

Stirling Water Seafield Ltd Almond Valley, Seafield and Esk project

WICS Consultation – Stirling Water Seafield response

Re-financing

In discussing the possibility of re-financing the PPP contracts the Consultation document has ignored projects, such as the Almond Valley, Seafield and Esk project, which were financed by bonds. As the Consultation document correctly noted in last years process, lenders such as banks are averse to construction risk and charge relatively high interest rates. Once construction was past, some PFI/PPP contractors, in a range of industries, redeemed their bank debt and re-financed at rates that could exclude construction risk.

Aside from bank debt, the other common form of refinancing was by wrapped bonds which, by virtue of offering guaranteed repayment, are less risky for investors and carry a lower rate of interest. At the time the Almond Valley, Seafield and Esk project was being set up, bond providers were expressing interest in funding projects from the outset including the construction phase. They reduced their construction risk by exercising much tighter control of contractors than would have been the case in respect of bank finance.

In such bond-financed cases then, the public sector has already received (and continues to receive) the benefit of these cheaper finance costs. It is misleading to suggest that there is scope for further reduction of finance costs. Indeed, as the bonds guarantee repayment in full the breakage costs plus the costs of setting up new funding would almost certainly outweigh any reduction of interest rates and annual costs would actually increase. However, we are willing to investigate this with Scottish Water.

PFI is a long-term commitment, and is costed and funded as such. At Closing, agreements were put in place that gave best value for money to the customer and hence the public. To revisit this value-for-money assessment in the light of current market conditions is wrong and ignores the underlying costs that would be incurred by terminating the long term commitment.

Risk transfer

While one objective of PPP was to transfer some risk to the private sector, certain risks inevitably remains with the public sector. With waste water treatment performance, for example, the financial risk of failure is taken by the contractor but Scottish Water suffers the adverse criticism. The pain of criticism is abated to some extent by the mechanisms allowing payment to be withheld in some form from the contractor.

Public perception

The general impression given by the WICS consultation paper is that the PPP shareholders are already, or are about to start, earning excess profits at the expense of Scottish Water's customers. Returns are driven by the overall risks incurred. Thus, this impression is misleading. To give such an impression is unfair to those customers: it generates in them a false hope that their water bills may be reduced. It also makes the task of Scottish Water and its contractors harder, causing them to divert efforts into Public Relations and away from the prime objective of giving satisfactory service. There is, of course, nothing wrong with legitimate public scrutiny but customers should not bear the burden of wasted effort.

Efficiency targets

We believe, in general, in setting targets. It is common, when setting *internal* targets, for them to be beyond reasonable expectation. This, apart from increasing stress on managers, has no adverse effect. However, if used in setting *external* targets the situation is quite different. In the context of the Scottish PPP contracts it can have all the adverse effects on public perception and expectation noted above. We could only favour efficiency targets in this context if they are based on accurate analysis of all costs, were legislated for within the contracts that did not destabilise the balance of risk transfer and are (albeit at the cost of significant effort) achievable.