Presentation by Dexter Whitfield, European Services Strategy Unit, to meeting 'Rethinking Private Financing of Scottish Public Projects' at the Scottish Parliament on 29 January 2020, organised by Jubilee Scotland and chaired by Neil Findlay, MSP.

I welcome the refreshing straight-talking report on NDP and hub PPP contracts from Audit Scotland this week. I strongly recommend that the Scottish Parliament, local authorities and public bodies immediately adopt six strategies for public infrastructure projects in Scotland.

1 - Increase direct public investment in public infrastructure and stop all planned Mutual Investment Model projects

The Government should take the opportunity to increase direct public investment in infrastructure in the current period of low interest rates.

Planned MIM projects and those that have been approved with options appraisal and business cases, but yet not commenced the start of the contractual procurement process, should be stopped. The Scottish Government should support the local authorities and public bodies in arranging direct public investment for these projects.

The Mutual Investment Model (MIM) allows the public sector to invest up to 20% of the risk capital in project companies and to meet the private investment classification (off public sector balance sheet). However, the public sector, in effect, becomes a commercial partner with the private sector in sharing all the risks and rewards. This significantly deepens the degree of privatisation, extends the scope of secondary market trading in PPP equity and the takeover or merger of infrastructure funds (Whitfield 2016 and 2017b).

2 - Scotland should adopt a new public design/finance and operate model

This would have three objectives, to integrate the design and construction process, to reduce the cost of construction and to minimise the risk of delays. Two examples illustrate how these objectives can be achieved.

The UK's Integrated Project Insurance (IPI) offers a guaranteed maximum price and protection against defects underwritten by insurance. A project alliance is formed with a Gain/Pain Share agreement under IPI in which all members of the project Alliance share in risk and reward. It was recently successfully piloted at Dudley College. The target outturn construction cost of £9.83m was agreed and exceeded by only 1.8%. The client share of the additional cost was only 0.34% of the target cost. The building was ready for occupation as planned at the start of the 2017/18 academic year.

Construction Management At Risk (CMAR) has been widely used in many US states for public building, transportation and utility projects. The client selects an architect who commences the design and later selects the construction manager/contractor, based on qualifications and track record, before the design stage is completed. The architect and construction manager work together in the final stage of the design process. The construction manager/contractor gives the client a guaranteed maximum price and coordinates all the subcontracted work. This process strengthens coordination, enhances transparency, delivers efficiencies and minimises delays (Whitfield, 2020).

3 - Local authorities and public bodies should intensify the monitoring of PPPs to identify defaults and poor performance.

Monitoring of PPP projects has often been inadequate due to inadequate monitoring staffing levels being included in business cases and contracts and over-reliance on self-monitoring by the private sector. Local authorities should now intensify contract monitoring focusing on all aspects of the quality of performance and other contractual requirements. This information should be reported to relevant committees and publicly disclosed.

Local authorities should also establish contract reviews where defaults and poor performance have been significant or systemic. They should draw on evidence from service users, community and tenants organisations and trade unions. There remains considerable scope for local authorities and public bodies to consider terminating operational PPP service contracts and return provision in-house. Where defaults and poor performance are evidenced and remain after the issue of contractual warnings by the authority, termination without compensation is a viable and legal option. In some cases a contractor has withdrawn from a contract on technical or operational grounds. There have been 27 PPP contract terminations and 12 buyouts in the UK to date (Whitfield, 2020).

4 - Establish a comprehensive and rigorous Economic, Social, Equality and Environmental Cost Benefit Analysis methodology

This should be mandatory for all infrastructure projects in Scotland. The Scottish Government should also require comprehensive and rigorous **impact assessments** to identify the positive and negative economic, employment, equality and environmental consequences of projects and to identify where and what form of mitigation action is required.

The quality of impact assessment is reliant on assessment of the impact on inputs, processes, outputs, equity and outcomes to establish cause and effect and the use of a counterfactual (the situation that would exist if the project did not proceed). Furthermore, employment impacts must include a full analysis of current jobs, terms and conditions, health and safety and equality practices and planned changes.

5 - The Scottish Parliament and local authorities should oppose the sale of equity in PPPs

The average annual rate of return on the sale of equity in PPP projects was 28.7% (based on a significant data sample) at the end of 2016 with acquisition mainly by offshore infrastructure funds in tax havens (Whitfield, 2017b). This evidence is in sharp contrast with the expected 12%-15% rate of return contained in PPP business cases or contract documentation.

The scale of equity transactions and offshoring to tax havens is very significant. "*A total of 87.5% of Scotland's PFI/PPP education projects (280 out of 320 schools) are currently partly or wholly owned by offshore tax haven funds. Nearly half the schools had 100% of their equity owned offshore"* (Table 11, Whitfield, 2016). The NDP and MIM models in effect lock-in and legitimate public sector investment in PPP projects and the secondary market.

Whilst the sale of equity is legally permissible, there is a very strong case that it should be opposed on political economy and ethical grounds.

6 - Challenge the trend of Scottish pension fund investment in PPPs

There are direct links between Scottish public sector pension fund investments, offshore tax havens and shares in NPD and hub companies. At least four Scottish pension funds have investments in offshore infrastructure funds with stakes in NPD and hub projects. Glasgow City Council, on behalf of Strathclyde Pension Fund, has had a £30m investment in the Equitix Fund IV LP since 2016 which was extended by further £50m investment in the Equitix Fund V LP, managed by Equitix GP 5 Limited (Guernsey).

Edinburgh City Council, on behalf of Lothian Pension Fund and Lothian Buses Pension Fund and the Falkirk Council Pension Fund have investments in the Equitix Fund II LP. Equitix Ltd is one of the largest UK PPP companies and although a registered UK company it is owned by Tetragon Financial Group Limited and registered offshore in Guernsey (Whitfield, 2018).

The targeted 10% annual rate of return of these investments is not in the public interest because it ramps up the cost of public infrastructure. Likewise, public sector investments in NDP and MIM projects feed potential gains in the secondary market which may only cover the cost of risky investment in other PPP projects.

I believe these policies are essential in developing a genuine public alternative to PPPs in Scotland.

References

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