

Shan Morgan
Ysgrifennydd Parhaol
Permanent Secretary



Llywodraeth Cymru
Welsh Government

Mr N Ramsay
Cadeirydd, Y Pwyllgor Cyfrifon Cyhoeddus
Cynulliad Cenedlaethol Cymru
Bae Caerdydd
Caerdydd
CF99 1NA

05 Mawrth 2018

Annwyl Mr Ramsay

Cyllid Cychwynnol Llywodraeth Cymru ar gyfer Prosiect Cylchffordd Cymru

Ar ôl imi fod yng nghyfarfod y Pwyllgor Cyfrifon Cyhoeddus ar 5 Chwefror 2018, mae'r Pwyllgor wedi gofyn y cwestiynau isod:

- A roddwyd gwybod i'r cwmni cyn i'r Cabinet wneud penderfyniad fod problem gyffredinol gyda maint y warant ac mai dim ond pe bai gwarant Llywodraeth Cymru o leiaf 50 y cant yn llai y byddai modd datrys y sefyllfa?
- A oedd swyddog y trysorlys a roddodd gyngor i'r swyddogion a oedd yn cynghori'r Cabinet ar 20 Mehefin yn gwybod ac wedi rhoi gwybod, yn ysgrifenedig neu fel arall, mai dim ond pan fyddai'r prosiect wedi'i gwblhau y byddai'r warant yn dechrau?
- Ystyried a ellir rhannu gyda'r Pwyllgor y nodiadau am y cyfarfod crynhoi a gynhaliwyd rhwng Llywodraeth Cymru a'r cwmni ar 30 Mehefin.
- Cadarnhau a gadarnhaodd Swyddogion Llywodraeth Cymru wrth brif swyddogion Cylchffordd Cymru ar y dydd Gwener cyn penderfyniad y Cabinet nad oedd unrhyw faterion heb eu datrys.



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Rydym yn croesawu derbyn gohebiaeth yn Gymraeg. Byddwn yn ateb gohebiaeth a dderbynnir yn Gymraeg yn Gymraeg ac ni fydd gohebu yn Gymraeg yn arwain at oedi.

We welcome receiving correspondence in Welsh. Any correspondence received in Welsh will be answered in Welsh and corresponding in Welsh will not lead to a delay in responding

Rwyf i hefyd wedi cael cytundeb Ysgrifennydd y Cabinet dros Gyllid ac Ysgrifennydd y Cabinet dros yr Economi a Thrafnidiaeth imi anfon copi o'r llythyr hwn at Adam Price AC er mwyn ymateb i'r cwestiynau a gododd yn y Cyfarfod Llawn ar 7 Chwefror 2018, gan fod cysylltiad agos rhwng ei gwestiynau ef a'r rhai uchod. Dyma'i gwestiynau ef:

- Felly, a ddywedwyd wrth y cwmni, cyn penderfyniad y Cabinet, ynglŷn â'r asesiad a ddisgrifiodd yr Ysgrifennydd Parhaol o ran yr angen i leihau'r warant ymhellach?
- A hefyd, a ddywedwyd wrthynt y dydd Gwener blaenorol, cyn penderfyniad y Cabinet, nad oedd unrhyw broblemau sylweddol?
- Yn benodol, unwaith eto, a gaf fi ofyn i Ysgrifennydd y Cabinet a oedd y swyddog neu'r swyddogion yn Nhrysorlys Cymru a roddodd y cyngor hwnnw ar ddsbarthiad ar 20 Mehefin yn ymwybodol, ar y pryd, nad oedd y warant ond yn dechrau wedi i'r prosiect gael ei gwblhau?

Mae Mr Adam Price AC hefyd wedi gofyn nifer o Gwestiynau Ysgrifenedig y Cynulliad am y meysydd yr ymdrinnir â nhw uchod ac atebwyd y cwestiynau hynny gan ddefnyddio'r broses arferol ar gyfer ymdrin â chwestiynau o'r fath. Mae'r ymatebion i'r cwestiynau hynny i'w gweld yn Atodiad 1.

Mae'r ymatebion i gwestiynau dilynol y Pwyllgor ac i'r cwestiynau a ofynnwyd gan Mr Adam Price AC yn y Cyfarfod Llawn i'w gweld yn Atodiad 2 i'r llythyr hwn.

Ar ôl meddwl yn ofalus am drawsgrifiad y sesiwn tystiolaeth lafar ar 5 Chwefror, credaf y byddai o gymorth i'r Pwyllgor pe bawn yn cynnig eglurhad ac esboniadau pellach a allai helpu i leddfu rhai o'r pryderon a fynegwyd gan aelodau yn ystod y gwrandawriad hwnnw.

Er bod y mater o gategoreiddio, a chyfrifoldeb Llywodraeth Cymru i reoli risg mewn ffordd ddarbodus mewn maes sy'n un hynod gymhleth, wedi chwarae rhan bwysig wrth asesu a ddylid cefnogi menter Cylchffordd Cymru ai peidio, nid y materion hynny, o bell ffordd, oedd yr unig ystyriaethau wrth gynnal yr asesiad hwnnw. Yn wir, roedd materion eraill mwy masnachol eu natur yn destun pryder. Manylir ar y materion hynny yn yr adroddiadau diwydrwydd dyladwy a gyhoeddwyd am y prosiect hwn, e.e. yr hyn a oedd yn cael ei hawlio o ran nifer y swyddi a fyddai'n cael eu creu neu o ran hyfywedd y model busnes. Felly, nid ar sail dehongliad cul o'r rheolau cyfrifyddu, a hynny'n unig, y penderfynodd Llywodraeth Cymru beidio â chefnogi'r cynllun hwn.

Yn ystod y sesiwn graffu, dywedodd yr Ysgrifennydd Parhaol:

Ministers gave the project promoters a great deal of time and support to try and make this project work. There were a number of very different iterations of that project, which required different amounts of funding from the Welsh Government, which responded to concerns that were raised between 2011 and, in fact, last summer. So, we're talking about a period of more than six years of considering this project. Why was that? Because we felt that there was a potentially huge opportunity—a major private sector investment in a part of Wales that's received very little private sector investment in recent years—therefore, the Welsh Government was prepared to put a great deal of time into trying to develop a successful project. We applied very comprehensive due diligence to the final proposal. A summary of some of that due diligence has been published.²⁷

It was assessed to be a very high-risk project with most of the risk, in fact, being borne by the Welsh Government. It was also assessed that the benefits of the project, in particular the estimate of jobs created by the initial circuit element of the proposal, were, at best, very uncertain. As Andrew has indicated, there was a very strong likelihood as well that the asset and the associated debt, which was around £370 million, would be classified to the Welsh Government.

(Trawsgrifiad sydd ar gael yn Saesneg yn unig).

Risgiau ariannol yn bennaf a fyddai wedi dod i ran Llywodraeth Cymru. Pe na bai Circuit of Wales Ltd (CoW), ar unrhyw adeg ar ôl i'r gwaith adeiladu gael ei gwblhau, yn gallu cwrdd â holl gost neu unrhyw ran o gost y cyllid a ddarparwyd gan y cyllidwr allweddol, byddai Llywodraeth Cymru wedi bod yn atebol am unrhyw symiau na fyddent yn cael eu talu. Yn yr un modd, roedd risg na fyddai CoW yn gallu talu'r ffi a fyddai'n daladwy i Lywodraeth Cymru am gynnig gwarant. Pe na bai'r ffi honno'n cael ei thalu'n llawn, gallai hynny hefyd arwain at fwy o risg o her o dan y rheolau cymorth gwladwriaethol. Mae'n fwyaf tebygol mai'r hyn a fyddai'n arwain at sefyllfa lle na fyddai CoW yn gallu talu'r cyllidwr allweddol na Llywodraeth Cymru, fyddai methiant ar ran Cylchffordd Cymru i greu'r incwm angenrheidiol, neu pe bai'r cwmni'n mynd yn fethdalwr.

Roedd risg ychwanegol hefyd mewn perthynas â nifer o agweddau nad oeddent yn rhai ariannol. Wrth roi contract y warrant ac yn ystod y gweithrediadau dilynol, roedd risg o her o dan y rheolau cymorth gwladwriaethol, er mai'r cwmni ac nid Llywodraeth Cymru fyddai'n ysgwyddo effaith ariannol unrhyw gosb o dan y rheolau hynny. Risg pwysig arall oedd y posibilrwydd na fyddai'r prosiect yn esgor ar y manteision economaidd disgwylidig i Gymru. Unwaith y byddai'r gylchffordd yn weithredol, pe nai bai'r buses yn perfformio yn ôl y disgwyl, gallai hynny hefyd effeithio ar swyddi uniongyrchol a swyddi yn y gadwyn gyflenwi ac ar yr economi dwristiaeth ehangach pe bai nifer y gwylwyr yn llai na'r disgwyl. Dylid nodi bod disgwyl i'r rhan fwyaf o'r swyddi a'r effaith economaidd ddeillio o'r parc technoleg fodurol nad oedd yn rhan o'r cam hwn o'r prosiect.

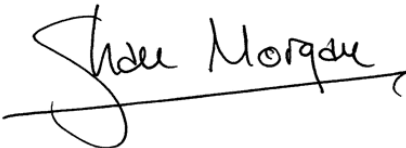
Wrth asesu'r risgiau sy'n gysylltiedig â chategoreiddio unrhyw ddyled, mae angen asesu'r risg sy'n gysylltiedig â'r ddyled honno. Yr hyn a olygir wrth ddyled isradd, neu ddyled eilradd, yw'r rhwymedigaethau hynny sy'n is o ran blaenoriaeth na'r holl fenthyciadau a gwarannau eraill y gellir hawlio ar eu cyfer o asedau cwmni. Os yw'r benthyciwr yn methu ag ad-dalu'r ddyled, ni fydd credydwy'r sydd â dyled isradd yn cael eu digolledu tan i'r holl gyrff eraill y mae arian yn ddyledus iddynt gael eu talu'n llawn. Felly, mae dyled eilradd yn fwy o risg ac, o'r herwydd, rhaid ad-dalu mwy arni.

Roedd y cymorth yr oedd Llywodraeth Cymru yn bwriadu ei roi i Gylchffordd Cymru yn eilradd i'r offerynnau cyllido eraill heblaw ecwiti. Yn unol â'r Llawlyfr Dyledion a Diffygion Llywodraethau (MGDD) (2016) (a gyhoeddir gan Eurostat), mae'n ofynnol addasu offerynnau dyled sydd â mwy o risg ynghlwm wrthynt (megis dyled eilradd neu isradd) yn ôl maint y risg. Er bod y ddarpariaeth hon sy'n ymwneud â risg i'w gweld yn y bennod o'r Llawlyfr sy'n ymdrin â Phartneriaethau Cyhoeddus-Preifat, ac er nad oedd Cylchffordd Cymru yn bartneriaeth o'r fath, rhybuddiodd Trysorlys ei Mawrhydi Lywodraeth Cymru y dylai ystyried yr egwyddor honno wrth iddi fynd ati i ddadansoddi. Gan gadw'r cyngor hwnnw mewn cof, nid oedd Llywodraeth Cymru o'r farn y byddai'n ddoeth rhagdybio na fyddai Eurostat yn cymhwyso'r ddarpariaeth hon i gynlluniau nad oeddent yn Bartneriaethau Cyhoeddus-Preifat. Ar ôl addasu cymorth Llywodraeth Cymru er mwyn rhoi ystyriaeth i'r risg gymharol a oedd yn gysylltiedig â'r ddyled, byddai'r warant yn fwy na 49% o gyfanswm costau'r prosiect, hyd yn oed o fabwysiadu agwedd haelfrydig i gyfanswm costau'r prosiect, fel y'u cyflwynwyd gan y cwmni. Roedd risg sylweddol hefyd y byddai'r benthyciadau yn cael eu hystyried yn rhan o gyllidebau Llywodraeth Cymru.

Er bod gan y Swyddfa Ystadegau Gwladol (ONS) broses ffurfiol ar gyfer gwneud penderfyniadau ar gategoreiddio, nid oes unrhyw ofyniad gorfodol i ymgynghori â'r ONS am faterion o'r fath. Yn wir, nid yw ond yn iawn ac yn briodol bod swyddogion yn cynnal eu hasesiadau eu hunain ar sail y canllawiau perthnasol. Dim ond pe byddai'r dogfennau perthnasol bron ar eu ffurf derfynol a phe bai penderfyniad wedi'i wneud mewn egwyddor i gynnig cymorth oddi wrth y Llywodraeth y byddid wedi ceisio cyngor ffurfiol yr ONS am Gylchffordd Cymru.

Swyddogion Trysorlys Cymru oedd yn gyfrifol am baratoi'r cyngor ar gategoreiddio, ac fe'i lluniwyd gyda chymorth y tîm categoreiddio yn Nhrysorlys ei Mawrhydi. Er nad yw'n ofynnol i Lywodraeth Cymru ymgynghori â Thrysorlys ei Mawrhydi, oherwydd bod y cynnig yn un mor gymhleth, a chan gydnabod bod gan Drysorlys ei Mawrhydi fwy o arbenigedd yn y maes o dan sylw, trafodwyd y mater gyda swyddogion Trysorlys ei Mawrhydi nifer o weithiau. Defnyddiwyd y cyngor a gafwyd oddi wrth Drysorlys Cymru ac mewn adroddiadau diwydrwydd dyladwy allanol wrth baratoi papur y Cabinet. Craffwyd yn ffurfiol ar y papur hwnnw a chynhaliwyd proses sicrwydd a chymeradwyo ar lefel uchel arno, cyn iddo gael ei gyflwyno i'r Cabinet.

Gobeithio y bydd yr wybodaeth ychwanegol hon yn rhoi sicrwydd ichi fod y prosesau yr ymgwymerwyd â nhw wrth ystyried cynnig Cylchffordd Cymru yn rhai trylwyr a chadarn. Er bod cryn sylw wedi'i roi i sut y byddid yn ymdrin â'r ddyled ar y fantolen, hoffwn ddatgan unwaith eto mai un yn unig o'r rhesymau dros wrthod y cais am gyllid ar gyfer y prosiect cymhleth hwn oedd hwnnw.

Yn gywir, 

Shan Morgan

Ysgrifennydd Parhaol/ Permanent Secretary
Llywodraeth Cymru / Welsh Government

Cc: Adam Price AC



Atodiad 1

Relevant Welsh Assembly Questions Responses

WAQ75888

Adam Price (Dwyrain Caerfyrddin a Dinefwr): A wnaiff Llywodraeth Cymru gyhoeddi ei nodyn o'r cyfarfod gyda'r Heads of the Valleys Development Company ar 30 Mehefin 2017 os nad yw'r cwmni yn gwrthwynebu? WAQ75888

Ken Skates: Mae fy swyddogion wrthi'n trafod y mater gyda'r cwmni ar hyn o bryd. Bydd y nodiadau'n cael eu cyhoeddi os ceir cytundeb y cwmni.

WAQ75889

Adam Price (Carmarthen East and Dinefwr): Was the Welsh Treasury official who gave advice on 20 June 2017 on the balance sheet classification issue regarding the Circuit of Wales aware at that time that the Welsh Government guarantee did not cover any element of the project revenue? WAQ75889

Ken Skates: Welsh Treasury officials who advised on the balance sheet classification issue regarding the Circuit of Wales were aware at that time of the information relevant to that issue.

WAQ75890

Adam Price (Carmarthen East and Dinefwr): Was the Welsh Treasury official who gave advice on the balance sheet classification issue regarding the Circuit of Wales on 20 June 2017 aware that 100 per cent of the construction risk was held by the private sector at the time the advice was given? WAQ75890

Ken Skates: Welsh Treasury officials who provided advice on classification were aware of the relevant details of the proposal at the time of providing that advice. Whether the guarantee only commenced after the construction was complete would not have made a difference to the assessment of classification risk.

WAQ75891

Adam Price (Carmarthen East and Dinefwr): Did the Welsh Treasury official who provided advice on the balance sheet classification issue on the Circuit of Wales on the

20 June 2017 apply weightings to the financial risk based on the subordination and not the risk of exposure? WAQ75891

Ken Skates: Weighting was applied to the share of costs guaranteed by Welsh Government, given its subordinate nature in the capital structure and hence greater exposure to risk.

WAQ75892

Adam Price (Carmarthen East and Dinefwr): What was the reason for the removal of the developer's equity in the calculations of the balance sheet classification risk relating to the Circuit of Wales by the Welsh Treasury official who gave advice on 20 June 2017? WAQ75892

Ken Skates: Developers' equity was not removed in the calculations of the balance sheet classification risk.

WAQ75893

Adam Price (Carmarthen East and Dinefwr): Did Welsh Government share with UK Treasury the paper produced for it showing all the mitigating steps available to Circuit of Wales such as capex deferral, asset sales, operational cost reduction, refinancing, commercial renegotiation and lifecycle cost deferral that would preserve earnings to satisfy the loan exposed to the guarantee? WAQ75893

Ken Skates: Officials shared relevant information with UK Treasury on this matter. However, officials do not recognise the paper you refer to in your question.

Atodiad 2

Ymateb Llywodraeth Cymru i Gwestiynau'r Pwyllgor Cyfrifon Cyhoeddus ac Adam Price

Cwestiwn 1

A roddwyd gwybod i'r cwmni cyn i'r Cabinet wneud penderfyniad fod problem gyffredinol gyda maint y warant ac mai dim ond pe bai gwarant Llywodraeth Cymru o leiaf 50 y cant yn llai y byddai modd datrys y sefyllfa?

Adam Price AC

Felly, a ddywedwyd wrth y cwmni, cyn i'r Cabinet wneud penderfyniad, am yr asesiad a ddisgrifiodd yr Ysgrifennydd Parhaol o ran yr angen i leihau'r warant ymhellach?

Ymateb Llywodraeth Cymru

Ni ddaeth Llywodraeth Cymru i gasgliad ffurfiol ynghylch pa lefel o warant na fyddai'n arwain at risg sylweddol o ran categoreiddio. O ystyried maint y buddsoddiad a'r risg fasnachol a ddeuai i ran Llywodraeth Cymru o dan y trefniant arfaethedig, byddai angen gwarant lawer llai er mwyn lliniaru'r risg o gategoreiddio anffafriol – gostyngiad posibl o fwy na 50%. Fodd bynnag, nid oedd modd cadarnhau rhif diffiniol heb wybodaeth cwbl bendant.

Felly, ni roddodd Llywodraeth Cymru wybod i HOVDC, cyn i'r Cabinet wneud y penderfyniad, y byddai angen gostyngiad o 50% o leiaf yn y warant y gofynasid i'r llywodraeth ei rhoi. Heblaw hynny, ni fyddai lleihau'r risg o ran categoreiddio'r ddyled wedi golygu o reidrwydd y byddai'r prosiect yn un addas i Lywodraeth Cymru roi cymorth ar ei gyfer. Nid yw risg o ran categoreiddio yr un peth â risg fasnachol. O leihau'r risg o ran categoreiddio drwy leihau maint y warant yn sylweddol, byddai proffil risg a manteision y prosiect yn wahanol iawn i'r un y gofynnwyd i Lywodraeth Cymru ei ystyried.

Cwestiwn 2

A oedd swyddog y trysorlys a roddodd gyngor i'r swyddogion a oedd yn cynghori'r Cabinet ar 20 Mehefin yn gwybod ac wedi rhoi gwybod, yn ysgrifenedig neu fel arall, mai dim ond pan fyddai'r prosiect wedi'i gwblhau y byddai'r warant yn dechrau?

Adam Price AC

Yn benodol, unwaith eto, a gaf fi ofyn i Ysgrifennydd y Cabinet a oedd y swyddog neu'r swyddogion yn Nhrysorlys Cymru a roddodd y cyngor hwnnw ar ddsbarthiad ar 20

Mehefin yn ymwybodol, ar y pryd, nad oedd y warant ond yn dechrau wedi i'r prosiect gael ei gwblhau?

Ymateb Llywodraeth Cymru

Roedd y swyddogion yn Nhrysorlys Cymru a roddodd gyngor ar gategoreiddio i'r swyddogion yng Ngrŵp yr Economi, Sgiliau a Chyfoeth Naturiol a ddrafftiodd y papur ar gyfer y Cabinet yn gwybod am fanylion perthnasol y cynnig pan roddasant y cyngor hwnnw ar 20 Mehefin. Nid oedd y ffaith na fyddai'r warant ond yn dechrau pan fyddai'r prosiect wedi'i gwblhau, ai peidio, yn berthnasol oherwydd mai'r prif faen prawf yn yr asesiad oedd y gyfran o gyfanswm y costau a fyddai'n dod o dan y warant, nid pryd y gallai'r warant gael ei defnyddio. Felly, ni fyddai amseriad y warant wedi gwneud unrhyw wahaniaeth wrth asesu'r risg o ran categoraiddio.

Cwestiwn 3

Ystyried a ellir rhannu gyda'r Pwyllgor y nodiadau am y cyfarfod crynhoi a gynhaliwyd rhwng Llywodraeth Cymru a'r cwmni ar 30 Mehefin.

Ymateb Llywodraeth Cymru

Paratôdd swyddogion nodiadau am y cyfarfod ar 30 Mehefin i'w cadw fel rhan o gofnod mewnol Llywodraeth Cymru am y prosiect. Yn unol â'r hyn sy'n arferol ar gyfer dogfennau mewnol, ni chafodd y nodiadau eu rhannu'n allanol ar y pryd. Fodd bynnag, cafodd y nodiadau eu cylchredeg yn fuan ar ôl y cyfarfod i'r swyddogion yn Llywodraeth Cymru a oedd yn bresennol yn y cyfarfod, a chytunwyd bod y nodyn yn gofnod teg o'r cyfarfod.

Yng ngoleuni'r ffaith y gallai nodyn mewnol Llywodraeth Cymru am y cyfarfod gael ei ddatgelu, mae wedi cael ei rannu gyda chynrychiolwyr HOVDC a oedd yn bresennol. Mae'r nodiadau gwreiddiol am y cyfarfod, a gymeradwywyd gan Swyddogion Llywodraeth Cymru at ddefnydd mewnol yn unig, i'w gweld yn Atodiad 3. Yr wybodaeth sy'n cael ei chuddio yw enwau swyddogion iau ac enwau prif gyllidwyr y prosiect, oherwydd sensitifrwydd masnachol. Ni chafwyd cytundeb HOVC am y nodiadau.

Cwestiwn 4

Cadarnhau a gadarnhaodd Swyddogion Llywodraeth Cymru wrth brif swyddogion Cylchffordd Cymru ar y dydd Gwener cyn penderfyniad y Cabinet nad oedd unrhyw faterion heb eu datrys.

Adam Price AC

A hefyd, a ddywedwyd wrthynt y dydd Gwener blaenorol, cyn penderfyniad y Cabinet, nad oedd unrhyw broblemau sylweddol?

Ymateb Llywodraeth Cymru

Cynhaliwyd cyfarfod anffurfiol gyda HOVDC ddydd Gwener 23 Mehefin, a hynny'n rhan o'r rhaglen o gyfarfodydd rheolaidd a drefnwyd ymlaen llaw i drafod cynnydd. Ni chadarnhaodd swyddogion wrth HOVDC nad oedd unrhyw broblemau mawr na materion heb eu datrys. Fodd bynnag, cadarnhaodd swyddogion nad oedd rhagor o wybodaeth yn cael ei geisio oddi wrth HOVDC cyn i'r Cabinet ystyried ei benderfyniad.



Atodiad 3

Notes of meeting with HOVDC to discuss Balance sheet issue re Circuit of Wales 30 June 2017

Attendees: Mick McGuire (MMcG) – Welsh Government
Andrew Jeffreys (AJ) - Welsh Government
[REDACTED] (XX) – Treasury, Welsh Government
[REDACTED] – Welsh Government
Richard Parry-Jones (RPJ) – HOVDC
Gheev Changizi (GC) – HOVDC
Martin Whittaker (MW) – HOVDC
Michael Carrick (MC) – HOVDC

1. AJ and XX introduced their roles within WG treasury.
2. MMcG stated that the primary reason of the meeting is to discuss issues arising from the likely classification of the Circuit of Wales (CoW) project. The discussions at the meeting are to be treated as confidential.
3. HOVDC stated that they were disappointed and disenchanted in the decision not to support the project. They had previously worked with Treasury on balance sheet treatment of similar projects. They had asked for the meeting to better understand the WG decision and to discuss if this can be taken forward. They also stated their disappointment in the lack of communication on the way forward.
4. WG – Economic activity is recorded and classified in the national accounts based on rules provided by Eurostat. The budgetary treatment flows from whether this activity is classified to the public or private sector. ONS would classify the company. Its debt would be classified to the public or private sector accordingly. WG have had concerns on whether the debt would be classified to the public sector for some time. AJ has been aware of the project for some time and of potential issues with classification since around spring 2016. AJ met with MC at that time, when classification was discussed. At that time the guarantee was bigger than the recent proposal. Classification was not therefore a new concern. MC acknowledged their earlier meeting and said he was confident then that it would not be classified on balance sheet and he remains bullish today.
5. MW – In July 16 there was a meeting where HOVDC talked about the balance sheet concerns and shared examples of projects underwritten by government where the debt was not on the balance sheet. HOVDC have always understood that the project costs for the CoW needed to be off the Welsh Government balance sheet. HOVDC still cannot see how the current proposal could be on the balance sheet. They need to understand what parts of the proposal in terms of contracts and the risks that means the debt will end up on the Welsh Government balance sheet. HOVDC needs to understand that if they have different views on this than WG what can be done to take the project forward.

6. WG – There has been no ONS decision at this time as they will only give a classification decision on an actual contractual proposition. This process could take between two or three months. It would take longer if a decision were referred to Eurostat, which AJ thought was possible given the novel nature of the proposition, and its high public profile. AJ said that advice had been sought by Ministers on whether there was a risk that CoW would be classified to the public sector; and that advice had been given, i.e., that there is significant risk that CoW and its debt would be classified to the public sector and hence hit the Welsh Government budget.
7. WG confirmed that advice had been sought from UK Treasury, and that discussions around the relevant guidance had been taking place with the ONS and Eurostat for some time. The UK Treasury's view is that elements of the proposal did give rise to a risk that the debt will be classified to the public sector.
8. Eurostat has recently reissued the PPP guidance on classification as set out in the Manual on Government Deficit and Debt (MGDD, 2016). Guidance on other types of transactions is not as comprehensive, although Eurostat will now begin the work of revising other chapters in the MGDD. Advice has been received that the guidelines on PPP classification can to some extent be used as a benchmark for classifying other types of transaction – applying a relevant risk weighting to debt that is exposed to a higher level of risk being a case in point. Whilst the WG guarantee can be seen as technically less than 50% applying a risk weighting to reflect the junior nature of this debt in the capital structure would increase the percentage to over 50%.
9. Whilst the equity is the riskiest bit of the capital structure, the WG guaranteed tranche of £210m is riskier than the [REDACTED] and non-guaranteed [REDACTED] funding. As the guarantee is more junior to this latter funding, this will increase the risk weighting. It doesn't need to be weighted very heavily to get the risk-weighted percentage funding over the 50% limit.
10. Furthermore, there were concerns that, even without applying a risk weighting, the guarantee was over 50% of the project costs. The project costs appeared to double count certain elements of funding as the equity appeared to be sourced from the senior debt, rather than being additional. It was possible therefore that the ONS would discount certain things, possibly reducing the project costs to £373m, so £210m out of £373m is more than 50% (56%). Risk weighting would exacerbate this.
11. WG stated that the MGDD has different sections within it eg guarantees, PPP. Eurostat have updated the guidance on PPP, and whilst CoW is not a PPP some of the key principles can be applied to an assessment of the classification of its debt. It is believed that there is a significant risk that CoW could be classified to the public sector as public corporation.
12. HOVDC stated there was no governance or control by the WG, no risk of the delivery of construction. There are lots of examples out there which are not on balance sheet. They were astonished that the PPP guidance is being applied for

something that is very different. There are lots of projects where this treatment does not apply. The key criteria is that it's less than 50%.

13. WG stated that a guarantee equating to less than 50% could mean, other things equal, that it would not be classified to the public sector as a public corporation. But this was not a question where the WG or the UK had discretion. The approach was rules based. Officials' role is to provide advice to Ministers on risk in the context of those rules. HOVDC could reduce the classification risk by reducing the amount being guaranteed or by increasing the ranking of the debt such as it was genuinely *pari passu* with the most senior debt, or a combination of the two.
14. RPJ – HOVDC have calculated the percentage as 49.8%
15. WG – The numbers aren't necessarily approached in this manner for reasons already cited. Equity is funded by the debt so it is arguably double counted – borrowing is recycled back into the funding package, so the equity element appears to give an inflated figure for the cost of the project. Need to focus on the capital cost of the project primarily. But even if the value of equity were included in the project cost, if the risk weighting of the guaranteed tranche still will make the total percentage greater than 50%.
16. The due diligence work on the project enabled WG to see the figures in some detail for the purposes of classification for the first time – a reliable assessment could not be made until the DD process was completed. The assessment made on the basis of these figures, for the reasons already cited, is that there is a significant risk that CoW would be classified to the public sector. However ONS is the ultimate arbiter of these decisions, and a formal decision cannot be taken unless the relevant documents are submitted to the ONS for assessment.
17. HOVDC stated their exposure to the funding and the return on the equity should not be discounted. The level of security is an issue.
18. WG stated the only element of the funding considered is the value of the guarantee and not the likelihood of it being called.
19. RPJ stated that if the guarantee is called then the repayment is over a long period of time.
20. WG stated the assessment is on what the guidelines state. No discounting process is required under the guidelines for the purposes of establishing the relevant percentage of government financing in the form of a guarantee.
21. HOVDC stated that the Ernst and Young report states that the process being discounted is key.
22. WG restated that discounting is not a factor for the classification assessment. This was more about the treatment of the debt covered by the guarantee in the national accounts.

23. RPJ said in the worse case scenario and the guarantee is called on the day after the construction is completed. Is the classification based on the DCF value or the nominal value?
24. WG stated it doesn't matter if the guarantee is called – ONS is only working out whether the debt is in the private or public sector. As the debt is repaid the debt on the Government's balance sheet would reduce.
25. HOVDC stated that this is an inflexible process. If the project is a success and the guarantee is not called or the guarantee is bought out are WG still saying that the guarantee would still be on the balance sheet?
26. WG – the UK government is very compliant with the Eurostat rules. The purpose of the rules is to make sure it is clear whether Government is liable for the debt or not. The classification is not a permanent arrangement – if there is a significant change in the capital structure then it would be possible to seek to change a classification decision. It was reiterated that ONS could only take a decision at a point in time on the contractual conditions agreed at that point in time – if contracts are varied then reclassification would be required. The ONS cannot make a decision based on outcomes that might or might not come about.
27. WG – our assessment is that there is a risk that CoW debt would go on the balance sheet with a real opportunity cost for WG.
28. HOVDC stated the guarantee does not contractually start for 27 months. So why do we need to worry about the classification now and why can't we wait until then?
29. WG stated that it is not as simple as that. The fact that WG was obliged to guarantee the debt associated with the company would still need to be considered now. The fact that the guarantee is a contingent liability in terms of its being called did not mean it was not also a contractual obligation which means it needs to be dealt with at the start. It is not up to WG how the debt is classified – ONS would need to make the decision.
30. HOVDC stated they need to sit down with their advisors to work this through. HOVDC are still on a different page on this and believe this is not consistent with how other projects are being classified.
31. WG disagreed with this comment.
32. HOVDC – what would the impact be if the guarantee is reduced to £100m and equity was significantly increased?
33. WG – WG would need to consider the impact on classification if such a proposition were made.
34. HOVDC stated that this process has taken 7 years but without a steer on this point. There have been massive costs and they don't understand why this opinion was not provided previously. HOVDC appreciated the additional insight to the decisions

made – whilst they did not agree at least they understood the rationale. The issues identified need to be addressed and a way forward needs to be found. HOVDC asked for another meeting, face 2 face, to take this forward.

35. MMcG would discuss this request with the Minister and will come back once a decision has been made