Scottish Construction Forum Conference

Building Scotland's Future

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Good morning everyone, and thank you Chair for your introduction and thank you to Douglas and Archie for the invitation to speak today.

For those of you who don't know SCDI, we are a unique organisation, the largest independent economic development body in Scotland with members across the public and private sectors, the trade unions, academia, and the voluntary sector.

Our key role since we formed in 1931 has been to lead the debate on delivering stronger economic growth in Scotland. Indeed we were formed in similar circumstances to today, as a means of bringing industrialists and politicians together to look for ways out of the Great Depression. Over the years we have delivered pioneering work on promoting overseas trade, attracting inward investment and delivering an economic legacy from the discovery of oil and gas in the North Sea.

Our current policy work builds on that heritage, with a major study on the threats and opportunities from the Scottish Government's renewable energy strategy analysis of how we improve the way we use our physical and electronic networks to improve our productivity a study of how Scottish businesses can compete internationally in the modern economy.

In terms of today's topic of construction, the first thing I would say is that you don't need me to tell you about the difficulties facing the construction sector: 70% fall in mortgage approvals in the last year.

Forecasts of 9000 new homes in 2009 - the smallest number since 1924. Numbers of properties on the market up by 50 per cent on last year but numbers of sales down by 50 per cent.

It is now clear that the construction sector is in recession and that further bad news for the sector is inevitable.

Today's event is titled 'Making the Difference' and what I want to do today is look at what will make the difference – and a positive difference to the performance of Scotland's construction sector.

Earlier this week SCDI hosted a meeting of contractors, lawyers, bankers, trade unions and estate agents and, today I want to share some of the ideas that we developed or that emerged from that session.

We all know the economic crisis is fundamentally due to the collapse in the banking sector, which is in turn is due to a total lack of confidence in the wholesale and retail money markets. The financial institutions are either refusing to lend to each other or are charging higher margins to protect themselves against risk.

So the most powerful and long-term solution to the downturn is to open up these markets and restore a sensible balance to lending – not a return to the overheated levels of credit that fuelled the crash, but a sensible, transparent and risk-based approach.

I want to quickly illustrate the impact of the turmoil in the financial markets on borrowing rates, and how this has impacted on the credit markets.

The chart on the screen shows the Bank of England base rate in red and the rate at which banks are lending to each other on the blue line. Until August 2007 strong relationship between the two lines, so cost of borrowing dictated by Bank of England base rates

However, second half of the 2007 see s noticeable spike in the cost of borrowing as banks start to get nervous about fall out from the American sub-prime market and the collapse of Northern Rock last August. Then with the government's intervention to protect Northern Rock creditors, and with the right downs in asset values and the share issues of the big banks at the start of the year we see a fleeting return of confidence, with LIBOR once more coming down to meet BoE rates.

However, as further bad news emerges about the state of banks balance sheets in US and UK, we can see the price of interbank lending drifting upwards
And then the dramatic collapse of HBOS and Bradford and Bingley and the run on RBS's share price, we can see further increases in the cost of lending despite cuts in Bank of England base rates earlier this year.

It's this increase in the cost of credit for the banks which is driving up the costs of mortgages, overdrafts and loans – for those people that can get them.
However, the good news is that the markets have responded positively to the government's proposed injection of capital and liquidity, last month's cut in base rates. If we look at the right hand side of the chart we see a recent decline in LIBOR.

So the first thing that we want to see at SCDI is a further cut in interest rates to cut the cost of borrowing. With survey after survey predicting falling demand and falling output; and with the fall in oil and other commodity prices, it is clear that the Bank of England's priority has to be getting the economy moving, not keeping the lid on inflation.

Whilst not all of the cut may be passed on to savers it will ultimately contribute to freeing up the money markets and cutting the cost of mortgages.
The second proposal to inject more money into the system is the re-introduction of Business Expansion Scheme, a targeted tax break to increase private investment in the housing sector. This was used to encourage greater investment in housing at a time of low confidence in the early 1990's. Basically,

this would mean tax relief on all private capital invested in the housing sector, opening up access to funds which would not otherwise be invested in this area.

However, this still leaves us with the problem of selling units once they are built. So, we want consideration of a government guarantee for home owners, where changing circumstances mean that they are unable to meet their mortgage payments. We are not talking about under-writing the entire British property market, simply helping people pay their mortgage for a limited time to ensure that they can stay in their own homes, rather than claiming housing benefits further down the line to pay for temporary accommodation. This will give home owners and banks confidence and is another small step to getting the property market moving again.

The next area I want to talk about is public spending and how we can use this to ensure we have a strong construction sector when the upturn inevitably comes. Not a new idea as the slide shows – most of you will be familiar with McCaig's Folly, built to provide work for stonemasons in West Argyll. However, with our housing problems, poor transport and health infrastructure, there are no shortages of good cases for investment in 21st century Scotland.

The Scottish Government has announced an acceleration of £100m spending on social housing, which will provide an injection into the system at this time of lower private sector demand. However, more than two months after the announcement it is still unclear **if**, **when** and **how** this money is to be spent.

The majority of the spending will be from central government, but 40 per cent is to come from local government. I know from speaking to local authorities that there is still great uncertainty about how they will bring forward their £40m share of this investment.

It is our intention to now bring together the government, COSLA, the housing associations and the industry to look at how we can programme this spend, deliver certainty to the construction sector, and ensure that Scottish firms are best-placed to capture the value of this extra public investment.

The other area of public spending I want to touch on is the government's proposal for the establishment of a Scottish Futures Trust. In the Government's own words, 'The aim of the SFT Initiative is to support the effective planning, funding and delivery of public sector infrastructure investment across Scotland, providing a better deal for taxpayers as a result.'
You'd be hard pushed to find anyone that would disagree with these aims, yet it's clear that there is very limited support for the Scottish Futures Trust at this stage in its development. Indeed when looking at responses to the SFT, everyone agreed on the need for more detail before they could say what they really thought about the proposal. With so much uncertainty still hanging over its operations, the emphasis on the word *trust* grows stronger every day.

Although you have to give credit to the Government for getting business, the unions, and local government – not common political bedfellows - to all agree in their disquiet over the proposals:

1. Business is concerned about uncertainty and limits on returns on investment
2. Unions are concerned about the continuing private sector profit
3. And local government is still greatly concerned about the lack of detail in the proposals

And I think this concern is because the Futures Trust – at this stage - provokes far more questions than it answers.

First of all, will it raise finance any more cheaply than existing procurement models?

Secondly, will it raise the finance needed if profits are capped so tightly that there is no incentive for private sector funders?

Thirdly, the constraints of the Scotland Act mean that only local authorities would have to issue bonds, which begs questions about regionally or nationally significant projects.

And at a time when the Government has the aim of de-cluttering the public sector landscape, why add another non-departmental public body? One of the Trust's roles will be to provide advice and expertise, but is a another new body really necessary just months after the launch of the national procurement centre of expertise, Procurement Scotland?

The final and perhaps the greatest criticism is the uncertainty that has been caused by the lack of detail in the government's proposals. There is great concern that this is slowing down vital investment in infrastructure as procuring authorities wait to see just how the Trust will operate, and how it will compare with existing funding models.

The First Minister has explicitly recognised the importance of increasing public spending to reflate the economy but delays to the Futures Trust are doing exactly the opposite.

With the slowdown in commercial investment, and the disproportionate size of the public sector in Scotland, there is no doubt amongst our members that any brake on public investment as a result of delays in getting the Trust up and running will have a very direct - as well as an indirect - negative impact on the economy. We need those doubts clarified to ensure that we can get additional public investment under way and get on with the job of renewing our roads, schools and hospitals.

The third area of increased public investment I want to highlight is improving the energy efficiency of our existing building stock. The Scottish Government has a climate change target of an 80 per cent reduction in greenhouse gas emissions by 2050. Given that the majority of carbon emissions come from the production of electricity and heat in our homes and businesses, increasing the energy efficiency of our building stock is absolutely key if we are to get anywhere near an 80 per cent cut.

And targeting our existing building stock is central to this objective, as we will renew less than 40 per cent of our entire housing stock between now and 2050. And the good news is that there is a fund of £120m set aside for exactly this kind of investment, built up through the Scottish Renewables Obligation fund.

However, the bad news is that the Scottish Government has been told that every pound it uses from this fund will result in a corresponding decrease in the block grant, again limiting attempts to inject more money into the economy at this time.

So our final demand in terms of public spending is that the UK Government releases this cash with no decrease in the block grant to allow the devolved administration to use this extra money to improve the environmental performance of our existing buildings now.

Before I finish, I want to look at a few other ways in which we can help the industry – and in which the industry can help itself. And all of those involve new ways of working and targeting new markets.

First of all, despite the difficulties with the Scottish Futures Trust, there are huge sums of money being invested in national infrastructure over the coming years:

1. £1bn annual capital investment in transport
2. £500m a year in water and waste infrastructure
3. £190m in FE and HE
4. £600m in health
5. and £400m in the national schools estate.

All of these markets are growing and offer opportunities to the construction sector. But, we need to make sure that tender processes allow our home grown construction industry to compete, and to make sure that there is support and advice to business on how to target this investment.
Much of this work will be beyond the scale of many of our firms, so we want to see detailed financial and legal advice to support small and medium-sized firms working together to form consortia to compete for contracts that would otherwise be too large for them to take on.

Similarly, there are real opportunities from the Commonwealth Games and London Olympics that businesses must look to capitalise on. However, at the last count only 800 Scottish businesses had registered on the *competefor* website used to highlight supply chain opportunities for London 2012. That's 800 out of a total of 30,000 registered users from around the UK. Less than 3 per cent.

We need to make sure that Scottish businesses are competing to be amongst the winners of the huge public investment going in to ***these*** and other major events.

And finally, there are numerous examples of Scottish firms taking their knowledge and expertise to overseas markets. We need more firms to follow the lead of businesses like Keppie Design and the work they are undertaking in growing markets like Libya.

So in conclusion, we know that times are tough out there, with continuing job cuts and falls in property prices.

You would have to be very brave or very daft to predict what is going to happen in the economy over the next few months, but there are signs that the worst is behind us in terms of the banking crisis, and today's interest rate cut should continue to free up credit for investment and bring down the costs of mortgages for homeowners.

But to ensure that we have a vibrant and healthy industry in place for the upturn when it comes, we want to see government in Edinburgh and London kick start the market through three fundamental interventions:

1. Continuing steps to increase investment in the industry
2. Action to increase demand for construction services
3. Support and advice to the sector to help it target new opportunities
4.

That is how we believe decision makers can make a difference, not just to the future of the construction industry, but to their two main goals of a wealthier and fairer Scotland.