

European System of Accounts (ESA) Impact on the Newbattle Project**Report by Garry Sheret, Head of Property and Facilities Management****1 Purpose of Report**

This report has been prepared to provide the Council with an update regarding the effect of the recent European directive ESA10 on the delivery programme for the Newbattle replacement school and associated community facilities.

2 Background

- 2.1** On Monday 2 February 2015, John Swinney, Scottish Parliament Cabinet Secretary for Finance, Employment and Sustainable Growth, responded to the following written question in the Scottish Parliament:

"To ask the Scottish Government whether it will provide an update on the non-profit distributing (NPD) pipeline of infrastructure investment."

A full copy of the Cabinet Secretary's response is attached in Appendix 1.

- 2.2** The impact of the delay to the Schools for the Future programme affects eight projects including Newbattle.

Previously, revenue funded design build finance maintain (DBFM) projects were classified under European System of Accounts 1995 (ESA95) guidance. This guidance has recently been updated and is now termed European System of Accounts 2010 (ESA10).

Scottish Futures Trust (SFT) and the Scottish Government have been working for several months on a solution to determine how revenue funded hub design build finance maintain (DBFM) projects are classified under this updated guidance, ESA10, as it has an impact on how these projects are budgeted for.

The Scottish Government are engaging with the UK Office for National Statistics, who decide on classification matters, and has agreed that SFT consider the options that are available to introduce contractual changes to satisfy the new rules. Given the particular governance and shareholder structures that apply to hub, this will take time to agree and implement with partners.

3 Update**3.1 Scottish Futures Trust Position**

Scottish Futures Trust no longer expect the eight hub DBFM health and school projects planned to reach financial close during this financial year. This includes Newbattle and may also have consequential delays for the Paradykes and Roslin projects.

As SFT provide two thirds of the funding required for the school, construction will not start on Newbattle until this issue is resolved.

Current work on the design for Paradykes and Roslin primary schools is not affected by this delay. However the funding of these projects is dependent on a successful outcome to the classification and contractual changes in relation to ESA10 as this is linked to the Newbattle project.

3.2 HubCo Position

HubCo are continuing to work towards financial close in anticipation of a contractual solution being progressed. A Stage 2 report, confirming the result of market testing the final design prior to financial close, is expected during March 2015.

3.3 Midlothian Council Position

The Council will continue to work with SFT and the Scottish Government and take all necessary steps to ensure these important projects reach financial close and their start on site as soon as possible.

As stated above, work continues with Hubco towards financial close on the Newbattle project to avoid any further delays beyond those associated with ESA10.

Similarly the pre-construction design work, following stakeholder consultations, on Paradykes and Roslin will continue in accordance with the planned programme.

In the meantime the Council's partners, stakeholders, staff, pupils and others involved in these projects have been notified of this issue and will continue to be kept informed of progress as appropriate.

4 Report Implications

4.1 Resources

Pre-construction design and cost management work continues towards Stage 2 and Financial Close on the Newbattle project with resources being met from the budget agreed by Council on 24 June 2014 and updated on 12 August 2014.

Initial design work, following consultation, on Paradykes and Roslin primary schools will commence during February 2015 following the tender process to appoint the design team.

4.2 Risk

There continues to be the risk that SFT do not find a resolution to how projects are classified under ESA10, or that a solution is not agreed by shareholders and participants of HubCo, and as a result projects continue to be delayed incurring inflationary increases in cost and the non-delivery of essential replacement educational and community facilities.

4.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

- ☐ Community safety
- ☐ Adult health, care and housing
- ☒ Getting it right for every Midlothian child
- ☒ Improving opportunities in Midlothian
- ☐ Sustainable growth
- ☐ Business transformation and Best Value
- ☐ None of the above

4.4 Impact on Performance and Outcomes

The delay of the Newbattle project has a direct impact on the quality of educational and community facilities available to the residents of Midlothian in the short term.

4.5 Adopting a Preventative Approach

Not applicable.

4.6 Involving Communities and Other Stakeholders

All stakeholders involved with these projects are being kept informed of the progress and / or delays in the design, build and overall delivery programme.

4.7 Ensuring Equalities

There are no equality implications arising from this report.

4.8 Supporting Sustainable Development

The delay in these more energy efficient projects will have an adverse effect on the Council's overall carbon footprint and the climate change challenge.

4.9 IT Issues

There are no IT issues outlined with this report.

5 Recommendations

Council is asked to:

- a) Note the delay in progress to the Newbattle project as detailed in this paper: and
- b) Receive update reports by the Director, Resources in due course.

12 February 2015

Report Contact:

Garry Sheret Tel No 0131 561 5249

garry.sheret@midlothian.gov.uk

Background Papers: Appendix 1 Copy of John Swinney's Response

Declaration Box

Instructions: *This box must be completed by the author of the report. The box will be copied and saved by the Council Secretariat who will delete it from the report prior to photocopying the agenda.*

Title of Report: European System of Accounts (ESA) Impact on the Newbattle Project

Meeting Presented to: Council

Author of Report: Garry Sheret, Head of Property and Facilities Management

I confirm that I have undertaken the following actions before submitting this report to the Council Secretariat (Check boxes to confirm):-

- ☐ *All resource implications have been addressed. Any financial and HR implications have been approved by the Head of Finance and Human Resources.*
- ☐ *All risk implications have been addressed.*
- ☐ *All other report implications have been addressed.*
- ☐ *My Director has endorsed the report for submission to the Council Secretariat.*

For Cabinet reports, please advise the Council Secretariat if the report has an education interest. This will allow the report to be located on the Cabinet agenda among the items in which the Religious Representatives are entitled to participate.

Likewise, please advise the Council Secretariat if any report for Midlothian Council has an education interest. The Religious Representatives are currently entitled to attend meetings of the Council in a non-voting observer capacity, but with the right to speak (but not vote) on any education matter under consideration, subject always to observing the authority of the Chair.

Appendix 1 – Copy of John Swinney's Response

Question S4W-24246: Mark McDonald, Aberdeen Donside, Scottish National Party, Date Lodged: 30/01/2015Hide Full Question <<

To ask the Scottish Government whether it will provide an update on the non-profit distributing (NPD) pipeline of infrastructure investment.

Answered by John Swinney (02/02/2015):

The Scottish Government has placed infrastructure investment at the heart of its economic strategy, delivering jobs, increased economic activity and assets of benefit to the people of Scotland. Through our programme of revenue-financed NPD/hub projects, we have sought to maintain investment at a time when, over the 2010-11 to 2015-16 period, conventional capital budgets have been reduced by around a quarter in real terms.

The NPD programme has successfully delivered two completed projects and sixteen that are in construction, with an estimated capital value of £1.4 billion, injecting around £600 million into Scotland's economy this financial year alone, supporting or maintaining around 6,000 jobs.

Following recent updates to relevant Eurostat technical guidance on national statistical accounts (the European System of Accounts – ESA 10), applied in September 2014, I wish to advise Parliament about action the Scottish Government is taking in order to secure this continued investment. This relates to the latest interpretation of factors that influence a public or private sector classification for infrastructure projects. Since 2010 external financial advice has been sought to ensure the correct classification is applied to NPD/hub projects on four separate occasions. Following the introduction of ESA 10, the Scottish Futures Trust (SFT) commissioned financial advice in October 2014 to confirm that the NPD programme classification remained robust. This was the fifth piece of external financial advice sought on classification since 2010 and concluded that private sector classification remained appropriate. In November 2014, SFT became aware from Infrastructure UK officials within HM Treasury that the Office of National Statistics (ONS), who report on classification, had raised classification issues on privately financed projects under development in Whitehall in the light of the recent application of ESA 10, which appeared to these officials likely also to be relevant to the NPD programme in Scotland.

In December 2014 the ONS decided to review the classification issues surrounding the Aberdeen Western Peripheral Route (AWPR) project. I expect this process to take a number of months. For the sake of clarity, this process will have no effect on the construction of the AWPR project itself, which will continue as planned.

In light of this, I have considered it appropriate to put in place a number of steps to refine the NPD programme, whilst seeking confirmation and further advice on the appropriate classification under the most recent Eurostat approach for infrastructure projects under NPD. Under HM Treasury budgeting rules, were an NPD project to be classified to the public sector, no additional cash would be required. However, the Treasury could require upfront budget cover (capital departmental expenditure limits (DEL)) for the project. The Scottish Government and SFT believe that current project arrangements demonstrate consistency with the relevant guidelines. However, until the process of engagement with the ONS has concluded, I believe it is appropriate to put in place contingency measures.

Given that we are now so close to the end of the 2014-15 financial year, I have therefore agreed with HM Treasury that it would be prudent to treat as a contingency arrangement in the short term the Scottish Government's planned carry forward from 2014-15 into 2015-16 of around £150 million of resource DEL. In turn, HM Treasury has agreed that, as a contingency, additional budget cover of £300 million will be included in the Spring Supplementary Estimate. The budget cover from HM Treasury will not be available for general spending on public services in the event it is not required for contingency purposes. The £150 million of Scottish Government resource DEL will continue to be available to the Scottish Government through the Budget Exchange Mechanism if the contingency is not required.

As all of the government's efforts will be focused on ensuring there is no need to call on this contingency, I do not intend to make changes to the spending plans set out in the 2015-16 Budget Bill currently before Parliament.

Finally, I have considered the potential implications for projects that are due to reach financial close shortly. In relation to NPD projects – the Royal Hospital for Sick Children in Edinburgh and the Dumfries and Galloway Royal Infirmary – the government intends to take these projects to financial close as soon as possible, while making some appropriate contractual adjustments in consultation with partners. In relation to eight hub projects that are due to close this financial year, the government will also, as a precaution, be considering some contractual changes. These will take some time to agree and implement with partners. We will take all necessary steps to ensure that these projects are ready to reach financial close as soon as practicable after our engagement with the ONS has reached a conclusion. I will keep Parliament informed of progress toward financial close on these projects. I can assure Parliament that I am taking all appropriate action to protect vital capital investment in Scotland and to resolve these issues as promptly and effectively as possible.

Current Status: Answered by John Swinney on 02/02/2015