide on the most appropriate format and set of functions for the National Infrastructure Company.”

The Scotland Against PPPs Task Force welcomes this commitment to create a new infrastructure company, and notes that the Programme for Government 2021-22 sets the timeframe for considering options as being in the coming year.

A suggestion for what such a National Infrastructure Company should look like has already been developed by Common Weal.[52] The suggestion is that local authorities should be supported by a national body in order to find the best possible solutions for designing, building, financing, operating and managing their projects. This national body - the National Infrastructure Company - should be a place where local authorities have free access to a team, with “cutting edge expertise in public financing, planning, legal issues, energy strategies, architectural design and construction.”[53] The National Infrastructure Company should also be designed to help local authorities find the best financing packages to fit their project, avoiding the trap of short-term thinking and expensive solutions where a large stakeholder’s dividend is needed for private stakeholders. It should be designed as a support and advice body which encourages lifecycle planning, community involvement and comprehensive impact assessments for projects and independent inspections.

A National Infrastructure Company should also be mandated with providing local authorities with unbiased advice on whether or not it might be worth investing in older buildings in local communities. PPP contractors have had no interest in old buildings being mended and repurposed, as this does not promise the big financial rewards sought by these companies. However, many buildings around Scotland have stood the test of time – mending them and making do with what we already have could be the most sensible solution. Especially since these buildings are often placed at central locations in communities. PPP companies have been too keen on taking control of these locations and using them for alternative purposes, pushing our public services to less desirable and less convenient areas of towns. Experts at the National Infrastructure Company would be able to help local councils assess their assets realistically and weigh up the costs of repairing against new projects. Both the Councils and the environment would benefit from such considerations. [54]

SFT were the ones developing [55] and pushing the MIM model, which indicates that this company may be part of the problems Scotland faces around its infrastructure, rather than part of the solution. As suggested above, it may be relevant to consider redirecting resources from SFT on to a new body. This new body could be the National Infrastructure Company. This would solve any hesitations around budgeting for the new National Infrastructure Company since it would be a reallocation of existing resources already committed to SFT which has the majority of their work funded by the Scottish Government. [56]

Path Forward

1. We urge the Scottish Government to honour the commitment to creating a new infrastructure company, and to commence the considering of options in the time frame suggested by the Program for Government 2021-22.

2. We recommend that the Scottish Government consult broadly on the creation of the new infrastructure company, and invite input from diverse stakeholders.

3. The Scottish Government should make the National Infrastructure Company a body which helps local authorities find the best possible solutions for designing, building, financing, operating and managing their projects.

4. We recommend that the Scottish Government mandate the National Infrastructure Company with providing unbiased advice on investing in mending and repurposing older buildings, as part of Scotland's commitment to Net Zero.

5. The Scottish Government should redirect resources from the Scottish Futures Trust into the National Infrastructure Company.

6. Mandate SNIB to invest in public infrastructure projects

In addition to the new National Infrastructure Company, the Scottish National Investment Bank (SNIB) could play a significant role in establishing a new model for investment in public infrastructure.

The mission and effectiveness of SNIB has been questioned [57] after Reform Scotland published Professor Ross Brown's review of the bank. [58] While noting that SNIB "is exactly the kind of big, ambitious policy experiment that Holyrood should be embarking on" the review concludes that "SNIB looks rather unfocused and ill-conceived". [59]

SNIB has a mission-based strategy focused on stimulating "underdeveloped and underfunded markets that are crucial to Scotland's future (...) it also carries the responsibility of advancing broader societal goals, such as the transition to Net Zero and improved equality of opportunity" [60]

Considering the responsibility of advancing broader societal goals, and needing a more focused mission the Scotland Against PPPs Task Force suggests that SNIB should play a key role in pushing private finance options out of public infrastructure investment. In collaboration with the new National Infrastructure Company SNIB could design financing options suited to Scottish local authorities, allowing them to invest in repairing old buildings (thereby contributing to the Net Zero transition) or building new infrastructure which contributes to broader societal goals of high standard public spaces. In the assessment of SNIB's investment portfolio Professor Ross Brown notes that in terms of enquiries regarding funding "No enquiries had been elicited from the public sector" in the period between the bank's inception in 2020, up until February 2022.[61] Illustrating the huge scope for improvement in this area.

SNIB will need a dispensation (like Royal Bank of Scotland) in order to lend to the public sector. The Bank is created with the intention of having a 'mission-oriented' role focusing on solving Scottish societal issues[62] which should make such a dispensation attainable as it distinguishes SNIB from commercial banking. The Nordic Investment Bank, the KfW Bankengruppe and the European Investment Bank all lend to the public sector,[63] and would be examples to follow.

In order for SNIB to invest in public infrastructure a few key steps need to be taken: [64]

- SNIB needs to seek dispensation in order to lend to the public sector. Lending to the public sector would be treated with the same scrutiny as private lending.
- SNIB needs to be granted the powers to issue bonds to provide for lending to the public sector. This allows for greater utilisation of the changes in the Scotland Act 2012, as these bonds are likely to prove more flexible and will be able to take advantage of the current low interest rates. It was recognised in the Implementation Plan that most successful national investment banks are able to leverage initial public capital by issuing bonds. [65]
- SNIB needs to be open to alternative public investors, to generate the capital necessary to lend to the public sector. A significant investor can be Scottish pension funds, such as the Scottish Government Pension Fund. Thus, investment in public infrastructure has an added advantage of offering sustainable, safe, long-term places for pension funds to invest their money.

Considering Scotland's lending limitations, allowing Scottish National Investment Bank to lend to public bodies presents a unique opportunity for Scotland to create a solution for financing public projects tailored to Scotland.

In order to set up SNIB to play a significant role in establishing a new model for investment in public infrastructure it is important that reforms are made to the Board of SNIB in order to reflect public interest. It is essential that those serving on the Board of SNIB do not represent a neo-liberal agenda and conventional understanding of finance opportunities for Scotland.

Path Forward

1. We urge the Scottish Government to mandate SNIB to invest in public infrastructure as a means to advance broader societal goals and lead the transition to Net Zero.
2. We recommend that a clear collaborative role is carved out for SNIB in the development of the National Infrastructure Company.
3. Scottish Government should act on the review of SNIB and reimagine the bank as a cornerstone in moving Scotland towards an alternative to private financing of public projects.
4. We recommend that SNIB gets a dispensation in order to lend to the public sector and be granted the powers to issue bonds.
5. We recommend that reforms are made to the Board of SNIB to reflect public interest.

7. Rethink the use of prudential borrowing powers and address the budgetary incentives for using PPPs

Scotland has become reliant on PPPs because of the budgetary advantage these models offer. It is clear that the PPP usage in Scotland is partly rooted in that the country is unable to borrow at optimal terms and that the Scottish Government's spending power is limited by the Total Management Expenditure Budget set by the UK Treasury.

It is interesting to note - as the paper did on earlier pages - that the UK Government abolished the use of PPPs back in 2018 because the model, among other things, was found to be "inflexible and overly complex".[66] Considering this move from the UK Government, it would be reasonable for the Scottish Government to engage with the UK Government on how the restricted powers currently in operation under the fiscal settlement is leading Scotland to rely on the exact model that the UK Government Office for Budget Responsibility called a "source of significant fiscal risk to government".[67]

In Scotland it is the responsibility of each local authority to allocate financial resources available in accordance with local needs and priorities.[68] The total revenue funding available to local authorities is made up of a general revenue grant, distributable non-domestic rate income, and a small number of specific revenue grants.[69] Additionally the Scottish Government provides a general capital grant and specific capital grant to local authorities. Local authorities are also permitted to finance capital expenditure through borrowing.[70]

A major component in Scotland's reliance on PPPs is the Prudential Code for Capital Finance in local authorities. Under this code local authorities can determine their own levels of capital expenditure and borrowing,[71] an area formerly under the Scottish Government's control in the form of local authority's need for borrowing consent. Now, local authorities are mainly restricted by the CIPFA code, which is designed to ensure that authorities act prudently and sustainably.[72] This is a system where local authorities easily find themselves "over-committed, both in terms of traditional borrowing, and in terms of the contractual commitments they are undertaking through various forms of Public-Private Partnerships".[73]

The realities in which the Prudential Code has to operate are different from what was expected when the code was designed.[74] It has to cope with uncertainty about long term levels of local authority resources, and the possibility of severe long term cuts in revenues. Another aspect which is different from the early days of the prudential code is the scale of investment undertaken by local authorities through PPPs: "when the prudential code started, the total amount of local authority capital expenditure in Scotland which had been undertaken via PPP projects was something over £800m. By September 2016, the corresponding figure was around £4bn."[75] It is therefore extremely important that the issue of PPP deals is handled appropriately in the Prudential Code.

While the Scotland Against PPPs Task Force supports that local authorities should be making decisions about what their communities need, we also recognise that putting local authorities in charge of assessing their future expenditure commitments has led to certain challenges. Namely that local authorities often work with time horizons that are too short and estimates which are too optimistic. Updates to the Prudential Code in the form of requiring authorities to be more realistic and openly communicate the financing costs incurred under Public Private Partnerships would force longer term planning and more realistic estimates.

There are also several weaknesses to the prudential code as it currently operates which need to be addressed, in particular:[76]

- Local authorities need to use longer timescales in their prudential assessments: it is common not to look further forward than three years, and assessments may be too inconsistent and optimistic.

- The Scottish Government does not provide a meaningful steer to local authorities on what central government support to local authority revenue budgets is likely to be in the medium to long term.

- Local authorities do not appear to take into account the potential impact on their budgets if any of their Arm's Length External

Organisations, (ALEOs), run into problems. Although arm's length, any liabilities of ALEOs would come back on to the authority's books if the ALEO ran into trouble.

The Infrastructure Company discussed earlier in this paper should play a key role in supporting local government in making realistic long term predictions and investments. A first step towards this is more clear lines of communication between local authorities and national bodies when it comes to financial plans and national assessments.

There is a danger, when a body like the Scottish Government is trying to deliver services under severe constraints on its freedom of action, and with limited powers to get round these constraints, that it may be forced to turn to sub-optimal policy hacks. We have already noted at least two examples of this in this report:

- One is the way in which Scotland, (and Wales), have adopted in principle the use of the flawed MIM PPP model because of the constraints on their borrowing limits under the devolved fiscal settlements, while on the other hand, the Westminster Government, which is in control of its own borrowing powers, simply decided to renounce the use of PPPs altogether. This contrast is forcefully brought out in the quotation from the SFT paper given on page 3 of this report.
- The second example is the way in which the LEIP programme was developed, to exploit the fact that local authorities have prudential borrowing powers, but the Scottish Government does not. While, as noted earlier, there are potentially excellent aspects to LEIP, its use does throw increasing strain on the prudential borrowing system – a system which was already badly in need of being tightened up.

Finally, it is a glaring inequity in the current fiscal settlement in Scotland that local authorities possess prudential borrowing powers, while the Scottish Government does not. But extending prudential borrowing powers to the Scottish Government is not that simple. Ultimately, revenue expenditure commitments made under Scottish Government prudential borrowing would have to be secured against the Scottish Government's own tax revenues and the Scottish Government's tax raising powers are already arguably overstretched against its current policy commitments. Extending prudential borrowing powers to the Scottish Government would require UK Treasury approval, and so would, in effect, require re-negotiation of the current post referendum fiscal settlement.[77]

Path Forward

1. We recommend that the Scottish Government ask the UK Government to support changes to the fiscal settlement which supports Scotland to move away from using the PPP model.

2. We urge local authorities to work with longer time horizons than many of them are currently using when assessing the future budgetary consequences of the capital funding decisions they are making.

3. We recommend that a joint-system is developed, under which local authorities' independent financial plans are informed by, and in turn, inform, a national assessment of local authority budgets.

4. We recommend that the Scottish Government update the Prudential Code to require authorities to be transparent about the financing costs incurred under public private partnerships.

5. We recommend that the Scottish Government seek to tighten up the operation of prudential borrowing and find ways to provide a meaningful steer to local authorities on their prudential assessments

8. Rebuild public sector capability and capacity for managing infrastructure

PPP's have systematically reduced the capabilities of local government in Scotland. The planned key role of the Infrastructure Company will require public bodies to increase their capabilities so that they can prepare evidence and proposals to work cooperatively with and negotiate with the Company.

Local authorities must ensure they have the in-house capability and capacity to identify current and future community needs and infrastructure requirements, to ensure they participate in the planning and design of infrastructure, the monitoring of the construction process and in the management, maintenance and upgrades of operational facilities. It will be important to consolidate and maintain this capacity to build local knowledge and intelligence. They will also significantly reduce the future role and cost of management or technical consultants. These functions also require local governance and accountable processes that can be monitored and reviewed.

The Scottish Futures Trust issued Guidance on pathways to Net Zero for assets delivered under PPP contracts in June 2022. It stated "… it recognises that public bodies are unable independently to put in place effective carbon reduction strategies or to set carbon reduction targets." [78] However, local authorities have a responsibility for establishing effective carbon reduction strategies and to set carbon reduction targets. All the parties involved in operational and planned PPPs will be required to cooperate in agreeing how the effective carbon reduction strategies and targets will be implemented and achieved by each PPP.

Scottish local authorities should: [79]

- apply public service principles and values.
- ensure the participation of service users and staff.
- commit to sustainable development, equality and social justice.
- commit to good quality public buildings, public spaces and the public realm.
- implement joint working on cross-cutting issues and shared services between departments/directorates and with other public bodies and agencies.
- commit to innovation and improvement of policy process, planning, project management and service delivery.

The capabilities and capacity of Scottish local authorities can be increased by adopting the following six elements of best practice:

1) evidence-based policy making based on effective use of evaluation, research assessing economic, social, equality and environmental impacts and continuous monitoring and scrutiny review.

2) service planning and design should involve staff/trade unions and service users/community organisations in preparing and implementing Public Service Innovation and Improvement Plans.

3) regularly assess the authority's skills/capabilities in the planning, design and construction of infrastructure projects and the need for increased training or retraining and/or recruitment.

4) monitor the implementation and performance of policies, projects and employment practices which must be fully resourced and reviewed.

5) options appraisal should include twelve key criteria. An in-house option should be developed as standard practice and be based on a Service Improvement Plan which sets out a programme of how the service(s) can be improved and developed.[80] Local authorities should maximise public sector delivery of facility management services and employment of staff.

6) the commissioning of management or technical consultants should only proceed after in-house capabilities have been fully assessed and be subjected to rigorous evaluation and the inclusion of an in-house training component.

Path Forward

1. We urge the Scottish Government to put plans into action which ensure that local authorities have the in-house capability and capacity to identify current and future community needs and infrastructure requirements.

2. We recommend that the capabilities and capacity of Scottish local authorities are increased by adopting the above outlined six elements of best practice.

3. Scottish Government should take steps to ensure that an in-house option is developed as standard practice when new infrastructure projects are planned

9. Let Net Zero be at the heart of Scottish infrastructure investment

Scotland aims to reach Net Zero emissions by 2045[81] and this national commitment is highly relevant to the issue of PPPs. As part of the plan the government has committed £1.6bn to "transform our homes and buildings over the next Parliament".[82] It is essential that this investment is used wisely and not necessarily just to build new infrastructure. Investing in older buildings in local communities will be essential to pursue Net Zero targets, while also having community well-being at its heart. PPP contractors have historically had no interest in old buildings being mended and repurposed, as this does not promise the big financial rewards sought by these companies. However, many buildings around Scotland have stood the test of time – mending them and making do with what we already have could be the most sensible solution.

The path to Net Zero has five key elements:

- Decarbonisation of construction, public transport, heavy goods vehicles and cars.
- Retrofitting to improve warmth and comfort, reduce energy bills and reduce emissions in homes - and similarly in public buildings and business premises.
- Adaptation and environmental protection from rising sea levels and extreme weather to develop asset management strategies to increase resilience.
- Just Transition including the secure stranding of fossil fuel assets.
- Increased provision of renewable energy plus storage and increased grid capacity.

The Infrastructure Company discussed earlier in this paper would ideally be able to help Local Councils assess their assets realistically and weigh up the costs of repairing against new projects, in a way where financial restrictions, well-being and Net Zero is taken into consideration.

Path Forward

1. We recommend that the Infrastructure Company is equipped to provide advice on how local authorities can plan for well-being and Net Zero in their infrastructure investments.

2. The Scottish Government should explore how the National Performance Framework and plans for Net Zero could be supported by implementing an alternative to PPPs across sectors.

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