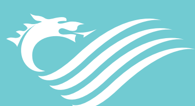
National Assembly for Wales
Finance Committee

Borrowing Powers and Innovative Approaches to Capital Funding

July 2012



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National Assembly for Wales
Finance Committee

Borrowing Powers and Innovative Approaches to Capital Funding
July 2012

Finance Committee

The Committee was established on 22 June 2011. The Finance Committee's role is to carry out the functions set out in Standing Order 19. This includes consideration of the use of resources by the Assembly Commission or Welsh Ministers, and in particular reporting during the annual budget round. The Committee may also consider any other matter relating to expenditure from the Welsh Consolidated Fund.

Current Committee membership

Jocelyn Davies (Chair)
Plaid Cymru
South Wales East

Peter Black
Welsh Liberal Democrats
South Wales West

Christine Chapman
Welsh Labour
Cynon Valley

Paul Davies
Welsh Conservatives
Preseli Pembrokeshire

Mike Hedges
Welsh Labour
Swansea East

Ann Jones
Welsh Labour
Vale of Clwyd

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Ieuan Wyn Jones
Plaid Cymru
Ynys Môn

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Chair's foreword

Against a backdrop of decreasing capital budgets and tightening economic circumstances, it is becoming ever more important that governments are able to employ scarce resources effectively to undertake necessary capital investment which, in itself, can act as a valuable lever to support economic growth.

During the course of our inquiry we have explored the borrowing arrangements which are currently in place across the UK and considered the powers which should be granted to the Welsh Government. We have taken account of the lessons which can be learned from local government experiences of borrowing, and from the application of controls to ensure that such borrowing is affordable, sustainable and prudent.

We have considered alternative sources of financial flexibility, and innovative capital financing models which could be employed by the Welsh Government to support and drive its capital investment programme. We have also considered mechanisms to share best practice, to drive innovation, ensure robust asset management, and to support the development of skills and capabilities.

We have made a series of recommendations as a result of the evidence that we have heard. A number of these are closely linked to the work of the Silk Commission, and we hope that the Commission will give our recommendations due regard in the course of its work. We have also made recommendations that relate to aspects of financing which are already within the Welsh Government's competence, and we hope that these will be taken forward.

We are grateful to all those who have given evidence during the course of our inquiry, and particularly to our expert adviser, Angela Scott, whose support and advice have been of great assistance.

Finally, I would like to thank all the members of the Finance Committee for their contributions throughout this inquiry.

The Committee’s recommendations

The Committee’s recommendations are listed below, in the order that they appear in this report. Please refer to the relevant pages of the report to see the supporting evidence and conclusions:

Recommendation 1. The Welsh Government should be granted the power to borrow, without negative impact on the Welsh block grant, for the purpose of financing capital spending. **(Page 17)**

Recommendation 2. Capital borrowing powers for the Welsh Government should, if granted, be put onto a firm legislative footing. **(Page 17)**

Recommendation 3. If borrowing powers were granted to the Welsh Government, a control framework should be negotiated between the Welsh Government and HM Treasury which provided the Welsh Government with maximum flexibility to use borrowing effectively to respond to investment needs. The negotiated framework should be reflected in the *Statement of Funding Policy*. **(Page 21)**

Recommendation 4. In order to maximise flexibility for the Welsh Government if it were granted borrowing powers, and respect HM Treasury’s fiscal and macroeconomic responsibilities, a protocol should be negotiated between the Welsh Government and HM Treasury to enable a national borrowing limit to be agreed, if required by economic circumstances. **(Page 22)**

Recommendation 5. If the Welsh Government were granted borrowing powers, proposals for upper limits for its borrowing requirements, demonstrating affordability, sustainability and prudence, should be presented to the Assembly within the budget motion. **(Page 24)**

Recommendation 6. If borrowing powers were granted to the Welsh Government, a protocol should be negotiated with HM Treasury to ensure that the Welsh Government would be notified sufficiently early of any proposed or planned movements in National Loan Fund or Public Works Loan Board rates. **(Page 26)**

Recommendation 7. Any legislation which granted borrowing powers to the Welsh Government should make provision for HM

Treasury Ministers to grant the Welsh Government the power to issue bonds. **(Page 27)**

Recommendation 8. The Silk Commission should consider whether the devolution of tax varying powers is a pre-requisite for the granting of borrowing powers to the Welsh Government, or whether the focus should be on whether borrowing is affordable, prudent and sustainable, regardless of tax-varying powers. **(Page 31)**

Recommendation 9. The Welsh Government should undertake exploratory discussions with HM Treasury about the possibility of drawing forward future capital budgets where appropriate, particularly in relation to large scale infrastructure projects. **(Page 33)**

Recommendation 10. The Welsh Government should be able to switch its departmental expenditure limit budget allocation from resource to capital in year without requiring HM Treasury approval. **(Page 34)**

Recommendation 11. In its discussions with HM Treasury, the Welsh Government should negotiate modifications to the Budget Exchange System, including the removal of the cap on the level of underspends which can be carried through, with a view to increasing budgetary flexibility. **(Page 36)**

Recommendation 12. In the light of reductions in its capital budgets, the Welsh Government should consider using revenue-financed models, including Non-Profit Distributing models, as an alternative source of financing for capital investment, subject to robust value for money assessments. Account should be taken of the discrediting of the approach to traditional Private Finance Initiative value for money assessment. **(Page 41)**

Recommendation 13. The Welsh Government should take account of the outcomes from the business rates review, and lessons which could be learned from Tax Incremental Financing pilots elsewhere in the UK, and consider the merits of undertaking pilot projects in Wales. **(Page 44)**

Recommendation 14. The Welsh Government should consider whether its departments have the right mix and standard of the skills and capabilities required to develop, design and make use of innovative financial models and undertake borrowing, if it were granted the powers to do so. **(Page 48)**

Recommendation 15. Taking account of lessons which could be learned from the establishment of a centre of expertise in Scotland, the Welsh Government should consider putting in place arrangements to ensure that the whole Welsh public sector has access to a central source of expertise which complements existing capability and capacity. It would be essential that the costs of these arrangements did not outweigh the benefits. **(Page 52)**

Recommendation 16. The Welsh Government should commission an independent assessment of the quality of asset management across the public sector in Wales, with a specific focus on reviewing the systems in place to ensure investment needs are robustly challenged. Subject to the findings of such an assessment, the Welsh Government should consider lessons which could be learned from Scotland on the role of an independent body to challenge the assessment of investment need by public bodies. **(Page 54)**

Recommendation 17. The Welsh Government should consider lessons which could be learned from Scotland on the role of an independent body to co-ordinate asset management planning and decision making across multi-agency boundaries. **(Page 55)**

Introduction

Who are we?

1. The Finance Committee is a cross-party committee of the National Assembly for Wales, made up of Members from all four of the political parties which are represented at the Assembly.

2. We are not part of the Welsh Government. Rather, we are responsible for reporting on proposals laid before the Assembly by Welsh Ministers relating to the use of resources. We are also able to consider and report on any other matter related to, or affecting, expenditure from, the Welsh Consolidated Fund.

What is the Commission on Devolution in Wales?

3. On 11 October 2011, the Secretary of State for Wales, the Rt Hon Cheryl Gillan MP, launched the independent Commission on Devolution in Wales ("the Silk Commission"). The first phase of the Silk Commission's work, on which it will report in autumn 2012, will be to:

> "Review the case for the devolution of fiscal powers to the National Assembly for Wales and to recommend a package of powers that would improve the financial accountability of the Assembly, which are consistent with the United Kingdom's fiscal objectives and are likely to have a wide degree of support."[1]

4. The Silk Commission's Terms of Reference specifically exclude consideration of the proposals of the Independent Commission on Funding and Finance in Wales ("the Holtham Commission") for reform of the Barnett Formula.

What did our inquiry consider?

5. As a Committee, we were keen to add value to the work of the Silk Commission, and to avoid any duplication with its review. At our meeting on 25 January 2012, we agreed to consider aspects of the financing and funding of devolution in Wales with a view to informing the Part 1 report of the Silk Commission.[2] In particular, we agreed to:

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[1] Commission on Devolution in Wales, *Terms of Reference*, October 2011
[2] Minutes of the Finance Committee FIN(4)-02-12, 25 January 2012

- explore the extent to which the Welsh Government could be granted borrowing powers, looking at lessons learned from the experience of local authorities' current borrowing powers; and
- consider innovative mechanisms which could be utilised by the Welsh Government to lever capital funds for infrastructure projects, without negatively impacting on the Welsh block, including the extent to which current borrowing powers of local authorities and other organisations could be utilised.

6. In order to do this, we agreed to look at:

- measures taken by local authorities to determine and keep under review their prudential borrowing limits and how this is undertaken;
- differing levels of prudential borrowing used by local authorities in Wales, and any reasons for such differences;
- an overview of the nature of projects for which unsupported borrowing has been used, and whether there are particular reasons for such;
- lessons learned from local authorities on prudential borrowing, including the long term impact of repayments;
- how local authority borrowing could be used to boost the levels of capital available for Welsh infrastructure;
- any alternative measures being considered by local authorities to finance capital expenditure;
- alternative mechanisms for levering capital funding being considered by the Welsh Government in the preparation of its Infrastructure Plan, including the possibility of boosting borrowing by local authorities and other organisations; and
- exploring innovative capital models proposed elsewhere in the UK, how these have been developed, utilised, and, where possible, how they have performed.

How did we undertake our inquiry?

Expert adviser

7. Given its particularly technical nature, we agreed that our inquiry would benefit from the support of an expert adviser. In line with the Assembly's procedures for the appointment of committee advisers, at

our meeting on 20 February 2012 we appointed Angela Scott, Head of Regions for the Chartered Institute of Public Finance and Accountancy Group ("CIPFA").[3] Angela's experience in working with parliamentary committees, her policy and technical background in the field of public finance, and her experience working with the Scottish Government on prudential borrowing have been very helpful to us in our inquiry.

Evidence

8. During the course of our inquiry we issued a general call for evidence and a targeted written consultation of local authority Directors of Finance. We also took written and oral evidence from a range of individuals and organisations. Full lists of those from whom we received evidence and consultation responses can be found at Annexes A, B and C.

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[3] Minutes of the Finance Committee FIN(4)-03-12, 20 February 2012

1. Borrowing

Why do governments borrow?

> "Borrowing does not represent 'new' money, rather it changes the time at which money becomes available."[4]

9. Borrowing gives governments, local or central, greater flexibility about when and how they make use of resources. The result is that it can become possible, even taking account of the costs associated with borrowing, to finance assets or projects which might not otherwise be affordable from ordinary budgets. This represents not an increase in financial settlement, rather an increase in financial autonomy.

10. The Local Government Association ("LGA") told us that local government's ability to undertake prudential borrowing had increased the flexibility for local authorities to take greater advantage of potential opportunities, and to work in partnership with other funders to make possible capital investment which otherwise could not go forward, for example in relation to proactive road maintenance or housing.[5]

11. Similarly, in its response to our consultation, Carmarthenshire County Council told us that:

> "Without [prudential borrowing], we would not have been able to build so many new schools nor refurbish many more. [...] We would not have been able to retain and improve our Council housing stock."[6]

12. The Minister for Finance was clear that the Welsh Government's desire for borrowing powers was "about borrowing for a purpose, such as capital investment",[7] and, in her written evidence, she told us that, if it were granted borrowing powers, the Welsh Government would use borrowing to:

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[4] Independent Expert Group, *Evidence from the Independent Expert Group to the Commission on Scottish Devolution: Should Scottish Ministers be Able to Borrow?*, June 2009
[5] Finance Committee, FIN(4)-07-12 Paper 2, *Written evidence from the Local Government Association*, 16 May 2012
[6] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation response from Carmarthenshire County Council, FIN(4)-DF08
[7] ROP [para 35], 16 May 2012, Finance Committee

> "Finance major infrastructure initiatives that would otherwise be unaffordable. For example, large transport infrastructure projects, with high-upfront costs and long lifespans, are ideally suited to being financed via borrowing."[8]

Borrowing powers across the UK

Devolved administrations

13. Financial arrangements between the UK Government and the three devolved administrations in Northern Ireland, Scotland and Wales are set out in the *Statement of Funding Policy*.[9] Under these arrangements, HM Treasury retains responsibility for "fiscal policy, macroeconomic policy and public expenditure allocation across the United Kingdom".[10] To reflect this, the *Statement of Funding Policy* puts in place a range of controls which allow HM Treasury to discharge its responsibilities, whilst allowing the devolved administrations the "freedom to make their own spending decisions on devolved programmes within the overall totals".[11]

14. In his written evidence, the Chief Secretary to the Treasury told us that:

> "All three of the Devolution Acts […] make provisions to enable the Devolved governments to borrow to manage short term cash flow. […] The current situation in respect of borrowing powers is therefore one of parity across the devolved administrations."[12]

15. We agree that this is the case in terms of the borrowing powers referred to in the *Statement of Funding Policy*, which relate only to those powers detailed in Sections 121-2 of the *Government of Wales Act 2006* i.e. the ability of the Welsh Ministers to borrow from the Secretary of State in order to meet temporary shortfalls, or provide a working balance in the Welsh Consolidated Fund.[13] However, with

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[8] Finance Committee, FIN(4)-07-12 Paper 1, *Written evidence from the Minister for Finance*, 16 May 2012
[9] HM Treasury, *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*, October 2010
[10] Ibid
[11] Ibid
[12] Finance Committee, FIN(4)-08-12 Paper 3, *Written evidence from HM Treasury*, 24 May 2012
[13] *Government of Wales Act 2006*

regard to borrowing to fund capital investment, the parity between the devolved administrations is coming to an end.

Northern Ireland

16. The Northern Ireland Executive has borrowing powers under the *Northern Ireland Loans Act 1975* and the *Northern Ireland Miscellaneous Provisions Act 2006* to fund capital expenditure. The level of borrowing is limited to £200 million per annum, and is agreed with HM Treasury at each Spending Review.[14]

Scotland

17. Under the *Scotland Act 2012*, a new borrowing regime will be introduced for Scottish Ministers from April 2015.[15] The Chief Secretary to the Treasury told us that under the new arrangements:

> "Scottish Ministers will be responsible for raising around £6bn of devolved taxes from April 2015 onwards. This provides an independent source of revenue which Scottish Ministers can adjust as necessary to support Scottish borrowing."[16]

18. The *Scotland Act 2012*, and the accompanying non-legislative framework, places a series of controls and limits on Scottish borrowing, to ensure that it will be affordable within the broader UK context. This includes a borrowing limit of up to 10 per cent of the Scottish capital budget each year, currently approximately £230 million, with a cumulative limit of £2.2 billion.

Welsh local government

19. Welsh local government has the statutory power to borrow under the *Local Government Act 2003* for "any purpose relevant to its functions" and "the purposes of the prudential management of its financial affairs".[17]

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[14] Finance Committee, FIN(4)-08-12 Paper 3, *Written evidence from HM Treasury*, 24 May 2012

[15] *Scotland Act 2012*

[16] Finance Committee, FIN(4)-08-12 Paper 3, *Written evidence from HM Treasury*, 24 May 2012

[17] *Local Government Act 2003.* The *Local Government Act 2003* also applies to local government in England. Local authorities in Scotland have equivalent borrowing powers under the *Local Government in Scotland Act 2003*.

20. The levels of capital expenditure funded by local authorities in Wales through unsupported borrowing are shown in Table 1.

Table 1: Unsupported borrowing by local authorities in Wales[18]

Year	**Level of unsupported borrowing £000**
2004-05	30,465
2005-06	62,509
2006-07	97,182
2007-08	163,724
2008-09	125,046
2009-10	106,137
2010-11	144,448
Total	**£729,511**

21. Levels of unsupported borrowing have increased from £30 million in 2004-05 (4 per cent of total capital expenditure), to £144 million in 2010-11 (15 per cent of total capital expenditure). It has been forecast that in 2011-12, levels of unsupported borrowing will increase to £256 million, representing 24 per cent of total local authority capital expenditure.[19]

22. In its written evidence, the Welsh Local Government Association ("WLGA") told us that the common drivers for borrowing were:

- *Opportunity*
  Borrowing can enable improvements in efficiency e.g. fleet management via purchase rather than lease;
- *Return*
  Borrowing can allow local authorities to access returns on investment e.g. release of funding through elimination of surplus school places through school reorganisation; and
- *Members' priorities*
  Borrowing can enable Members' priorities to be achieved when resources are otherwise limited.[20]

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[18] Finance Committee, FIN(4)-08-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 24 May 2012
[19] Ibid
[20] Ibid

Welsh Government

23. Under the *Welsh Development Agency Act 1975*, the Welsh Government has restricted borrowing powers in relation to a range of environmental, economic and social development functions. However, the Minister for Finance, in her written evidence, told us that:

> "At present Treasury rules prevent us from exercising these powers in a way that would benefit Welsh citizens."[21]

24. This is because if the Welsh Government were to use the borrowing powers available to it under the *Welsh Development Agency Act 1975*, it is expected that there would be a corresponding offset against the Welsh block grant.[22]

25. Improving access to these borrowing powers is one of the subjects under discussion as part of the intergovernmental talks between the Welsh Government and HM Treasury on funding reform. The Minister told us that*:*

> "We have to have the capacity to borrow because we have underborrowed in Wales. We must take this one step at a time, and having a simple framework for that is an incremental move towards enabling us to use our powers effectively. […] We are asking to use our existing powers to fund our capital infrastructure needs."[23]

26. However, in the medium term, the Minister for Finance told us that broader devolved borrowing powers were needed to support capital expenditure, infrastructure investment and the Welsh economy.[24] In the Welsh Government's view:

> "[Borrowing] powers are part of the normal range of tools available to elected governments across the UK to manage their finances in an effective way."[25]

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[21] Finance Committee, FIN(4)-07-12 Paper 1, *Written evidence from the Minister for Finance*, 16 May 2012
[22] Ibid
[23] ROP [para 39], 16 May 2012, Finance Committee
[24] Finance Committee, FIN(4)-07-12 Paper 1, *Written evidence from the Minister for Finance*, 16 May 2012
[25] Ibid

27. The Holtham Commission concluded in its final report that "the Assembly Government should acquire limited borrowing powers to finance capital spending".[26] This view was reflected in a poll of 1,000 residents of Wales undertaken by the Silk Commission in February 2012, which indicated that "66% were in favour of the Welsh Government being able to borrow money to spend on capital projects such as building roads and hospitals".[27]

28. We agree that in order to fund capital investment in Wales' infrastructure, where it is cost effective and represents value for money, the Welsh Government should have access to the increased flexibility which borrowing can provide.

Recommendation: The Welsh Government should be granted the power to borrow, without negative impact on the Welsh block grant, for the purpose of financing capital spending.

29. We recognise that the Welsh Government already has limited borrowing powers, although there are barriers to making effective use of them without impacting negatively on the Welsh block grant. Therefore while it might not be wholly necessary to create new legislation to provide the Welsh Government with borrowing powers, we believe that it would be sensible to put borrowing powers onto a firmer legislative footing, rather than relying on the existing limited powers available under the *Welsh Development Agency Act 1975*.

Recommendation: Capital borrowing powers for the Welsh Government should, if granted, be put onto a firm legislative footing.

Local authority borrowing

Background

30. Prior to 2003-04, capital expenditure by local government was financed in a variety of ways. General capital funding was a combination of general capital grant (from Government) and basic credit approvals (permission to borrow which was financed by the revenue support grant). Supplementary credit approvals and capital grants were provided for spending on specific projects. Local

[26] Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, July 2010
[27] Commission on Devolution in Wales, Press release, *Survey reveals majority in favour of powers to borrow and vary tax*, 14 March 2012

authorities also had the option to augment this spending by the application of capital receipts (with some limitations) or making contributions from a revenue account.

Prudential borrowing

31. Prudential borrowing, a system of unsupported borrowing by which local authorities are allowed to borrow for capital purposes without Government consent, provided they can afford to service the debt, was introduced by the *Local Government Act 2003*, which came into effect on 1 April 2004.[28] From that date, basic and supplementary credit approvals were replaced by unhypothecated supported borrowing, general capital grant and specific grants such as the Major Repairs Allowance. The Government retained reserve powers to set limits on overall borrowing and credit in exceptional circumstances.

32. Section 3 of the *Local Government Act 2003*:

- imposes a duty for local authorities to determine, and keep under review, the amount they can afford to borrow; and
- empowers the Welsh Ministers to define that duty in more detail in regulations, which may require local authorities to have regard to specific codes of practice.[29]

33. Since 1 April 2004, local authorities in Wales, England and Scotland have been required by Regulation[30] to have regard to the *Prudential Borrowing Code for Capital Finance in Local Authorities* ("the Code"), which was developed by CIPFA. The Code, which is not statutory, although local authorities are under a strong obligation to follow it, was fully revised in 2009 to reflect the move towards International Financial Reporting Standards.

34. The prudential framework requires local authorities to demonstrate that their capital expenditure is prudent, affordable and sustainable, and is underpinned by a set of prudential indicators. Under the Code, these indicators must take into account: service objectives; stewardship of assets; value for money, prudence and

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[28] *Local Government Act 2003*
[29] Ibid
[30] In relation to Wales, the relevant regulations are: *The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003*, SI 2003/3239(W.319), as amended by S.I. 2004/1010 (W. 107), 2004/2918 (W.257), 2006/944 (W.93), 2006/2914, 2007/1051 (W.108), 2008/588 (W.59), 2009/560 (W.52) and 2010/685 (W.67)

sustainability; affordability; and practicality.[31] The indicators are produced by authorities before the start of each financial year, monitored at an appropriate frequency (often quarterly) and reported at the appropriate political level.

Controls on borrowing

35. HM Treasury retains responsibility for UK fiscal and macroeconomic policy. For any devolution of borrowing powers to the Welsh Government therefore, appropriate controls would need to be agreed to ensure that sub-national borrowing did not place national macroeconomic parameters at risk.

36. We are aware that the ability of regional governments to borrow, and, particularly, the ability for sub-national bond issuance, has been discussed at an EU level following the recent Eurozone crisis. Andrew Jeffreys, the Deputy Director for Strategic Capital Investment at the Welsh Government, told us that the Welsh Government was aware that in some European countries, Spain for example, central governments had not placed restrictions on the borrowing undertaken by sub-national governments. However, he told us that:

> "The Welsh Government's position is that it is perfectly proper for national Governments to seek to place reasonable constraints on sub-national or regional Governments' ability to borrow, and it is a matter of agreeing on the appropriate limits."[32]

37. There are a number of different models which can be used to control the borrowing of sub-national governments, although there is no consensus on whether any particular model produces consistently better outcomes. According to the evidence submitted by the Independent Expert Group to the Commission on Scottish Devolution, the control framework models can be summarised as:

- *Market discipline*
  No limits set on sub-national borrowing. Local government is free to decide how much to borrow, from whom to borrow and what to spend borrowed money on. Financial markets enforce discipline and ensure sound borrowing practices through increases in borrowing costs or limiting access to financing;

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[31] CIPFA, *Prudential Borrowing Code for Capital Finance in Local Authorities*, 2011
[32] ROP [para 42], 16 May 2012, Finance Committee

- *Rules-based controls*
  Variety of forms, including restrictions on overall budget deficits, operating budget deficits, indicators of debt servicing capacity, levels of accumulated sub-national debt or levels of spending. Alternatively, rules can limit the purposes for which borrowing can be undertaken;
- *Administrative approach*
  Direct control by central government over sub-national borrowing, including by setting temporal limits on overall debt, reviewing and authorising individual borrowing operations or the centralisation of all government borrowing with on-lending to sub-national governments; and
- *Cooperative approach*
  Negotiated process between central and sub-national government to design sub-national borrowing controls.[33]

38. The limits currently applied to borrowing by the Northern Ireland Executive, and which will be applied to borrowing by Scottish Ministers, are examples of rules-based control. In its response to the *Scotland Bill*, the Scottish Government stated that it did not:

> "Consider an arbitrary statutory limit on borrowing set by Westminster and lacking any objective justification to be acceptable as the basis for an agreement between Governments. [...] A regime along the lines of the prudential regime for borrowing which applies to local authorities, where decisions are made based on affordability, would be more appropriate."[34]

39. We recognise the fiscal and macroeconomic responsibilities of HM Treasury, and its reasonable need for controls to be agreed in relation to devolved and local authority borrowing activity. We also recognise that there are different models by which this control could be applied. Our preference, should the Welsh Government be granted borrowing powers, is that the agreed control framework should be one which gives the Welsh Government the maximum flexibility to respond to investment needs while taking robust account of affordability and

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[33] Independent Expert Group, *Evidence from the Independent Expert Group to the Commission on Scottish Devolution: Should Scottish Ministers be Able to Borrow?*, June 2009
[34] SPICe Briefing 11/37, *Financial Scrutiny Unit Briefing*: *Borrowing Powers*, June 2011

value for money. We do not believe that the application of a national limit would provide that flexibility.

Recommendation: If borrowing powers were granted to the Welsh Government, a control framework should be negotiated between the Welsh Government and HM Treasury which provided the Welsh Government with maximum flexibility to use borrowing effectively to respond to investment needs. The negotiated framework should be reflected in the *Statement of Funding Policy*.

40. In contrast to the rules-based approach put in place for the Northern Ireland Executive and the Scottish Ministers, the prudential borrowing regime which applies to local government in the UK is a hybrid of the control models set out above. There is no statutory limit on the level of local authority borrowing, meaning that, in theory, local government is free to decide how much to borrow and what to spend that borrowing on. However, there are restrictions preventing local authorities from running budget deficits. Additionally, as a high proportion of local authority borrowing is undertaken through the Public Works Loan Board,[35] the operation of local government borrowing is effectively controlled by central government through the lending rates.

41. Further to this, HM Treasury retained a 'backstop' to allow it to set a limit on local government borrowing, should the macroeconomic circumstances require it. Arrangements for this reserved ability are set out in an established protocol which was negotiated by local and central government in Scotland, and in a draft protocol negotiated by the Welsh Government and Welsh local authorities.[36]

42. We asked local government representatives for their views on the control central government retained over local authority borrowing. The Scottish Local Government Directors of Finance told us that:

> "One of the key learning points from the practical operation of the prudential regime is that against that background of local responsibility, government has retained power to impose limits

[35] See paragraph 51
[36] Finance Committee, FIN(4)-08-12 Paper 1 *Written evidence from CIPFA Directors of Finance Section*, 24 May 2012

on capital expenditure. Local authorities therefore require to be prepared in the event of any limit being imposed."[37]

43. This suggested to us that, while the protocol to impose a national limit on borrowing has never been required, local authorities take account of the potential for it to be used in their borrowing considerations. It is therefore a key component of the self-regulation which characterises the prudential borrowing framework.

44. We believe that it is reasonable for such a 'backstop' to be in place in order to enable HM Treasury to fulfil its fiscal and macroeconomic responsibilities whilst maintaining flexibility and the principle of self-regulation.

Recommendation: In order to maximise flexibility for the Welsh Government if it were granted borrowing powers, and respect HM Treasury's fiscal and macroeconomic responsibilities, a protocol should be negotiated between the Welsh Government and HM Treasury to enable a national borrowing limit to be agreed, if required by economic circumstances.

Use of borrowing powers: governance arrangements

Local government

45. The use of borrowing powers by local government is subject to robust and transparent arrangements. Through asset management planning, local authorities determine their needs in terms of new capital investment. Robust assessment is required to distinguish needs from wants.[38] The identified needs are then costed, and resource requirements established. The local authority then has to determine the most suitable financing model to support its capital programme, for example, by borrowing, use of capital receipts, or grants.[39]

46. Once this has been established, the collective sum of borrowing need is expressed via the prudential indicators, and the decision whether or not to borrow is made by the full council.[40] The prudential

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[37] Finance Committee, FIN(4)-08-12 Paper 1 *Written evidence from CIPFA Directors of Finance Section*, 24 May 2012
[38] See chapter 5
[39] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation response from Bridgend County Borough Council, FIN(4)-DF02
[40] ROP [paras 161-2], 16 May 2012, Finance Committee

borrowing arrangements place a duty on the Chief Financial Officers of local authorities to ensure that all matters which must be taken into account are brought to the attention of the budget decision making body.[41] The effect of the full council acting as the decision making body is that there is an opportunity for scrutiny by the opposition of the administration's proposals, and real transparency around proposed borrowing. The financial statements at year-end provide an opportunity for scrutiny of the progress of investment plans, as well as of the actual borrowing undertaken.

Welsh Government

47. We welcome the publication of the *Wales Infrastructure Investment Plan for Growth and Jobs*, which identifies the Welsh Government's infrastructure priorities and proposals.[42] We also welcome the evidence we received from the Minister for Finance that the Welsh Government will be:

> "Supplementing existing processes and building on previous mechanisms by strengthening cross-departmental procedures, including more rigorous, consistent evaluation and ranking of assessment options."[43]

48. If borrowing powers were granted to the Welsh Government, we believe that it would be important for it to continue to build on its emerging practice of assessing capital investment needs and to present its borrowing proposals to the Assembly for approval, providing an opportunity for scrutiny of their affordability, sustainability and prudence.

49. In a letter to the Chair, the Minister for Finance told us that:

> "Borrowing would comprise a part of the budget, which would continue to be proposed by Welsh Government Ministers, and put to a vote."[44]

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[41] Finance Committee, FIN(4)-07-12 Paper 2, *Written evidence from the Local Government Association*, 16 May 2012
[42] Welsh Government, *Wales Infrastructure Investment Plan for Growth and Jobs*, May 2012
[43] Finance Committee, FIN(4)-10-12 Paper 1, *Written evidence from the Minister for Finance*, 20 June 2012
[44] Ibid

50. We agree that proposed upper limits for borrowing should be included within the budget motion, and believe that this would be a transparent way of holding the Minister for Finance to account.

Recommendation: If the Welsh Government were granted borrowing powers, proposals for upper limits for its borrowing requirements, demonstrating affordability, sustainability and prudence, should be presented to the Assembly within the budget motion.

Sources of borrowing

Local government

51. Local government has the power to borrow from commercial banks or to issue corporate bonds. We heard during the course of our inquiry that Transport for London, which has borrowing powers equivalent to those of local authorities, issued £200 million of bonds in 2006 as part of its 5-year investment programme.[45] However, the most significant provider of debt to local authorities is the Public Works Loan Board ("PWLB"). The PWLB is a statutory body which operates within the Debt Management Office, which is an executive agency of HM Treasury. The PWLB's funds are drawn from the National Loans Fund. Table 2 shows the main sources of UK local government borrowing since 2006.

Table 2: Sources of UK local government borrowing[46]

	2006	2007	2008	2009	2010	2011
PWLB	80%	79%	78%	77%	76%	76%
Banks	13%	15%	16%	16%	17%	17%

52. HM Treasury's 2010 Spending Review included a decision to increase the rate of interest charged by the PWLB to local authorities.[47] The impact of this was to significantly reduce the amount of borrowing local authorities undertook from the PWLB. The LGA told us that:

> "Between January 2009 and September 2010 (the month before the rate increase), local authorities across the UK borrowed on

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[45] Transport for London, *TfL issues new bond*, 17 March 2006
[46] Department for Communities and Local Government, Statistical Release, *Local authority borrowing and investments – 2010-11*, December 2011
[47] HM Treasury, *Spending Review 2010*, October 2010

> average £554m a month from the PWLB. Since October 2010 local authorities across the UK have borrowed on average £228m a month from the PWLB."[48]

53. One consequence of the PWLB rate change was exploration by the LGA and WLGA of the possibility of establishing arrangements for local authorities to draw finance from bond markets. The LGA told us that:

> "The tentative conclusions were that, in normal market conditions – and, again, I emphasise that because we are in abnormal market conditions at the moment – it could make a great deal of sense for local authorities to collaborate as some sort of funded collective vehicle to borrow."[49]

54. Under such arrangements, which have been utilised in a number of other European countries, the market would have confidence to lend to local authorities at a favourable rate.[50]

55. However, in its 2012 Budget, the UK Government said that it would:

> "Introduce in 2012-13, a 20 basis points (bps) discount on loans from the Public Works Loan Board (PWLB) under the prudential borrowing regime for those principal local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans."[51]

56. It also said that it would give consideration to possible arrangements for further reductions in rates. This reduction in the PWLB rate made a local government bond issue comparatively less attractive. As Carmarthenshire County Council told us in its response to our consultation:

> "Currently with the PWLB interest rates, the prudential borrowing tends to be the most flexible cost effective option."[52]

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[48] Finance Committee, FIN(4)-07-12 Paper 2, *Written evidence from the Local Government Association*, 16 May 2012
[49] ROP [para 180], 16 May 2012, Finance Committee
[50] Ibid [para 180]
[51] HM Treasury, *Budget 2012*, March 2012
[52] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation response from Carmarthenshire County Council, FIN(4)-DF08

Welsh Government

57. The Holtham Commission considered the sources of borrowing which the Welsh Government might wish to access, should it be granted borrowing powers. The Commission's report stated:

> "It is unlikely, on purely financial grounds, that the Assembly Government would ever want to borrow from anywhere other than the National Loans Fund or PWLB."[53]

58. We were concerned by the impact which the volatility of the PWLB rates had had on local government borrowing plans, and do not believe that such volatility, or the risk of such volatility, is conducive to robust long-term borrowing and investment planning. Given the likelihood, on cost grounds, that the Welsh Government, if granted borrowing powers, would access financing through the PWLB, we believe that there should be a mechanism in place to increase the degree of certainty which the Welsh Government could have about the PWLB rates.

Recommendation: If borrowing powers were granted to the Welsh Government, a protocol should be negotiated with HM Treasury to ensure that the Welsh Government would be notified sufficiently early of any proposed or planned movements in National Loan Fund or Public Works Loan Board rates.

Devolved administration bonds

59. HM Treasury told us in its written evidence that:

> "The *Scotland Act 2012* enables Scottish Ministers to borrow from the National Loan Fund, and, for capital purposes, commercial banks."[54]

60. The Chief Secretary to the Treasury said that in his view:

> "The case for a devolved administration borrowing from the bond market is not clear cut, and has potential implications that extend further than for other sources of borrowing."[55]

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[53] Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, July 2010

[54] Finance Committee, FIN(4)-08-12 Paper 3, *Written evidence from HM Treasury*, 16 May 2012

[55] Ibid

61. In relation to bond issuance, in its November 2010 response to the financial provisions of the then *Scotland Bill*, the Scottish Government said that:

> "Whilst the Scotland Bill provides an increase in the Scottish Government's ability to manage its infrastructure investment programme, it is significantly more restrictive than the borrowing permitted by Local Authorities and other public bodies such as Transport for London."[56]

62. The UK Government has committed to undertaking a consultation on the issues around the issuance of Scottish bonds.[57] We welcome this consultation, and look forward to seeing its outcomes.

63. The *Scotland Act 2012* contains provisions which would enable, in circumstances which would not have a negative effect on total UK borrowing or undermine the overall UK fiscal position, HM Treasury Ministers to grant Scottish Ministers the power to borrow by way of bonds.[58] In our view, this is a sensible provision, and one which would be equally applicable to Wales.

Recommendation: Any legislation which granted borrowing powers to the Welsh Government should make provision for HM Treasury Ministers to grant the Welsh Government the power to issue bonds.

Taxation and borrowing

Local government

64. In its written evidence, the WLGA stated that:

> "Any borrowing needs a revenue resource to pay for it over the period of the loan, so without extra revenue to fund the costs of borrowing (for instance through tax raising) scarce revenue resources will be used up."[59]

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[56] Scottish Government, *Response to Scotland Bill Financial Provisions*, November 2010

[57] Finance Committee, FIN(4)-08-12 Paper 3, *Written evidence from HM Treasury*, 16 May 2012

[58] Ibid

[59] Finance Committee, FIN(4)-08-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 24 May 2012

65. Evidence we heard from the WLGA and in responses to our consultation suggested to us that the use of prudential borrowing in Wales had varied greatly between local authorities according to local policies, needs and risk appetites.[60] We heard that some Welsh local authorities have taken policy decisions that they will not increase council tax to finance unsupported borrowing.[61] However, the WLGA was clear that:

> "It is critical that the 'golden rule' of unsupported borrowing is adhered to i.e. that the borrowing should not be undertaken unless there is a sufficient sustainable revenue stream committed to support it."[62]

66. In 2010-11, local authorities in Wales budgeted £340 million for debt management, representing 4.7 per cent of net revenue authority expenditure. This level was forecast to remain stable for 2011-12.[63] The stable allocation for debt management suggests that Welsh local authorities are choosing to reduce revenue spend on other activities in order to finance the cost of debt associated with capital investment. There is a risk associated with this course; Carmarthenshire County Council, it its response to our consultation, explained this very clearly:

> "Whilst there are many benefits of prudential (or unsupported) borrowing, there are limits to its use in as much as the more your borrowing costs go up the more you tie up future revenue budgets. In an era of likely reductions in grant settlements the more of your budget that is legally committed the less opportunity you will have to deliver any required efficiency."[64]

67. Local authorities in Scotland have been subject to a council tax freeze since 2008-09. The Scottish Local Government Directors of Finance told us that prior to the announcement of this freeze:

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[60] Finance Committee, FIN(4)-08-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 24 May 2012 and Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation responses from Pembrokeshire County Council (FIN(4)-DF01), Bridgend County Borough Council (FIN(4)-DF-02), Cardiff Council (FIN(4)-DF04), Conwy Council (FIN(4)-DF07), and Carmarthenshire County Council (FIN(4)-DF08)
[61] Finance Committee, FIN(4)-08-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 24 May 2012
[62] Ibid
[63] Ibid
[64] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation response from Carmarthenshire County Council, FIN(4)-DF08

> "There were at least two authorities that had formerly planned to increase council tax and to use that additional revenue stream to augment their capital expenditure plans. Clearly as a result of the freeze [...] they had to find a combination of alternative means of meeting those loan charges and perhaps scaling back on their capital programmes."[65]

Housing Revenue Account

68. The Housing Revenue Account Subsidy System ("HRASS") in England was reformed in March 2012, when local authorities took on the historic debt which was previously financed by the UK Government through the national pooling of housing rents. As a result of the reform, local authorities in England are able to borrow against rental income.

69. In Wales, discussions are ongoing between local government and the Welsh Government with a view to ending the current HRASS through a settlement which would replace subsidy payments for the next 30 years.

70. In England, the level of prudential borrowing which can be undertaken against the Housing Revenue Account has been capped.[66] The LGA told us that the new system allows local authorities greater flexibility, but said that the borrowing cap is unnecessary, given the requirements for self-regulation under the prudential framework.[67] The Housing White Paper, introduced by the Welsh Government in May 2012, has provisions in it for controls on rental levels,[68] but it is not yet clear whether a limit on borrowing against rental income would be introduced in Wales (no equivalent limit applies in Scotland). The WLGA told us that:

> "We do not understand why [HM Treasury] wants a limit because that limit works in a very uneven way. Some authorities that still have housing stock in England cannot borrow very much more because of the way in which the

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[65] ROP [para 55], 24 May 2012, Finance Committee
[66] Ibid [paras 49-50]
[67] ROP [para 190-4], 16 May 2012, Finance Committee
[68] Welsh Government, *A white paper for better lives and communities*, May 2012

> Treasury has set the limit. Some can, and they have been quite fortunate, but others cannot and they have been unfortunate."[69]

Welsh Government

71. The Chief Secretary to the Treasury told us that, in his view:

> "There is an inherent link between borrowing powers and the ability to raise revenue independently to support borrowing for two reasons. First, borrowing powers can be appropriate and necessary to reflect and manage the increased responsibility from raising revenue. Secondly, an independent source of income can be adjusted as appropriate to support the costs of borrowing."[70]

72. However, in his oral evidence, Andrew Jeffreys, the Welsh Government's Deputy Director for Strategic Capital Investment, suggested that there is no direct link:

> "The borrowing limits that the Treasury has agreed for the Scottish Government are not explicitly related to the scope for the Scottish Government to vary its income. They are, effectively, reasonably arbitrary limits that have been set, and it will be up to the Scottish Government to choose how it finances any debt that it raises. So it is a distinct possibility that the Scottish Government will start borrowing from 2015 without doing anything to tax rates in Scotland, and it will be up to it to do that. So, there is no necessary linkage between raising tax income and borrowing in the Scottish settlement."[71]

73. The *Scotland Act 2012* gives Scottish Ministers limited borrowing powers along with an enhanced ability to vary taxes. Capital borrowing will need to be self-financed through increased revenue from taxation in Scotland, or a reduction in public spending.[72]

74. The Holtham Commission's report stated that:

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[69] ROP [para 157], 24 May 2012, Finance Committee
[70] Finance Committee, FIN(4)-10-12 Paper 1, *Written evidence from HM Treasury*, 20 June 2012
[71] ROP [para 36], 16 May 2012, Finance Committee
[72] Finance Committee, FIN(4)-08-12 Paper 3, *Written evidence from HM Treasury*, 16 May 2012

> "There is enough certainty to allow a constrained borrowing power for capital expenditure that fits within a UK framework provided it was small enough that its serving was not a significant burden on the block grant. Some limited borrowing could therefore be undertaken in the absence of tax devolution."
>
> "The case for borrowing powers is stronger once tax varying powers are devolved. The Assembly Government would have a distinct source of revenue under its own control that would provide additional reassurance about its ability to repay borrowed funds."[73]

75. We recognise that there is a need to ensure that a recurring revenue stream is available to service the recurring debt incurred as a result of borrowing, and to ensure that borrowing is affordable in the short and medium terms. We also recognise that there are differing views on whether tax varying powers are the only way in which this recurrence can be achieved.

76. We heard that in England local authorities are able to borrow, up to a capped level, against their rental income under the new HRASS arrangements, and we received evidence from local government that prudential borrowing has been undertaken despite the council tax freeze in Scotland and the decisions taken by some local authorities in Wales not to vary council tax rates in order to fund borrowing.

77. We also heard about the risk of 'silting up' revenue budgets with the costs of borrowing in the absence of the flexibility of varying revenue via taxation, and the Chief Secretary to the Treasury was clear that, in his view, there is an inherent link.

Recommendation: The Silk Commission should consider whether the devolution of tax varying powers is a pre-requisite for the granting of borrowing powers to the Welsh Government, or whether the focus should be on whether borrowing is affordable, prudent and sustainable, regardless of tax-varying powers.

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[73] Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, July 2010

2. Budget flexibility

78. Borrowing can provide governments with a valuable tool to increase the financial flexibility available for capital investment. However, borrowing is not without its associated costs, and, as the WLGA told us:

> "It is important that "fixed" costs such as capital charges do not become too great a proportion of the revenue budget as that makes efficiency savings harder to achieve as there is less ordinary revenue budget to be saved."[74]

79. During the course of our inquiry, we therefore considered other mechanisms which could increase the financial flexibility available to the Welsh Government.

Large scale infrastructure projects

80. We heard evidence from the Scottish Futures Trust that the Scottish Government was funding the Forth Replacement Crossing, which is anticipated to cost around £1.45 to £1.6 billion,[75] from its traditional capital budgets.[76]

81. The Welsh Government's capital budget was reduced in the 2010 Spending Review by over 40 per cent in real terms.[77] This reduction makes it more difficult for large projects to be funded via traditional capital budgets.

82. In its final report, the Holtham Commission suggested that the main argument for borrowing powers was that there are projects of a sufficiently large scale as to make them an insupportable burden on the Welsh budget, unless their financing could be stretched over a longer time period.[78] The example considered in the Commission's

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[74] Finance Committee, FIN(4)-08-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 24 May 2012
[75] Scottish Government, *Work starts on Forth Crossing*, 21 December 2011 (Costs relate to 2016 prices)
[76] ROP [para 33], 2 May 2012, Finance Committee
[77] Welsh Government, *Wales Infrastructure Investment Plan for Growth and Jobs*, May 2012
[78] Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, July 2010

report was the “new M4”, which had been rejected by Welsh Ministers because of concerns about its affordability.[79]

83. We recognised in our consideration of why governments borrow, that borrowing does not create new money.[80] Instead it changes the time at which resources become available, and thereby increases the flexibility available for investment planning. We believe that similar flexibility could, in some circumstances, be introduced through adjustments to the timing of traditional capital budgets, although caution would need to be exercised in using such a facility. Indeed the UK Government’s 2008 Pre-Budget Report provided the Welsh Government with the opportunity to bring forward £140 million of capital expenditure from 2010-11 into 2008-09 and 2009-10.[81]

Recommendation: The Welsh Government should undertake exploratory discussions with HM Treasury about the possibility of drawing forward future capital budgets where appropriate, particularly in relation to large scale infrastructure projects.

Resource to capital transfers

84. The departmental expenditure limit (“DEL”) budgets set by HM Treasury for the three devolved administrations include a resource component and a capital component. This split reflects HM Treasury’s management of the UK’s macroeconomic aggregates, and, in particular, its imposition of fiscal rules. The devolved administrations, like UK Government departments, are not permitted to switch allocations between the two budgets. This restriction is not a feature of the *Government of Wales Act 2006*, but instead reflects the evolution of the *Statement of Funding Policy* as HM Treasury exercised its requirement to relate borrowing to capital expenditure. In practice, the devolved administrations have found that HM Treasury is agreeable to permitting them to switch their allocation from resource to capital. Stern resistance has been met however to proposed switches from capital to resource.[82]

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[79] Welsh Government, Ieuan Wyn Jones AM (Deputy First Minister and Minister for the Economy and Transport), *Cabinet oral statement on the National Transport Plan*, 15 July 2009
[80] See paragraph 9
[81] Welsh Government, Andrew Davies AM (Minister for Finance and Public Service Delivery), *Cabinet written statement on Final Budget 2009-10*, 2 December 2009
[82] Independent Expert Group, *Evidence from the Independent Expert Group to the Commission on Scottish Devolution: Should Scottish Ministers be Able to Borrow?*, June 2009

85. The Welsh Government has made use of the ability to switch its allocation from resource to capital: for example, in its 2011-12 Supplementary Budget, it made a resource to capital transfer of £97 million.[83]

86. The WLGA told us that in its view:

> "The Welsh Government should have more discretion over how its own capital and revenue split is determined."[84]

87. We agree with this position, and welcome HM Treasury's approach to permitting resource to capital transfers, and the additional flexibility for financial planning and allocation which it provides. At present, the Welsh Government requires HM Treasury approval before undertaking any reallocation from resource to capital. To ensure that the Welsh Government has the maximum flexibility over its financial planning, we believe that it should have an automatic ability to switch its allocation from resource to capital in year.

Recommendation: The Welsh Government should be able to switch its departmental expenditure limit budget allocation from resource to capital in year without requiring HM Treasury approval.

Saving unspent funds

88. Until its abolition was announced in the 2010 Spending Review, the End Year Flexibility ("EYF") system enabled UK Government departments and the devolved administrations to carry forward unspent departmental expenditure limit ("DEL") to future years. This was intended to avoid an end of year spending rush (the 'use it or lose it' principle) which is not conducive to good financial management or value for money. Unlimited DEL underspends could be carried forward as EYF funds, with any underspend remaining within the control totals of revenue DEL and capital DEL. EYF funds could be rolled over into subsequent years, allowing stocks to be built up over time. However, draw down of EYF funds was not automatic, requiring the approval of HM Treasury.

89. The final report of the Holtham Commission considered funding flexibility and, in particular, Welsh Ministers' limited ability to save

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[83] Welsh Government, *Second Supplementary Budget Motion 2011-12*, February 2012
[84] Finance Committee, FIN(4)-10-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 20 June 2012

unspent funds which could then be drawn down in future years. It concluded that because access to EYF funds was not automatic, it had limited usefulness as a mechanism for saving resources for transfer into future years. The Commission recommended that the Welsh Government should have a "free hand" in accessing EYF funds without need for prior discussion or agreement from HM Treasury.[85]

90. The 2010 Spending Review announced the abolition of EYF, and the accumulated stocks, which had amounted in total to some £20 billion, as the UK Government was of the view that it would "further increase the deficit if they were spent".[86] The Welsh Government therefore lost its accumulated EYF stocks, some £385 million.[87] The Welsh Government opposed this, saying that it would "oppose […] any arrangement which would result in taking away money which ha[d] already been voted by Parliament for Wales".[88]

91. In March 2011, the UK Budget announced the introduction of the new Budget Exchange System ("BES") from 2011-12. The BES allows UK Government departments to surrender any underspend, subject to a prudent limit, in advance of the end of the financial year, in exchange for a corresponding increase in the following year's budget.[89] The Minister for Finance confirmed to us in July 2011 that, under the new system, the Welsh Government would be able to carry forward underspends, and that the devolved administrations were receiving flexibility in comparison with Whitehall departments, as underspends would not be capped.[90]

92. The Finance Ministers of the devolved administrations met in July 2011 with the Chief Secretary to the Treasury to discuss arrangements for the operation of the BES. The outcome was a modified BES, under which a cap would be agreed for underspends which could be carried through (agreed at 0.6 per cent of revenue DEL and 1.5 per cent of capital DEL), but there would be no requirement, unlike for UK Government departments, to notify HM Treasury of expected underspends in advance. The devolved administrations could choose

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[85] Independent Commission on Funding and Financing for Wales, *Fairness and accountability: a new funding settlement for Wales*, July 2010
[86] HM Treasury, *Spending Review 2010*, October 2010
[87] Finance Committee, FIN(3)-11-R01, *Report on GEN-LD8296 – Draft Budget Proposals 2011-12*, March 2011
[88] Welsh Government, *Draft Budget 2011-12 Narrative*, November 2010
[89] HM Treasury, *Budget 2011*, March 2011
[90] Finance Committee, *Scrutiny of Supplementary Budget Motion 2011-12 (Summer 2011)*, July 2011

to notify HM Treasury by early December, which would result in the ability to access the carry over earlier in the subsequent financial year.[91] The Minister for Finance said that:

> "While underspends which are in excess of this limit will not be carried forward, a cap at this level is sufficient to ensure that, with careful financial management, resource voted to Wales by Parliament will not be lost. The cap is significantly in excess of our underspends in recent years."[92]

93. While carry through of underspends is permitted, stocks cannot be accumulated under the BES. The Minister told us that:

> "The budget exchange system is inadequate, as the Welsh Government said in response to the Silk Commission. The Ministers for Finance from Scotland, Northern Ireland and Wales argued and worked hard to get something out of the abolition of end-year flexibility that we could use. Therefore we have the exchange mechanism but it does not give us meaningful access to end-of-year flexibilities – which we have used prudently and responsibly to great effect in terms of the impact on public services. We need access to flexibility. We can use unspent funds and carry them forward into the next financial year, and to be constrained in this way [...] is very unhelpful."[93]

94. We agree that the BES, in its current form, does not provide the Welsh Government with sufficient end-year flexibility.

Recommendation: In its discussions with HM Treasury, the Welsh Government should negotiate modifications to the Budget Exchange System, including the removal of the cap on the level of underspends which can be carried through, with a view to increasing budgetary flexibility.

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[91] Welsh Government, Jane Hutt AM (Minister for Finance), *Cabinet written statement on New End Year Flexibility Arrangements for Devolved Administrations*, 19 July 2011
[92] Ibid
[93] ROP [para 88], 16 May 2012, Finance Committee

3. Innovative financing models

Revenue-financed models

95. In a statement in late 2011, the Minister for Finance said:

> "The Welsh Government's position on the old, discredited private finance initiative model is clear: we do not use it. I am pleased to note that the Chancellor of the Exchequer has now recognised this too, and has embarked on a review. However, my officials are in discussion with the UK and Scottish Governments about different public-private partnership models that could offer value for money."[94]

96. The Minister for Finance highlighted to us in her oral evidence the contrast between Wales and Scotland with respect to the use of such revenue-financed models:

> "We have been proven right [...] in rejecting the old PFI schemes. In contrast to Scotland, which has a £1 billion repayment bill, ours is only £100 million a year."[95]

97. Recently, the House of Commons Public Accounts Committee reported on equity investment in privately financed projects. In its report, it concluded that:

> "The excessively high returns being made by private investors in PFI projects are further evidence that the previous emphasis on using PFI is inappropriate for the future."[96]

98. The Scottish Government supports the use of the Non-Profit Distributing model[97] to deliver revenue funded investment. This model was developed and introduced as an alternative to, and has since superseded, the traditional Private Finance Initiative ("PFI") model in Scotland. The Scottish Government's *Infrastructure Investment Plan 2011* states that it aims to ensure that revenue funded methods will be used at a sustainable level, and has capped future revenue

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[94] Welsh Government, Jane Hutt AM (Minister for Finance) *Cabinet oral statement on Wales Infrastructure Investment Plan*, 22 November 2011
[95] ROP [para 93], 16 May 2012, Finance Committee
[96] House of Commons Committee of Public Accounts, Eighty-first report of session 2010-12, *Equity Investment in Privately Finance Projects*, HC1846, 2 May 2012
[97] See paragraphs 104 to 113

commitments to a maximum of 5 per cent of the expected future annual DEL budget.[98] At current funding levels this is equivalent to £1.4 billion.[99]

99. The Scottish Government's Cabinet Secretary for Finance, Employment and Sustainable Growth, in a letter to the Chair, told us that:

> "Revenue commitments include the Scottish Government share of historical PFI commitments, debt payments on future borrowing flowing from the new powers in the *Scotland Act 2012*, and payments in relation to Network Rail's Regulatory Asset Base (RAB) and our Non Profit Distributing (NPD) programme."[100]

100. The discussions currently taking place in relation to development, costs and timescales of individual NPD projects, and the Scottish Government's talks with HM Treasury about the operation of the borrowing powers granted by the *Scotland Act 2012*, mean that it is not possible to "state with certainty the long-term level of revenue commitments in relation to the cap".[101] Estimates provided to the Scottish Parliament project that the revenue-financed investment charges will rise from 3.1 per cent of total DEL in 2012-13 to 3.6 per cent in 2014-15, but the Cabinet Secretary advised that this:

> "Is likely to be an overestimate of the charges related directly to investment, as some of the PFI payments will include costs related to ongoing maintenance."[102]

Local government

101. The WLGA told us in its written evidence that:

> "Local authorities continuously seek alternative funding mechanisms to lever much needed resources into local areas and economies. This investment can be used to directly fund

[98] Scottish Government, *Infrastructure Investment Plan 2011*, December 2011
[99] Finance Committee, FIN(4)-10-12 Paper 5 *Written evidence from John Swinney MSP, Cabinet Secretary for Finance, Employment and Sustainable Growth*, 20 June 2012
[100] Ibid
[101] Ibid
[102] Ibid

assets or to work in partnership with others, to allow greater levels of investment."[103]

102. These alternative mechanisms include use of European funding, Public Private Partnerships and exploration of Tax Incremental Financing.[104] However, in a number of the consultation responses we received from individual local authorities, we were told that the authorities intended to continue to use those mechanisms which were presently in use, and were not seeking to innovate.[105]

103. The WLGA told us that it was likely that:

> "The lack of innovation may be explained by excessive central prescription and the work of innovation, at a strategic level, has to be done nationally and collaboratively through groups like the Capital Financing and Investment Group and through the work of the WLGA and the LGA."[106]

Non-Profit Distributing model

104. In Scotland, use has been made of the Non-Profit Distributing ("NPD") model as an alternative to the traditional PFI model. NPD is a revenue-financed model, from which any profits accruing are capped. NPD models involve a partnership with a private sector provider, which finances, constructs and maintains an asset. The public sector body then, from its revenue budget, pays an annual charge over a period to the private sector provider once the asset has been built.

105. In his oral evidence to us, Peter Reekie of the Scottish Futures Trust told us that:

> "The NPD model is a public-private partnership and the critical difference between it and PFI is that it caps the profit that can

[103] Finance Committee, FIN(4)-08-12 Paper 2 *Written evidence from the Welsh Local Government Association, 24 May 2012*
[104] See paragraphs 114 to 122
[105] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation responses from Pembrokeshire County Council (FIN(4)-DF01), Bridgend County Borough Council (FIN(4)-DF02), Conwy Council (FIN(4)-DF07), and Carmarthenshire County Council (FIN(4)-DF08)
[106] Finance Committee, FIN(4)-10-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 20 June 2012

be made by the private sector partner [...] to a reasonable level, commensurate with the risk being taken."[107]

106. Initially, profits in excess of the cap were paid to a nominated charity. However, the structure has since been amended to permit:

"Any surpluses over and above the capped profit level [to] return to the procuring body, which will be a local authority, health board or whatever."[108]

107. The Scottish Local Government Directors of Finance told us that they were not aware that the cap on profits had had any detrimental impact on attracting bidders.[109]

108. In November 2010, the Scottish Government announced a pipeline of £2.5 billion NPD projects across core public services in transport, education and health. The Scottish Futures Trust is delivering this pipeline in partnership with the Scottish Government, local government, NHS Boards and other public bodies.

109. We asked the Scottish Local Government Directors of Finance about how the NPD model compared with borrowing from the PWLB. Mr West told us that although the headline interest rates suggested that borrowing would have been the cheaper option, when the overall value for money assessments were conducted, the NPD model was shown to be slightly better value for money.[110]

110. We were interested in the way in which value for money was assessed, and are clear that such assessments must be robust in relation to any financing models developed or used by the Welsh Government. A recent House of Commons Public Accounts Committee inquiry into the lessons which could be learned from the use of traditional PFI models concluded that:

"It has been far too easy for the Government to use [PFI] as the only form of financing available without clearly proving whether it is value for money."[111]

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[107] ROP [para 39], 2 May 2012, Finance Committee
[108] Ibid [para 39]
[109] ROP [para 61], 24 May 2012, Finance Committee
[110] Ibid [para 61]
[111] House of Commons Committee of Public Accounts, Forty-fourth report of session 2010-12, *Lessons from PFI and other projects*, HC1201, 18 July 2011

111. The Committee cited a lack of sufficient challenge to the use of PFI instead of conventional procurement, and recommended that:

> "Assessments of new projects should include: a more transparent and complete comparison of alternative funding, the current high cost of using private finance; a rigorous assessment of the transfer of risk to investors; how substantial long-term financial commitments will be accommodated within the public sector's need to make spending cuts; and the potential for improvements in the delivery of conventional projects."[112]

112. In relation to NPD, the Scottish Futures Trust told us that:

> "The value for money of the NPD programme is assessed on the basis of its ability to deliver much-needed infrastructure that adds substantial value to Scotland and its economy now, rather than having to wait until budgets become available. […] On individual projects, we have published specific guidance on assessing the value for money of projects in this programme. […] The value-for-money guidance refers to choosing projects that are appropriate for this sort of financing and delivering them well."[113]

113. We welcomed the evidence from Gerald Holtham, in his capacity as Infrastructure Investment Adviser to the Welsh Government, that NPD was one of the models being explored by the Welsh Government as a means of funding infrastructure in relation to certain projects.[114]

Recommendation: In the light of reductions in its capital budgets, the Welsh Government should consider using revenue-financed models, including Non-Profit Distributing models, as an alternative source of financing for capital investment, subject to robust value for money assessments. Account should be taken of the discrediting of the approach to traditional Private Finance Initiative value for money assessment.

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[112] House of Commons Committee of Public Accounts, Forty-fourth report of session 2010-12, *Lessons from PFI and other projects*, HC1201, 18 July 2011
[113] ROP [para 47], 2 May 2012, Finance Committee
[114] ROP [para 94], 16 May 2012, Finance Committee

Tax Incremental Financing

England

114. In September 2010, the Deputy Prime Minister, the Rt Hon Nick Clegg MP, announced that "local authorities in England will be granted new borrowing powers aimed at driving local investment and economic growth" by allowing them "to borrow against predicted growth in their locally raised business rates".[115] The proposal was considered by the Department for Communities and Local Government as part of its Local Government Resource Review,[116] and was included in the *Local Government Finance Bill*, which was introduced on 19 December 2011 and is now being considered by the House of Lords. Amongst other things, the Bill:

- enables local authorities to retain a proportion of the business rates generated in their area, providing them with a strong financial incentive for them to promote local economic growth; and
- enables local authorities to carry out Tax Incremental Financing ("TIF"), giving them the ability to undertake borrowing against future business rates growth, supported by the forecast tax increment that accrues from additional development.[117]

Scotland

115. Scottish Ministers have brought forward secondary legislation[118] under the existing provisions of the *Local Government Finance Act 1992*, which enables up to six TIF pilot schemes to take place. In total, 16 applications were received for TIF pilot projects.[119] The Scottish Government will evaluate the outcomes from the pilots before deciding whether to introduce a wider scheme through primary legislation.[120]

116. Bruce West of the Scottish Local Government Directors of Finance told us that his authority, Argyll and Bute, was one of the pilot

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[115] HM Treasury Press Release 47/10, *More financial freedom for local authorities*, 20 September 2010
[116] Department of Communities and Local Government, Local Government Resource Review
[117] *Local Government Finance Bill*
[118] *The Non-Domestic Rating Contributions (Scotland) Amendment Regulations 2010*, SI 2010/391
[119] Scottish Futures Trust, Tax Incremental Financing
[120] Scottish Government, Tax Incremental Financing

authorities. At the time of giving evidence, the authority was developing its full business case, which was anticipated to be completed by March 2013. In Mr West's view, the purpose of the pilot programme was to undertake:

> "The initial stages of looking into the merits of the project and testing whether there is a likelihood of future incremental increases in non-domestic rates income sufficient to fund the ongoing borrowing costs."[121]

117. He also told us that:

> "There is a significant amount of work to be done on the detailed scoping of the project, putting together outline designs and costings and also, perhaps more significantly, some economic and financial assessment of what this investment will bring in the way of additional business activity leading to additional non-domestic rates."[122]

118. We were particularly interested in the importance of "additional business activity". Mr West explained to us that additional business rates accruing within the TIF area were calculated by assessing the baseline of rates within a defined area, and tracking any increases above the baseline.[123]

Wales

119. TIF has not, to date, been used in Wales, although the WLGA told us that:

> "For certain authorities, and especially in the context of the work that the Minister for Business, Enterprise, Technology and Skills is pursuing around City-Region economic growth [...] it has the potential to be a useful additional funding mechanism."[124]

120. This was echoed in Cardiff Council's response to our consultation, in which it told us that while there are limitations on the scale of project for which TIF could be suitable, given the potential

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[121] ROP [para 66], 24 May 2012, Finance Committee
[122] Ibid [para 68]
[123] Ibid [para 72]
[124] Finance Committee, FIN(4)-10-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 20 June 2012

difficulties associated with linking increases in non-domestic rates specifically to investment, it is "lobbying for the use of Tax Increment Financing in the city, specifically for the Central Business District development".[125]

121. The Minister for Finance told us in her oral evidence on 16 May 2012 that before she considered the possibility of tax-related provisions, she was awaiting the report of Professor Brian Morgan's review of business rates arrangements in Wales,[126] as a key part of the review's remit had been to assess how the rates regime might operate as a lever for economic growth.[127]

122. The Minister also told us that she had received advice from her officials that a cautious approach should be taken to using TIF.[128] As we were told by Andrew Jeffreys, the Deputy Director for Strategic Capital Investment at the Welsh Government, there is a risk that:

> "It would only be those local authorities that have a buoyant business rates base that could really benefit from this. […] In England, this is arguably leading to a concentration of investment in areas where there is already good scope for local development."[129]

Recommendation: The Welsh Government should take account of the outcomes from the business rates review, and lessons which could be learned from Tax Incremental Financing pilots elsewhere in the UK, and consider the merits of undertaking pilot projects in Wales.

Wales Infrastructure Investment Plan for Growth and Jobs

123. The Welsh Government published its first *Wales Infrastructure Investment Plan for Growth and Jobs* on 22 May 2012, during the course of our inquiry. In relation to innovative financing models for infrastructure investment, the Plan states:

> "We are also exploring other innovative means of financing infrastructure investment. As set out in our Programme for

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[125] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation response from Cardiff Council, FIN(4)-DF04
[126] ROP [para 98], 16 May 2012, Finance Committee
[127] Welsh Government, *Business Rates Policy Review*. The Business Rates Task and Finish Group published its report on 12 June 2012.
[128] ROP [para 98], 16 May 2012, Finance Committee
[129] Ibid [para 105]

> Government, we are considering the full range of potential funding partners – both public and private – and a wide range of instruments and delivery mechanisms, including development of non-dividend vehicles."[130]

124. The Plan also provides further detail in relation to innovative financing approaches which the Welsh Government had previously announced, including the Local Government Borrowing Initiative.

Local Government Borrowing Initiative

125. The Local Government Borrowing Initiative ("LGBI") is a model developed by the Welsh Government to provide revenue support to allow local authorities to undertake unsupported borrowing in order to fund investment in highways infrastructure. It is an example of the way in which the Welsh Government has been able to utilise the legal borrowing powers of local government in order to generate additional investment in the absence of having its own borrowing powers. The Minister for Finance told us in her written evidence that:

> "The LGBI was designed as an initiative to provide a new tranche of support to local authorities to address revenue shortfalls, allowing them to eke out additional resources with which to undertake prudential borrowing."[131]

126. In response to our consultation, Flintshire County Council told us that:

> "In the current absence of Welsh Government having the ability to borrow, this is a means which could be utilised further, subject to funding being made available to meet the capital financing costs which councils will incur in their revenue accounts. [...] Government has committed to meeting the revenue costs through specific grant in 2012-13 and through provision within the Local Government Financial Settlement in 2013-14 and 2014-15. To remain viable, it is essential that

[130] Welsh Government, *Wales Infrastructure Investment Plan for Growth and Jobs*, May 2012

[131] Finance Committee, FIN(4)-07-12 Paper 1, *Written evidence from the Minister for Finance*, 16 May 2012

Welsh Government support continues throughout the whole terms of the borrowing."[132]

127. In a letter to the Chair, the Minister for Finance confirmed that:

> "The Welsh Government is providing additional revenue funding to assist local authorities in meeting mounting revenue pressures, allowing them to free up resources for self-financed borrowing up to an expected aggregate total of approximately £170 million, exclusively for capital highway improvement investment during the 3-year period 2012-2015. Revenue funding will be made available over a 22-year period."[133]

128. The WLGA told us that while "local government will always maintain that funding should come without conditions" it welcomed and was supportive of the LGBI.[134] However, it was also clear that although unsupported borrowing by local government can currently be used in this way to try to bridge the gap between investment need and available funding, it is important that the cost of servicing the borrowing is balanced with the potential to constrain delivery of mainstream services.[135]

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[132] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation response from Flintshire County Council, FIN(4)-DF06

[133] Finance Committee, FIN(4)-10-12 Paper 1, *Written evidence from the Minister for Finance*, 20 June 2012

[134] Finance Committee, FIN(4)-10-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 20 June 2012

[135] Finance Committee, FIN(4)-08-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 24 May 2012

4. Capacity and capability

129. It is a matter for the Silk Commission to consider whether or not to recommend that the Welsh Government be granted borrowing powers, although, as set out above,[136] we believe that such powers would be appropriate. We are, however, of the view that the Welsh Government should take steps in the meantime to ensure that it is prepared to respond effectively should such powers be granted, and that it is able to make the best use of the mechanisms currently available to it in relation to innovative financing and budget flexibility.

Welsh local government

130. In its written evidence, the WLGA told us that:

> "The freedom provided by the introduction of the prudential code encouraged a new way of thinking about capital investment decisions and how they link with wider strategic objectives and plans. It also required the development of a new set of skills in order to make best use of the powers for the benefit of local communities."[137]

131. While there are, therefore, benefits to be reaped from the additional flexibility provided by the prudential borrowing framework, there are also challenges which need to be met.

132. The WLGA told us in its oral evidence about work which had been undertaken on its behalf in 2006 by PricewaterhouseCooper, to look at the management of capital investment projects and programmes. That, and work with the Confederation of British Industry, had suggested that if financial innovation were to take place, capacity, skills and capability needed to be developed in a range of areas, including proactive risk management, building business cases and commercial negotiation.[138]

133. If the Welsh Government were to be granted borrowing powers, or were to make increased use of innovative financial models, it would be important that the right skills and capabilities were in place.

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[136] See chapter 1
[137] Finance Committee Paper, FIN(4)-08-12 Paper 2, *Written evidence from Welsh Local Government Association*, 24 May 2012
[138] ROP [para 166], 24 March 2012, Finance Committee

Recommendation: The Welsh Government should consider whether its departments have the right mix and standard of the skills and capabilities required to develop, design and make use of innovative financial models and undertake borrowing, if it were granted the powers to do so.

Scottish Futures Trust

134. We took evidence from the Scottish Futures Trust ("SFT"). Initially established in 2008 as an independent arm's length body to fulfil the newly elected Scottish National Party Scottish Government's manifesto commitment to investigate a Scottish bond, the role of the SFT has since developed and diversified. Its Director of Finance, Peter Reekie, told us that its role, in addition to developing potential new financial models, is to:

> "Bring together, in a centre of expertise, the people and knowledge to do things differently to how they have been done before. [...] an expert body that looks at different ways of doing things, and brings the public and private partners together, if that is needed, to innovate with these structures. [...] spending our money more wisely and adopting a 'needs not wants' attitude to specifying and buying buildings and infrastructure."[139]

135. We were particularly interested in the operational independence of the SFT, and the benefits that this had brought to the organisation and the wider public sector. Mr Reekie told us that it allowed greater:

> "Freedom and flexibility to look around the environment at where there could be opportunity to do things differently and to make improvements, and to pursue those, and not, at any point in time, to pursue something that the Government or Ministers may prioritise for us."[140]

136. TIF was one example of the results of operational independence, as it had not been a political priority during the model's initial development, but was now being taken forward as a pilot programme.[141]

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[139] ROP [paras 13 and 20], 2 May 2012, Finance Committee
[140] Ibid [para 14]
[141] Ibid [para 14]

137. The Scottish Local Government Directors of Finance told us that "we have found [the Scottish Futures Trust's] support helpful in ensuring that we drive out as much value as we can from the whole process".[142] We were also told that:

> "The Scottish Futures Trust has made considerable progress in the last 18 months or so. It has more than found its feet and is delivering on a number of areas. [...] It also has a funding capacity expertise and we have achieved a number of procurement savings as a result of the influence of the Trust."
>
> [...]
>
> "It has also demonstrated an ability to provide professional services and advice, as an overhead to the infrastructure projects, at a very low cost. That has been reflected in the overall cost of infrastructure investment."[143]

138. We asked the Scottish Government about the costs of establishing the SFT. The Cabinet Secretary for Finance, Employment and Sustainable Growth told us that a full business case had been prepared in 2008, before the SFT had been established.[144] The business case set out the estimated costs of the set up and operation of the SFT over five years, stating that:

> "SFT estimated costs are based on a combination of set-up and running costs (set-up over a 2 to 3 year period). The assumption is that SFT is a small, high value added organisation."[145]

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[142] ROP [para 41], 24 May 2012, Finance Committee
[143] Ibid [paras 44 and 45]
[144] Finance Committee, FIN(4)-10-12 Paper 5, *Written evidence from John Swinney MSP, Cabinet Secretary for Finance, Employment and Sustainable Growth*, 20 June 2012
[145] Scottish Government, *Taking forward the Scottish Futures Trust*, May 2008

Table 3: The estimated costs of the Scottish Futures Trust[146]

£000	2008-09	2009-10	2010-11	2011-12	2012-13
Payroll (Incl pension and NI)	1,000	1,300	3,700	4,200	4,300
Premises	50	50	100	100	100
Marketing/PR	50	50	50	50	50
Advisory	100	250	250	250	250
Contingency	250	350	500	550	600
Start-up costs	1,050	1,100	1,300	750	250
Total	**£2,500**	**£3,100**	**£5,900**	**£5,900**	**£5,550**

139. The business case also estimated the benefits and savings expected to accrue from the SFT, stating that it was:

> "Expected to generate £100-£150 million per annum of savings to invest in Scotland's capital infrastructure."[147]

140. The actual costs of, and the benefits delivered by, the SFT once it had been established are shown in Table 4.

Table 4: Costs and benefits of the Scottish Futures Trust

£million	2009-10	2010-11
Costs	3[148]	4[149]
Benefits	111[150]	129[151]

141. The SFT therefore achieved the level of benefits estimated in the business case and comfortably exceeded the commitment made in its Corporate Plan to deliver at least £7 of benefits and savings for every £1 spent on the organisation.[152]

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[146] Scottish Government, *Taking forward the Scottish Futures Trust*, May 2008
[147] Ibid
[148] Scottish Futures Trust, *Statement of Benefits 2009-10*, September 2010
[149] Finance Committee, FIN(4)-06-12 Paper 1, *Written evidence from the Scottish Futures Trust*, 2 May 2012
[150] Scottish Futures Trust, *Statement of Benefits 2009-10*, September 2010
[151] Finance Committee, FIN(4)-06-12 Paper 1, *Written evidence from the Scottish Futures Trust*, 2 May 2012
[152] Ibid

A Welsh centre of expertise?

142. During an inquiry into Public Private Partnerships ("PPP") in Wales, the Finance Committee of the Third Assembly recommended the Welsh Government "establishes a central body or unit to promote and support partnership projects with the private sector".[153] The role of such a body would also include the provision of advice and training to other bodies.

143. In his response to the recommendation, the then Minister for Finance and Public Service Delivery said that the Welsh Government did intend to establish a central unit of this nature, which would:

> "Contain a small number of highly skilled professionals with expertise and a successful track record of developing and implementing PPPs. […] The purpose of the Unit will be to work in a cross-cutting way to help the public and private sectors to identify, promote and coordinate the delivery of PPP opportunities. The Unit will also take the lead in providing advice on the legal aspects of establishing partnership arrangements between the public and private sectors, including issues around the transfer of risk."[154]

144. While Value Wales undertakes some of these functions, including providing advice and support to public bodies in relation to procurement,[155] to date the Welsh Government has not created a central body to perform the full range of functions.

145. The Minister for Finance told us that she had visited Scotland to meet her Scottish Government counterparts with responsibility for infrastructure and finance, and had looked at the SFT. She was clear that Wales could learn lessons from the Scottish model, but stressed the importance of considering the cost-effectiveness of any unit that was established.[156]

146. Gerald Holtham, the Welsh Government's Infrastructure Investment Adviser, said that a range of models for the provision of expertise had been considered. He told us that there was variance in

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[153] Finance Committee, *Inquiry into Public Private Partnerships*, September 2008

[154] Finance Committee paper, FIN(3)-16-08 Paper 1, *Written Response to the Committee Meeting on 6 November 2008 by Andrew Davies, Minister for Finance and Public Services*, 6 November 2008

[155] Welsh Government, Value Wales

[156] ROP [para 128], 16 May 2012, Finance Committee

the levels of expertise across Welsh Government departments, and that:

> "Some departments may not need an external source of expertise, but others might well benefit from it. Therefore it is a bit of a jigsaw puzzle in that sense. We are looking at how to structure this and at whether there needs to be a single body or whether we should proceed project by project."[157]

147. We welcome the consideration that the Welsh Government is giving to the appropriate mechanisms for supporting expertise across the public sector in Wales, and are pleased that account is being taken of the role undertaken by the SFT. In particular, the role that the SFT plays in sharing best practice is one that we would like to see developed in Wales.

148. We accept and share the Minister's view that cost effectiveness and value for money would have to be considered in relation to any mechanisms which were put in place to undertake these functions, and are clear that the benefits must outweigh the costs.

Recommendation: Taking account of lessons which could be learned from the establishment of a centre of expertise in Scotland, the Welsh Government should consider putting in place arrangements to ensure that the whole Welsh public sector has access to a central source of expertise which complements existing capability and capacity. It would be essential that costs of these arrangements did not outweigh the benefits.

[157] ROP [para 129], 16 May 2012, Finance Committee

5. Asset management

Local government

149. A cornerstone of the prudential framework is the requirement for better asset management. In its evidence to us, the WLGA told us that:

> "The management of capital expenditure is becoming increasingly sophisticated in Welsh authorities and there is an understanding that capital investment decisions need to contribute to the achievement of the authority's strategic objectives. Authorities will seek to link their asset management plan, capital strategy and treasury management strategy."[158]

150. In their written evidence, the Scottish Local Government Directors of Finance provided us with a case study setting out the integrated approach which local authorities in Scotland take to asset management and capital planning. This approach includes development of Capital Investment Strategies; dedicated Council-wide group assessment of business cases against objective criteria; asset management plans; integrated revenue and capital budget processes; consideration of backlogs in investment and maintenance; and asset rationalisation programmes.[159]

Welsh Government

151. We welcome the integrated approach to identifying investment need taken by the Welsh Government in publishing its *Wales Infrastructure Investment Plan for Growth and Jobs*. We also welcome the Minister for Finance's commitment to strengthening mechanisms for identifying investment need, including the establishment of the new Committee on Strategic Investment, which will support Ministerial decisions.[160]

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[158] Finance Committee, FIN(4)-08-12 Paper 2, *Written evidence from the Welsh Local Government Association*, 24 May 2012
[159] Finance Committee, FIN(4)-08-12 Paper 1, *Written evidence from the CIPFA Directors of Finance Section*, 24 May 2012
[160] Finance Committee, FIN(4)-10-12 Paper 1, *Written evidence from the Minister for Finance*, 20 June 2012

Public sector asset management

152. The SFT told us about its role in ensuring that the Scottish public sector "[spends] our money more wisely and [adopts] a 'needs not wants' attitude to specifying and buying buildings and infrastructure". An example of this was its pivotal role in allocating the central funding element for new schools, for which it developed a standard metric for the costs and the requirements per pupil, enabling them to "drive down the funding allocation centrally for schools without impeding the quality or sustainability of the buildings".[161]

153. We received evidence about improvements in local authority asset management practice as a result of the introduction of the prudential borrowing regime.[162] We were not, however, persuaded that there has been sufficient progress across the whole public sector in Wales towards robust challenge mechanisms which ensure that capital investment focuses sufficiently on needs rather than wants. We believe that this is an area which requires further assessment, irrespective of whether a Welsh centre of expertise is established to support public sector asset management.

Recommendation: The Welsh Government should commission an independent assessment of the quality of asset management across the public sector in Wales, with a specific focus on reviewing the systems in place to ensure investment needs are robustly challenged. Subject to the findings of such an assessment, the Welsh Government should consider lessons which could be learned from Scotland on the role of an independent body to challenge the assessment of investment need by public bodies.

154. The SFT also told us that it was "established as a centre of expertise in Scotland for workplace rationalisation and the effective disposal of buildings and estates that are not needed any more". Peter Reekie said that in his view the important thing was to get "public sector bodies [...] to work better together on asset management and to look at a portfolio of estate". This was an area in which the SFT was adding value, as it had undertaken work to support the mapping of

[161] ROP [para 20], 2 May 2012, Finance Committee
[162] ROP [para 166], 16 May 2012, Finance Committee and ROP [paras 31 and 133], 24 May 2012, Finance Committee

assets and estates, and the development of governance arrangements between public bodies to facilitate working together.[163]

Recommendation: The Welsh Government should consider lessons which could be learned from Scotland on the role of an independent body to co-ordinate asset management planning and decision making across multi-agency boundaries.

[163] ROP [para 21], 2 May 2012, Finance Committee

Annex A: Witnesses

The following witnesses provided oral evidence to the Committee on the dates noted below. Transcripts of all oral evidence sessions can be viewed in full at http://www.senedd.assemblywales.org/mgIssueHistoryHome.aspx?IId=1243

2 May 2012

Scottish Futures Trust

Peter Reekie	Director of Finance

16 May 2012

Welsh Government

Jane Hutt AM	Minister for Finance
Jeff Andrews	Specialist Policy Adviser
Gerald Holtham	Infrastructure Investment Adviser
Andrew Jeffreys	Deputy Director, Strategic Capital Investment

Local Government Association

Stephen Jones	Director of Finance and Resources

24 May 2012

CIPFA Directors of Finance Section

Ian Black	Head of Finance and IT, East Dunbartonshire Council
Bruce West	Head of Strategic Finance, Argyll and Bute Council

Welsh Local Government Association

Peter Davies	Assistant Head of Finance, Monmouthshire County Council
Will McLean	Strategic Partnerships and Engagement Lead, Monmouthshire County Council
Jon Rae	Director of Resources

Annex B: List of written evidence

The following provided written evidence to the Committee. All written evidence can be viewed in full at
http://www.senedd.assemblywales.org/ieIssueDetails.aspx?IId=2601&Opt=3

Organisation	*Reference*
Scottish Futures Trust	FIN(4)-06-12(p1) FIN(4)-09-12(p1)
Jane Hutt AM, Minister for Finance	FIN(4)-07-12(p1) FIN(4)-10-12(p1)
Local Government Association	FIN(4)-07-12(p2)
CIPFA Directors of Finance Section	FIN(4)-08-12(p1)
Welsh Local Government Association	FIN(4)-08-12(p2) FIN(4)-10-12(p2)
The Rt Hon Danny Alexander MP, Chief Secretary to the Treasury	FIN(4)-08-12(p3) FIN(4)-10-12(p4)
Jill Evans MEP	FIN(4)-10-12(p3)
John Swinney MSP, Cabinet Secretary for Finance, Employment and Sustainable Growth	FIN(4)-10-12(p5)

Annex C: List of consultation responses

The following responded to the Committee's consultation. All consultation responses can be viewed in full at http://www.senedd.assemblywales.org/mgIssueHistoryHome.aspx?IId=2601&Opt=0

Organisation	*Reference*
Pembrokeshire County Council	FIN(4)-DF01
Bridgend County Borough Council	FIN(4)-DF02
Chartered Institute of Housing Cymru	FIN(4)-DF03
Cardiff Council	FIN(4)-DF04
Community Housing Cymru	FIN(4)-DF05
Flintshire County Council	FIN(4)-DF06
Conwy Council	FIN(4)-DF07
Carmarthenshire County Council	FIN(4)-DF08
Welsh Local Government Association	FIN(4)-DF09
CIPFA Directors of Finance Section	FIN(4)-DF10