



**Cynulliad Cenedlaethol Cymru  
The National Assembly for Wales**

**Pwyllgor Cyllid  
Finance Committee**

**Dydd Iau, 24 Ebrill 2008  
Thursday, 24 April 2008**

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cynhwysir cyfieithiad Saesneg o gyfraniadau yn y Gymraeg.

These proceedings are reported in the language in which they were spoken in the committee.  
In addition, an English translation of Welsh speeches is included.

**Aelodau'r pwyllgor yn bresennol**  
**Committee members in attendance**

Mohammad Asghar	Plaid Cymru The Party of Wales
Angela Burns	Ceidwadwyr Cymreig Welsh Conservatives
Alun Cairns	Ceidwadwyr Cymreig (Cadeirydd y Pwyllgor) Welsh Conservatives (Committee Chair)
Alun Davies	Llafur Labour
Ann Jones	Llafur Labour
Alun Ffred Jones	Plaid Cymru The Party of Wales
Jenny Randerson	Democratiaid Rhyddfrydol Cymru Welsh Liberal Democrats
Joyce Watson	Llafur Labour

**Eraill yn bresennol**  
**Others in attendance**

Mike Clancy	Pennaeth y Tîm Mesur Teithio gan Ddysgwyr, Llywodraeth Cynulliad Cymru Head of Learner Travel Measure team, Welsh Assembly Government
Giles Frost	Pennaeth yr Is-adran Partneriaethau Cyhoeddus-Preifat, Babcock and Brown Head of PPP Division, Babcock and Brown
David Harris	Rheolwr Gyfarwyddwr Rhanbarthol, Cowlin Construction Regional Managing Director, Cowlin Construction
Carolyn Hughes	Rheolwr Prosiect, y Tîm Mesur Teithio gan Ddysgwyr, Llywodraeth Cynulliad Cymru Project Manager, Learner Travel Measure team, Welsh Assembly Government
Hugh Jones	Cyfarwyddwr Cyllid, Grŵp Gwalia Director of Finance, Grŵp Gwalia
Simon McCann	Cynghorydd Arbenigol i Ymchwiliad y Pwyllgor Cyllid i Bartneriaethau Cyhoeddus-Preifat Expert Advisor to the Finance Committee Inquiry into Public Private Partnerships
Jeremy Nixey	Prif Weithredwr, Shaw Homes Chief Executive, Shaw Homes
Giles Parker	Cyfarwyddwr Datblygu, Babcock and Brown Development Director, Babcock and Brown
Gronw Percy	Cynghorydd Arbenigol i Ymchwiliad y Pwyllgor Cyllid i Bartneriaethau Cyhoeddus-Preifat Expert Advisor to the Finance Committee Inquiry into Public Private Partnerships
Michael Williams	Prif Weithredwr, Grŵp Gwalia Chief Executive, Grŵp Gwalia

**Swyddogion Gwasanaeth Seneddol y Cynulliad yn bresennol**  
**Assembly Parliamentary Service officials in attendance**

John Grimes	Clerc Clerc
Abigail Phillips	Dirprwy Glerc Deputy Clerk

*Dechreuodd y cyfarfod am 9.33 a.m.*  
*The meeting began at 9.33 a.m.*

**Ymddiheuriadau a Dirprwyon**  
**Apologies and Substitutions**

[1] **Alun Cairns:** I thank Members for their attendance at today's meeting of the Finance Committee. I will not go through all the usual housekeeping rules, as usual Standing Orders apply.

[2] We have received apologies from Lynne Neagle; we have not been informed of a substitute, but should that happen, we will accept it as we go along.

9.34 a.m.

**Ymchwiliad i Bartneriaethau Cyhoeddus-Preifat: Tystiolaeth gan Tai Gwalia a Shaw Housing**  
**Inquiry into Public-Private Partnerships: Evidence from Gwalia Housing and Shaw Housing**

[3] **Alun Cairns:** The substantive items on the agenda today relate to our ongoing inquiry into private investment in public services. Two key areas are to be covered today. In item 3, we will receive evidence from the constructors and the financiers. In this item, we will hear from Gwalia Housing, which was highlighted in a brief last week, and from Shaw Healthcare in relation to health, which is a pretty hot topic in terms of private investment in public services. So, it will be useful to hear about its experiences.

[4] I thank the witnesses for their attendance today. We are grateful for the papers that you have provided; you can assume that they have been read and noted, and we have questions on them. For the record, I will ask you to introduce yourselves in turn and give a five minute overview, including anything that you want to underline in the paper or anything that you might want to add to it. I will ask Mr Williams to start, and then I will come to Mr Nixey. In our questions, we will try to cover all the issues that we want to pursue. Thank you for your attendance.

[5] **Mr Williams:** I am Michael Williams, the group chief executive of Gwalia. Some of you may know me in the health context as I am a non-executive director of the Abertawe-Bro Morgannwg University NHS Trust, a title I must remember. So, I have an interest in the health aspects of this inquiry and the housing aspects.

[6] Gwalia is a large association because it is diverse. It has around 5,000 social houses, mainly in the south-west of Wales, although we also cover Cardiff and the Rhondda Valleys. We have an active development programme, and I must emphasise that our core business is social housing. It is not easy these days to get grants for social housing, so we have diversified in order to inject more money into that core business.

[7] The other aspect of our core business is welfare. We look after people with mental health problems or learning difficulties, and we provide a wide range of services to vulnerable groups in society, including working with prisons, the probation service, and so on. We do that through an organisation called Trothwy, which some of you may have come across. Gwalia is a very wide organisation.

[8] Working in social housing in some of the university towns, it became clear to us that there is tremendous pressure on accommodation, particularly on private sector bedsits and small flats, in places such as Uplands in Swansea and certain parts of Bangor and Aberystwyth. That is often caused by student populations coming into the area and wanting to live close to the university. That has an effect on the quality of housing in the area, particularly houses of multiple occupation. You end up with some horrible hotspots of poor landlords. The students go in and pay their rent, and that results in a nuisance to the locality, with cars parked everywhere and so on. I am sure that those of you whose constituencies are affected will have heard all about it.

[9] We took the view that working with the universities had a positive impact, benefiting neighbourhoods where we would go in, deal with multiple occupation issues, and perhaps improve the area with other registered social landlords. It also results in money being injected into the local economy. As you can see from the paper, we are investing £40 million in Bangor, and we have injected more than £100 million in capital into student housing throughout Wales, working with the university sector. That generates income for us, it creates local jobs, and it creates good accommodation that students and their parents feel is more conducive to studying. It is also safer, and of course it is attached to the university, where the entertainment and learning facilities are located. With regard to entertainment and learning, we also invest in the ancillary aspects of student accommodation, such as the refectories, the dentists' and doctors' surgeries and so on. We also invest in the university itself, through grants and through sharing some of the benefits that we get from working in co-operation with it. Some of those benefits can be quite substantial.

[10] The final thing to say is that there is a risk and there is a misunderstanding about the way that these schemes operate. We started with Swansea University on a leasehold basis—we had a lease-back arrangement with them. We improved Tŷ Beck and built new property there, and, in return for the income that we agreed with them—and we agree a spot rent because we do not take rents from all the students—we agreed to keep the place in good repair for the next 30 years and hand it back to them in good repair.

9.40 a.m.

[11] The same applies across the board for the leasehold agreements and perhaps we will talk about this later, but they differ very much from the PFI agreements, which are much more detailed and have much more risk transfer; they are also more risk averse in a sense and, in my opinion, much more expensive. However, they are a good method of dealing with higher cost schemes. It was said in the Treasury by Paul Boateng a few years ago that PFI is best suited to schemes worth £100 million plus.

[12] The other issue, which is a sensitive one, is the way that our schemes are perceived, and we are very conscious of that. University accommodation on a university campus should be university accommodation. Therefore, in Bangor University halls, where we now own 1,000 units—we are developing some elsewhere and we have 5,000 in Wales—you will not hear people referring to them as Gwalia or Cartrefi properties, other than possibly in Swansea where people see our sign up occasionally. They are referred to as Bangor University properties or Aberystwyth University properties. It is the same with the staff. We do not have any TUPE problems because we came to an agreement with the university that it will maintain the property on the cleaning side and continue with the other small jobs—all the

things that they have been doing already. In terms of major works, they have always contracted out to major contractors in the past, so when it comes to the summer holidays, we put in a major contractor or our own workforce and we repair the boilers, the roof, update things and do deep cleans and so on.

[13] **Alun Cairns:** Thank you very much, Mr Williams. Mr Jones, may I ask you to introduce yourself? If there is anything particular that you want to add, you may do so; however I am conscious of the time, at this stage. I have no doubt that we will come back to you with questions.

[14] **Mr Jones:** I will keep it short. I am Hugh Jones, the director of finance at Grŵp Gwalia. Following on from what Michael has just said, I will add just a few points on some of the structural financial issues, without trying to bore people too much. There are certain aspects of the structures that Gwalia has pursued in terms of PPP and PFI projects in particular. There is a financial balance to be struck between that and our social and supported housing activities. We have three main areas of financial interest within the group. However, in terms of the new initiatives—the PPP and PFI type of solutions—I think that we have approached them in a particular fashion.

[15] Given that we do not distribute anything to shareholders as a commercial company does, we are able to put any of the surpluses or investment returns from these projects back into the mainstream provision. From the investment of £100 million or so that we have made, and are making currently, in this type of activity, we are probably going to have surpluses over the 25 or 30-year contracts that total something in the region of £50 million, depending on how successful the outcomes are. That is quite a significant amount of money to put back into the sectors. We are also able to structure these operations so that the university partners in particular that we have dealt with over the past few years can benefit directly. We have certain flexibilities that we can apply so that there are benefits that go back into the education sector as a direct consequence of the way we work—in perhaps more of a partnership spirit, I suppose—in terms of the way that the finances are structured.

[16] I think that that probably leads into the communication areas. We have found that the communication has been particularly effective in terms of being able to explain away some of the complexities, particularly in terms of taxation. Value added tax issues in particular have been quite difficult with regard to the way that these schemes have been progressed, and because of the joint ethos that we have with the education sector, we have been able to overcome these problems in a very efficient way. I will just leave it there because it is getting a bit technical.

[17] **Alun Cairns:** That was useful and there is no doubt that we will want to pursue many of those points.

[18] I also thank Mr Nixey for joining us. Please give us a brief introduction and an overview of your statement or, perhaps, underline particular concerns, but please do not feel that you have to do that. We will then progress to questions. Those are generally separated between Grŵp Gwalia and Shaw Healthcare, although the principles apply equally so the questions will, I hope, flow fluidly.

[19] **Mr Nixey:** I am the chief executive of the Shaw Healthcare group of companies, which is best understood as a group of companies providing a range of healthcare services to very dependent people living in small, closed community hospitals, people living under sections of the Mental Health Act, to people who have severe needs but a greater degree of independence, to the broad spectrum of elderly people needing care either in registered care homes, nursing homes or extra-care flats, through, finally, to people requiring domiciliary care at home. So, our core business is the whole spectrum of care in the community in its

broadest sense.

[20] That care is essentially a service provided by people to people, so we employ a lot of staff. By the end of this year, we will employ about 5,000 staff. Some care also requires buildings, so we do that on the side. Buildings are a tool within which certain types of care, but not all types of care, need to be provided. The growing thrust of everybody's wishes and of UK Government policy is to provide care in the community to people in their own homes. Nonetheless, some people with certain conditions, at some time in their life, need some kind of building, whether that is a hospital, a nursing home, an extra-care flat or whatever.

[21] I am glad to have the opportunity to present evidence to the committee because it is a shame that, as a Welsh-based organisation—our head office is in Wales—only about £2 million of our annual turnover, which, by the end of this year, will be between £120 million and £130 million, is generated in Wales. That is because the intellectual and cultural climate is very strongly opposed to the independent and private sector providing healthcare services. That is, frankly, a financial impoverishment for Wales and it means that, for instance—and I give this example in the written evidence—we could have put £100 million more investment into community hospitals in Wales than has been possible, because the culture is opposed to it. It is also a big loss for the people of Wales.

[22] Healthcare is a very fast and rapidly changing market. I state this as a matter of fact: those who have been working in the care services in the public sector for all of their working life are very often several years behind where current thinking is. That is a loss to them and it also a loss to those whom they serve.

[23] **Alun Cairns:** Thank you for your statement. I will open the questioning. The first group of questions, in general, are aimed at Grŵp Gwalia. Mr Williams, in your statement, you talk about a 'structured transaction'. What do you mean by that? What are the merits of the model?

9.50 a.m.

[24] **Mr Williams:** We have worked with the university sector and have asked it what it would like to see and what its needs are. Increasingly, because of its fashionability, in a sense, and because of the advice that it gets from its consultants, the last two transactions that we have done with universities have gone more towards PFI. Those transactions take absolutely months and sometimes years to negotiate to get right. The presence of consultants bumps up the price of the negotiations, and it takes away in the provision of accommodation over education. It takes quite substantial money away from the sector. We started off by creating a lease that suited the university and the lender—it could be a lease, for example, for 80 to 90 years. However, because the university does not want to lose the property for that time, it would have a break clause included which would give some safety to the lender and a positive period to the university. So, you would have a 30-year break clause. The lending would be over, say, 25 years. The university then has a choice: does it want to go beyond the 25 years; it is satisfied; does it want its property to be as good in 80 years' time as it was when it first was leased; or does it want to take the property back and manage it itself? That is the sort of structure that we work out with them with regard to the property lease, to suit them and to suit the funder.

[25] With regard to the management, we have tried various ways, but the best seems to be one in which the university allocates the property, so it has its own allocation policy and its own way of doing it—universities do differ, even in Wales, as to who goes into halls and for how long. So, that is left to the university. The FM and estates management arrangements are left with the university at the lower level, and then we take over at a higher level. Again, that is where that agreement is structured.

[26] **Alun Cairns:** Your income comes solely from the rental, from the leasing arrangements between you and the university. There is no other injection of cash or land in exchange for the agreement. Is that right?

[27] **Mr Williams:** It depends on the particular agreement. In Aberystwyth, when we took over the Student Village, we bought the whole village from the university. That would have been based on the income flow from the village and the amount of money that we agreed with the university would be paid to us so that the bank then could take that income flow and say, 'We'll lend you x'. Of the around £18 million that we paid them, we believe that approximately £10 million went on the development of education at that university.

[28] On another scheme, where we are doing the new-build, in which we are taking substantial risks, such as at Bangor, the land of the university may come in as part of the deal, and then we pay for the rest of it. We will then agree with it a unitary charge, which it will pay us over the life of the contract. We also agree a 30-year programme of maintenance, and we agree with them that that charge will be linked to RPI or whatever. They can then charge their students what they wish. So, if they decide that they do not have sufficient students in, they can lower their rent and perhaps subsidise it some of the way, or they can charge, and they usually do, more than the unitary charge. It is very much a two-way process that needs to be carefully negotiated.

[29] **Alun Ffred Jones:** To clarify, in the first instance, in Aberystwyth, you borrowed from the bank.

[30] **Mr Williams:** Yes.

[31] **Alun Ffred Jones:** I presume that, in Aberystwyth, you are borrowing from some other bank, and yet you state in your paper the high cost of private sector borrowing as an argument against PFI. How does that work? What is the difference?

[32] **Alun Cairns:** You meant Bangor in the second instance, presumably. You said Aberystwyth twice.

[33] **Alun Ffred Jones:** Aberystwyth is the first and Bangor in the second.

[34] **Mr Williams:** Money and prices are different at different times in the market anyway. At the moment, the market is nervous, so the margins are higher for certain types of project. However, because we are an RSR and blue-chip company, they will lend to us at substantially lower rates than to others. That will be the same for the private sector or anybody else who establishes that relationship with a bank.

[35] In relation to the leases, the banks see that as a much clearer and easier way of lending. They will lend to you on your house on a lease—they understand it and they are fine with that. They understand what the clauses are and, although they will check it inside and out, they are much calmer about lending, and they will therefore lower their margins.

[36] On the PFI, because of the transfer of risk, the banks invest much more in the project. You just would not believe the amount of stuff that goes on behind the scenes. We signed 300 documents for the Bangor deal, and we spent two days in a room, and that was just the end of a two-year process. So, the banks invest a lot in this: their charges have to be met, and their solicitors' costs, which are colossal, and they have a slightly higher margin for PFI.

[37] **Alun Cairns:** Mr Nixey, I saw you nodding when Mr Williams was talking at the outset about the downside of PFI—the potential costs, and so on. Do you want to add



anything briefly at this stage?

[38] **Mr Nixey:** Just to underline everything that he said. It is a cumbersome process, and it is made very expensive by the legal and other consultants that you have to use. The idea of risk-transfer is one of Whitehall's big PR coups—selling this as a transfer of risk to the private sector. You only get good rates and 90 per cent funding from the bank because the bank looks straight through your organisation to the public sector—whether it is universities, hospitals or local government—which is underwriting the revenue stream. The banks take jolly good care to ensure that there is not very much risk transfer. Everyone talks the talk about risk transfer, but it is an illusion. A real partnership between the public and the private sector would involve a very real risk transfer, whereby 50, 60 or 70 per cent of the volume risk would lie with the private sector. That is how we do our deals.

[39] **Alun Cairns:** Do you have a question on this, Angela?

[40] **Angela Burns:** Yes, it leads into a question that I particularly wanted to ask Mr Nixey. How do you fund your investment into partnerships with the private sector? In your paper you state that it is neither PFI nor PPP, yet you are putting in buildings, which obviously involve a huge capital cost. Is it literally a case of putting the buildings in and then getting money back over a certain period of time through the revenue that you take out every year? I am not quite sure how your funding situation works.

[41] **Mr Nixey:** The capital cost of a building is the same however it is developed. If it is funded by PFI, then the bank puts up 90 per cent of the cost of the building and the public sector partner guarantees to buy a certain volume of use of that building through a unitary charge. The Treasury reduces the cost of that unitary charge by PFI credits, so from the point of view of the local outpost of the Government that is buying it, it is seen as a cheaper service. The Government is underwriting the cost of the borrowing that we take out, if it is a private sector scheme.

[42] **Angela Burns:** In your paper you say that you take 60 or 70 per cent of the volume instead.

[43] **Mr Nixey:** Yes, we do. Although we have some PFI schemes, we have moved away from them because they are not worth the management time and the return that we get from them. I would rather build a £10 million community hospital at our risk and at the bank's risk, and then take a chance on selling some of the bits to the local NHS trust on a 10, 15 or 20-year lease. That is preferably to winning a tender with the same local NHS trust to construct a £10 million PFI hospital. In the second scenario, the risk to me and my organisation is significantly less, but the cost in management time, and the loss of opportunities to do other business, is very much greater. Have I explained that?

10.00 a.m.

[44] **Angela Burns:** Yes; I suspect that it is just about making sure in my mind where you hope to make your profit. You take a gamble, although I am sure that, if you were going to build a £10 million hospital, you would have some indication of whether or not the commissioning body would be interested in it. If it had been a traditional PFI project, you would be recouping the cost of your £100 million or £10 million build by, for example, charging the hospital £10 per week, per patient—for the sake of simplicity—but you are going to charge £20 per week, per patient, because you have to recoup so much more outlay that you have had to put on the line.

[45] **Mr Nixey:** To continue with your example, we would have to charge £20 per week because there is no certainty that the hospital will buy any beds the week after next. However,

we have to go on employing the nurses and paying the bank for the building that we have built. That is the reason for the differential pricing.

[46] **Mr Williams:** Gwalia also builds care homes and is responsible for nursing beds and we are doing that under an agreement with social services and the LHB that they will use us as first preference, provided that the work is of a high standard, which it will be.

[47] What is alarming to me, as someone who also works in the NHS, is the catch-up maintenance programme. The public sector does not seem to understand—perhaps it cannot do this, because the money is not there—that you have to put money away to keep places maintained. You cannot rely on the discretionary capital budgets that are used by hospitals to constantly repair them. So, the leasing structure of PFI should teach the public sector that, whoever’s money it is, you must make some kind of provision for surplus to reinvest. If you are a friendly society like us, that reinvestment into the sector will be greater. If that were done by the public sector itself, I am not sure what the Treasury would say, but we come at things differently; we have to in order to survive.

[48] **Jenny Randerson:** My questions are to Gwalia. Do you think that your dual function as a private sector partner and a registered social landlord gives you a better insight into what is required by the public sector?

[49] **Mr Williams:** I think that it has to. As a not-for-profit registered social landlord, and Jeremy may agree with this, when I first came into the business—and Jeremy also started during the early years—we were receiving 100 per cent grants and it was easy for organisations to build for rent. Frankly, some of the practices in those days were not very good and I am talking about 20-odd years ago. The discipline of this form of negotiation means that we have to negotiate and win contracts against the private sector. We have to be sure of our facts and convince banks and public sector partners and we have to be right, otherwise we would go bust. We have to do that over a 30-year period. The discipline of it is excellent and it could also be shared with the public sector.

[50] **Jenny Randerson:** I will now move on to another statement in your document in which you say that PFI contracts tend to focus on potentially negative outcomes and the consequent application of penalties and that an approach encompassing a spirit of working together to improve services will be a better result while still being possible to build in appropriate safeguards. Therefore, do you suggest that penalty applications should not be a feature of the contract? If that is the case, what are the appropriate safeguards because the public sector surely has to be protected in the event of poor performance?

[51] **Mr Williams:** You are absolutely right. It has to be protected, but there are better ways of doing it than PFI penalties, which tend to be terribly complicated. They are related to the unitary charge, which is not easily understood by public organisations. The attitude then is, ‘We are going to get some of our money back by not agreeing that they have done the job properly’; we have come across that. In the 10 years that we have been doing this, it has never happened because we have always met the target. Misunderstanding of how the contract works puts pressure on both organisations, which is not positive or helpful.

[52] I will give you an example of a positive approach: the vice-chancellor of Swansea University, Richard Davies, said publicly that the second phase in Swansea was good for Wales. It was a combination of Gwalia, the Principality and Swansea University. We kept everything inside Wales. It was a substantial investment in Wales. Through that scheme, we have raised over £12 million, which went into the economy of Swansea.

[53] It is in our interest to ensure that those buildings are in good repair and that the university does its bit to keep them in a state of good repair and clean and tidy. It is also in

their interest to ensure that we do our job. That is done by meeting with them, discussing with them constantly and ensuring that we do that work. If we go badly wrong, then there should be some penalty, but the idea of a PFI contract is that the penalties are so complicated, people give up the will to live after a while. I bet you any money that some of our university partners do not know where those contracts are.

[54] **Mr Jones:** On the structured property-leasing-type solution, we have managed to achieve deduction arrangements under property leasing arrangements that are similar to those of PFI. In fact, some of the documents are almost exactly the same in terms of protecting the interests of the public sector, so we do not shy away from performance standards. If we do not achieve those performance standards under a simpler arrangement, they can still be achieved so that there is full protection for the public sector partner.

[55] **Alun Cairns:** Before I bring in Alun Davies, when we talked about negotiations and squeezing out the best value, Mr Williams, you said that that was in your interest because otherwise you would go bust—that was the phrase that you used. However, in reality, because we cannot allow your services to be withdrawn, the public sector is underwriting everything because if you did go bust then the university or the Assembly Government, through its education division, would still need to fund accommodation for those students, would they not?

[56] **Mr Williams:** I wish. The climate is changing on that both in terms of social housing and the university PFI sector. We spent days with the bank and with the advisers talking about what happens if Gwalia went bust and what happens if the university went bust—it is not impossible because Liverpool almost went bust.

[57] **Alun Cairns:** Yes, but in reality the Assembly Government would be expected to step in because it is an essential public service.

[58] **Mr Williams:** It is not obliged to, but it may wish to. The bank would step in and take over management. Basically, it would put managers in and would treat it like any other kind of liquidation. It is not guaranteed. For any housing association to sit in front of you and say, 'If we go bust, we will be rescued,' that is not the real world. There is too much private investment now in associations for that to be a possibility. The only thing that we have always done in the housing association sector is rescue associations in trouble by absorbing them into other associations. That is still a possibility, but when you are talking about an organisation the size of Gwalia, the only associations that could rescue us if we got it wrong would be English groups or associations that are much larger than us or it would have to be an arrangement with the public sector or with the Welsh Assembly Government. However, we fully evaluate that risk and it will certainly not happen.

[59] **Mr Nixey:** I entirely endorse that. I do not think that there is a risk to the Assembly. On our contracts in England, the banks always work on the assumption that we will go bust. They do with everybody—that is their nature. In conjunction with the counter party, be that the NHS or the local authority, they would ask, 'What happens when Shaw Homes does go bust?'. There is a standard cascade of information and actions.

10.10 a.m.

[60] Everyone's interest is in getting another organisation—there are plenty of other organisations—to take over the role that Shaw was playing. The NHS trust, or the local authority, continues to want the service, and it continues to have the money set aside to pay for the service, because it would not have signed the contract otherwise. The only problem is to get in another operator speedily and efficiently to take over the service. There is no risk to the public sector. There is a bit of a hiatus, but it is poor, bankrupt Shaw that takes the can, or

rather its creditors, because if the new operator comes in and says, 'I'm not going to do it for x pounds, I am going to do it for x pounds plus 10 per cent', that 10 per cent is not a charge on the public sector, the charge returns to Shaw and its creditors and bankers. So, the public sector is basically not at risk from the collapse of Gwalia or the collapse of Shaw.

[61] **Alun Davies:** That is an interesting point, and we could spend some time discussing it. I would like to return to a point made by both Mr Jones and Mr Williams, in written evidence and here this morning. You have spoken and written about an ethos of service in a way that differentiates between what you contribute in terms of the provision of services, and what I presume that you assume is provided by a private business. Can you explain to us what you mean by 'an ethos of service', how you define it, and how you would differentiate it as far as you are concerned, because I presume that you are making the point that you want to differentiate yourselves from other providers?

[62] **Mr Williams:** We took a decision that we would only operate in Wales in this function. There were several reasons for that, one was that we wanted to help to alleviate problems relating to housing in university towns, secondly, we wanted to contribute significantly to the economy of Wales, and, thirdly, we wanted to diversify and increase our ability to invest in social housing. So, our viewpoint was that we could work in collaboration with other organisations in Wales, and to do that—and you may concur with this—in Wales, you must establish relationships and partnerships. The worst way to go about it is to cause confrontation by taking a stance that is unacceptable. We have worked hard on our partnerships at all levels. They work at a high level, I know that they involve the chancellors, chairs of councils and so on, as well as my board members, but the main thing is that they work at the ground level. We have maintenance staff in the university all year round, working with the university maintenance staff to ensure that things are done properly, and that collaboration works well.

[63] We also see a lot of money going into local firms. On our procurement route, we work with the University of Glamorgan on procurement systems, and we target and develop local companies whenever we can, and we sponsor things at university. It is about putting something back into our community, and we can do that. As Hugh said earlier, we do not distribute profits—it is unfair, and the private sector possibly hates that—but we are run as private, not-for-profit businesses. So, the money that comes in stays with us, it goes nowhere else—other than to the City, when we are repaying loans, because we must do that—but it does not go to shareholders or outside Wales. I do not know whether that covers your point, Alun.

[64] **Mr Jones:** To add a financial perspective on the issue about comparing us with a commercial operator, the distribution issue is important, but it also follows through that our main aims and objectives are reinvestment in social housing products and other types of product. That means that we operate on margins that are as low as we can possibly achieve, while still remaining financially viable. So, it is a maximisation of putting that resource and money back into the job that we do, rather than having to answer to boards of shareholders or whoever, who are possibly calling the tune with certain commercial operations. It is fundamentally different at that level.

[65] **Alun Davies:** Thank you both for that. In terms of taking forward your approach, we know that there are strategic partnership models available—the local improvement finance trusts scheme is a good example of that. Do you believe that that approach could be successfully used to develop further the work that you are doing in your sector of the market?

[66] **Mr Williams:** It has possibilities. I am especially interested in mental health, and I am appalled at the state of our mental health estate. Some years ago, I went to Leeds to look at the Leeds Mental Health Teaching NHS Trust. All of its hospitals had been refurbished and

new hospitals had been built through an arrangement that was a sort of a public-private partnership arrangement with a housing association in Leeds. There was an investment of £150 million. The difference that that made to service users and to the clinicians was immense. With regard to the NHS and an organisation such as Gwalia, a jointly floated company or a not-for-profit partnership company could be a way around all of these problems. The only difficulty is that you would have to be clear about who is responsible for what if things went wrong. The banks would want to know that. However, that can be explored and such an arrangement could be made financially viable. Something has to come in from somewhere.

[67] In housing, we now tend to lose money every time we build a rented house. We receive around a 40 per cent grant and we put in 60 per cent, either of our own money or money from a bank. An arrangement like that could work in the NHS. It would bring in some private capital, reduce the huge amounts of money that are seen to be there on PFI, but would have the kind of incentive to budget properly and would increase the stock. The mixture of private and public—which, incidentally, I was very much opposed to in the early 1980s—seems to work and produces things. When you go too far and inject far too much private money, you become under the control of the lender more than anything else.

[68] **Alun Davies:** Mr Nixey, would you like to comment on that? I was interested in your earlier response to a question on risk transfer. You answered that—how should I put this—quite bluntly, and your answer gave us some food for thought. Do you believe that the LIFT programme, which I assume you are familiar with in England, would be a way of encouraging or helping the work that you do in Wales, or do you think that it would simply add another level of bureaucracy and complexity to an already complex position?

[69] **Mr Nixey:** The short answer is that I believe that it would be the second option; it would add a layer of complexity for the following reasons: the establishment of a LIFT organisation and structure involves the participation of a number of different bodies, such as GPs, local healthcare groups, local authorities, and so on. As a political move, this is obviously a very good thing, but in terms of getting a job done, it slows it down greatly. So, the political structure that is inherent in a LIFT programme is quite cumbersome and militates against risk-taking, venturesomeness, and fast-moving market responsiveness. It seems to me to be predicated on a desire for the public sector to retain control over not only the staff and the direct employment of the staff providing healthcare services, but also of the facilities providing those services.

10.20 a.m.

[70] That is an idea whose time has long passed. The longer it is clung on to, the more people whom Government and companies exist to serve are disadvantaged. On it being a mechanism for obtaining—to the extent that grants are available—like all grants, the cost of getting them makes you wonder whether the value of the grant is worth the indirect costs that you incur, in delay and management time, in securing the grant. Therefore, I have moved far away from thinking that the direct application of grants by Government is a good way of promoting things—I do not believe that it is. That is a general, strategic statement.

[71] **Alun Davies:** You have been pretty brutal this morning about PFIs and PPPs. You have described the Shaw way in your written evidence, and have given us examples of that. Chair, it might be useful for us as Members to understand in more detail the models that have been developed here. Perhaps our expert advisers could speak to Mr Nixey and we could have a written note on that, to understand it in some more detail.

[72] **Alun Cairns:** I am conscious that you have an operation, or are investing in an operation, in Pembrokeshire. Do you want to outline that? You are investing in Wales, so

people are commissioning your services in Wales and it might be useful for us to have a better-informed picture at this stage of the questioning. I am conscious of the time, so please be brief, if you do not mind.

[73] **Mr Nixey:** No, not all. The scheme in Pembrokeshire is actually two schemes. It is a 16-bed, closed, very intensive care, long-stay hospital. I have to pick my words carefully, because I could suffer an almighty VAT penalty if I use the wrong words, because, for VAT purposes, it is not treated as a hospital. If you walked around it and looked at the needs of the people, you would say, 'I would expect people like this to be in hospital'. In that sense, you would be correct. On the other hand, a hospital is a short-stay place, and hospitals have a different VAT structure in their construction to that of care homes. Therefore, we are building a 16-bed thing that, in terms of the people who will use it, looks like an intensive place of care, so it is at the hospital end of the care spectrum, but it is people's home for two or three years.

[74] **Alun Cairns:** Who would commission those services? Would it be the local authority, the local health board, or would they do it jointly?

[75] **Mr Nixey:** No, it is the health commission.

[76] **Alun Cairns:** Health Commission Wales?

[77] **Mr Nixey:** Yes.

[78] **Alun Cairns:** Is it operating yet, or is it under construction?

[79] **Mr Nixey:** It is under construction; it will be operating at the end of the year.

[80] **Alun Cairns:** So there is a health, or a care, facility—however it is interpreted—in Pembrokeshire being constructed privately, but the services are being commissioned by Health Commission Wales?

[81] **Mr Nixey:** Yes.

[82] **Alun Cairns:** Do you have a guarantee in terms of the length of time?

[83] **Mr Nixey:** No.

[84] **Alun Cairns:** So it is at your risk?

[85] **Mr Nixey:** Yes, it is our risk.

[86] **Alun Cairns:** If Health Commission Wales changed its policy, and suddenly said that it is now using a residential nursing home with a similar intensity of support, that would, effectively, take your income away?

[87] **Mr Nixey:** Yes.

[88] **Alun Cairns:** Okay, thank you. That gives us a much better idea. Joyce Watson has the next question.

[89] **Joyce Watson:** Thank you for your honesty; I will perhaps display some too. You mentioned in your analysis of a LIFT model of partnership—and you have been brutally honest about all models—

[90] **Mr Nixey:** I am a caring person. [*Laughter.*]

[91] **Joyce Watson:** I am not disputing that. You are putting your business case on the line, which is a different matter, and I understand that. I need to understand what you said about the public sector's desire to hold on to staff retention—those were the words that you used. That is what I want to focus on. I understood you to say that that was not necessarily advantageous or useful in delivering a service. However, I am going to come at that from the other end, particularly because I happen to live in Pembrokeshire, which has a very low-paid economy, and I cover Mid and West Wales, which also has a low-paid economy, and people are employed in large numbers by the public sector. We have heard this morning about putting money back into the community. In the long term, it is the people who are employed who ultimately put the maximum amount of money back into the community, from the wages that they earn. I think that you can see the direction of my question. How can you assure me and the staff who receive very good wages, compared with the wages of others in the locality, and very good terms and conditions, that those will not be depleted when the public sector relinquishes its responsibility? How can you assure me that yours are of equal value?

[92] **Mr Nixey:** That is a very fair question, but it is not an easy question to answer. The long-term answer is that, in any sector of business, whoever operates it, whether it is the public sector or the private sector, whether you are talking about education, health, housing, transport, cars, making clothes or making food, there is, as a result of the operation of some kind of market, however free it is, a continuous upward spiral of quality and a continuous downward spiral of prices. If you think back, you realise how many more hours you would have had to have worked, 10 or 20 years ago, to obtain a particular good that we now enjoy for a lot fewer hours. The effect of a productive and free economy is a constant increase, through the marketplace and market pressures, in the quality of services and goods and a constant downward pressure on their price in real terms. Having said that, the opening up of any area, whether it is a high-income or a low-income area, to greater market freedom and operation is, in the long term, a good thing for that area. However, in the short term, it involves a great deal of pain and transition and you will see that in any economy, national or local, that has moved from a controlled economy into an open market economy. There is a very difficult transition period for economies as a whole, and it goes down before it goes up. However, in the longer term, it would be much better for the people of west Wales if there were a freer economy in healthcare.

[93] **Alun Cairns:** May I just end the conversation there? We are in danger of going down the route of ideological economic arguments, although the question and the response were, nonetheless, valid.

[94] **Alun Ffred Jones:** I have a question for Mr Williams. Noting your previous comments on PFI, you mentioned that you were a member of a hospital trust. Have you had experience of PFI as a member of that hospital trust and, if so, has that given you any insights?

[95] **Mr Williams:** The committee has received evidence on that. It is Baglan hospital.

[96] **Alun Ffred Jones:** The evidence presented to us by the chief executive was that that scheme was working perfectly and was very good. Is that at odds with what you have been saying about PFI schemes in your own sphere of work with Gwalia?

10.30 a.m.

[97] **Mr Williams:** It is different. The difficulties of Baglan hospital are shown in the response to the Minister's request that car park charges be stopped. We suddenly found that we had 30 years of car park charging that had to be negotiated out of the contract. The

contract works very well for the trust because it gives it a set amount of money per year that it must pay out to maintain the hospital and keep it under the contract. At the end of that contract, the hospital will be handed back. In terms of patient care, the hospital teaches us that a very good health environment, however it is produced, is beneficial to patient care. It is a fantastic hospital and patients respond well there. The way that it is paid for is another issue. It certainly gives certainty in terms of balancing the trust's books but it has long-term problems. However, you do have a maintained hospital, which would not have been there otherwise. I was not there when it was built; it was part of Bro Morgannwg NHS Trust. I was chairman of the Swansea trust at the time.

[98] **Alun Cairns:** Oscar, was your question further to this point?

[99] **Mohammad Asghar:** Yes. My question is to Jeremy Nixey. Thank you for giving us a brief on your report. You mentioned 'torturous VAT treatment' and inflexibility in private finance initiative contracts. What alternative partnership arrangement or agreement do you have to overcome these issues of inflexibility?

[100] **Mr Nixey:** I will explain the inflexibility with the VAT problem. If you build a nursing home, it is counted as a zero-rated building. In other words, the VAT, the 17.5 per cent of whatever the cost of the building is, which the builder charges you, can be fully recovered. However, if the end user of the building is judged by Her Majesty's Revenue and Customs to be the local authority—and 90 per cent of the beds are bought by the local authority, albeit through the agency of Shaw—that concession is removed and the nursing home that would otherwise have cost, let us say, £4 million to build, now costs £4 million plus 17.5 per cent. So, that means that the cost is very much higher. To deal with that problem, you have to put in quite a complex legal and financial structure that removes the VAT problem but comes at the price of having a much more complex legal arrangement, which, later on—a year later, for instance—when the local authority says, 'We know we asked you to build us 50 residential care beds, but we now need lots of those to be nursing beds', will mean that you and the local authority have a real problem and you have to go back to customs. We have been through this a few times and it is not easy. In fact, the jury is still out as to whether the local authority will be able to flex that PFI scheme in the way that it would like to meet the changing needs of its client group. The problem, in that case, comes from the very specific customs treatment of certain types of PFI and public-private partnership contract.

[101] **Mohammad Asghar:** Is this one of the reasons why you are moving away from PFI, as you said earlier?

[102] **Mr Nixey:** It is a secondary reason. The primary reason is because I want the freedom to develop the services that the market requires and to do that quickly. I cannot get that if I go down the PFI route, because it is so slow. Management time, at every level, is an organisation's most precious resource. It is much more precious than money. PFI and PPP contracts tie up a totally disproportionate amount of management resource and we, as an organisation, have concluded that the game, on the whole, is not worth the candle. Added to that, as an organisation, we do not consider that you have the freedom to develop the best-quality care service and so forth.

[103] **Alun Cairns:** I am conscious that we are running way over time. However, the questions and answers have been very useful, so I will look for Members' support in covering the issues. Alun Ffred, you have question 9. Let us have brief questions and brief answers if that is okay. Perhaps you feel that the issues have already been covered.

[104] **Alun Ffred Jones:** It was the question that Joyce Watson was pursuing about the transfer of staff, was it not?



[105] **Alun Cairns:** Yes.

[106] **Alun Ffred Jones:** Have you had experience of this? One of the criticisms of PFI is that, when staff transfer, the quality of their employment is diminished or they have to work at a cheaper rate. I think that you addressed that point.

[107] **Mr Williams:** We have experience of arranging staff transferrals as part of our social services contracts through TUPE. We guarantee the staff the same level of employment rights and salaries, and, in fact, we sometimes find that those are enhanced. However, we will not offer anything less than those rights. That is on social service care transfers.

[108] **Alun Cairns:** Jenny, has question 12 been covered?

[109] **Jenny Randerson:** I think that it has, largely. We dealt with virtually all of that ground.

[110] **Ann Jones:** Previous evidence indicated to us that the low take-up of PPP or PFI in Wales in comparison with what happens in England and Scotland has led people to say that Wales is closed for business. What do you think about that? Does that statement hold true for your organisations?

[111] **Mr Nixey:** Yes; Wales is closed to healthcare business. That is the broad simplification.

[112] **Mr Williams:** It is not entirely closed. To illustrate the problem and what goes wrong, although my organisation is big in Welsh terms, it is not huge in UK terms, and if I lose a preferred bidder status in a PFI contract, I could end up having abortive costs of nearly £1 million, so I have to choose very carefully where I go and what I do. As Jeremy said, one contract took up to three years to negotiate.

[113] **Mr Nixey:** One took five years.

[114] **Mr Williams:** It is ludicrous. The need exists for two or three years before, and by the time you have built what is needed, it is five years later, because it takes a couple of years to build.

[115] **Alun Davies:** So what are the obstacles? You note the problems of losing preferred-bidder status, when you have put in a great deal of time and investment, but that would be true of any contract at any level anywhere.

[116] **Mr Williams:** Not at that level.

[117] **Mr Nixey:** No, no, no. It is nothing like the same extent.

[118] **Alun Davies:** So what are the additional obstacles in Wales that differentiate it from other areas?

[119] **Mr Williams:** Let me give you a quick illustration. I made a presentation to Carmarthenshire County Council about building housing for low-cost sale for local people on their brown-field sites. That presentation cost me probably in the region of £10,000 to put together and to present. It probably cost the same for Lovells and all the others who bid. We won that competition, and we set about negotiating with the council. The council set up a partnership team, and we are now finishing our first scheme in Llanelli and rolling out the rest. With the universities, however, it depends on the staff and on their skills, and it depends

very much on the consultants that they bring in. As soon as they bring PricewaterhouseCoopers in or some great big firm like DLA Piper, it becomes completely onerous. You find yourself sitting at a table in a room that is not as nice as this one for hours and days and weeks and months, and the costs ratchet up because, every time you go to a meeting, you take with you your solicitor, because there are problems relating to legal aspects, your accountant, and VAT advisers—they are like bookends either side of me, and it drives me mad, but you have to have special advisers on VAT, and they cost a fortune.

[120] **Alun Davies:** I understand that.

[121] **Mr Williams:** You have to have that all ready, and when you put your preferred bid in, that is basically what you are going to produce. There are further negotiations afterwards, but that is the bedrock on which you are winning that contract; that is what you have to deliver, and you must get it right.

[122] **Mr Nixey:** I thought that you were enquiring as to why Wales was different to England for PFI and PPP.

[123] **Alun Davies:** What would be the difference in status?

10.40 a.m.

[124] **Mr Nixey:** As I have not worked on a PFI or PPP in Wales, I do not know if there are any differences. My concern is that the costs are inherent in the very nature of the problem, whether you do it in Wales, England or Scotland. When I said that, in my view, Wales is closed to business for my kind of healthcare, I was not talking about a lack of PFI or PPP. Even if it was available, I am not sure whether I would want it—it would depend on the terms. The problem is more to do with the attitude that assumes that the service we provide is inferior and not in the interests of the general public. That is simply not true as a matter of fact, and it is no basis on which to do business. You cannot sell services to people who do not believe that they are worth having.

[125] **Alun Cairns:** I am grateful to the three of you for the evidence that you have provided. It has been helpful. I will write to you for your responses on the issue of expertise and on whether the expertise within the various public sector organisations in Wales is good enough to respond to the demands of the private sector and not-for-profit and independent organisations. It would be useful to have your views on that as operators, but unfortunately we do not have time to pursue it now and I do not want to open another debate.

[126] If there is an additional point that anyone would like to make, please make it in writing to the clerk or to our special advisers. To Mr Nixey in particular, it would be useful to have some details on the Pembrokeshire model and any other information that you can provide. Similarly, in relation to Aberystwyth, Swansea and Bangor, any additional information you want to provide would be useful. If any further questions arise from that, we will obviously let you know in writing. So, please make any additional points in writing to the clerk or to our special advisers—bearing in mind Mr Williams's comments about accountants and lawyers, who act as the special advisers to the committee. [*Laughter.*]

[127] **Mr Williams:** They are much more modestly paid.

[128] **Ann Jones:** Begging your indulgence, could we ask Mr Nixey to explain staff transfer and how he would go about that as part of his model? He did not really answer the point; Mr Williams answered that point for Alun Ffred. If he would put that in his note, that would be helpful.

[129] **Mr Nixey:** Certainly. Do you want me to answer it now?

[130] **Alun Cairns:** Unfortunately, we are short on time. We are running way over time, but that is my fault and I accept that. Thank you to all three of you for the evidence that you provided. We are very grateful; it is valuable evidence for our report.

[131] **Mr Williams:** Thank you for inviting us. It was an interesting start to the day.

10.43 a.m.

**Ymchwiliad i Bartneriaethau Cyhoeddus-Preifat: Tystiolaeth gan Cowlin  
Construction a Babcock and Brown  
Inquiry into Public Private Partnerships: Evidence from Cowlin Construction  
and Babcock and Brown**

[132] **Alun Cairns:** We now continue our investigation into private investment in public services by coming to the constructors, project managers and financiers—depending upon how you interpret this.

[133] I welcome the three of you and I thank both organisations for the papers that were provided. You can assume that they have been read and understood by Members. Members will raise questions in relation to the papers if they need clarification.

[134] Jenny, if you leave we will not be quorate. Members are just using the opportunity of a changeover of witnesses to take a short comfort break, so please accept my apologies for that. I want to press ahead because I am conscious that we are overrunning.

[135] For the record, please introduce yourself and your colleague. I also ask Mr Harris to introduce himself for the record. I will come back to you, Mr Frost, for a broad outline of the points you wish to underline in your paper or to hear any additional comments that you wish to make in a few minutes, if that is okay. We will then go to you, Mr Harris, to do the same.

[136] **Mr Frost:** Thank you for inviting us. My name is Giles Frost and I run the public infrastructure units at Babcock and Brown. I will explain a little more about that in a second. I am with Giles Parker, who is based in Cardiff and is development director for Wales and the west country region.

[137] **Mr Harris:** My name is David Harris. I am divisional managing director for Cowlin Construction based in Cardiff. We employ around 240 people and have a turnover of around £100 million.

[138] **Alun Cairns:** Thank you. Mr Frost, you may now underline any points you wish to in your paper or make any additional comments.

[139] **Mr Frost:** The starting point is that we have been involved in public-private partnership in Wales for quite a long time. I know that it is a nascent and at times controversial initiative in Wales. However, my organisation is responsible for the development of the north Wales police headquarters at St Asaph near Colwyn Bay; we will shortly complete the new secondary school that we are building with Cowlin Construction at Maesteg; and we are also the partner of the Welsh Assembly Government in the Welsh Investment Strategic Partnership initiative. Given that PFI and PPP are relatively young and developing forms of procurement in Wales, we have probably had as much experience as anyone else in the field.

[140] My organisation is one of the leading developers of PPP projects, not only in the British Isles, but worldwide. We have developed some 30 schemes in the UK and we have teams of people who are actively developing similar projects in France, Germany and Italy and other parts of continental Europe as well as in Canada, Australia and the US. PPP is obviously controversial, but given the scale of take-up of PPP procurements internationally—for example, 28 states in the US have now passed laws to promote PPP—the debate is not so much about the use of PPP as against conventional traditional public expenditure, but how we collectively structure PPPs in a way that delivers the best long-term value for money for the taxpayer. That is where my business philosophy comes from and how at Babcock and Brown we have tried to develop our own internal business plans.

[141] **Alun Cairns:** That was helpful. Mr Harris, can you offer your perspective from a constructor's point of view?

[142] **Mr Harris:** Yes. Giles has talked about the global market and his global experience. Our experience relates to works that we have done in Wales. At the moment, we have four PFI projects ongoing and two semi-PFIs that are PPP arrangements, so our experience relates to those projects, and I have included those details in our written submission. At the moment, two of those projects have been handed over and the rest are at various stages on site.

[143] **Alun Cairns:** Mr Frost, our first group of questions is for Babcock and Brown, although their principles can apply equally to Cowlin Construction. So we will start with you and then switch back the other way.

[144] Mr Frost, on WISP, it would seem to me that any finance Minister or economic development Minister has two crude options at the end of each scale. The first would be to go for a traditional build and then aim to lease the office space to the private sector; the second would be to go down the PFI route completely. Can you tell me where WISP fits into that and how the taxpayer gets better value for money or better opportunities? What has WISP delivered that is different from what we would otherwise have had?

10.50 a.m.

[145] **Mr Frost:** WISP is quite a young initiative. It is a 10-year programme of the Assembly Government. We currently have one building that is finished, namely SA1, which is now in the process of being let. We have one building that is halfway through being constructed in Newport and we have a building that is about to go on site at Nantgarw, probably in the course of the next two or three months. The logic behind the WISP initiative was that there was a significant undersupply, and the WDA, as it was in those days, had commissioned quite a lot of evidence to show that the market was failing to construct new office buildings of a suitably high quality to attract occupiers of the nature that the Assembly Government of the time was looking for—national or multinational bodies moving into Wales. There was a feeling that the local property market was focusing more on slightly lower-grade, lower-specification buildings that were generally taken up by established Welsh businesses, but that the market had not responded adequately with a higher-end, higher category of building. By stimulating it through WISP, there would be a knock-on effect of attracting better quality businesses that would bring more value to Wales.

[146] **Alun Cairns:** Can you comment on the broad financial structure? I mentioned both extremes, but, obviously, it is not one or the other; it fits in the middle somewhere. So, how is it structured financially?

[147] **Mr Frost:** It is structured financially in that the capital cost of the building is entirely sourced by the public sector—by us. In reality, it is a mix of real equity plus bank debt from the Royal Bank of Scotland. That is repaid over time, and our returns are made through the

rental that the Welsh Assembly Government pays for the completed building.

[148] **Alun Cairns:** That is useful.

[149] **Alun Ffred Jones:** This question is for Mr Parker and regards a specific scheme, the North Wales Police headquarters, in which you were involved. To begin with, is that contract a conventional PFI procurement scheme?

[150] **Mr Parker:** If you are addressing the question to me, I was not involved in the North Wales Police headquarters; I manage WISP and the Maesteg PFI.

[151] **Mr Frost:** I can help on that. It was a broadly conventional PFI for the police sector.

[152] **Alun Ffred Jones:** What would be the advantages to the North Wales Police Authority of taking this route, rather than the design and build route?

[153] **Mr Frost:** There are probably two main advantages. The most important one is the assurance about the long-term maintenance of the building and the provision of services in it. We are responsible, for instance, for cleaning and catering in that facility and for maintaining the building to pre-defined standards for a 25-year period at a fixed price that is known to North Wales Police. So, in terms of budgeting, North Wales Police knows exactly what it must spend on that building for the next 25 years, and it knows exactly to what standard it will be maintained and has been developed.

[154] In terms of the original construction of the building, there was again complete certainty as to the design specification, which would come through a design and build route, as you said. There was also a lot more certainty around the cost of the building than you would get even on a standard design and build contract, because PFI contracts get delivered on time and to budget with no risk of cost overruns to the public sector. So, those are the two principal benefits.

[155] **Alun Fred Jones:** As it happens—I know that this is anecdotal—I went around that building with some police officers, and there was a complaint about the inflexibility that comes along with the PFI route. They simply did not like the design of the inside of the building. Is that a downside to PFI?

[156] **Mr Frost:** Traditional PFI runs the risk of being polarised, because traditional PFI—we may talk in a minute about other forms of procurement, WISP being one—tends to cement relationships in a legal contract at the outset. Therefore, the ability to flex the design during the process, or to flex the service provision during the life of the contract, can be limited. To be candid, the North Wales Police headquarters project has strengths and weaknesses. If you want to go through where the process could have been improved in that scheme, some people on the police side procured the building—and were, therefore, responsible for agreeing the design specification—but they were not really linked into the operational police needs. So, there was a core of people who were focused on delivering the building without, in my view, giving sufficient thought to exactly what the building needed to have in it to make it work for the police. The building was delivered to the exact specification required, but, as you said, that specification may change over time or it may not have been the right specification at the outset. So, how can we find systems or solutions that allow buildings to flex in their design or to evolve in their design and suitability for their occupants during the course of their lives? That is where these slightly more subtle PPP relationships provide, in the long term, better value for money than pure PFI.

[157] **Alun Ffred Jones:** I have a question for Mr Harris that is linked to this. I am fascinated to hear that you have a project for student accommodation at Bangor University

that you are developing alongside the Gwalia Housing group.

[158] **Mr Harris:** Yes, that is right; we are working together on it.

[159] **Alun Ffred Jones:** So, it is between the university, your company—Cowlin—and Gwalia. Why did you need three partners for this scheme?

[160] **Mr Harris:** Effectively, our responsibility in all of the PFI and PPP projects that we are dealing with is as the constructor; we are responsible for designing and delivering the facility. The inquiry that was sent out by the Bangor University was for a total package; it was for the full delivery, including the management and the facilities management over a 30-year period. We are a construction company, and we partner and work regularly with Gwalia. As its construction partner, we supported it on the construction and the delivery side. So, an element of its responsibilities was passed to us for the delivery of the facilities. The facilities management is then being taken on by Gwalia, which also dealt with the arrangement of the finance and the like. We were a part of its integral team.

[161] **Angela Burns:** I want to pursue the issue of flexibility raised by Alun Ffred. Mr Frost, in your evidence—for which I thank you—you state that genuine benefits must flow to both parties. You talk about a level of flexibility being maintained throughout the contract without any undue cost or administrative burden. We have taken evidence in the last few sessions that has suggested that, sometimes, if you need something extra in a school or hospital, it can cost a shocking amount of money 10 or 15 years down the line. You have said that you believe that there are nuances to be played, and you indicated that you have a slightly different working model, or that you can see a different working model. How does your company ensure that you have that flexibility in your contracts? It is easy to talk it, but do you have some evidence or could you describe that culture?

[162] **Mr Frost:** The starting point is that we are long-term investors in these assets. So, while we are absolutely looking to make an investment return from these assets, I see that our investment interests are completely aligned with the public-sector occupants of these buildings. We want to make an investment over the life of the asset; this is a long-term asset, so we want to ensure that we are making money not just this year, but in 20 years' time. From the public sector point of view, the occupants need to show that that building is fit for purpose and, ideally, increasingly so; that is, that it moves with technological or education change over that time. Maintaining that partnership—I see it completely as a partnership—is very important to us. The business that I work in has, at times, been characterised by some very ropey behaviour from some people who feel that making a big profit in year 1 or year 2 is fine, because they will not be around two or three years later.

[163] Many of these PFI and PPP bids are run by construction companies. I have a lot of respect for construction companies, but many take an inherently short-term view, because they are involved in the building of the facility, and will not necessarily be—for very good reasons—focused on the long-term operations and long-term benefits coming out of it. As an investor and developer of assets that have these long terms, I want to be involved in assets when they are reaching the end of their life as well as at the beginning of their life. There is no project in the UK that is more than 10 or 12 years old in terms of the PPP scheme. However, that long-term relationship is important.

11.00 a.m.

[164] Therefore, if a headteacher in a school that we manage wants changes made to the building, we will always approach that on the basis of transparency in terms of cost, discussing costs before they are incurred, and not presenting people with bills that they do not expect. Many of our guys who spend their time in schools talking to people about the

facilities will be developing ideas alongside the headteacher. The headteacher knows that they will have an extra reception class in two or three years' time, because demographics have changed, so we can plan for that, and we can plan how we respond to those natural changes.

[165] **Angela Burns:** You are talking about little chunks of capital that might be required; I am talking more about the general maintenance side of it, when the hall floor starts to curl at the edges, or that kind of thing. That seems to be where many projects have fallen down, because that kind of cost gets extrapolated hugely over time.

[166] **Mr Frost:** Perhaps it is unfair to use it as an example, but in the schemes that we are involved with, if the hall floor starts to curl at the edges, the cost of sorting it out is our cost, and we would have no ability to pass that cost. Assuming it was defective in some way, or had not been designed properly, that would be entirely passed to us, and would not be a risk that our clients would bear.

[167] **Angela Burns:** That is encouraging to hear, because we have heard contrary evidence to that. However, following on from that, you talked about the fact that you are a long-term investor in assets. Like any investment company, do you have a minimum below which you will not go? Would you be interested in these smaller projects, or add-ons to a major project that you have that is coming to the end of its term?

[168] **Mr Frost:** In terms of doing small changes to schemes that we run already, yes, absolutely, that is our business. I see our business as a customer service business; I do not see it as being an arm's length, remote investment business—it is a people business like any other business, and it involves real people and real relationships. Therefore, the answer is 'yes, absolutely' for existing schemes. If your question about new schemes is whether there is a de minimis level that you would not go to, I think that the initial costs of these transactions can be considerable, not least through the bid phase—if you do not win the bid for these schemes, it can cost you hundreds of thousands of pounds. Therefore, £20 million is probably a capital expenditure size of project, which is probably a minimum size.

[169] **Angela Burns:** That knocks you out of the running for small schools.

[170] **Mr Frost:** Stop me if I am going on to different topics, but I believe that one way in which WISP has been interesting is that these kinds of programme arrangements are a good way of effectively dealing with that issue. You have some set-up costs for a programme, but WISP is potentially a 10-year programme, so those costs are effectively for a 10-year period and for a series of schemes, which allows each individual scheme to be relatively small. A typical local improvement finance trust scheme would perhaps be £5 million to £7 million in value. In England, my company is involved in several schemes through LIFT, which is all about producing new community health facilities, for instance. Again, each scheme there is typically £3 million or £5 million, but because the scheme has been set up as an ongoing relationship, I believe that that has been quite positive.

[171] **Mr Parker:** My experience of our projects in Wales is that many of these issues can be headed off by dialogue. We have regular meetings with the headteacher and the stakeholders—in Maesteg, for example. Many of these smaller issues can be headed off by dialogue. It is not purely about what the contract says, and so on. For example, in Maesteg, the school still retains a significant responsibility for soft facilities management, which means that the caretaker there will be empowered to carry out some of these smaller tasks, where the cost of running an administrative chain gives you these sorts of uneconomic scenarios. Therefore, my experience is that dialogue is important, to build into the process.

[172] **Alun Cairns:** Mr Frost, in your paper you say:

[173] ‘Structures are available which can enable parties to share returns above agreed thresholds, where they occur.’

[174] Can you explain what such structures entail and how they would be implemented in order to achieve that?

[175] **Mr Frost:** There are several. The Wales Investment Strategic Partnership, for instance, has a number of protections. It is interesting that when we bid for WISP, we offered the Assembly Government an equity share in the project and asked, ‘Why not actually be joint venture partners?’ Going back to LIFT, which you mentioned a second ago, the NHS does have a genuine equity share in that scheme, so you are sharing profits from day one. In WISP, there are a few mechanisms, particularly around overage, which is, effectively, additional profit over that expected on any potential sale of the asset. There is a sharing of any benefits that come through refinancing or reducing the cost of the debt in the project. So, a series of contractual measures were put in to ensure that unexpected profits benefit the Assembly Government. There is that, plus the partnership approach, which recognises that, frankly, if I was sufficiently mad to try to exploit a relationship or make a super profit, I know that the pipeline of opportunities coming to me in the future would be likely to be diminished. So, it is self regulating in that respect.

[176] **Alun Cairns:** I will paraphrase what you said and focus on the very grand building that has been completed in Swansea. Were there a huge property boom in Swansea, partly, perhaps, sparked by the building that you constructed on SA1, which meant that the price per square foot would go through the roof, the Assembly Government could share part of the excessive rates from any new lease arrangements that were entered into in relation to that property, over and above a certain level.

[177] **Mr Frost:** The Assembly Government would receive 100 per cent of the benefit, because it has contracted to pay a certain rental level. I believe that it is letting that space at a rental level above that rate, so 100 per cent of the benefit goes to the Assembly Government.

[178] **Alun Cairns:** Let me push you further on that. Is it not the case, then, that the Assembly Government is accepting all of the risk on that?

[179] **Mr Frost:** It has accepted the risk of the base rental that it is paying to us, which is below the current market rental level. It also has the upside, which is partly the result of property inflation since the time that that deal was struck, and partly as a result of the fact that SA1 has obviously been a tremendous success in terms of becoming the preferred business quarter in Swansea. It has certainly taken some risk, but as a result there is now an office product—if I can call a building an ‘office product’; sorry, that is a bit jargon-like—that is a top-quality office block that I think will attract new tenants, which will benefit Swansea.

[180] **Joyce Watson:** Following on from all that has just been said, would any of you be interested in the alternative non-profit distribution models that are about? Would any of you be willing to adopt such a partnership model?

[181] **Mr Frost:** I fear that I am going to be controversial here. I think that the non-profit model is completely flawed. The reason why I think that is that ultimately people will not do these schemes unless they are going to make some money out of them; you can characterise that money as being non-profit or profit, but, at the end of the day, it is money. I think that the distinction is one without any material difference, to be honest. In Scotland, it has a bit of traction because it is politically more acceptable to talk about not-for-profit models, but I do not think that there is a significant difference in essence when you start pulling these things to pieces.



[182] **Mr Harris:** On the construction side, as I said before, we are a construction partner for companies such as Babcock and Brown and Gwalia. Therefore, as far as our relationship is concerned, we do not have an equity stake in the PFI itself. We are a delivery vehicle, so we are not in the same position.

[183] **Alun Ffred Jones:** So, you are part of the PFI deal, but, in fact, you limit yourself to construction aspects only. Was that a deliberate choice on your part?

11.10 a.m.

[184] **Mr Harris:** Yes, because of the scale of the business. Certain responsibilities in the PFI are then stepped down to us for the area of responsibility that we take.

[185] **Alun Ffred Jones:** So, you do accept some risks?

[186] **Mr Harris:** Yes, there are step-downs in terms of the delivery criteria for the buildings for design, quality, aesthetics and functionality. All of those elements are passed down to us and the professional and technical teams that we employ.

[187] **Alun Ffred Jones:** So, you are part of these deals where you spend days and weeks in rooms with all sorts of—

[188] **Mr Harris:** Yes, very much so. We are an intrinsic part in that respect but we are not part of the financing vehicle and equity stake. Our responsibilities do not lie there.

[189] **Mr Parker:** Cowlin Construction and the Welsh investment strategic partnership very much sit together and liaise directly with the Assembly through the whole construction process, but the risk sits with our side in terms of the timing of delivery and the ultimate cost of delivery of those buildings.

[190] **Mr Harris:** If there was any defect with the building or any inadequacy relative to meeting the design criteria that has been set, that is stepped down to us as per our responsibilities for delivery.

[191] **Alun Davies:** Thank you for those responses. The previous witness described PFI schemes as cumbersome and expensive and said that the idea of risk transfer was simply a public relations coup from Whitehall. Do you any of you agree with that analysis?

[192] **Mr Frost:** I do not know the exact context in which he said that, but you have to separate out the philosophical drivers for using non-traditional sources of procurement, which are, essentially, twofold. Using the private sector to source capital assets that, historically, have been publicly financed is driven by two things. First, you get long-term, fixed price maintenance of the asset, so that you know what you are getting, you pay for it over time and there is a recognition, generally, that the traditional sources of public sector capital are not available to finance these things in the way that they used to be.

[193] There are plenty of bad examples of procurement but I would not characterise all PFIs in that way. There is plenty of really good experience. You can go to loads of different facilities and find that the public sector occupants are delighted with their buildings and recognise that they would not have been maintained or provided in the same way had they been provided publicly. It is a very easy sector to kick, but I do not subscribe to that view at all.

[194] **Mr Harris:** From our side, as I said in our paper, it is very important that you get the right procurement route for the type of building that you are looking for at the outset, whether

it is bespoke and has a described and prescribed use or whether it has to accommodate change over the period of the PFI. It is very important to be clear about that at the outset and so that you can start to shape the vehicle to deliver. As Giles has said, there are good examples of that and there are some bad examples, where PFI has been put in place and has strict requirements are built into it, and, when you try to amend that, it becomes cumbersome and difficult. You have to ensure that the parameters that you set out with are correct, are thought through and are properly considered. However, there is no doubt, certainly on our side—and I have alluded to this in the paper—that, for us, as a delivery vehicle, it is significantly more cumbersome, there is significantly more upfront risk and there are a lot of costs involved up front to put the whole deal together. However, in another way, that is an investment in terms of ensuring that what is being delivered and what is being agreed has been considered by the right parties and has been drafted in the right way.

[195] **Alun Davies:** In your written evidence, you refer to a lack of knowledge and expertise in local authorities and public procurement agencies, shall we say, covering the whole sector. While we might accept that assumption, is it not also true that some private sector providers lack knowledge and understanding of the public sector ethos? In our earlier session this morning, I was struck by the fact that one of the witnesses, in written evidence and in answers to questions, returned repeatedly to the idea and concept of an ethos of provision of services to the public, contrasting that with the requirement—which you have repeated this morning—on business to generate profit from provision of that service. Do you see that lack of knowledge about local authority procurement issues being balanced possibly by that lack of public service ethos in private business?

[196] **Mr Harris:** It is two-way traffic. You have to say ‘yes’; there is a lack of understanding in both respects. In Wales, PFI is not mature, and there are not limitless practitioners in that respect. In other parts of the world, such as London and the areas where Giles operates, there is a different level of experience and expertise, I would suggest.

[197] **Mr Frost:** I think that we need to question the concept—the underlying ethos. I do not think that it is as simple as it sounds. I do not think that anyone would doubt the commitment, ability and dedication of individual staff members. There is certainly an ethos in that regard, and I do not think that we would see a significant difference in the individual motivation of people who do a good job in a PFI facility against a public sector one. At that level, I do not see a distinction.

[198] I am more questioning of what this ethos is when you start looking at the bureaucracy that sits behind those front-line workers in either a private or a public organisation. The reason why I am not totally satisfied with the assumption of such an ethos is because, when you get away from the front-line provision of services, you see a real difference between a private sector organisation and a public sector organisation. Private sector organisations are by definition as lean as they reasonably can be within that management structure, because it is a matter of pure cost and does not directly generate benefits or profit. In a public sector organisation, the motivations are less clear—that is one way of putting it—in that it is not always clear what people’s personal priorities are and whether those personal priorities are directly aligned with their organisation. That needs to be weighed in the cost equation because, when you get down to the cost of these budgets, typically, in this sector, we get a criticism that using us must be more expensive, because we are making a profit, to put it simplistically, while the public sector is not making a profit. However, no-one has yet really found an effective, objective or satisfactory way of weighing the value erosion of different mentalities in the provision of public services. That, in a nutshell, is what we are all struggling with in this whole sector, because, at the simplest level, we can all say that we want to improve public services and provide better value for money. That is undoubtedly true, but we are struggling with what that means for how that philosophy of provision develops. I would come down on the side of promoting private companies to manage that provision, because I

think that, ultimately, they will do it more efficiently, albeit that they are making a profit, over an increased dependence on public sector managers to provide them.

[199] **Alun Davies:** Would you say that that is an absolute?

[200] **Alun Cairns:** We are running out of time, Alun.

[201] **Alun Davies:** Okay. I just wanted to follow up on that. It is my final question.

[202] I am interested that you say that. Would you say that it is an absolute that the private sector will always provide a better service than a public sector operator?

[203] In terms of the delivery of these services, you both referred to bureaucracy and complexity, which we have heard about this morning. Do you think that bundling contracts together and creating a LIFT-style strategic partnership model, would help to overcome some of that bureaucracy, or would it just add another layer to it?

11.20 a.m.

[204] **Mr Frost:** There are two questions there. Obviously, it is not absolute. We all know that there are some fantastically able and motivated people in policy and management in the public sector, so it is not absolute in that sense. I believe that you have to start with the philosophy rather than the procurement method because, otherwise, you risk ending up with two systems running in parallel with increasing inefficiency. So, bundling and creating these larger relationships is absolutely the way to go, but you then need to devolve sufficient power to people within that partnership, so that you are not just adding an extra layer of management or process on top of the existing ones. Does that make sense?

[205] **Mohammad Asghar:** The public sector may be lacking appropriate skills, Mr Frost. We agree on the fact that the delicate negotiation and management of complex PPPs require skill and expertise, and, as you mentioned, local authorities lack those. What impact has that had on your experience of partnership with public sector bodies? Do you have any suggestions as to how this problem can be overcome? That is my first question. Secondly, would you like us to appoint an independent Welsh body for expertise and guidance in this field—like the 4ps partnership with UK Ltd in England?

[206] **Mr Frost:** Is there a skills gap? Yes, I think that there is, but I do not mean that in a pejorative sense; I do not think that it is anyone's fault. It is entirely natural that there should be a skills gap because, ultimately, I do not think that many people have gone into public service to run the public side of PPP procurements, and therefore the people who have been taking up the challenge, some very successfully and others with less success, have been taking it on as an additional responsibility to their core jobs. So, I think it is entirely natural that there is a skills shortage. In a country the size of Wales, there must be an opportunity to centralise that expertise into a core body of people. Some of those skills used to sit with the WDA, which had vast experience of real estate and related transactions across the whole of the country. So yes, I think that centralising expertise and experience, although the two are not necessarily the same thing, would be a prudent move.

[207] **Mohammad Asghar:** You mentioned working in three or four continents. Which is the best model that you can bring to Wales?

[208] **Mr Frost:** That is an interesting question. The approach differs between countries. Some countries have taken a scheme-by-scheme approach, so each new scheme is not necessarily similar to the previous one. You have probably gathered from what I have said that I think that the schemes that involve a genuine partnership with the public sector, based

on a long-term relationship, are the ones that work well. There is a temptation on both sides for one-off schemes to follow a pattern. You go through all this pain, you spend six months negotiating the documentation, you sign the documents and go off to have a meal to celebrate together, and then everything moves on. As you were saying, the scheme is left stuck there, and it can be a bit inflexible.

[209] The work done in the UK on the NHS Local Improvement Finance Trust, and the work that the WDA, now part of the Assembly Government, did on the Welsh Investment Strategic Partnership, has been quite innovative and, in our view, quite successful. Problem issues are not just my problem or your problem. If I have a problem on a particular site—whether it is a problem because the building is not designed in the right way for the occupants or because someone has discovered a sewer under the site that needs to be moved—it will be approached in a constructive way, rather than a way that passes risks back to people who should not have them. We would work together on that constructively, as you would with any project or business. Ultimately, although I am not remunerated directly on the satisfaction that my customer, the Assembly Government, feels, I know that I will not get more commissions out of it unless I produce a product that is seen as beneficial for it.

[210] **Jenny Randerson:** Going back to full-blown PFI and PPP and the issue of risk transfer, which Alun was discussing with you, I have a specific question: if one of your companies went bust, who would pick up the tab?

[211] **Mr Frost:** I think what you are driving at is what would happen if you were engaged in the provision of an essential service, such as a school, and you went bust, because, ultimately there is a statutory duty to provide education to children, which falls on the local authority; that is a fact. I can give you a semi-relevant example from our own experience. Certainly, none of our companies have gone bust, but a construction company that we used went bust. It was building a large scheme for us in east London in Tower Hamlets several years ago. That was a difficult experience because the construction company was halfway through building the facilities when it went bust, so there were concrete foundations sticking out of the ground with no school on top of them. So, it was difficult.

[212] That is quite an interesting example, because there was a concern at the time on the part of the local education authority that we would walk away and say that it was not our problem—that we had lost our money, but that we would not sort it out. In fact, we brought in new contractors and finished the school, although probably slightly later than originally scheduled because of the delay in finding a new contractor. However, it is now held up by Tower Hamlets and the Department for Education and Skills in London as a good example of a relationship because, again, we said that we were in it for the long term, that the problem had happened to us—although it was not directly our fault because we could not be held responsible for a third party after it had gone bust—but we that we would stick at it, put more management resource in, put more money in, as needed, and that we would complete the project with a different contractor. So, those are two answers to your question.

[213] **Mr Harris:** That has partly answered the issue from our side. We are a delivery vehicle, so we are a part of the team that is integrated with the vehicle that delivers the project. We put guarantees in place in terms of bonding and guarantees and so on, which are in place as a backstop to protect the likes of Giles's company. If we fell away, the responsibility would ultimately fall on Giles, as he has just demonstrated with the Tower Hamlets example. However, we have put financial guarantees in place that are held by the banks that can be called upon by Giles's company in the case either of our not being there or not delivering.

[214] **Alun Cairns:** In the Tower Hamlets example, was there an additional cost to the local authority after that third-party constructor went bankrupt?

[215] **Mr Frost:** No.

[216] **Alun Cairns:** Do you have experience of a constructor going bust in a traditional public sector arrangement?

[217] **Mr Frost:** I do not have direct experience of that, but it is clear in those circumstances that the responsibility lies with the public sector, both as a statutory provider of education and with regard to being stuck with a half-built building. Therefore, that risk would sit fairly and squarely, legally and commercially, with the public sector.

[218] **Alun Cairns:** Is it fair to ask you whether there was an additional cost to you in finding a second constructor?

[219] **Mr Frost:** Yes, there was.

11.30 a.m.

[220] **Ann Jones:** We have heard from witnesses in the course of this review that the low uptake of PFI and PPP in Wales has effectively led to the perception that Wales is closed for business. Do you think that that statement holds true? If so, what is the potential impact for the public and private sectors in Wales?

[221] **Mr Frost:** Is that question for me?

[222] **Ann Jones:** It is for either of you or all of you.

[223] **Mr Frost:** I will start. No, I do not think that at all. I am English, so I would not pretend to have a comprehensive knowledge of Wales, but I have certainly found Wales to be very much open for business.

[224] **Mr Parker:** I am Welsh and I moved from London to Wales to set up the office for Babcock and Brown. I would like to think that that is a statement of intent from a significant company that is involved in this in Wales.

[225] **Mr Frost:** It is true to say that Wales has not taken on board lock, stock and barrel some of the initiatives that have been developed in the UK. My suggestion, if I am permitted to make one, is that I do not think that there is sufficient clarity in Wales about the priority of capital investment projects. I do not think that the precise procurement methodology matters so much, but, based on my limited experience, Wales has lacked a real identification of the top 50 schemes, or whatever it might be, and the policy and political drive to implement them. For instance, there is the building schools for the future scheme in England, which is a secondary school replacement programme that has high priority. A great deal of time and effort has been spent on it; its value for money may be open to question, but time will tell on that. As a country, Wales has not been as explicit in identifying its medium-term capital investment programme and the fact that it is open to a variety of proposals on how that programme might be met. That clarity would help.

[226] **Mr Harris:** Traditionally, it is not a widely used tool in Wales, and political statements have been made that have alluded to the fact that it is not a tool that is encouraged, which does not demand a heavy response from the market. However, we are currently dealing with six projects on a PPP-type arrangement, and they are all new projects, so we are going through a curve and momentum is being gained.

[227] **Alun Cairns:** Maybe the reality is not being met by the rhetoric. Is that right, or is it

the other way around?

[228] I thank the three of you for your evidence and for the frank and candid answers that you have offered, which have been extremely helpful to our review. As I have said to everyone else, if there is anything else that you would like to add thereafter, which you feel that you should have underlined or stated when you were here, please feel free to communicate with the committee through the clerk. That would be helpful. I have no doubt that we will be reflecting on the evidence that you have given when we produce our ultimate report to the Assembly Government. We are grateful to the three of you.

11.33 a.m.

### **Trafod y Mesur Arfaethedig ynghylch Teithio gan Ddysgwyr (Cymru) 2008 Consideration of the Proposed Learner Travel (Wales) Measure 2008**

[229] **Alun Cairns:** I am now hoping for the committee's indulgence, because we have run over our allotted time, and I apologise for that.

[230] **Alun Ffred Jones:** I will have to leave shortly, Chair, because I have another committee in less than three-quarters of an hour.

[231] **Alun Cairns:** I accept that.

[232] **Jenny Randerson:** I must leave by 12 p.m. at the very latest.

[233] **Alun Cairns:** I hope that we will have finished by then, based on the information that is available. I apologise to the committee; we have learnt a lesson from items 1 and 2.

[234] I thank both Mr Clancy and Ms Hughes for coming to respond to the questions of the committee on the proposed Learner Travel (Wales) Measure 2008. We are grateful to the Business Committee for giving us the opportunity to report before the Stage 1 debate next week. I would also like to underline the efforts made by the Deputy First Minister to be present, but it was not possible for us to meet when he was free and vice versa, and the Assembly wanted to move to Stage 2 as quickly as possible. I ask you to introduce yourselves for the Record and to draw attention to any particular item in the Measure that you want to underline. If you do not wish to do so, we will go straight to questions.

[235] **Mr Clancy:** Thank you, Chair. I am Mike Clancy, the head of the learner measure team. I have been working on this for the past five or six months.

[236] **Ms Hughes:** I am Carolyn Hughes, the project manager for the learner travel Measure team. I have also been working on this for six months.

[237] **Alun Cairns:** Thank you very much. I will start with the first question, which relates to the way in which any additional funding to local authorities would be made, bearing in mind the financial notes contained in the Measure. Should those be accurate, how will the funding be distributed to local authorities?

[238] **Mr Clancy:** We have tried to be as robust as possible in making the calculations. They are based on actual costs. That is the first point to make. These figures on the costs in local authorities came from the Wales Audit Office, so they were as consistent as possible across authorities. In looking at the numbers, we looked at the census information, which is collected on an annual basis—I think that it is called the pupil level annual school census. So, again, these were actual numbers from 2006. To that we applied inflation factors to get up to 2009-10, which is the first financial and school year in which we could introduce the changes.

As regards how we distribute that to local authorities, we are open to discussion with local authorities at the moment. There is a distribution sub-group, on which the Welsh Local Government Association sits, and we would be happy to talk through that with it. At the moment, the moneys are parked, so to speak, in the transport main expenditure group, but, as you know, there is a revenue settlement that is distributed each year to local authorities, and it would be possible to transfer it to that if local authorities wished that to be the case.

[239] **Ann Jones:** If authorities wanted it to be transferred into the RSG, how would you ensure that the amount of cash that we give to local authorities for a Measure like this, if it goes through, would be used to fulfil the requirements of the Measure? Local authorities are given a great deal of money to provide many services, and they choose to use their own local initiatives to do it. Is this another way of just giving them some money that they will then spend on something else?

[240] **Mr Clancy:** I can see your point, but there are checks and balances. If we distributed the money through the revenue support grant, it would be done on a formula basis. So, we are moving some distance from the calculations that we have made because there is a formula basis. However, that would be discussed with local authorities. It is not hypothecated. School transport is quite a big expenditure item for local authorities. We have essentially created a duty for local authorities to provide this school transport and an expectation among those entitled—because individual children over the age of eight will be newly entitled. That is the balance for local authorities; they have a duty to provide school transport and people will be aware of that new duty and that new entitlement.

[241] **Ann Jones:** Local authorities have a duty to educate every child, but some local authorities fail.

[242] **Alun Cairns:** That might be a separate issue to be pursued on another occasion.

[243] **Jenny Randerson:** You have referred to the expenditure sub-group; I am aware from my discussions with local authorities that the impact of this new duty—or the new aspects of this duty—on some local authorities will be much greater than it is on others in terms of the changes to their existing practice. The contrast between rural and urban areas in this regard is obvious. Will the expenditure sub-group be taking those variations into account when the money is allocated?

[244] **Mr Clancy:** It certainly can. The basis on which we have calculated the figures very much takes those points into account. In Powys and Ceredigion, for example, the costs are much greater than in Cardiff or Neath Port Talbot. That comes out of our figures very clearly. However, there is a balance to be struck. In theory, we could distribute this £6.6 million—because that is what we are talking about for a full financial year—on the basis of the costs. However, I think that local authorities have found that it is swings and roundabouts if they get it in the revenue settlement, which takes account of rurality factors.

11.40 a.m.

[245] **Jenny Randerson:** You state that the number of additional children is 7,700, and you say that your figures are robust. Can you give us some idea of how you reached this estimate?

[246] **Mr Clancy:** I will go through that quickly, and perhaps Carolyn can add to that. As I mentioned, we used census data to get the numbers, and we applied to those the distance factors. Therefore, our cartographics unit in the Welsh Assembly Government looked at the numbers of over-eights who lived between two and three miles from school. That is essentially the change; we are now saying that all children in primary schools will be eligible if they are two miles from the school. This change was then factored on the actual numbers.

So, again, it was from accurate census data, looking at the post codes and at the schools that those pupils attended, so there was an in-depth analysis done.

[247] **Jenny Randerson:** I am sure that you are aware that the Welsh Local Government Association has expressed concern that local authorities were not asked to estimate the figure. Can you comment on that?

[248] **Mr Clancy:** Yes. I was not personally involved at the time, but my clear understanding is that there was an initial look at figures from local authorities. It was clear that some calculated their transport costs on a different basis to others, and that is why we went to the Wales Audit Office for audited figures. The WAO used to have a benchmarking group to look at school transport, and the figures came out of that, so they were tested in that way by the independence of the WAO.

[249] **Alun Cairns:** Have you used the latest data, or has the pupil level annual school census been updated since you made the calculations?

[250] **Mr Clancy:** The data that we used was the 2006 data; if anything, we would expect the school rolls to be falling.

[251] **Alun Cairns:** Are you planning on changing the financial allocation as a result of that?

[252] **Mr Clancy:** We may need to look at it in the light of several changes. However, that is the money that we have in the budget at present on that calculation.

[253] **Alun Cairns:** Can you explain something to me—and I think that I know the answer. The explanatory memorandum notes that the cost for 2009-10 would be £3.7 million, yet it notes that it would rise to £6.6 million in 2010-11. I assume that that is not a phasing in of the policy, because the Measure does not state that. Is it fair to say that that is as a result of a full financial year and a half financial year, as it were?

[254] **Mr Clancy:** That is absolutely right. At first, it is just the seven months, in financial year terms, because it would start in the academic year in September.

[255] **Alun Cairns:** Okay. Angela has the next questions.

[256] **Angela Burns:** Thank you both for coming to committee today. While we are talking about the financial side, have you factored into these numbers the additional capital costs that some schools may incur because they will have to provide better dropping off and picking up points and places for buses to turn around within the safe environments of a school area?

[257] **Mr Clancy:** We looked at that, and we came to the conclusion that it would be impossible to calculate. If one looks at this in broad terms, as we did, we are looking at 7,700 additional pupils being affected by this Measure in primary schools. There are some 1,500 primary schools in Wales. Therefore, on average, we could be talking about an additional five children per school. Therefore, an extra bus will often not be needed, and therefore, whatever arrangements are currently in place for the bus should suffice.

[258] **Angela Burns:** I am sorry but I slightly disagree with you on that point. I come from a rural constituency, and the children are spread thinly. I support being able to bring children safely to school, but if you are going to go to pick them up in a bus, you are going to need other small buses, because no-one will be tied in and you will be going up and down little lanes and roads—unless you propose starting to pick up children with very long buses down country lanes, very early in the morning, to get around them all.



[259] **Mr Clancy:** I take your point. What we found was that it was impossible to look at more than 1,500 primary schools and come up with any meaningful figure.

[260] **Angela Burns:** I appreciate that, but will any money be set aside for this or would authorities get any financial help if they had to implement such arrangements? Obviously, many will not have to.

[261] **Mr Clancy:** No, it is not something that we have been able to take into account.

[262] **Alun Cairns:** May I clarify that? I am sorry, but my attention was drawn to something else at that point. Angela, were you talking about the infrastructure costs that may be needed by local authorities? The WLGA has come out quite strongly on that, that there will be a need for infrastructure changes to some schools. So, the funding that you have made available, or that has provisionally been identified, which is necessary because of the Measure, does not include any estimate for that at all?

[263] **Mr Clancy:** No, our figures are entirely based on the revenue consequences, the extra transport itself.

[264] **Alun Cairns:** I have a final question. Are there any other questions that any other Members wish to ask?

[265] **Jenny Randerson:** For the purposes of the Record, I just wish to say that that particular point is of great significance, and not just in rural areas. I represent an entirely urban area and the change from three miles to two miles will have a significant effect on primary schools such as the church schools and the Welsh-medium primary schools in Cardiff, for example. I think that we need to take that into account.

[266] **Alun Cairns:** Before I come to my final question, I have a question about the financial estimates that have been provided. Clearly, the whole objective of this Measure is to improve safety, as well as convenience and so on. Safety is, without doubt, the prime motivator behind the Measure and I am sure that that is something that we would all applaud. Secondary legislation will follow, in terms of guidance thereafter—whether it is a code of conduct or a requirement—regarding the sorts of buses that should be used, for example, by local authorities. What consideration have you given in these financial estimates to the fact that there may be higher costs due to the sort of transport envisaged in the Measure, and also in the secondary legislation that will follow?

[267] **Mr Clancy:** That is a very good point. The stark answer is that we have not taken that into account yet because we cannot. The policies in the area are still developing. I think that the undertaking that the Minister gave was that, where there are financial implications, where there would be extra duties placed on local authorities by the secondary legislation, local authorities would be consulted on that. There is also a continuing commitment from the Welsh Assembly Government to fund fully any new duties placed on local authorities. It almost goes without saying that the Finance Committee has the ability to look at such secondary legislation and its financial implications. It is not that it would not be scrutinised in the future.

[268] **Alun Cairns:** That partly answers my final question. In section 8 of the explanatory memorandum to the Measure, you state that additional provisions would be subject to a separate regulatory impact assessment. I am assuming that that regulatory impact assessment would also include a full financial impact assessment so that we may choose to consider it, or not, as the case may be at the time. I strongly call for it to do so, and I highly suspect that it would be something that we would want to look at.

[269] **Mr Clancy:** Yes, it would, Chair.

[270] **Alun Cairns:** Thank you, that is useful. Are there any other questions that we need to pursue? I see that there are not. I therefore thank you both for the evidence that you have provided. I apologise for the late start to this item on the agenda; we overran on the other two items. We are very grateful for the candid answers that you have provided.

[271] I am grateful to members of the committee. Are there any particular points that you want to make at this stage in relation to the report? There is a quick turnaround in terms of when we need to come out with the report.

[272] **Jenny Randerson:** I will simply repeat what I said earlier. I think that we need to express concern that there is no reference in the figures, and nothing allocated, for the cost of infrastructure work, which I can see being much more significant than might, at first, be suggested.

[273] **Ann Jones:** I think that Jenny is right. That point has been sadly overlooked and it is one that local authorities will use as a stick to beat us over the head with for introducing the Measure without having thought it through or thinking through the cost implications properly. There are some gaping holes in it.

[274] **Alun Cairns:** I am disappointed that the figures, although provided by the Wales Audit Office, have not been reconciled by local authorities in order to create that positive tension. That really should have been done, bearing in mind that they intend to introduce it.

[275] **Jenny Randerson:** It brings a bit of rigour into it, if you check one set of figures against another.

11.50 a.m.

[276] **Alun Cairns:** Yes, because you have people on the one side arguing that they do not feel that it is sufficient.

[277] **Angela Burns:** My only confusion on this, with the rising costs that have been put down, is that when you talk to local authorities and schools, they say that school numbers are anticipated to drop over time. They seem to be going the opposite way, and I would like an explanation on that, because it will impact on the whole transport situation.

[278] **Jenny Randerson:** The issue is that when you are talking about buses, the cost is not necessarily in direct relationship to the number of children. You have to have a minibus or whatever whether you are picking up 20 kids or 10.

[279] **Mohammad Asghar:** According to annex A, under 'Welsh Assembly Government funding provision for school transport', for 2008-09, there is £991,000 and, for 2009-10, there is over £3 million. It is such a big jump.

[280] **Alun Cairns:** This is annex A to the Members' research service paper. Could you repeat the point, Oscar?

[281] **Mohammad Asghar:** For 2008-09, there is £991,000, but then there is over £3 million for 2009-10. Something needs to be clarified there.

[282] **Alun Cairns:** The funding for 2009-10 includes funding for the increase in funding as a result of this new law, so that is the reason for that. It then jumps to £6 million.

[283] **Mohammad Asghar:** It is such a big jump.

[284] **Jenny Randerson:** It is for half a year.

[285] **Alun Cairns:** It is in the region—

[286] **Mohammad Asghar:** It is more than double.

[287] **Jenny Randerson:** It is half a year versus a whole financial year.

[288] **Alun Cairns:** It is £991,000 for 2007-08—let us assume that is £1 million—and there is £1 million for 2008-09. It then jumps to £3.6 million on the basis that this new law is passed. So, in 2009-10, it will need to go to that level, but do not forget that it is being introduced in September 2009, when half the financial year will have passed. So, the figures for 2010-11 incorporate a full financial year of the new provision.

[289] One thing that has not been made clear so far—but I did not give Mr Clancy the opportunity to pursue it—was the potential demand because of the changes in relation to the encouragement of Welsh-medium education. That is provided at present at the discretion of a local authority, but this is creating a new obligation on the local authority. I am conscious that I did not put that to Mr Clancy. Can we put that to the Minister's office and ask for an immediate response, before we write the report? We need to know whether a cost is envisaged for that. I suspect that there could be.

[290] **Mr Grimes:** Would you like me to incorporate that into the report?

[291] **Alun Cairns:** Yes.

[292] **Jenny Randerson:** In some ways—and this is pure speculation—it is almost a case of swings and roundabouts. There are now more Welsh-medium schools in urban areas that are closer to where people live; for example, in Cardiff, years ago, the vast majority of children would travel more than 3 miles to their Welsh-medium school. Now there are so many Welsh-medium schools that, mostly, pupils are closer, but this reduction to the 2-mile limit will bring in a significant number. So many are planned that, in time, everyone will be within a 2-mile limit of them.

[293] **Ann Jones:** I may be in a minority of one, but I do not mind being in the minority on this.

[294] **Alun Cairns:** We are not voting on this occasion.

[295] **Ann Jones:** No, but I feel strongly that any additional money that goes into this should be ring-fenced and should not just go into a revenue support grant so that local authorities can not implement the Measure's requirements. I know that it is a statutory duty but, as I pointed out, local authorities are failing on many statutory duties and they just cite a funding fog. This is an opportunity for us to introduce a Measure, to put the money in and to be able to audit it quite clearly. I would like to see it ring-fenced.

[296] **Alun Cairns:** To achieve consensus, can we say that some Members called for that? Are you happy, Ann, for us to say that that could be interpreted as a policy decision rather than a funding decision, which could be beyond our remit?

[297] **Ann Jones:** Yes; I am happy with that.

[298] **Alun Cairns:** It notes the point that some Members want made.

[299] **Ann Jones:** I do not mind if the point just stays on the record. I have said it on the record, and I am happy to stand by what I have said.

[300] **Alun Cairns:** Okay. I see that Members do not have any other points to make. I thank you for your indulgence. We are 25 minutes over schedule, for which I am sorry. The lesson to learn is not to give our witnesses the opportunity to speak at the outset, but to go straight to questions. Jenny has made that point once before. That brings the meeting to an end.

*Daeth y cyfarfod i ben am 11.55 a.m.*  
*The meeting ended at 11.55 a.m.*