Project scope

Revenue financing of assets

The Non-profit distributing (NPD) and Hub models

AUDITOR GENERAL

ACCOUNTS COMMISSION

Prepared by Audit Scotland
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Background

Public infrastructure, including hospitals, schools and other community facilities, is key to delivering services and contributing to positive outcomes for the people of Scotland. The Scottish Government introduced the NPD model in 2007 as a successor to the Public Private Partnership/Public Finance Initiative used by previous UK and Scottish governments. NPD formed a major part of the Scottish Government's investment strategy. It has mainly been used to deliver large infrastructure projects, including hospitals and transport projects.

Since 2009 the NPD investment programme has been led by the Scottish Futures Trust (SFT). The SFT has developed the NPD model and provides professional support to public sector bodies financing projects via this route.

The SFT has also developed the Hub initiative on behalf of the Scottish Government to deliver both traditional and revenue financed capital investment projects (meeting the costs from revenue expenditure).

From 2010 onwards, five Hub Companies (HubCos) have been set up as partnerships between public sector bodies and the private sector to deliver community assets within defined geographical areas. A range of projects have been delivered via this route, including a number of school rebuilding and refurbishment programmes.

The Scottish Government regularly updates its pipeline of infrastructure projects. Assets being funded from revenue with a combined capital value of £3.5 billion are now included within the pipeline. Approximately £2.7 billion of the capital costs of these 47 projects will be financed from revenue using the NPD/HubCo models, with the rest being financed via traditional capital contributions. Another five NPD projects, with a capital value of £0.5 billion, predate the pipeline.

For the 52 revenue funded projects (NPD/HubCo), the Scottish Government has committed to making annual payments (repayment of borrowing, interest and annual service costs) of around £9.2 billion between 2018/19 and

2047/48. This is on top of around £18.5 billion of commitments relating to previous revenue financed projects (Exhibit 1).

Why are we doing this audit?

The Accounts Commission published *Taking the initiative: Using PFI contracts to renew council schools* in 2002. This was our last national report exclusively focused on the use of private finance to fund public sector infrastructure investment, although capital investment is a core part of statutory annual audit work. The 2002 audit found that councils had managed PFI processes well. But that the cost advantage of using PFI, when compared to notional publicly funded alternatives, was narrow and took no account of the higher costs of private sector finance compared to council borrowing.

Since then there have been a number of significant developments with regard to delivering large infrastructure projects. These include:

- the introduction of CIPFA's Prudential Code (2004), removing the need for councils to receive consent from Scottish ministers to incur capital expenditure and increasing their flexibility to develop financing strategies to suit their own local priorities and needs
- the introduction of NPD (2007), the Scottish Futures Trust (2008) and HubCos (2010)
- the implications of changes to national accounting rules (2014)[1] and the Office for National Statistics' decisions to classify some NPD projects as subject to public sector control (2015)[2] for the Scottish Government budget and structure of future NPD projects
- the Scotland Act (2016) increasing the Scottish Government's capital borrowing powers to a maximum of £3 billion with an annual cap of £450 million from 2017/18.

What will the scope of the audit be?

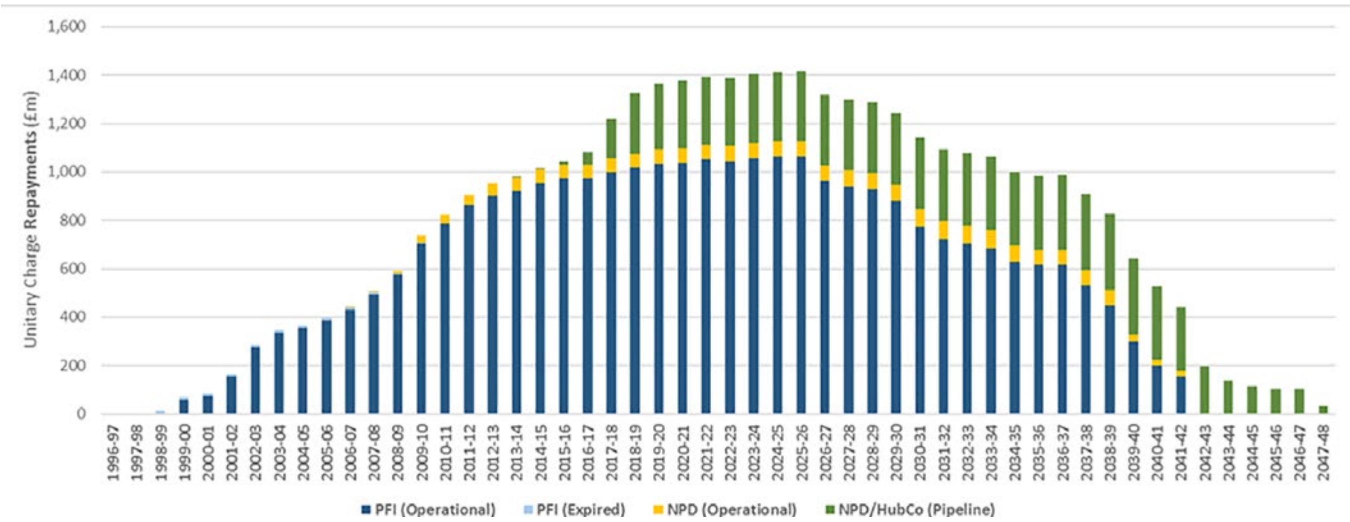
The audit will aim to assess whether the NPD and revenue financed via HubCo models (NPD/HubCo) provide value for money, and how effectively they are contributing to the delivery of infrastructure investment across Scotland. It will seek to answer four key questions:

- do the NPD/HubCo revenue models provide advantages compared to other ways of financing infrastructure (including previous methods of revenue funded infrastructure financing such as PFI)?
- how much use has been made of the NPD/HubCo models in Scotland and what are the long-term public sector financial commitments relating to all revenue financed infrastructure projects?

Exhibit 1

Current public sector commitments under revenue financed capital investment models

The public sector has committed to making significant annual payments under current contracts up until 2047/48.



Source: Scottish Government and HM Treasury data (as at March 31 2017)

- how well have the Scottish Government, SFT and HubCos worked together to deliver value for money from the NPD/HubCo programme?
- to what extent have individual NPD/HubCo financed projects been managed well and can they demonstrate they are value for money?

Alongside our analysis of the overall use and management of the models, given the large number and scale of projects that fall within the remit of this audit, we will use case studies to allow us to look in detail at a number of capital projects across central government, health and local government. This will allow us to assess how value for money was considered at the inception of each project and how it is being monitored and managed during the lifetime of the contracts in place.

The audit will not look at projects financed by more traditional means (including capital funded HubCo projects), rail infrastructure projects financed via the Regulatory Asset Base (RAB) or a range of other models of partnership between the public and private sectors (for example, the National Housing Trust, Tax Incremental Financing or the Growth Accelerator Model).

How will we carry out the audit?

We will gather evidence using a range of methods, including:

- analysing national data as published by the Scottish Government and HM Treasury
- interviews with senior staff in the Scottish Government and SFT
- analysing data from audited public sector accounts
- liaising with appointed auditors and examining case studies of nine projects across a range of sectors (reviewing business cases, accounting treatments and the budgetary implications for both the individual bodies and the Scottish Government).

Throughout the audit, we will engage with senior staff involved in the financing, procurement and delivery of projects.

What impact will the audit have?

The audit will improve public understanding of how revenue financed models of capital investment work. It will also help to assess if capital projects using the current revenue funded models were financed and delivered in a way that provides value for money; and how this is being monitored. It is also likely that the audit will identify areas for future audit work.

The audit will also make a series of recommendations to help improve how these projects are evaluated and managed to help to secure value for money.

Audit timing and contacts

We plan to publish in the summer of 2019. We are carrying out the audit on behalf of the Auditor General for Scotland and the Accounts Commission.
For further information, please contact Martin McLauchlan, Audit Manager, on 0131 625 1768 or mmclauchlan@audit-scotland.gov.uk.

1 European System of Accounts – ESA 2010.

2 For example, the ONS published the results of its assessment of the Aberdeen Western Peripheral Route project in July 2015. The ONS noted that the operation and delivery of the project is being managed by three special purpose vehicles (SPVs). It considered that, due to the contractual relationships and sharing of directors between the three units, the SPVs should be considered as one institutional unit for statistical purposes. The ONS concluded that, "based on the Scottish Government's influence over the collective corporate policy of the SPVs, including effective vetoes over key aspects and accruals of surpluses to the Scottish Government, the AWPR SPVs are subject to public sector control". The ONS also found that, "due to the Scottish Government's share in the economic rewards associated with the asset, it was judged to have economic ownership of the AWPR asset".

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