



Cynulliad Cenedlaethol Cymru
The National Assembly for Wales
Y Pwyllgor Cyllid
The Finance Committee

Dydd Mercher, 16 Mai 2012
Wednesday, 16 May 2012

Cynnwys
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Cynnig o dan Reol Sefydlog Rhif 17.42 i Benderfynu Gwahardd y Cyhoedd o'r Cyfarfod
Motion under Standing Order No. 17.42 to Resolve to Exclude the Public from the Meeting

Cofnodir y trafodion hyn yn yr iaith y llefarwyd hwy ynndi yn y pwyllgor. Yn ogystal,
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

Peter Black	Democratiaid Rhyddfrydol Cymru Welsh Liberal Democrats
Christine Chapman	Llafur Labour
Jocelyn Davies	Plaid Cymru (Cadeirydd y Pwyllgor) The Party of Wales (Committee Chair)
Paul Davies	Ceidwadwyr Cymreig Welsh Conservatives
Mike Hedges	Llafur Labour
Ann Jones	Llafur Labour
Ieuan Wyn Jones	Plaid Cymru The Party of Wales
Julie Morgan	Llafur Labour

**Eraill yn bresennol
Others in attendance**

Jeff Andrews	Cynghorydd Polisi Arbenigol, Llywodraeth Cymru Specialist Policy Adviser, Welsh Government
Katherine Himsworth	Furnace Farm Cyf. Furnace Farm Ltd
Gerry Holtham	Cynghorydd ar Fuddsoddi mewn Seilwaith Infrastructure Investment Adviser
Jane Hutt	Aelod Cynulliad, Llafur (y Gweinidog Cyllid ac Arweinydd y Tŷ) Assembly Member, Labour (Minister for Finance and Leader of the House)
Andrew Jeffreys	Dirprwy Gyfarwyddwr, Buddsoddi Cyfalaf Strategol, Llywodraeth Cymru Deputy Director, Strategic Capital Investment, Welsh Government
Stephen Jones	Cyfarwyddwr Cyllid ac Adnoddau, Cymdeithas Llywodraeth Leol Director of Finance and Resources, Local Government Association
Chris Williams	Cyfarwyddwr Datblygu, Tidal Energy Cyf. Development Director, Tidal Energy Ltd

**Swyddogion Cynulliad Cenedlaethol Cymru yn bresennol
National Assembly for Wales officials in attendance**

Dan Collier	Dirprwy Glerc Deputy Clerk
Helen Finlayson	Clerc Clerk
Joanest Jackson	Cynghorydd Cyfreithiol Legal Adviser

*Dechreuodd y cyfarfod am 9.29 a.m.
The meeting began at 9.29 a.m.*

Cyflwyniad, Ymddiheuriadau a Dirprwyon Introduction, Apologies and Substitutions

[1] **Jocelyn Davies:** Welcome to the Finance Committee. We are grateful, Minister, that you have been able to join us. I would just like to draw your attention to a few housekeeping matters. Everybody will know that the meeting is bilingual. The translation is on channel 1 of your headsets and the amplification is on channel 0. Please check that your mobile phones and other electronic devices are switched off. This is a formal meeting, so you will not need to operate the microphones yourself. We are not expecting a fire drill, so if you hear the alarm, it is a genuine emergency and please take instructions from the ushers. I do not think that we have received any apologies.

9.30 a.m.

Cyllid Datganoledig: Pwerau Benthg a Dulliau Arloesol o Ddefnyddio Arian Cyfalaf Devolved Funding: Borrowing Powers and Innovative Approaches to Capital Funding

[2] **Jocelyn Davies:** Minister, will you introduce yourself and your colleagues for the record? We are very grateful that you have provided papers in advance. We have a lot of questions today so, if it is okay with you, we will go straight to those. We also have some questions that we will probably need to send you in writing. So, after the introductions, I will start with the first question.

[3] **The Minister for Finance and Leader of the House (Jane Hutt):** Thank you very much indeed. I am Jane Hutt, Minister for finance. I have with me Jeff Andrews, specialist policy adviser, and Andrew Jeffreys, the head of infrastructure investment planning. We are very pleased that Gerry Holtham is also here as our adviser on innovative finance and infrastructure investment planning.

[4] **Jocelyn Davies:** Thank you. Minister, we understand that the Wales Audit Office has been asked to review local government prudential borrowing. What are you able to tell us about the purpose and scope of the review?

[5] **Jane Hutt:** My understanding is that the Wales Audit Office review is a wide-ranging review to get a collective understanding between the Welsh Government and Welsh local government about how local government can manage its reserves and to look at key issues to do with accounting for future financial settlements. Of course, this has been commissioned by the Minister for Local Government and Communities, Carl Sargeant. The review is also looking at differences of approach to prudential borrowing between local authorities and areas of good practice. I understand that it is also looking at the use of unsupported borrowing. It will be available in July.

[6] **Jocelyn Davies:** Thank you for the clarification.

[7] **Julie Morgan:** Good morning. I would like to ask about the housing revenue account subsidy. What is the current position of the ongoing discussions with UK Government Ministers with regard to the reform of the housing revenue account subsidy system in Wales?

[8] **Jane Hutt:** This is an area on which I have been working very closely with the

Minister for Housing, Regeneration and Heritage, Huw Lewis. We have been bringing this to the attention of UK Government Ministers and negotiating with them. We have been pressing the case with the UK Government for reform of the HRAS as it applies to Wales for some time. We are all in agreement that the transfer of council HRAS revenue to Treasury seems unfair. Of course, it takes vital investment away from the local authority housing sector. Discussions with the UK Government are ongoing, and we hope that we will have a package of reforms to take forward to enable the HRAS to be abolished in Wales.

[9] **Julie Morgan:** What do you think the likely cost of a buy-out would be?

[10] **Jane Hutt:** We are doing some more research on the reform package that we are proposing. We are in a position of having had stock transfer ballots quite recently, which clarifies the position on HRAS. It is early days for me to say what the shape of the reform package will be. This might be best followed up with the Minister for housing. However, I assure you that I am working closely with him and pressing the case with the UK Government.

[11] **Mike Hedges:** What ability do local authorities have to borrow against future rent income streams in order to modernise houses? Do you have any thoughts on that?

[12] **Jane Hutt:** Again, as I said, this depends very much on the shape of the reform package. We need to get the best possible settlement for Wales. However, it is essential that we work with the UK Government to clarify these points. Andrew or Gerry might have something to add on this point.

[13] **Mr Holtham:** The reform of the HRAS in England resulted in the Treasury imposing specific borrowing limits on local authorities' housing accounts, quite separately from prudential borrowing. One of the items in the negotiation will be whether they attempt to do that in the Welsh case and whether they have the power to do it in the Welsh case. Of course, if we get out of the HRAS, councils will be able to alter rents. Effectively, at the moment, there is no point doing that because the money is sent off to London. It would free them to reconsider rents, and then it depends whether there is a limit on their borrowing as to what use they could make of any rent increase that they bring in.

[14] **Mike Hedges:** Over the next 15 years, most council housing will be paid for, will it not? Most council housing was on a 60-year debt, having been built between the early 1940s and the mid to late 1960s; there was a huge drop after 1970 and a complete stop after 1979. So, in the next 10 years or so, the debt will reduce rapidly on an annual basis. Would that not give an opportunity, with the income stream not being spent on debt, to use some of that for investment?

[15] **Mr Holtham:** That is probably right, yes.

[16] **Jocelyn Davies:** I am glad to hear you make a prediction on the record that the council house debt will be paid off in the next 15 years—all things being equal, I guess.

[17] **Peter Black:** I have a quick follow-up question. I understand that there are discussions within England to allow prudential borrowing on housing revenue accounts. Do you know the situation with regard to that?

[18] **Mr Holtham:** No.

[19] **Jane Hutt:** Perhaps that is a question for the Minister for housing.

[20] **Peter Black:** You made a statement in April on the progress of the ongoing bilateral

talks on fair funding. Can you report any further progress on these talks and explain the nature of the evidence base that you referred to? Would you be willing to share that evidence with the committee?

[21] **Jane Hutt:** I made a statement in April following my meeting after Easter, on 17 April, with the Chief Secretary to the Treasury, Danny Alexander. What was important about that meeting, as you said and as I made clear in my statement, was that a shared understanding of the analysis of convergence was agreed between Treasury officials and our officials. Obviously, Gerry has provided us with the evidence on convergence, which we were satisfied with, in the first report of the independent commission. However, the Treasury had to go through this to agree our analysis, and it has done so. That is a major step forward in moving towards a solution. Of course, our preferred solution would be to reform the Barnett formula to take account of need, but we recognise that the first step would be to halt convergence, because it is also clear that convergence has progressed since 1999. Then we move to a point where it will pick up again, and there will be an upturn. So, the funding floor is what we are pressing for in the fairer funding arrangements. I am due to meet Danny Alexander again in June, and I anticipate that the inter-governmental talks will conclude before the summer recess. These will involve the First Minister, the Prime Minister, the Chancellor and the Deputy Prime Minister.

[22] Clearly, we are also negotiating our borrowing powers. We have the borrowing powers through the Welsh Development Agency Act 1975, and we feel that we should acquire them. We are progressing with that as well. So, those two areas—convergence and funding needs, and borrowing powers—are progressing well in the talks, but I would want to keep the Assembly updated on those.

[23] **Ieuan Wyn Jones:** I have a point on that response. The Government here has made it clear that it does not really wish to have taxation powers unless there has been reform of the Barnett formula. Are you now saying that, if the floor is conceded, then that would be sufficient reform for you to take taxation powers, or would you require total reform of Barnett before accepting them?

[24] **Jane Hutt:** We are being practical and realistic about what we hope to achieve from the inter-governmental talks. What has been very good is that we have cross-party consensus here on this. I recall the debate last year, in which we had an agreed motion from all parties, which was very clearly that the first step to Barnett reform that would assist us would be the floor and progressing with enabling us to use our borrowing powers. The point for the Silk commission is the timetabling of this; it is not reporting until the autumn. I know that it has been around Wales and it has had widespread consultation about further fiscal devolution and tax-varying powers. Our responsibility at this stage is clearly to move and deliver on our fairer funding settlement.

[25] **Paul Davies:** You have already mentioned the Welsh Development Agency Act 1975. In your paper, you state that the borrowing powers under the Act are not as broad as those sought. Can you tell us exactly what you are seeking in these talks?

[26] **Jane Hutt:** The short-term gain and goal is to use the powers that we already have through the WDA Act. We do not need to negotiate further on any change in our legal borrowing powers in the short-term to access those powers. If we were able to gain access to those powers, the current system could be unsatisfactory from a Welsh perspective, because it leaves us vulnerable to arbitrary changes in Treasury policy. So, in the medium term, we think that our borrowing powers should be in a new and firmer framework and one that provides us with assurances that the UK Government will not restrict our borrowing powers in the future. Also, we must recognise, as I have always said, that we need to look at these borrowing powers within the UK's own fiscal framework, so that reasonable checks and

balances are in place.

[27] Those are the kind of medium and longer term issues, and they are being considered by the Silk commission. The first goal and objective is to enable us to access our borrowing powers. I have said more than once in the Chamber in recent times that the difficulty is that we need an agreement, and we need a set of rules, if you like, about the use of those existing borrowing powers. Otherwise, if we use them, any borrowing that we undertook would just be lost from our block grant. So, we must come to an agreement with the UK Government on this.

[28] **Ieuan Wyn Jones:** Rydych chi wedi dweud y byddech yn cymryd pwerau benthyca, hyd yn oed pe na baech yn cael pwerau trethu. Pa mor ymarferol, realistig a fforddiadwy yw hynny, o gofio y byddai'n rhaid ichi gael ffrwd ddigonol o refeniw i dalu am y llog ar y cyfalaf?

Ieuan Wyn Jones: You have said that you would take borrowing powers even if you could not obtain taxation powers. How practical, realistic and affordable is that, bearing in mind that you would need a sufficient revenue stream to pay for the interest on the capital?

[29] **Jane Hutt:** We know that we need borrowing powers in order to progress with our infrastructure development and capital programme. Northern Ireland has borrowing powers and the Scottish Government will have them soon. We would say—and this goes back to Gerry and his evidence—that we have the revenue stream with our block grant and it is not likely that the UK Government will turn off our block grant and leave us without any public resources. We have a stream of revenues from which we could finance borrowing—and I may want to bring Gerry in here, because this goes back to his role in respect of the independent commission—and some borrowing could be possible in the absence of tax devolution. The issue about streams of revenue is important, over and above our block grant, and that has been raised with me by the Chief Secretary to the Treasury in our inter-governmental talks. So, we have moved on to considering those income streams; we have already touched on them in relation to housing revenue, and that is where the toll income from the Severn crossings has been considered as a future potential stream of revenue to finance borrowing.

[30] Also, going back to the Silk commission, there are discussions around stamp duty, air passenger duty and so on, and the evidence that we gave as the Welsh Government looks at these as part of a broader package of reforms. I do not know whether Gerry would like to add to that.

9.45 a.m.

[31] **Mr Holtham:** Not really, except simply to say that revenue is revenue and there has to be some limit on debt that is related to your revenue stream. So, the more revenue you have, the more debt you can carry. However, there would be a prudent level of debt that could be carried just on the block grant. If you had the ability to expand your budget through tax receipts, you could afford to carry a little more debt.

[32] **Ieuan Wyn Jones:** Mae cwestiwn hefyd o ran beth fyddai'r Trysorlys yn fodlon ei dderbyn. A fyddai'n fodlon rhoi yr un lefel o hawliau benthyca i chi pro rata â'r Alban heb bwerau trethu?

Ieuan Wyn Jones: There is also a question of what the Treasury would be prepared to accept. Would it be prepared to give you the same level of borrowing powers pro rata as Scotland without the power of taxation?

[33] **Jane Hutt:** Perhaps this is again pre-judging not only where we will be going in our inter-governmental talks but also the Silk commission and its considerations. If we look at the situation in Scotland—and I am sure that we will go on to this in our discussions this morning—we see that it is getting a specific borrowing limit, and I am sure that the Treasury

will have a preferred approach of giving us an annual limit on borrowing. So, we need to look at that and at the proportionate arrangements that we could have. We are perhaps at an early stage, but it might be helpful for the committee's consideration.

[34] **Ieuan Wyn Jones:** I need to press you a little on this, Minister, because it is fairly obvious that the Scotland Act 2012 gives the Scottish Government greater tax-varying powers than it had previously, and it was against that backdrop that the Treasury allowed borrowing limits of up to £2.2 billion, because the Scottish Government would then have an additional revenue stream to tap into. If Wales were to get, pro rata, the same level of borrowing powers, would that not mean that there had to be a limit on the borrowing that could be done against the block, although if you had tax-varying powers, you could go up pro rata to the same amount? If you are looking for that same pro rata proposal from the Treasury, is it not clear that there must be tax-raising powers?

[35] **Jane Hutt:** I have mentioned the evidence that we will give as the Welsh Government in relation to the tax devolution that we think would be appropriate at this point. You know the view and the position that we have taken on tax-varying powers, with the need to hold a referendum if we were to move in the direction of tax-varying powers in respect of income tax. This is a matter for joint agreement between Governments and the Silk commission. At this stage, we need a simple and agreed framework for our borrowing requirements, with clear limits and clear regular mechanisms for those limits. I must say that this has to be about borrowing for a purpose, such as capital investment. Andrew Jeffreys might want to come in.

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

[37] **Jocelyn Davies:** Mike, I know that you have been waiting to come in.

[38] **Mike Hedges:** While I was waiting, the first half of my question was answered. The second half is this, however: is the block grant not more reliable than taxation? The problem with taxation is that it goes up and down, while you know what you are getting with the block grant. Although Scotland may have the ability to move taxation up and down, it will not be able to do it in such a way as to guarantee its income to a certain level year on year. The Westminster Government has been unable to do that. So, if you are borrowing, you are much safer borrowing with a block grant, where you know what you are getting, as opposed to borrowing based on taxation, where you do not know what you are getting.

[39] **Jane Hutt:** That is a fair point. You have answered your own question, Mike. I want to follow up a point that Andrew made. We have to have the capacity to borrow because we have underborrowed in Wales. We must take this one step at a time, and having a simple framework for that is an incremental move towards enabling us to use our powers effectively. Indeed, Andrew made the point clearly that this is not based on tax devolution as the point at which you can then progress with those powers. I hope very much that the committee will see that this is a fundamental point on which to support me in my inter-governmental talks. We are asking to use our existing powers to fund our capital infrastructure needs, which we will present clearly next week in the Wales infrastructure investment plan. Obviously, the points that Ieuan has made will be taken into account as we move forward with the Silk commission.

[40] **Christine Chapman:** I understand that there have been talks at European level on the ability of regional Governments to borrow. Have you been party to any of those or do you have any information on that?

[41] **Jane Hutt:** I have not been party to any such talks, and I am not aware of any of my ministerial colleagues having been either. I do not know whether Gerry or Andrew want to comment on this. Clearly, we are in a difficult position now, which may be linked to the eurozone issue.

[42] **Mr Jeffrey:** My understanding is that there have been some issues in the eurozone with not just national Government debt but sub-national Government debt. In certain countries in Europe, central Government does not constrain the ability of sub-national Governments to borrow. For example, there have been particular issues in Spain. So, we are sort of aware of that but, as the Minister has already said, the Welsh Government's position is that it is perfectly proper for national Governments to seek to place reasonable constraints on sub-national or regional Governments' ability to borrow, and it is a matter of agreeing on the appropriate limits.

[43] **Jocelyn Davies:** That issue was raised with Chris and me in another forum. Perhaps we will just flag that up with you, then.

[44] **Jane Hutt:** We will look into it.

[45] **Jocelyn Davies:** On the control of borrowing limits for central and local government, you will be aware of the draft protocol between the Welsh Government and Welsh local government on the procedures to be followed in the event of a national limit, if that is required. Do you envisage a similar protocol being introduced between the Treasury and yourselves, if you were granted borrowing powers of the nature that you are asking for?

[46] **Jane Hutt:** Yes. You will know that our funding arrangements operate according to a statement of funding policy between the Welsh Government and HM Treasury. So, a new written set of rules would have to be endorsed by both Governments and then reflected in the statement of funding policy. That follows on from the kind of detail that we would have to agree on what it would mean to have that protocol.

[47] **Ann Jones:** If we assume that the Welsh Government is granted borrowing powers and a national borrowing limit imposed, how would you envisage that borrowing limit being shared between central Government and local government?

[48] **Jane Hutt:** I see them as being separate because local authorities have their own existing potential borrowing regime, so any borrowing limit for the Welsh Government would not restrict the existing borrowing powers of local authorities. The powers that we are seeking are additional, and they must not and cannot come at the expense of local government.

[49] **Mike Hedges:** The Scotland Act does not impose that in Scotland, does it?

[50] **Jane Hutt:** No, not that I am aware.

[51] **Jocelyn Davies:** We will get clarification of that.

[52] **Mike Hedges:** No, it does not.

[53] **Jocelyn Davies:** Oh, right. That was another 'Do you agree with me?' question from Mike. *[Laughter.]*

[54] **Mike Hedges:** Yes, I should have asked, ‘Will you confirm...?’.

[55] **Peter Black:** Would you be looking to have a prudential arrangement similar to the one with local government for the Welsh Government in respect of these borrowing powers?

[56] **Jane Hutt:** We are probably at too early a stage to consider that, because the first port of call is to gain access to borrowing powers. I think that, in the longer term, the Silk commission will be looking at that as a model. However, what is important, and what is happening, is that the Welsh Government and local government are working closely together on these issues, on how we are borrowing to build our own infrastructures, together and separately.

[57] **Peter Black:** Given the restrictions in the Welsh Development Agency Act 1997 on the block grant, I was thinking that a prudential regime would probably be the best fit for the Welsh Government.

[58] **Jane Hutt:** I think that those matters should be fed in to the considerations not just of this committee but of the Silk commission, because it will be interested in your report. So, that can be factored in. At this point in time, I do not think that we have anything to add—unless Gerry wishes to add something.

[59] **Mr Holtham:** Speaking as an ex-chairman rather than as a Government consultant, so this is an independent view, I think that a more thoroughgoing reform is required. At the moment, we have this departmental expenditure limit, so we are treated as a Government department. Rather than try to wangle that to fit borrowing into it somehow, I would just say that there is a block grant and there is a limit on the borrowing, and there is no such thing as a departmental expenditure limit. You are a different level of government. You are at state or provincial level in the European sense. We give you a certain block grant. We do not give you any more. You have tax powers, which are limited, and you have a borrowing capacity that is limited. It is your party. I do not think that we should persist with the DEL, prudential borrowing and all this nonsense. I think that a more thorough and simplifying reform would be in order, but that is just my personal opinion. I do not think that we have a governmental line on it.

[60] **Peter Black:** I could buy in to that.

[61] **Jane Hutt:** That sounds very empowering.

[62] **Jocelyn Davies:** The Government might take your advice.

[63] **Ieuan Wyn Jones:** Yr ydym wedi cyffwrdd â'r cwestiwn hwn yn ystod y cwestiynau blaenorol, ond hoffwn gael cofnod ohono. Mae terfyn ar y swm y gall Llywodraeth yr Alban ei fenthyca. Credaf mai'r cyfanswm yw £2.2 biliwn ond ceir terfyn blynyddol o £220 miliwn neu £230 miliwn. Ai dyna'r ffordd gywir o wneud hynny, sef pennu terfyn ar yr arian y gallwch ei fenthyg, neu a ddylid cael cytundeb y dylid cael pwerau benthyca gan adael i chi benderfynu faint sy'n fforddiadwy?

Ieuan Wyn Jones: We have touched on this question during the previous questions, but I just want to get it on record. There is a limit on the amount that the Scottish Government can borrow. I think that, in total, it amounts to £2.2 billion, but the annual limit is £220 million or £230 million. Is that the best way to do it, namely to set a limit on the amount that can be borrowed, or should there be an agreement to grant borrowing powers and to leave it to you to decide how much is affordable?

[64] **Jane Hutt:** That goes back to having powers for a purpose, namely having powers to borrow in order to meet our investment needs. That is the underlying principle and purpose of

it all. It is reasonable to say that those kinds of limits should also be applied proportionately to Wales. I have mentioned in my written evidence a limit of £1 billion—or perhaps £1.1 billion or £1.2 billion—and an annual limit of around £130 million. We already have our capital programme, which enables us to move forward and make progress. However, it goes back to the fact that this is a starting point, but it would be a major step forward if we could have those proportionate limits on our borrowing at this stage.

[65] **Ieuan Wyn Jones:** Felly, yn eich trafodaethau gyda Danny Alexander—ac nid ydym yn disgwyl ichi ddatgelu'r cyfan ohonynt, yn naturiol—yr ydych yn disgwyl iddynt fod am gael terfyn ar yr hawl i fentyca, yn hytrach na'r rhyddid i chi benderfynu ar yr hyn sy'n fforddiadwy.

Ieuan Wyn Jones: Therefore, in your discussions with Danny Alexander—and we do not expect you to disclose all the information, naturally—you expect them to be about setting a limit on borrowing, rather than giving you the freedom to decide what is affordable.

[66] **Jane Hutt:** Hopefully, we can bring these two together, as a shared purpose and outcome. We are not getting into that detail, and I appreciate that you do not want to get into that level of detail in committee this morning about our talks. The important point is that we should certainly be treated comparably with Scotland in respect of our borrowing powers and the arrangements for those borrowing powers. The Silk commission, I am sure, will have further views on this.

10.00 a.m.

[67] **Julie Morgan:** On a general point, is it not the case that one of the big problems is that the Treasury is the judge and the jury with regard to all of these things? It has struck me during this discussion that it can change the rules at any point. I suppose that that is more of a comment than a question, but I do not know whether you have any views on that.

[68] **Jane Hutt:** I think that Gerry's point earlier—whichever hat he was wearing and in whichever capacity he spoke—sums it up. If you look at Gerry's report, the report of the independent commission, you will see that it is very clear that we need to have much greater freedoms. That is where the statement of funding policy should be reformed. We should have an understanding and not a statement of funding policy. I know that Ieuan was very engaged in these discussions in the Joint Ministerial Committee as part of the One Wales Government. So, we want those freedoms and that is for a clear purpose: to enable us to move on. Gerry, I am sure that you would like to speak on this point.

[69] **Mr Holtham:** It is the case that the UK's claim to be a country governed by the rule of law has a small hole in it where the Treasury is concerned, where law does not come into it. If it wants to change something, it changes it. It is a wonderful example of arbitrary rule. That, of course, is one of the reasons why, in the longer run, you would want the borrowing power to be put on a statutory basis, because, even if it agrees to change the funding formulae, as you have said, it could change them back.

[70] **Julie Morgan:** That seems to hover over us.

[71] **Jocelyn Davies:** Yes, it does.

[72] **Mr Holtham:** I think that there is scope for a greater codification and clarification of people's powers in this area.

[73] **Jocelyn Davies:** Before you come on to your next point, I think that Paul wanted to come in on the point that you have raised, Julie.

[74] **Paul Davies:** I am not clear as to what you want as a Government. Do you want a borrowing limit imposed upon you by the Treasury, or do you want that flexibility in how much you can borrow? Which is it?

[75] **Jane Hutt:** Clearly, this is about negotiating, is it not, Paul? It is about negotiating to enable us to access those borrowing powers.

[76] **Paul Davies:** I appreciate that, but what do you want as a Government?

[77] **Jane Hutt:** I want to have maximum flexibility to meet our investment needs. However, when we move on to the infrastructure investment plan that we are launching next week, we have to have financing for a purpose, do we not, for a clearly identified investment need? So, I do not think that it is an either/or; it is about flexibility, getting and using the power, getting that flexibility and, as Gerry has said, consolidating those powers and having greater freedoms. However, it has to be based on what it is we want it for. It asks us, 'What are you going to spend it on?' We have our investment plans laid out, but it is a very difficult time economically. Financially, we have to recognise the opportunity costs. You have to pay to borrow and we have not yet touched on the impact of those costs.

[78] **Paul Davies:** So, your preference is to have that flexibility, then, is it?

[79] **Jane Hutt:** Naturally. However, I am realistic in that it is assuming the power step by step.

[80] **Jocelyn Davies:** Minister, the committee appreciates that you are in discussions with the Treasury—I will not say 'negotiations', because it does not seem to be the right word. You are in talks with the Treasury and we do not expect you to compromise your position by revealing anything here that you perhaps ought to keep for those discussions. I think that you have probably been as candid as you can in that regard.

[81] Julie, would you like to ask your question?

[82] **Julie Morgan:** Could the future investment need in Wales be addressed through the utilisation of local authority borrowing powers?

[83] **Jane Hutt:** Obviously, local authorities have the power to borrow to finance investment, and that is through traditional or innovative routes. As I have just said, borrowing has to be paid for, and that requires revenue. That is very difficult given our position on constrained revenue funding. So, those revenue streams will be very difficult. It does not substitute; the Welsh Government needs borrowing powers.

[84] **Christine Chapman:** The final report of the Holtham commission referred to the 'moral hazard' of imprudent actions by sub-national governments associated with borrowing powers and suggests that the design of a regulatory framework for such powers is important. Can you describe, from international experience, what the key aspects of such a regulatory framework are?

[85] **Jane Hutt:** Thank you for that question. It goes back to the point I made earlier on our borrowing responsibilities. Gerry looked at that carefully, and I will bring him in on this point. We need to ensure that we do not undermine the UK Government's ability to meet, for example, its fiscal arrangements and deficit targets. That is a responsibility that I have to consider. Gerry, do you want to add anything? We have moved on a lot since your report with regard to the situation.

[86] **Mr Holtham:** The Welsh Government should accept a hard constraint—in other

words, there is a level that you are not allowed to go beyond. However, you do not want that level to be determined in the same way as the Treasury determines things at the moment, which is that it does what suits itself and lets you know at the last minute. That would not be a satisfactory procedure. You need either a formula or an agreed procedure for arriving at that limit. The limit must then be observed. There has to be macroeconomic control and I think that everybody accepts that. However, there needs to be a procedure or a formula for arriving at a reasonable allocation that is not subject to arbitrary diktat from the Treasury. That is the main point.

[87] **Paul Davies:** The Holtham commission's report also covered the issue of funding flexibility in relation to the accumulation of, and access to, end-year flexibility. That system has gone and the replacement budget exchange system does not allow for accumulation of stocks over years. The Government's response to the Silk commission states that the new system is inadequate in its flexibility. How would you like to see the system operate, given that the new system takes practically the opposite approach to that recommended in the report?

[88] **Jane Hutt:** The budget exchange system is inadequate, as the Welsh Government said in response to the Silk commission. The Ministers for finance from Scotland, Northern Ireland and Wales argued and worked hard to get something out of the abolition of end-year flexibility that we could use. Therefore, we have the exchange mechanism but it does not give us meaningful access to end-of-year flexibilities—which we have used prudently and responsibly to great effect in terms of the impact on public services. We need access to flexibility. We can use unspent funds and carry them forward into the next financial year, and to be constrained in this way—which counters all the recommendations made in Gerry's report—is very unhelpful.

[89] **Mike Hedges:** The commission also recommended that the Welsh Government should have the power to draw forward capital budgets across the spending review period. How would that work in practice? Would you have to borrow in order to use capital in one year, and, if you were to borrow, who would you borrow from?

[90] **Jane Hutt:** Bringing forward capital is a simple matter of handling it. Ieuan and others will recall that the previous UK Government enabled us, at the height of the recession in 2008, to bring forward capital. We also made that call in terms of the most recent budget. I raised this at the last quadrilateral meeting and wrote to the Chief Secretary to the Treasury to say that we would like to be able to bring forward our capital. However, if we had access to borrowing powers, we would not find it necessary to bring forward capital in this way. Nonetheless, I think that it is a route that the UK Government could now adopt to help us to deal with the need for growth stimulus.

[91] **Ann Jones:** Turning to your infrastructure plan and the statement that you made in November regarding the fact that you are now looking at innovative methods of financing investment, can you tell the committee which models you are looking at? Are you looking at a not-for-profit distributing model, or are you considering an alternative use of pension funds? Also, could you expand a little on the co-operative and the mutual models and where you think they will be applied?

[92] **Jane Hutt:** I want to bring Gerry in on this, because we brought him in for his expertise in this matter, and for advice and guidance to all Ministers. For example, you have mentioned the co-operative model; you will be aware of the written statement issued by the Minister for housing on Monday in which he talks about bringing forward his targets for 12,500 homes. It also mentions the Ely Bridge development model.

[93] Before I bring Gerry in, it is important that we recognise that we have been proven

right—as I have said in written evidence—in rejecting the old PFI schemes. In contrast to Scotland, which has a £1 billion repayment bill, ours is only £100 million a year.

[94] **Mr Holtham:** On the use of not-for-profit, or rather, of having a company that does not pay any dividends as a special purpose vehicle for financing and managing infrastructure projects, that is very much one of the things that we are exploring quite actively with respect to certain specific projects. There are precedents in the Scottish experience. Scotland has done this, so it is a fairly well explored route and something that we could implement.

[95] The question of using pension funds is, in a sense, a different kind of question, as it is about the source of funds. Where is the money coming from? There are two questions: who are we going to borrow from, and what is the appropriate vehicle for borrowing? The SPV could borrow from pension funds, if that were the cheapest source of finance, or it could borrow from the banks if that were cheaper. The first thing, really, is to decide what the appropriate vehicle is for borrowing, then it is just a case of exploring the most likely and the easiest source of finance—who is going to be the lender? Certainly, some talks that have taken place in the housing area have revealed that pension funds are a fruitful place to look to obtain competitive finance. That is certainly true.

[96] **Jane Hutt:** Perhaps I could just come back, in terms of innovative financing routes, to the project at Ely mill that Huw Lewis highlighted in his statement on Monday. There is now a new Ely Bridge Development Company—it is a social enterprise, which has been created by the Welsh Government and the Principality Building Society. It is a new venture and an innovative investment model for unlocking capital funding and building housing. It is going to deliver around 700 homes, more than half of which will be affordable properties. So, it is a very good example of a new vehicle that we are developing, supported by the private sector in the form of the Principality. We are also doing the same with the Welsh housing partnership, in which the Principality is also involved. We recognise the huge contribution that Peter Griffiths has made and, hopefully, will continue to make in Wales in respect of all these needs and developments.

10.15 a.m.

[97] **Peter Black:** I want to move on to tax incremental financing. Given that there are plans to proceed with tax incremental financing in England and that there are pilot schemes under way in Scotland, what is the position on the use of tax incremental financing in Wales, has this been considered and would it require further legislation?

[98] **Jane Hutt:** As for where we are with the possibilities of tax provisions, we have, within the Localism Act 2011, the potential for use of these instruments by local authorities in Wales. However, we are awaiting the findings of the Brian Morgan review into business rates policy, because I understand that the review considered these issues. So, the advice from officials is that we need to be cautious about TIF, because it is unlikely that an increase in business rates alone would provide sufficient capital to finance a large-scale strategic investment programme. So, it is one source, but we need to await the business rates review.

[99] **Peter Black:** I do not think that the intention of using tax incremental financing has always been for large-scale strategic programmes, but for local regeneration projects, which are important. Is there a timescale for the reporting of the review into business rates?

[100] **Jane Hutt:** The Minister for Business, Enterprise, Technology and Science has stated—last week in her questions, in fact—that it is growing and growing, and that it needs to be pulled back to get a response. So, perhaps the Minister for business could update us on that point.

[101] **Peter Black:** I was just wondering whether you would contradict her, that was all.

[102] **Jocelyn Davies:** You were not caught out by Peter's question, Minister. A note on that would be useful. Mike wants to come in on this as well.

[103] **Mike Hedges:** Do you have concerns regarding TIF that, if it was implemented, an out-of-town development somewhere could generate quite a lot in rateable value, but would lead to a number of closures in other places, so the total national non-domestic rate would be lower coming in, and the money would be generated just for that local authority? A lot of that could happen, which would mean that you would be cutting your total income, while some local authorities would start to see an increase in income.

[104] **Jane Hutt:** I am sure that Andrew would agree with you on that point.

[105] **Mr Jeffreys:** Yes, that is one of the risks of any arrangement such as this. The other challenge is that it would be only those local authorities that have a buoyant business rates base that could really benefit from this. At the moment, the business rates income is pooled across Wales and redistributed. In England, this is arguably leading to a concentration of investment in areas where there is already good scope for local development. So, that is one of the other issues.

[106] **Mike Hedges:** All local government borrowing is supported either by Government grant or by local council tax collection. As such, most of it is supported by the Government, whether it is called prudential or not, and whether it is in England or in Wales. How does this type of borrowing differ—whether it is prudential borrowing or not—from the old supplementary credit approval system, because it is all based upon the income stream that is coming in from the Welsh Government here and, in England, from the Treasury?

[107] **Jane Hutt:** Andrew, do you want to respond to that?

[108] **Jocelyn Davies:** Would like to give us a brief explanation of that old supplementary credit approval system? I know that you gave us a seminar the last time that you were here, but, for the record, could you give us a brief explanation?

[109] **Mr Jeffreys:** I am no expert on the old supplementary credit approval system. Lots of other people know a lot more about it than me—

[110] **Jocelyn Davies:** It is a mechanism that local authorities used to have at their disposal, is it not?

[111] **Mr Jeffreys:** Yes, before the introduction of prudential borrowing in 2004.

[112] **Jocelyn Davies:** Okay, I think that that is a sufficient explanation. Minister, do you want to answer Mike's question?

[113] **Jane Hutt:** You may want to look at our new routes to borrowing that we are trying to develop with local government, in terms of the local government borrowing initiative. We must be clear that this is not supported borrowing and it is not classed as such. We have been very clear about that from the outset. It is innovative; it is an initiative that no other parts of the UK, or local authorities with Government, as far as we understand, are pursuing. It is a partnership initiative between the Welsh Government and local authorities. We are paying a revenue grant to assist the borrowing this year, and it will go into the revenue support grant in the years ahead to assist local authorities with the borrowing. I know that there has been cross-party welcome in the committee for this initiative.

[114] **Jocelyn Davies:** Do you have any idea why this confusion is taking place, and why some people are calling it supported borrowing?

[115] **Jane Hutt:** We have discussed this before in this committee, and we need to be very clear and on the record about this. Andrew, do you want to add to my points?

[116] **Mr Jeffreys:** We provided the committee with a note about this last year. The key distinction within the overall prudential borrowing regime is between supported borrowing and unsupported borrowing. Supported borrowing is financed by central Government and scored in central Government capital DEL. Unsupported borrowing is financed in different ways and is scored in local authorities' self-financed annually managed expenditure in the public finances. This is the latter, not the former.

[117] **Jane Hutt:** Gerry, do you want to add to this, because it was your idea?

[118] **Mr Holtham:** There is absolutely no point in the former, because if it is scored against the DEL, they will just take it off the block grant. So, we have to make the point that this is not supported borrowing. That requires you to go around the houses a bit, because if you simply say, 'You guys borrow to do this and we'll service the debt', you have had it, because the Treasury will just say that that is supported borrowing. So, there has to be an agreement whereby local authorities do certain things and you do certain things for them that are not explicitly linked, or they may be linked but they are not the same thing.

[119] **Jocelyn Davies:** It is clearly not supported borrowing then. Ieuan, did you want to come in?

[120] **Ieuan Wyn Jones:** Rydych wedi cytuno â llywodraeth leol bod yr arian sy'n cael ei fenthg ar hyn o bryd yn cael ei ddefnyddio i gynnal a chadw ffyrdd, ac yn y blaen. A wnaeth yr awdurdodau lleol ofyn yn benodol am hynny, neu a ydych wedi ystyried trafod sectorau eraill, ar wahân i ffyrdd, lle gallech ddefnyddio'r arian hwinnw?

Ieuan Wyn Jones: You have agreed with local government that the money that is currently being borrowed should be used for road maintenance work, and so on. Was that something that local authorities specifically asked for, or have you considered discussing with them other sectors, apart from roads, where this money could be used?

[121] **Jane Hutt:** It was Gerry's initiative that came before us and we took it up. We had Welsh local government engaging very early with my colleague Carl Sargeant. In fact, it came from local government. I met Councillor Andrew Morgan from Cynon valley, who is now chair of South East Wales Transport Alliance, who said that this would be ideal for highways improvement. This is the best way that things come out in partnership. So, it very much came from local authorities, and because they have a collaborative approach regionally and nationally in terms of transport groups, it was applied very quickly across Wales. So, I want to pay tribute to Andrew Morgan for what he initiated. That is the starting point, and we need to evaluate it to see how it has gone. We also need to see what the prospects could be for applying it to other sectors.

[122] **Paul Davies:** Have you considered other methods of supporting local government borrowing, such as the provision of guarantees, as is being done in Scotland with the National Housing Trust?

[123] **Jane Hutt:** We are already supporting some local authority borrowing directly with £107 million in this financial year. That goes out through the revenue support grant. Huw Lewis and I have been looking at the National Housing Trust in Scotland, which has some interesting elements. However, it goes back to the fact that a guarantee is not cost free,

because there is an opportunity cost to it. That could mean a reduction in capital expenditure if the guarantee was called upon. We have some prospects, for example, with companies such as the Ely Bridge Development Company, in terms of releasing more public land for affordable housing. Those are the types of routes that we are looking at as alternative ways of supporting local authorities and RSLs with regard to housing. Again, I do not know, Gerry, whether you want to add anything to that about the National Housing Trust route?

[124] **Mr Holtham:** I think that the issue is always about the nature of the guarantee. We are back to the same sort of question about supported and unsupported borrowing. If it is very explicit and attached to the act of borrowing, we may have some trouble with the Treasury. If we say, 'Look, we will look after you in some other way to make assistance less direct', that would probably be acceptable to the Treasury. I do not think that we evade the basic problem of the link to the borrowing just because it is a guarantee and not a sum of money.

[125] **Jane Hutt:** I would like to bring Andrew in at this point.

[126] **Mr Jeffreys:** I would just like to add to Gerry's point. The effect of the guarantee in the National Housing Trust model in Scotland is to reduce the cost of the finance that the local authorities then raise. However, crucially, they still have to repay the debt that they raise. They also need a revenue stream to finance that debt. So, this model has been pushed at housing for a reason, because, of course, you build an asset that has a revenue stream attached to it. However, one of the controversies about how the Scots are doing this is that pure social housing does not generate enough revenue to repay the debt that you generate to construct the housing. Therefore, they are only able to use this to build what is called 'intermediate housing', which has a sufficient income stream to finance the debt at the price that they are paying for it. So, it has led to questions about the priorities of the Scottish Government in terms of affordable housing, social housing and intermediate housing. One of the key challenges for us is how we can finance genuine social housing that does not enable you to finance the debt directly going forward. It is a model for delivering a certain type of housing, but it would not work, for example, for pure social housing.

[127] **Peter Black:** The traditional method in social housing is to have a grant to subsidise it and, obviously, you have to mix and match accordingly. If we stick with Scotland for a bit, representatives from the Scottish Futures Trust gave evidence to the committee and we were impressed with them. They stressed the benefits of being a centre of expertise and their operational independence from the Scottish Government. Has any consideration been given to establishing a similar centre for expertise in Wales and, if not, will you explain why?

[128] **Jane Hutt:** We have explored all avenues. I have been to Scotland and met the Ministers with responsibility for infrastructure and finance. I have also looked at the Scottish Futures Trust. I am sure that Gerry will want to come in on this point. As Gerry has said, we are looking carefully at non-dividend special purpose vehicles to raise the funds. We are depending very much on Gerry's advice about how we do that most cost-effectively. Setting up something like the Scottish Futures Trust would be a very expensive route. That was set up a few years ago, when they were in a better position financially, and we need to consider whether we need that kind of institution. We need centres of excellence and we can learn a lot from Scotland. Gerry, would you like to comment on that?

[129] **Mr Holtham:** Of course, there are different kinds of expertise: there is expertise in project management, in procurement and in finance. In Scotland, what they have tended to do is to have an advisory body and then, for specific projects, they create a special purpose vehicle that can draw on the advice of the advisory body, but the advisory body is not necessarily involved in each and every case. That is one particular model—a sort of hub of expertise and then specific special purpose vehicles for each project. There is a sort of grander model which entails having one body that does everything. We have been trying to get our

heads around the best way to structure matters in the Welsh case, where, to be honest, there is quite a difference in the level of, say, procurement expertise across departments: some departments may not need an external source of expertise, but others might well benefit from it. Therefore, it is a bit of a jigsaw puzzle in that sense. We are looking at how to structure this and at whether there needs to be a single body or whether we should proceed project by project.

10.30 a.m.

[130] **Peter Black:** Are there any specific advantages to Treasury rules on the independence of these bodies?

[131] **Mr Holtham:** The bodies have to be independent. Yes, absolutely. The question is whether you have a number of independent bodies—

[132] **Peter Black:** Or one, yes.

[133] **Mr Holtham:** Yes.

[134] **Mr Jeffreys:** It is worth adding that the Scottish Futures Trust is effectively a quango of the Scottish Government, but it does not raise the finance for the not-for-profit-distributing projects generated in Scotland. They are separate entities in each case, and it is the special purpose vehicle that raises the finance, rather than Scottish Futures Trust, which advises on and supports delivery of the projects.

[135] **Mr Holtham:** One of the implications of that is that, if you combined the centre of expertise with the fundraising body, you would, in a sense, be privatising the expertise. It would not be simply independent; it would be in a private company because only a private company can borrow. Again, that is the reason for hesitating before just creating a single entity.

[136] **Jane Hutt:** Obviously, we are looking at these vehicles in order to deliver Welsh Government policies and programmes for infrastructure and investment. Gerry is working on the most appropriate models, but, as I said, we are already making progress not only with the Welsh Housing Partnership, but the Ely Bridge Development Company. We have also already done this with waste management.

[137] **Jocelyn Davies:** I think that we also took evidence that, in the Scottish case, they spread good practice around the country. As we know, that is something that does not travel all that well in Wales. It is an organisation, albeit a quango, that now has several functions and appeared to me to be gaining more functions as time went on. Minister, you have managed to answer all our questions and an extra one within the time allowed, so we are very grateful. As usual, we will send you a copy of the transcript for you to check for accuracy. Is there anything you would like to put on the record or highlight in the last minute or two available?

[138] **Jane Hutt:** I would just say that it is vital that we progress, and your review is going to be very helpful with regard to achieving a fairer funding regime for Wales, including using our borrowing powers, specifically because the cuts in our capital programme this year are draconian—more than 40%. On Tuesday, I will make a statement, which I will publish and share with you all, on the Wales infrastructure investment plan. Therefore, your report will underpin how we are going to deliver on that infrastructure investment plan for Wales.

[139] **Jocelyn Davies:** Thank you very much for your evidence.

10.33 a.m.

**Cyllid Datganoledig: Pwerau Benthg a Dulliau Arloesol o Ddefnyddio Arian
Cyfalaf**

**Devolved Funding: Borrowing Powers and Innovative Approaches to Capital
Funding**

[140] **Jocelyn Davies:** We will now take evidence from the Local Government Association. Stephen Jones is the director. We are very grateful to you for joining us today and for the evidence that you have submitted. As you probably know, we have only 45 minutes for this slot. We have about 20 questions to ask you, and I have no doubt that there will be supplementary questions. As we have already received written evidence from you, do you mind if we go straight to questions? As with the Minister, perhaps you can add something at the end if you feel that there is something we have not covered. Does that suit you?

[141] **Mr Jones:** By all means, Chair. Fire away.

[142] **Jocelyn Davies:** Okay, thank you. To what extent has the regime of prudential borrowing successfully replaced centralised control?

[143] **Mr Jones:** Prudential borrowing has been very successful. It is fair to say that, since 2004, authorities have been on a learning curve with regard to how best to use this. However, increasingly, we have seen authorities using the greater flexibility available, particularly with regard to what to invest in. This is the great point of prudential borrowing: there is no third party looking over the council's shoulder to second-guess whether the project is a good one. The council has to make up its own mind on that, and that encourages the council to look at the totality of its asset base, its capital stock, and work out how best to maintain and develop that for the benefit of the local community, in accordance with local political priorities, of course. The discipline of prudential borrowing has very successfully ensured that borrowing has remained affordable and sustainable, and that is extremely important. It is particularly important going into the spending climate set by the spending review of 2010, where we can see capital grant funding from Government cut very substantially and where, in England, we also see the level of revenue funding for local authorities being cut very substantially in real terms over the current spending review period. It is likely to be cut further in the next spending review.

[144] **Ann Jones:** What do you see as the UK Government's controls that remain over local government borrowing?

[145] **Mr Jones:** There is no doubt that the UK Government is interested in the amount of local authority borrowing. That, of course, scores as public borrowing. As the UK Government is trying to reduce public debt, it tries to reduce levels of local authority borrowing just as it tries to reduce its own level of borrowing. The controls on this are quite subtle but very effective. In my evidence paper, I referred to the increase in the interest rate by the Public Works Loan Board, and I illustrated the immediate impact that had had on new borrowing. The use of the PWLB interest rate is a very effective control on borrowing, particularly when coupled with changes to revenue funding and the diminution of capital grants. Again, as I illustrated in the evidence paper, we have now more or less moved to a world where there is no supported borrowing in England, so the sources of finance for capital are capital grants, prudential borrowing, asset sales and revenue expenditure. There are only those four. The Government controls capital grants, and, through the interest rate, it can impose some limits on the use of prudential borrowing. Certainly, local authorities feel that, in one sense, prudential borrowing gives them a lot of freedom, but in another sense they are acutely aware that the Treasury is looking to control borrowing and spending.

[146] **Peter Black:** What impact, if any, did the introduction of prudential borrowing have on local government's use of broader funding partnerships, such as private finance initiatives?

[147] **Mr Jones:** At the time, initially, there was probably not much of an impact of one on the other. We are now moving into a world where, with more experience of prudential borrowing, a council can genuinely look at the alternative ways of financing a project and make decisions on what is best for it. Of course, with PFI, the approval of the funding department is required. PFI credits have to be obtained whereas, with prudential borrowing, provided the council has the headroom and that the borrowing is sustainable, the council can do it. Councils are increasingly seeing that their real flexibility lies around prudential borrowing, although PFI and similar mechanisms that transfer construction risk or operational risk as well as simply financing risk are always useful tools in the armoury, although one has to be very careful about one's understanding of the risk transfer element, as numerous inquiries have shown.

[148] **Christine Chapman:** I want to ask you about the potential indicators. Do you think that there needs to be any change with them?

[149] **Mr Jones:** This was fairly recently reviewed by the Chartered Institute of Public Finance and Accountancy, which regularly updates the prudential code. The evidence of its reviews over the years is that the existing indicators work and, therefore, there is no great need to change them. Looking forward, I would say that the important thing for a council, when looking at prudential borrowing, is to think about whether it can afford the borrowing not so much today, but in five years' time in the light of the likely public spending climate then.

[150] **Christine Chapman:** As a follow-up question to that, you have talked about the affordability and sustainability, but do you think that, at the moment, local authorities are adequately allowed to demonstrate the affordability, sustainability and prudence of their debt plans? I know that you said that there is no change at the moment.

[151] **Mr Jones:** At current levels of borrowing, in relation both to the asset base of local authorities and the size of the revenue account budget, prudential borrowing is at a level that an ordinary household, if it had a budget of that size, would regard as eminently sustainable.

[152] **Julie Morgan:** You say that there is no need to change, but do you think that there should be guidance around the acceptable parameters for each indicator?

[153] **Mr Jones:** I would say that the code seems to strike a nice balance between setting parameters and allowing the use of responsible judgment, both professional and political, in the size of the borrowing. If you tightened in the indicators, I am struggling to think how you would do that in ways that relate to real life. The indicators are appropriate for a real world in which there is variation and change.

[154] **Julie Morgan:** Do you think that elected members have a sufficient understanding of that?

[155] **Jocelyn Davies:** You do not have to name names. *[Laughter.]*

[156] **Mr Jones:** That is a broad question. Local government is a broad church of capabilities, both among officers and members. There are specialists in this area in both camps. Most councils are fortunate in having members who can apply the acid test of common sense to these decisions. Members run businesses and their personal finances. There is no mystique about a council's finance that goes beyond the discipline of running a business

or a household.

[157] **Julie Morgan:** So, you think that everything is fine with the indicators.

[158] **Mr Jones:** Yes.

10.45 a.m.

[159] **Jocelyn Davies:** We have just had elections, and you could very well be a candidate standing for election and not be a member yet and so would not know anything about the indicators. You could be making promises and be elected on a mandate to, for example, build a new leisure centre using the local authority's borrowing powers. You mentioned earlier that there is a political mandate and there are political choices to be made, but they have to stay within the parameters of those indicators.

[160] **Mr Jones:** Absolutely, and of course finance officers have to exercise important statutory responsibilities in that regard to ensure that the council maintains a proper financial position.

[161] **Jocelyn Davies:** It is normal practice at local authority level for the whole council to make the borrowing decision, and not just the executive. Am I right in saying that?

[162] **Mr Jones:** Yes.

[163] **Paul Davies:** On borrowing trends, current forecasts indicate that local government borrowing in England has fallen back sharply in 2011-12 although it has risen in Wales in 2011-12. How do you see local government borrowing developing in the next few years? Do you expect local government borrowing to continue to fall in future years?

[164] **Mr Jones:** Local authorities in England face some difficult decisions on this. On the one hand, given the size of the stock of assets, they have real value-for-money judgments to make about maintaining the quality of the current asset stock, which requires investment. On the other hand, the size of reductions in the revenue funding from Government is massive: there is a 28% real-terms reduction in councils' revenue funding from the Department for Communities and Local Government between 2010-11 and 2014-15. The limitations on raising council tax mean that councils are facing a big squeeze on the costs of running services and the cost of capital. The cost of the capital programme has to be fitted in within the context of that overall squeeze. So, it raises difficult issues for councils as to the pace at which the capital stock is renewed and, indeed, expanded.

[165] **Mike Hedges:** Is there any evidence that the prudential regime is working and is operating as a driver to improve asset management and value for money?

[166] **Mr Jones:** There is some evidence that that has happened. For example, I included in my written evidence the Lincolnshire case study, which is an excellent example of improving value for money by having the flexibility to take a decision about investment in 'preventative' capital expenditure, if I can so describe it. Similarly, there is the example of Newcastle City Council. The various projects that it has funded through capital investment have been successful and have stabilised its local economy at a time of considerable turbulence in the wider economy.

[167] **Ieuan Wyn Jones:** Pan fydd **Ieuan Wyn Jones:** When local authorities awdurdodau lleol yn defnyddio dulliau use prudential borrowing, what evidence is benthyca darbodus, pa dystiolaeth sydd eu there that they can achieve outputs that they bod yn gallu cyflawni allbynnau na fyddent would not have been able to achieve

yn eu cyflawni fel arall?

otherwise?

[168] **Mr Jones:** Quite a lot of the benefit can come from having more control over the timing of expenditure and over how it first gets off the ground and is firmly financed for the long term. It also allows opportunistic investment to be made. There is the example of Newcastle City Council buying the Northern Rock tower, which had to be done at a pace that, in the conventional world of project approval, just would not have been possible.

[169] **Julie Morgan:** Are there any types of project for which supported borrowing, as opposed to other forms of finance, has proved more relevant, and, if so, why?

[170] **Mr Jones:** I do not think that I have seen any evidence of a particular project type or a particular asset type being predominant. One issue that authorities will have to come to terms with over the next few years is schools capital and how it is funded. In the years up to 2010-11, there was the very extensive Building Schools for the Future programme in England, which took schools capital funding down a particular path, but that has now been stopped. So, the question arises for the future of how that investment is to be maintained. That raises an important challenge for the future use of prudential borrowing in that area and, indeed, wider issues on schools capital. In the rest of the capital spectrum, as I said, I do not see any particular chosen form of investment for prudential borrowing. However, the freedom has allowed authorities to do things like the opportunistic investment in Newcastle that I mentioned, and also to think about investments where borrowing by the council would enable partnering with other funders, which might make capital investment possible but which would not have been possible by the other funders on their own. That is particularly the case in housing.

[171] **Jocelyn Davies:** You have mentioned the revenue budget several times. What impact is the current level of unsupported borrowing having on authorities' revenue budgets, and is not the budget stream the money that is used to pay people's wages?

[172] **Mr Jones:** If we look at the size of the revenue budget and the size of the minimum revenue provision, which is what has to be set aside each year to fund borrowing, we see that, at the moment, the minimum revenue provision is just under £2 billion. That compares with total spending in England on things other than the schools side—and it is fair to separate the schools side, as it is largely covered by a specific grant from Government in England—of the order of £50 billion. So, we are looking at £2 billion capital financing out of a total of £50 billion. That is a pretty good guide to the overall scale of the capital financing requirement impact on the revenue account, plus the interest costs. Again, you think of the stock of borrowing of around £70 billion with an interest cost of perhaps an average of 6%, so around £4 billion in interest has to be found to service that debt each year.

[173] **Jocelyn Davies:** The revenue stream does pay people's wages and, if there is a tight squeeze on that and you use the revenue stream for other things, does that not have an impact on the ability to employ?

[174] **Mr Jones:** Of course it does, and we have seen that in the decline in the number of people employed in local government in England, which has been quite marked over the past couple of years.

[175] **Peter Black:** Can you expand on the changes made to the interest rates charged by the Public Works Loan Board in the 2012 budget and their likely impact on the affordability of local authority borrowing in the future?

[176] **Mr Jones:** In 2010, when the interest rate was jacked up by 1% overnight, we said—and this is putting the message colloquially—'Hang on, that is not fair; we expect at least

stability in the behaviour of the Public Works Loan Board'. It made people, including us, think that the PWLB had made itself uncompetitive by setting the interest rate 1% over the gilts rate. Therefore, we looked around to see whether a better deal could be had if we just borrowed from the market, particularly if local authorities collaborated to do that. The evidence so far suggests that, in normal market conditions—and I emphasise the word 'normal'—local authorities probably could do better. Our discussions suggested that the market would charge a premium of around 0.75% over the gilt rate. You can see some evidence that that is right in the Transport for London funding issues, which got off at around that premium over the gilt rate.

[177] There are two parts to the 2012 budget announcement. The first is the Government putting its hand up slightly and saying that it probably did not get the call right on how high to set the PWLB rate, and so it has made a promise to introduce what it calls a 'certainty rate', set at 0.8% above the prevailing gilt rate, in return for more information about borrowing. We are currently in discussion with the Government about how that will happen, what information is required, and at what point the new arrangement will be introduced. Beyond that, it has promised to consider, although not to act on, making a further reduction in the rate to a much lower premium-over-the-gilts rate—and, again, the exact amount has not been specified—for those projects that the Treasury regards as good value for money.

[178] That is a double-edged sword. On the one hand, having cheap funding is nice and helpful, but, on the other hand, having the Treasury look over your shoulder is exactly what the prudential code was supposed to stop. So, the jury is out on the second element of the change, in particular.

[179] **Ann Jones:** Did the Local Government Association arrive at a conclusion on the possibility of local authorities drawing finance from bond markets?

[180] **Mr Jones:** Yes, that was the research that we did. The tentative conclusions were that, in normal market conditions—and, again, I emphasise that because we are in abnormal market conditions at the moment—it could make a great deal of sense for local authorities to collaborate as some sort of funded collective vehicle to borrow. The market would then have confidence to lend at around 0.75% above the rate at which the Government can borrow through its own gilts issues. A number of countries elsewhere in Europe, such as Finland, Sweden and France, have taken that kind of approach to local authority borrowing.

[181] **Jocelyn Davies:** So, your research showed that this is a possibility. Are there examples of local authorities coming together to take out the debt?

11.00 a.m.

[182] **Mr Jones:** We have not seen any examples in England of authorities doing that. The reason for that is that the Public Works Loan Board, which used to be stable, is now very unstable, and there have been a number of changes to the rules in quick succession. Given that the changes to the rules have come along in such quick succession and arranging borrowing, particularly through the markets, is a long-term activity, no-one has had the time to put in an issue before the rules have changed again. Everyone needs to sit back and have a rethink.

[183] **Mike Hedges:** Following on from bonds, do you know why Transport for London went for a bond issue, which, I understand, was oversubscribed, rather than using the Public Works Loan Board? Can other instruments be used apart from bonds and the Private Works Loans Board, such as the European Investment Bank? Could you provide a list of those that are available and which, if any, are being used? If they are not being used, why are they not being used?

[184] **Mr Jones:** I am afraid that I cannot give a good answer to that question, mainly because the Greater London Authority is not currently a member of the Local Government Association. Therefore, we do not represent Transport for London and I do not have a deep understanding of how and why it took the route that it did. In relation to other sources of funding, it would be mainly be the European lending institutions, but I do not think that there is a great deal of current use of those by local authorities.

[185] The split in the use of sources of funding is more or less three quarters and one quarter between the Public Works Loan Board and bank borrowing. Why do authorities borrow from banks? Sometimes a bank is able to construct a product that is more flexible than a PWLB loan, but it effectively trades on the same stability of funding and guarantee of access to future funding to price it.

[186] **Christine Chapman:** On the housing revenue account buy-out in England, what do you see as the key benefits and limitations for local authorities of the self-financing changes?

[187] **Mr Jones:** There is no doubt that this is a significant benefit for local government, because, under the previous rules, the effect of the regime was that local government and tenants in particular were, effectively, paying into the Treasury a growing net amount each year. At one point, we described this as the tenant tax, because that was its practical impact. What this means now is that local authorities can plan their programme of investment in their housing stock free from constraints, other than to set out a reasonable level of rent that does not prejudice the general fund of the council, as councils are required to do. It should not be an excessive level of rent either, but, in between the two, there should be a great deal of flexibility.

[188] The borrowing has enabled a backlog of investment in relation to the decent homes standard to be funded. So, if you like, it represents a new beginning for housing finance outside of detailed Treasury control. Given the market rate at which the deal was done, which was historically low, I think that authorities will, over time, see this as a very good change.

[189] **Christine Chapman:** Are there any limitations?

[190] **Mr Jones:** Yes, there are limitations on this. If you do not maintain your stock then you have a depreciating asset against often quite a large, fixed amount of borrowing. Whereas in the past the Government might, under the old rules, in some sense have bailed you out for that, that is now your responsibility. So it has transferred responsibilities as well as rights, but, by and large, they are the kind of responsibilities that local authorities welcome.

[191] **Paul Davies:** You have touched on this. What is the likely impact that the ability to borrow against rental income will have on debt levels and rent levels going forward?

[192] **Mr Jones:** There are still restrictions on rent increase levels, and, on the other side, rents have to be set at a sufficient level to balance the housing revenue account and provide for the eventual repayment of debt. There is now more of a range of flexibility than there was for councils. That is the impact of the change.

[193] **Peter Black:** I understand also that England has limited the prudential borrowing in terms of the housing revenue account as part of this. Are there ongoing discussions around that issue?

[194] **Mr Jones:** Yes, in the reform there is something called the borrowing cap that applies separately to the housing revenue account borrowing. We have argued that the borrowing cap is unnecessary given councils' track record on the wider prudential borrowing scheme, but so

far we have not been able to persuade the Government to remove the borrowing cap.

[195] **Peter Black:** Currently in Wales, there is a prudential borrowing regime around the housing revenue account. Is that correct?

[196] **Mr Jones:** I am afraid that I am not familiar with the arrangements in Wales.

[197] **Ieuan Wyn Jones:** Roedd Chris yn holi yn gynharach am y cynllun prynu allan a ddilynodd trafodaethau rhwng awdurdodau lleol yn Lloegr a'r Trysorlys. Rydym yn deall bod trafodaethau'n dechrau rhwng Llywodraeth Cymru, awdurdodau lleol yng Nghymru, a'r Trysorlys ynglŷn â chynllun tebyg. A oes gwersi o'r trafodaethau yn Lloegr y byddai'n briodol i Lywodraeth Cymru eu dysgu yn y broses hon?

Ieuan Wyn Jones: Chris asked earlier about the buy-out scheme that followed discussions between local authorities in England and the Treasury. We understand that discussions are starting between the Welsh Government, local authorities in Wales, and the Treasury regarding a similar scheme. Are there lessons from the discussions in England that the Welsh Government should take on board in this process?

[198] **Mr Jones:** Yes, I think that there are. A study of what happened in England would be extremely beneficial. There were a number of changes of mind by the Government about how the buy-out scheme would work, and, in particular, around the interest rate to be charged and the time of borrowing. At first it was said that councils would have to pay the 1% premium over the gilt rate, but that they would be free to borrow within quite a long window of time leading up to the transaction date in March 2012. We lobbied very hard that the imposition of the premium was unfair, and councils were able to persuade the Treasury to change that, although the change was announced at quite a late stage, and after a number of authorities had invested a good deal of time and effort looking at alternative borrowing arrangements that might have been cheaper.

[199] The other thing that changed leading up to the reform was that the borrowing window, having originally been several months, was then compacted down to a single day, and I think that everybody was a little nervous about whether that would actually work. It did work, and all went smoothly on the day in the event. I would say that the main lesson in terms of wider Government policy is to set the rules with clarity at the outset for a major change such as this, so that authorities, which really have to change their mindset about how they think they are going to run housing in the future, have proper time to plan for that, and think about their overall future strategy. There is no doubt that for some authorities, particularly district councils in England that were previously debt free and have now taken on substantial borrowing, a change of that nature is a very big one for everybody to get their heads around and to understand the new opportunities that arise and the new skills that will be required to operate in that environment. So, I would say that plenty of notice, stability in the rules and plenty of sharing of experience of how the new world might operate are the keys to success.

[200] **Ann Jones:** If the Welsh Government were to be granted borrowing powers, is there a role that local government could play by undertaking the borrowing on behalf of the Welsh Government?

[201] **Mr Jones:** An issue that will arise if the Welsh Government has borrowing powers is this: from what source will that borrowing be repaid? As I understand it, the Welsh Government's principal source of income is its funding under the Barnett formula, and that can change, depending on overall levels of public spending in the UK. On the other hand, with council borrowing, councils do have a tax source over which they have control to determine repayment. Indeed, the law on borrowing in England requires that borrowers get paid, if necessary, out of tax revenue. There is an ultimate kind of charge, if you like, against the tax revenue. So, if the Welsh Government did have borrowing powers, then the way in

which it used those powers and its interaction with local government would need some thought. I hope that I have shown in discussing the English evidence with the Treasury that those interactions are real and they have implications for both sides.

[202] **Julie Morgan:** Could the future investment need be addressed through the utilisation of local authority borrowing powers?

[203] **Mr Jones:** I would say, on the English experience, that local authorities have a sizeable asset base and they are currently able to refresh that, but your question is extremely open-ended. We see with the substantial cuts to local authorities' funding in England that if you put a big squeeze on the revenue account and you constrain capital spending at the same time, you give authorities very difficult decisions to make about how to refresh their investment in order to maintain its value for the public. I suppose that that is a rather long-winded way of saying that I do not know. *[Laughter.]*

[204] **Julie Morgan:** The Welsh Local Government Association has a concern that such a move could have a detrimental effect on future budgets. Do you share that view?

[205] **Mr Jones:** I can see why it would have that concern. Of course, local government, whether in England or in Wales, always has concerns about any kind of third party looking over its shoulder and trying to poke it in one direction or the other.

[206] **Ieuan Wyn Jones:** Pe bai Llywodraeth ddatganoledig fel Llywodraeth Cymru am ddefnyddio pwerau awdurdodau lleol i fenthyca, a fyddai'n golygu bod rhaid cael ffrwd refeniw i ategu'r benthyciad bob amser, neu a oes ffyrdd eraill o oresgyn y broblem honno?

Ieuan Wyn Jones: If a devolved Government such as the Welsh Government wanted to use local authorities' powers to borrow, would it invariably mean that a revenue stream would be required to support the loan, or are there other ways of overcoming that problem?

11.15 a.m.

[207] **Mr Jones:** If I were a local authority in Wales, I would answer that by saying that, if someone else wants to use a facility that I have, there is a price attached to that and it has to work for both parties. If the Welsh Government seeks to use Welsh local authorities' prudential borrowing powers, a deal has to be struck that is satisfactory to both parties. The local authority is taking on a long-term obligation, so it needs to be sure that it can repay and deliver value for its local council tax payers.

[208] **Ieuan Wyn Jones:** So, you think that, under normal circumstances, that would call for a revenue stream to be supported in some way.

[209] **Mr Jones:** If it was not supported, there would have to be something in it that the local authority could value and that demonstrated value for its own taxpayers.

[210] **Ieuan Wyn Jones:** It could mean, perhaps, that it could build a school now rather than in five years' time. That would be the value that it would get.

[211] **Mr Jones:** Yes, and you could place a monetary value on that kind of thing.

[212] **Peter Black:** In your submission, you refer to two options for tax increment financing. Are these two options mutually exclusive, or could they be operated in tandem?

[213] **Mr Jones:** They can be operated in tandem. Certainly, in any one place, both could run concurrently for different projects. That is certainly true. The third twist to this is, of

course, the use of enterprise zones. A good way to describe this is as a kind of supported TIF. The fact that the enterprise zone has a 25-year life is particularly helpful, because the difficulties that authorities see with the TIF 1 approach, which is the general use of prudential borrowing, is that the period of reset under business rates localisation might be too short to give lenders the confidence to lend on future business rates revenue.

[214] **Paul Davies:** As tax increment financing is borrowing dependent on a future revenue stream, what work has been done to calculate affordability and the prudence of borrowing levels under such schemes?

[215] **Mr Jones:** Primarily, this is an issue for lenders. The lender in a TIF scheme wants to be sure that they are lending for something that will work and will ultimately allow them to get paid. So, I think that any authority that contemplates going into TIF will want to do a lot of detailed work on how the scheme will operate and the risks that it takes on the pace of development and pace of uptake, for example, so that sufficient new business rates income is generated to satisfy both itself and its lenders. Authorities that are interested in doing TIF are already looking very carefully at these issues to ensure that any assumptions made about the timing of new development and when that new development actually starts to generate business rates income are well founded and are grounded in the real world and not on someone's optimism.

[216] **Jocelyn Davies:** Thank you for that. We had one or two further questions, but we will have to leave it there as we have a video-conference at 11.30 a.m.. However, we are very grateful for the evidence that you have supplied to us in person and in writing. We will send you a copy of the transcript of the meeting so that you can correct it if there are any factual inaccuracies.

[217] We will take a short break and reconvene at 11.30 a.m..

*Gohiriwyd y cyfarfod rhwng 11.20 a.m. a 11.29 a.m.
The meeting adjourned between 11.20 a.m. and 11.29 a.m.*

Effeithiolrwydd Cyllid Strwythurol Ewropeaidd yng Nghymru The Effectiveness of European Structural Funding in Wales

[218] **Jocelyn Davies:** I welcome witnesses to this meeting of the Finance Committee. I welcome Chris Williams and, by video-conference, Katherine Himsworth. Can you hear us, Katherine?

[219] **Ms Himsworth:** Yes, I can hear you clearly.

11.30 a.m.

[220] **Jocelyn Davies:** You have both sent us written evidence, for which we are very grateful. We have about eight questions to ask you, and we have about 45 minutes in which to do that. That is just to give you an indication of the kind of time that we have for each question. Do you want to make an opening statement, Chris, or would you prefer us to go straight into questions?

[221] **Mr Williams:** Would it be useful for me to provide a bit of background to what we are doing?

[222] **Jocelyn Davies:** Yes, it would.

[223] **Mr Williams:** Very well. My name is Chris Williams, and thank you for inviting me here today. I am a development director at Tidal Energy Ltd. We are a relatively new company developing a tidal energy device, which is an innovative new tidal stream generator to provide electricity for the grid. We have been working on the project for about four years, and we are very lucky to have received money for the feasibility study and European regional development funding for the manufacture and testing of an innovative tidal energy device in St Davids, Pembrokeshire.

[224] **Jocelyn Davies:** Katherine, would you like to make an opening statement?

[225] **Ms Himsworth:** Just a few sentences, perhaps. I have set out the background in my note as to what Furnace Farm is. It is a new Welsh food centre. Furnace Farm Ltd is a private company that has been set up to manage the development. My position is that I am now a director of Furnace Farm Ltd, but I have been working with the project since about 2006, developing the construction project and the business.

[226] **Jocelyn Davies:** I have a question to both of you. You already know that the committee has received evidence highlighting a number of concerns about the application process for the current round of structural funds. So, expanding on your written evidence, could you describe your experiences of applying for support in the current round of structural funds? Chris, shall I come to you first?

[227] **Mr Williams:** We are not a small or medium-sized enterprise but a micro-enterprise, if you like. When we did the initial application process, there were four employees within the company, so we were trying to cover a lot of bases, including technology, raising funds and so on. As a private micro SME, we do not have massive resources to spend on procurement, legal aspects, estates and so on. So, the overall process of putting together the business plan was quite hard work. It took maybe two years to get approval for the initial project, and that was probably mainly to do with the fact that we did not fully understand the process that we were going through, the complicated nature of the application process, the state aid issues and so on. Although the Welsh European Funding Office was very helpful in trying to guide us along the way, it would have been a bit more helpful to talk to experts within WEFO to help us to put together our case.

[228] **Jocelyn Davies:** I assume that this was the first time you had made an application of this nature.

[229] **Mr Williams:** It was. We are running only one project.

[230] **Jocelyn Davies:** Had you known what the process would be like, would you have gone ahead with it?

[231] **Mr Williams:** The project could not have gone ahead without the funding, so we had no choice. It is a collaborative research and development project—if it was a full commercial project, we probably would not have asked for ERDF funding—and there is an element of risk associated with the application process and the timescale. We had to keep running the business throughout the application process, and keep making progress while running the risk at all times that we might not get approval, or that the funding approved would not be considered eligible because we did not fully understand the rules and guidance. We understand them now, I am pleased to say.

[232] **Jocelyn Davies:** With just four employees, that must have been quite difficult.

[233] **Mr Williams:** It was, but it was a necessary evil.

[234] **Jocelyn Davies:** Katherine, what about your experience?

[235] **Ms Himsworth:** We found the process to be manageable, but we had a fairly typical standard construction project for which we applied for funding. It was purely for capital assistance for the buildings that we were converting into the food centre. Prior to our application for funding, we had commissioned a strategic development plan to advise us on a possible business on the site, and we had commissioned a business plan. So, we had two pieces of work to inform our application to WEFO. We were perhaps fortunate in applying to WEFO right at the beginning of the programme. We were working with WEFO at the time the process was being developed. Although I would not go so far as to say that it was an easy process, we found it manageable, and we found WEFO to be quite understanding of the position that we were in and of the constraints on what we could do as well as the constraints on what it was able to do.

[236] **Ann Jones:** My question is to both of you. Can you describe the process by which the targets for your projects were set and outline the progress that you have made to date on the outputs achieved? Katherine, would you like to answer first?

[237] **Ms Himsworth:** We discussed with WEFO what the targets of the projects should be. Looking at the targets that it was committed to meeting within the priority and theme for which we obtained access to funding, the ones that were relevant to us were the number of visits to the project and the number of new jobs created. As I said, we had already commissioned two pieces of work to inform our application, and those were able to guide us on the targets that might be reasonable. We agreed with WEFO that, over three years, there would be a visitor target number of 405,000. The target for new jobs created was a lower figure when we first applied for European funding. However, during the development of the project, we have continually revised our business plan. We have revised exactly what we can do on the site, and we have been able to discuss with WEFO increasing our target number of jobs to 43 from an initial figure of 33 to reflect the additional activities that are to be undertaken on site. In recognition of that, we have obtained an increase in grant funding from WEFO.

[238] On the progress made towards the targets, we are not yet open—although we will be next month—so we have not made any progress towards the visitors target yet. We already have a number of staff on our books. We have 41 staff already identified as coming to work for Furnace Farm, although not all of them are in post yet, and they will not be until just before we open.

[239] **Mr Williams:** We fall under the climate change framework. One of the targets was creating additional jobs, and we have managed to employ four full-time equivalents in our office in Cardiff. Initially, we proposed to have three new full-time employees, but we have increased that to four, which is good. As I mentioned before, the project is a collaborative research and development project, which is a key output of this particular framework. Subsequent to that, the remaining targets are, first, to create a renewable energy project, which we now have the funding for, although we will not achieve that until next year when we get the device in the water and, second, to deliver 1,000 MWh within the first month, which has an equivalent saving in tonnes of carbon dioxide compared with fossil-fuel generation.

[240] **Ann Jones:** Are you confident that you will meet the targets?

[241] **Mr Williams:** Yes, we are.

[242] **Paul Davies:** This is a question for Chris Williams, given that his company is the project sponsor. I should say from the outset, Chair, that I have been supporting Tidal

Energy's project, given that it is off the coast of my constituency.

[243] Only 11 of the 261 structural funds projects approved during this round of funding are led by the private sector. In your opinion, is the private sector sufficiently engaged with the structural funds programme in Wales? If not, what are the main reasons for the lack of engagement?

[244] **Mr Williams:** I can talk only from personal experience. How did we first find out? We found out about it because we have regular liaison and consultation with the Welsh Government and its energy department, and we were guided towards WEFO for the ERDF funding. From an advertisement point of view, it was directly through the Welsh Government that we became aware of it. I am not sure whether more than 11 initial inquiries were made to WEFO, but after making initial inquiries, there can be many reasons why your project might not fit in with the outputs and results required from the various frameworks. I am not aware of many projects within the climate change framework, for instance, and there are reasons for that. Turning to the application process itself, it is a long, protracted process and it requires a lot of expertise to get through it. Again, I cannot comment on how many other companies tried to make applications, but we were pleased that we managed to get through.

[245] **Paul Davies:** Based on your experiences as a project sponsor, would you recommend it to other small and medium-sized enterprises?

[246] **Mr Williams:** It depends on the business model of the company. Obviously, funding is available, and it is secure funding. We have found that when WEFO has made a commitment to us that funding will be made available, it has come through—and cash is obviously important to a private business. There are risks associated with obtaining the funding and ensuring that there is no clawback later, so people need to be aware of that process as they go into it.

[247] **Ieuan Wyn Jones:** Cwestiwn i'r ddau ohonoch yw hwn. Mae nifer o randdeiliaid wedi rhoi tystiolaeth i'r pwyllgor gan fynegi pryder am y broses gaffael gan ei bod yn gallu bod yn gymhleth ac anodd gan arwain at oedi yn y prosiectau. A yw hynny'n adlewyrchu eich profiadau chi? Dechreuwn gyda Chris.

Ieuan Wyn Jones: This question is for both of you. Several stakeholders have given evidence to the committee expressing concern about the procurement process given that it can be complex and difficult and can lead to delays in the projects. Can you tell us whether that reflects both of your experiences? We will start with Chris.

[248] **Mr Williams:** Yes, definitely. Procurement is one of the main reasons why we have had to take on additional staff, and it is also a reason why we may initially have underestimated the amount of time that it takes to go through the procurement process. I can understand that, for a standard capital programme that has a small number of contractors doing regular activity, the procurement process would not be so inhibiting. However, we are running an innovative project here. It is difficult to identify clearly from the outset the scope of the work that we want our contractors to carry out and, every time we go down a particular contracting route, there is always additional work or variations required.

[249] We are managing about 15 contracts at the moment. Each of those requires a process including expressions of interest, prequalification, tendering and tender assessments, and we find that the nature of the industry in Wales is that people are keen to win work, so we get a massive amount of responses, maybe 40, for a relatively small construction contract. We then invite 10 contractors to provide a bid, and only one will succeed. It is an awful lot of effort for us to identify the preferred contractor to carry out a relatively small item of work.

[250] For the more innovative work, it would be a lot easier if we could concentrate on the

abilities of companies and what specifically they have to offer us going forward, as opposed to going through the more regimented contracting route. I ask the question whether we, as a micro SME, need to follow the European procurement guidelines. We have done, and we have set up our own procurement guidelines in line with WEFO's guidance, which are that anything greater than £5,000 needs to go through a process. The larger contracts involve going through the *Official Journal of the European Union* process, namely advertising in the European journal and publishing the various notices that are required. However, if we make a minor amendment to that—if we are a day short on the tendering period, for example, or if we have not identified our Alcatel standstill period correctly—we run the risk of clawback. It is a very difficult process to go through.

11.45 a.m.

[251] We initially started with stage 1 of the project, which was to do with feasibility, and we learned a hard lesson there about procuring from certain organisations, particularly a university. We had been working with Cranfield University on this technology for two years before we started the process with the Welsh European Funding Office. We then found that we had to re-tender, although the university already had intellectual property associated with the technology. So, we felt that more of a single-source arrangement would have been better for us, and we decided not to claim that work and just to do it directly ourselves.

[252] **Ieuan Wyn Jones:** Therefore, although you had worked with Cranfield University to develop your project, theoretically, you would have had to give the work to someone else if they came up with a better value-for-money proposal, although they did not have the expertise. Is that right?

[253] **Mr Williams:** There were probably a lot of universities that had the expertise to do the job, but other universities might have been tied into agreements with our competitors, for example. This has happened with a number of our earlier contractors: people were putting in the effort, if you like, free of charge to us because we did not have the budget to pay them, and then subsequently we had to re-tender for those scopes of work.

[254] Through stage 2, we fully appreciated the processes, but it was only when we had the project inspection and verification for stage 1 that we realised how strict the procurement rules were. So, moving forward into the higher value contracts, we were very clear that, going through the process, everything had to be documented and kept in accordance with the procedures laid down.

[255] **Jocelyn Davies:** Would you like to answer that question, Katherine?

[256] **Ms Himsworth:** For our project, which is a capital project, the processes that we have needed to go through for procurement have been reasonably familiar. We have had two big procurement exercises: one for the managing architects and one for the main contractors for the site. For the first, on procuring the architects, we managed ourselves as Furnace Farm Ltd. In that instance, although the value of the contract was over the *OJEU* threshold, for a number of reasons, we did not want to go through that process. One of the reasons was timing. So, we took advice from the Office of Government Commerce on whether we did in fact fall under the public procurement regulations. It advised us that the regulations did not apply in full to us because the amount of public funding that we were receiving was under 50%. So, on the basis of that advice, we went through a formal procurement process, as we would have wished to do in any case, and we used a degree of advertising, on the Value Wales website, but we did not go through the *OJEU* process. That did simplify things for us. When it came to letting the main contract to the construction company, we did go through the *OJEU* process, but the managing architects were, by that time, on board and able to run that process for us.

[257] Since then, we have used procurement for a number of smaller contracts, and it does result in more bureaucracy than would otherwise be the case if we did not have funding. However, as I said, it is a familiar process, if you like, and so it has not been too onerous for us.

[258] **Peter Black:** I have a question to both of you. What is your assessment of the guidance offered by WEFO in relation to procurement? Perhaps we could start with Katherine.

[259] **Ms Himsworth:** I am trying hard to think what the guidance offered by WEFO is. Big procurement processes were undertaken at an early stage in the programme. I think that I am right in remembering that WEFO guidance was in its infancy at that stage, certainly in respect of the procurement processes that are now required for situations that would not have required them in the past. Those processes were only being developed at that time and did not apply to us. I am familiar to some extent with the guidance that has now been issued by WEFO, but I do not think that I can comment on it from a Furnace Farm point of view, because it has not been that necessary for us.

[260] **Mr Williams:** The guidance is useful and has been revised many times since we have been involved with the project. The difficulty with any guidance is that there is probably a disclaimer with it. Initially there were errors about the *OJEU* limits within the documents that we were dealing with. The advice that we were given by WEFO was that there was guidance but we needed to take our own expert opinion because, ultimately, we were responsible for the procurement process. We initially employed a firm of procurement solicitors to advise us throughout the process. Again, similar to the Furnace Farm experience, although our funding is greater than 50%, we took advice on whether we needed to follow the European procurement guidance, and I am still not exactly sure whether we do or not. However, we did so to ensure that, if we needed to, we had complied.

[261] We are not allowed, as a sponsor, to liaise directly with the procurement department or Value Wales within the Welsh European Funding Office, so going through our project development officer, messages can often be lost in translation—from the questions that we ask or the guidance that we ask for, because ours is not a normal project, and the response that we get back from the department. So, to sum up, the guidance is useful, but we still need to take our own independent advice because the risks ultimately lie with us and there may be things missing from the guidance that might help our project.

[262] **Jocelyn Davies:** So, you would have liked to be able to liaise directly with the procurement department. Was there a Chinese wall perhaps?

[263] **Mr Williams:** There is a Chinese wall. On equal opportunities, the environment and sustainability, there are progress meetings and we liaise directly with the individuals who can help us out, but when it comes to procurement particularly and legal advice, we are not able to talk directly to the department or the individual who will ultimately review whether we are right or wrong.

[264] **Jocelyn Davies:** I want to ask both of you whether WEFO ever asked for your views on how you found the process.

[265] **Mr Williams:** Yes, we had a meeting with the director of WEFO and it was a two-way flow. It was a case of WEFO telling us how we could have done things better and vice versa. It was a useful discussion both ways, and we did not write back formally but at least we had a meeting to express our views on such things.

[266] **Jocelyn Davies:** Is that standard practice?

[267] **Mr Williams:** No, I think that we needed to ask for a meeting after stage 1, after we failed to claim some of the funds that we had approval for, to ensure that we were clear about the process, particularly with regard to things like payment. For example, payments get delayed for whatever reason, but it could damage the business if cash does not come in. So, we talked about the processes to ensure that we were familiar with what WEFO required.

[268] **Jocelyn Davies:** Katherine, did WEFO ever ask you about your experience or your views?

[269] **Ms Himsworth:** Possibly not in so many words, but in the regular meetings that we have with WEFO, it makes it clear that it is open to comment on any aspect of the process, whether it be payments, procurement or targeted match funding. There has always been an opportunity to raise that. We have not specifically requested a meeting at a higher level, but I imagine that that would have been forthcoming had we asked.

[270] **Mike Hedges:** What guidance have you received from WEFO in relation to how project revenue might affect the amount of structural funding that you are ultimately eligible to receive?

[271] **Mr Williams:** From our perspective, we are in a state aid category—industrial research—so the revenue does not affect our project as it would a capital project.

[272] **Ms Himsworth:** Likewise, because we are subject to state aid, we are not caught by the revenue generation provisions.

[273] **Christine Chapman:** To both of you, how do you set about undertaking monitoring and evaluation work?

[274] **Mr Williams:** The monitoring and evaluation process is, again, quite complicated. For stage 1, we procured an external adviser, if you like, to carry out the environmental monitoring and evaluation of our particular project. It is quite a specific requirement and it takes a lot of time and, so that we can concentrate on the project at hand, we tend to outsource the monitoring and evaluation process. From my experience of being an engineer and wanting to move forward with tidal engineering, we sometimes lose track of what the framework might be looking for, and look more for lessons learned from more technical approaches. The lessons learned from the monitoring and evaluation can be very useful to other projects going forward, and that should be used a bit more as we try to move on with different projects.

[275] **Ms Himsworth:** The monitoring that WEFO is most interested in is that which will happen once the business is up and running and we start delivering the outputs, particularly jobs. That has not begun yet, but we have prepared for it. We have produced a monitoring and evaluation plan for WEFO, which is being discussed with the research and monitoring team within WEFO. Given that the amount of funding that we receive from ERDF is under £2 million, we are not obliged to commission an external evaluation. We did think that we would do the evaluation work ourselves, but we have reconsidered that, and we are in the process of commissioning an external evaluator to do the evaluation over the next 18 months, reporting perhaps towards the end of 2013. We have given him a specification that covers not only the direct benefits from the business, but also the indirect benefits. We feel that we are pretty well covered for monitoring and evaluation.

[276] **Christine Chapman:** We have had evidence from other witnesses who feel that there is too much emphasis in the current programmes on monitoring project expenditure at the expense of capturing the quality and impact of interventions. Do you agree with that analysis?

[277] **Mr Williams:** From my point of view, the monitoring did not touch on expenditure, as such; it was more about the softer issues OF equal opportunities, environmental sustainability and such like. The monitoring is a separate activity, in my experience, through the regular claims processes and the project meetings that we have with WEFO to make sure that we are always on target. I did not see that as part of the monitoring and evaluation programme set for our particular project.

[278] **Ms Himsworth:** I would agree with that. The monitoring has focused on the economic benefits and the cross-cutting themes and what is emerging there. Monitoring expenditure is ongoing, and each time we have a meeting with WEFO, it looks at where we are on our delivery profile and on our spend figures. We discuss delays as a part of that. I regard that as a separate issue to monitoring the outputs of the project.

12.00 p.m.

[279] **Julie Morgan:** Katherine, could you describe how straightforward or otherwise you found the process of applying for funding from the targeted match fund?

[280] **Ms Himsworth:** It was quite straightforward. We put in an application and it was approved within a reasonable space of time. I did not regard it as a very transparent process. I was not aware of the criteria against which our application was being assessed. We were just thankful to get it.

[281] **Julie Morgan:** Other witnesses have told us that it was bureaucratic and that there was a lot of duplication. Can you comment on that?

[282] **Ms Himsworth:** I do not recall duplication. We put in an application very early in the process. I do not recall much discussion of the application once we had submitted it. Since then, there have been one or two hiccups in drawing down TMF—it has been rather slow in paying, in contrast to our WEFO claims, which are paid remarkably quickly. However, I cannot say that the application process was too complicated.

[283] **Jocelyn Davies:** Thank you for answering all our questions. We are very grateful to you both for agreeing to be witnesses today. We will send you a transcript so that you have an opportunity to correct any factual inaccuracies.

[284] **Ms Himsworth:** Do come and visit Furnace Farm.

[285] **Jocelyn Davies:** You got in your advert for Furnace Farm. [*Laughter.*]

12.02 p.m.

Papurau i'w Nodi Papers to Note

[286] **Jocelyn Davies:** The papers to note are the correspondence about JESSICA, that is joint European support for sustainable investment in city areas, and the minutes of the previous meeting. Is everybody happy with those? I see that you are.

**Cynnig o dan Reol Sefydlog Rhif 17.42 i Benderfynu Gwahardd y Cyhoedd o'r
Cyfarfod**
**Motion under Standing Order No. 17.42 to Resolve to Exclude the Public from
the Meeting**

[287] **Jocelyn Davies:** I move that

the committee resolves to exclude the public from the remainder of the meeting in accordance with Standing Order No. 17.42.

[288] I see that the committee is in agreement.

*Derbyniwyd y cynnig.
Motion agreed.*

*Daeth rhan gyhoeddus y cyfarfod i ben am 12.02 p.m.
The public part of the meeting ended at 12.02 p.m.*