Cynulliad Cenedlaethol Cymru
The National Assembly for Wales

Y Pwyllgor Cyllid
The Finance Committee

Dydd Iau, 24 Mai 2012
Thursday, 24 May 2012

Cynnwys
Contents

Cofnodir y trafodion hyn yn yr iaith y llefarwyd hwy ynddi 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

Ian Black	Pennaeth Cyllid a TG, Cyngor East Dunbartonshire Head of Finance and IT, East Dunbartonshire Council
Peter Davies	Pennaeth Cyllid Cynorthwyol, Cyngor Sir Fynwy Assistant Head of Finance, Monmouthshire County Council
Will McLean	Arweinydd Ymgysylltu a Phartneriaethau Strategol Cyngor Sir Fynwy Strategic Partnerships and Engagement Lead, Monmouthshire County Council
Jon Rae	Cyfarwyddwr Adnoddau, Cymdeithas Llywodraeth Leol Cymru Director of Resources, Welsh Local Government Association
Bruce West	Pennaeth Cyllid Strategol, Cyngor Argyll a Bute Head of Strategic Finance, Argyll and Bute Council

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 1 p.m.
The meeting began at 1 p.m.

Cyflwyniad, Ymddiheuriadau a Dirprwyon
Introductions, Apologies and Substitutions

[1] **Jocelyn Davies:** Welcome to this meeting of the Finance Committee. As you will know, our meetings are bilingual, so you will find the translation on channel 1 and the amplification on channel 0 of the headsets provided. Please check that all mobile phones and other electronic devices have been switched off. This is a formal public meeting, so you will

not need to operate the microphones yourself. We do not expect a fire drill, so if you hear the alarm, follow the directions of the ushers. I have not received any apologies.

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

[2] **Jocelyn Davies:** For this item, we have witnesses via video-conference. Thank you very much for joining us. Perhaps you would like to introduce yourselves for the record.

[3] **Mr Black:** My name is Ian Black, head of finance and ICT at East Dunbartonshire Council.

[4] **Mr West:** My name is Bruce West, head of strategic finance at Argyll and Bute Council.

[5] **Jocelyn Davies:** We are very grateful that you are able to give us evidence today. I will start with the first question, but, just to give you some idea, we have about 45 minutes and almost 30 questions to get through, so we really need to get cracking on this. To what extent has the regime of prudential borrowing successfully replaced centralised control?

[6] **Mr Black:** I will take that question, Chair. The flexibility that the prudential code offers has been considerable. Since its introduction in 2004, local authorities in Scotland have substantially increased their level of capital expenditure. For example, in 2003-04, the total capital expenditure was around £1.2 billion, and that rose to a peak of around £2.2 billion in 2008-09, but it has remained around the £2 billion mark since then.

[7] **Mr West:** By way of a supplementary to that, I can tell you that it has allowed councils to take forward genuine capital investment schemes that have an ongoing saving or income stream associated to them. It allows them to be taken forward in a way that would not have been possible when capital spending constraints were in place under the statutory regime.

[8] **Julie Morgan:** Good afternoon. What do you see as the controls that remain with the UK Government or the Scottish Government over local government borrowing?

[9] **Mr West:** It is very much a backstop control for the national protocol, as far as I can see it. The purpose of the prudential code was really to do with self-regulation, and that passes the day-to-day control into the hands of individual councils and organisations. My view is that most councils have acted responsibly in their approach to borrowing under the prudential regime, particularly with regard to—

[10] **Jocelyn Davies:** Oh, no. We appear to have lost the connection to our witnesses. This did not come up at the training for Chairs that I attended on Monday, so I am not entirely certain what to do. Anyway, we will try to get them back and if we cannot, we will just have to have a break while we wait for the WLGA's representatives.

[11] I see that Mike has just arrived. Just to bring you up to date, Mike, we have lost contact with the witnesses that we were taking evidence from via video-conference, but this meeting is still being broadcast.

[12] **Mike Hedges:** Perhaps they went to the wrong building, like I did.

[13] **Jocelyn Davies:** Someone suggested the other day that if we were to sit very still, anyone watching this would not know what was happening and would think that they were watching a test card. [*Laughter.*]

[14] It looks as though we have our witnesses back. Thank you very much for re-joining us. We will move on to the next question, which is from Ann Jones.

[15] **Mr West:** We have been disconnected. I do not know what has happened, but we are the only ones left in the video-conference at the moment. If you could reconnect the video-conference, that would be good.

[16] **Jocelyn Davies:** Are you able to hear us now?

[17] **Mr Black:** Yes.

[18] **Jocelyn Davies:** Thanks for re-joining us. We will press on with a question from Ann Jones.

[19] **Ann Jones:** What impact, if any, did the introduction of prudential borrowing have on local government's use of broader funding partnerships, such as the private finance initiative?

[20] **Mr Black:** Local authorities still make considerable use of PFI in the schools programme, and we had to undertake a public sector comparator, which would have been on borrowing through the traditional route using prudential borrowing. There were a number of instances where local authorities opted out of PFI, in whole or in part, because prudential borrowing offered some affordable alternatives to PFI. It offered another option, but the funding streams that came with PFI—the level playing fields support and the central Government grant for PFI and public-private partnerships—meant that, quite often, they were more attractive financial propositions.

[21] **Paul Davies:** What changes, if any, would you make to the prudential indicators, and do they adequately allow a local authority to demonstrate the affordability, sustainability and prudence of its debt plans?

[22] **Mr West:** It is quite difficult to come up with alternatives, to be honest. I am not entirely convinced that the ones that we have are perfect, but, as I say, having considered it, I cannot come up with any alternatives that would represent the position better. On affordability, sustainability and prudence, there are wider issues around a council's overall consideration—and the quality of that consideration—of its capital planning and treasury management proposals that are as important as the indicators themselves.

[23] **Mr Black:** I would agree with Bruce. There is also the option for local authorities to adopt local indicators, which a number have done, to demonstrate the affordability of their investment plans. The indicators are flexible and they are an appropriate mix between affordability, prudence and so on.

[24] **Peter Black:** Do you think that there should be guidance on the acceptable parameters for each indicator, with upper and lower limits?

[25] **Mr West:** If it is guidance noting the issues to consider, that may be helpful, but if it is guidance in the form of targets, I do not think that it would be helpful, because the principles on which the prudential code are founded are that each council needs to give consideration to what is relevant to its own circumstances, having regard to issues of affordability, sustainability and prudence. Each council will be in a slightly different position

in that respect. So, guidance by way of principles and issues to consider would, potentially, be helpful, but I do not think that that would be helpful if it were targets.

[26] **Ieuan Wyn Jones:** Can you confirm that you have access to translation equipment there?

[27] **Mr Black:** Yes.

[28] **Ieuan Wyn Jones:** A oes tystiolaeth bod y system ddarbodus wedi arwain—

Ieuan Wyn Jones: Is there evidence that the prudential regime has operated—

[29] **Mr Black:** Sorry, but I do not think that we have the translation connected to us. It is not coming through.

[30] **Ieuan Wyn Jones:** Is there any evidence that the prudential regime has operated as a driver for improving your asset management and value for money?

[31] **Mr Black:** Yes; I think that there are a number of examples. I think that we set out the example of housing in the submission. Local authorities had a 10-year period to attain the Scottish housing quality standard and, over that period, set investment plans to achieve that. The prudential code has allowed authorities to take investment decisions over the longer term period, with specific targets in place to meet those housing quality standards. Housing is probably a good example. However, there are other examples, which include roads, where the asset base has been assessed and a number of authorities have put in place long-term—typically five-year—plans to upgrade their networks. That would have been very difficult to achieve without the flexibility to gain additional borrowing capacity that the prudential code has offered.

[32] **Jocelyn Davies:** So, this is an example of where you would have a revenue stream to repay the loan and, on the roads, you would save money in the longer term.

[33] **Mr Black:** Yes. They are both examples of how the loan could be financed.

[34] **Christine Chapman:** I wish to ask you about the borrowing trends. Do you consider, as was stated by Scottish Futures Trust in evidence to the committee, that local government in Scotland is getting close to borrowing limits?

[35] **Mr West:** I think that that may depend on what is meant by the term ‘borrowing limits’. From my point of view, there is no centrally imposed limit. In a sense, until the Treasury imposes a national limit, which would feed down through the protocol that we have in Scotland, there is no limit as such. If it is around a council’s ongoing capacity to borrow and to fund that borrowing, there are a number of different complicated factors in that. If you look at current borrowing costs or financing debt costs as a proportion of councils’ ongoing budgets, you will see that there potentially might still be some headroom for councils to carry additional borrowing there. However, that all depends on the local circumstances and any other pressures that they have on the revenue budgets, whether that is through demographics or requirements for the day-to-day maintenance of the road network and so on. The other factor that also comes into play there is just the general reduction in public sector funding.

[36] So, there are two or three different factors that are reacting with each other, which are currently dampening down councils’ ability to undertake additional borrowing. For example, as part of my own authority’s current budget process, we have put in place a savings programme over the next three years that will free up around £1.5 million, which we can commit to financing additional long-term borrowing. So, we have been able to add around £17 million on to our capital programme. It varies from council to council.

1.15 p.m.

[37] **Mr Black:** Given the public sector's overall financial position, Scottish local authorities will be cautious about taking on additional borrowing, because it is a long-term financial commitment borne by revenue budgets. They will be more cautious than they were previously. The capacity to borrow is still there. If authorities can identify funding streams and the investments are consistent with asset-management priorities, there is no issue with capacity for authorities in Scotland.

[38] **Peter Black:** How practical is the national limit on local authority borrowing protocol as a mechanism for control over local authority borrowing?

[39] **Mr Black:** The protocol has not been used yet. The Scottish Government went through a great deal of consultation during the formulation of the protocol. Inevitably, such a measure would be viewed as restrictive. There are a number of considerations that the Government has indicated that it would take on board in applying a limit. For example, it would look at any particular projects that had to be protected within a local authority's spending plans and look at the overall impact of the programme on the longer-term strategic interests of an area. It would be effective if it was used, but it has not been applied to date.

[40] **Jocelyn Davies:** You probably know that we took evidence from the Scottish Futures Trust. In its evidence, it described itself as a centre of excellence for workplace rationalisation and effective disposal of buildings and estate that are no longer needed. How effective has the trust been in providing support of that nature to local authorities?

[41] **Mr West:** My interaction with the trust has largely been around the Scotland's Schools for the Future programme in supporting the development of new-build programmes for schools that are currently running over a couple of phases. In that respect, we have found its support helpful in ensuring that we drive out as much value as we can from the whole process—from the initiation of school projects through to the completion of the building, although we are not close to that stage at this moment.

[42] **Jocelyn Davies:** Is that widespread among other local authorities?

[43] **Mr Black:** I reiterate the sentiments expressed by Bruce. The Scottish Futures Trust has made considerable progress in the last 18 months or so. It has more than found its feet and is delivering on a number of areas. I can reiterate some of the practical examples that Bruce has mentioned in my area. It also has a funding capacity expertise and we have achieved a number of procurement savings as a result of the influence of the trust.

[44] **Mr West:** As a supplementary point, in addition to the schools programme, the SFT has been involved with the national housing trust. It is involved in supporting the development of tax increment financing projects. Those are all pieces of a jigsaw that, when they are put together, help show progress in improving management of investment in infrastructure in Scotland.

[45] **Mr Black:** It has also demonstrated an ability to provide professional services and advice, as an overhead to the infrastructure projects, at a very low cost. That has been reflected in the overall cost of infrastructure investment.

[46] **Paul Davies:** I have a question on housing financing arrangements. Could you describe the freedoms and controls that you have around an ability to increase borrowing financed through increased rent levels?

[47] **Mr Black:** There is the ability for local authorities to vary their rents directly. There are no centrally applied controls on that. A number of authorities have made a conscious decision to increase their rents. They have consulted with their tenants on the basis that the additional rental streams would provide capacity for further capital investment in the housing stock. In a number of cases, local authorities have taken that approach with the support of their tenants. So, the flexibility that the prudential code offers to wider council services applies equally to housing. There have been a number of examples where housing improvements and new builds have been taken forward by using the prudential code.

[48] **Mr West:** Also, a small number of authorities in Scotland took advantage of proposals that allowed for a wholesale stock transfer to a registered social landlord. In those councils, decisions were taken to transfer all of the housing stock because that was seen as the best mechanism to get the required investment in place to meet the Scottish housing quality standard.

[49] **Peter Black:** I would like to ask a question about the controls that you have on your housing revenue account. In England, councils have controls on rent levels and a cap on borrowing, as I understand it. I am wondering whether that applies at all in Scotland. It is my understanding that you have full prudential borrowing powers, as well as powers to set your own rent without central interference. Is that right?

[50] **Mr Black:** Yes, that is correct.

[51] **Jocelyn Davies:** Thank you for that clarification. I now bring in Mike.

[52] **Mike Hedges:** I wish to talk about instruments of debt. As you are probably aware, the Welsh Local Government Association has considered having a bond issue, and the Public Works Loan Board has been talking about increasing the amount to be issued. As you are also probably aware, Transport for London had a bond issue that was very successful and was oversubscribed. Have Scottish local authorities considered having a bond issue?

[53] **Mr West:** The main issue around bond issuance is economies of scale—that is, the size that the bond issue would need to be to make it cost-effective. It is probably fair to say that most councils in Scotland would struggle on an individual basis to reach the scale of bond issuance that would make it cost-effective. There are, perhaps, a number of councils in Scotland that could take this forward. It is fair to say that, as a professional community, we have been watching developments in England around the collective bond proposals that the Local Government Association in England has been investigating—maybe that is the best term to use at this stage. Potentially, at certain points in time, there might be benefits from having a bond issuance, but there are a lot of issues relating to the size of the issuance and the administration and management issues that go with that.

[54] **Julie Morgan:** We are aware that there has been a council tax freeze in Scotland since 2008-09. Before the freeze took place, did any local authorities consider raising council tax in order to support an increase in unsupported borrowing?

[55] **Mr Black:** Yes, there were at least two authorities that had formerly planned to increase council tax and to use that additional revenue stream to augment their capital expenditure plans. Clearly, as a result of the freeze being applied universally in Scottish authorities, they had to find a combination of alternative means of meeting those loan charges and perhaps scaling back on their capital programmes.

[56] **Christine Chapman:** Looking at your paper, you talk about the non-profit distributing model and the involvement of a charity to receive the surplus funds generated. When we took evidence from the Scottish Futures Trust, it indicated that, although this has

been the case in the past, it is not the case for the current programme. Due to changes in the accounting rules, in more recent projects, profits generated above the cap are returned to the procuring body. In view of that, are any arrangements included in these contracts that specify whether the funds returned to the procuring body have to be used for a specific purpose?

[57] **Mr West:** I am not entirely familiar with more recent contracts, but my general assumption would be that, if the funds are returned to the procuring body, then they are returned without any restrictions on them.

[58] **Jocelyn Davies:** You are probably aware that the Public Accounts Committee inquiry into PFI concluded that the use of PFI has been based on inadequate comparisons with conventional procurement and that it has not been challenged sufficiently. There is a recommendation that the Treasury should issue new guidance. So, how is value for money assessed within the NPD model in comparison with conventional procurement and how would it fare in value-for-money terms?

[59] **Mr West:** I will talk historically about the NPD model because my council was one of the first to take it forward—that predates the Scottish Futures Trust. Our NPD model for schools went to financial closing in 2005 and, by way of a comparison with traditional procurement, we went down exactly the same route as a normal PPP or PFI project would have done. We followed all the steps in that process. The only difference between our project and a traditional PPP or PFI project was that ours was 100% debt funded. It has the restriction on distribution of profits, with any surplus profits being returned to the charity. So, from that point of view, our value-for-money assessment followed the same process as a traditional PPP or PFI one. The process that is now in place through the Hub programme is a slightly different one. Factors such as the ability to deliver the required investment immediately, rather than in the future, are seen to be indicators of improved value for money. It is probably fair to say that when the Hub programme, which is being used to deliver much of the NPD programme now, was established, a number of high-level, value-for-money assessments were made when the Hub business cases were established, but, unfortunately, I cannot recall the detail of that off the top of my head.

[60] **Mike Hedges:** On NPD, did the capping of the profit deter any private investors from getting involved and how did the costs differ between NPD and the borrowing from the Public Works Loan Board? It seems an interesting and innovative way of doing it in which I have a great deal of interest, but I am not quite sure how you prove value for money unless you use the same route as that which PFI uses.

[61] **Mr West:** To talk about the project that we had in Argyll and Bute, which I accept will be different from the projects that are being taken forward now, we are not aware that the NPD approach had a detrimental effect on attracting bidders for the project. It is probably fair to say that a couple of bidders came forward because they saw it as an innovative approach. In overall terms, looking at the headline interest rates, it would have been cheaper to borrow from the Public Works Loan Board. However, looking at the overall value-for-money assessments that are required, based on the Green Book and the guidance on PPP and PFI projects, the NPD variant came out as slightly better value for money.

1.30 p.m.

[62] It is also probably fair to say that the margins between traditional PPP, NPD and traditional procurement were probably quite small in our project. The main issue at the time was that, in a traditional PPP, you had some equity funding, which was at risk because it bore any losses first. In our NPD version, there is no equity funding, so that tranche of around 10% of the funding that is referred to as senior debt is at risk first. As it is at risk and there is no upside with regard to a dividend on it, the funders priced that at a higher rate of interest than

the junior debt or the Public Works Loan Board debt. So, there is quite a complex mix of an equity rate of return, the rate of return on the senior debt, the rate of return on the junior debt, and the conventional interest cost from the PWLB.

[63] **Jocelyn Davies:** Thank you. We will move on to questions on tax increment financing.

[64] **Ieuan Wyn Jones:** We understand that the Edinburgh waterfront regeneration project was the first to use tax increment financing in Scotland. There have been four pilot projects subsequent to that. Can you tell us whether you have had any involvement in those? If so, what has been your experience?

[65] **Mr Black:** Neither of our authorities has been involved in the pilot scheme; my authority put in a proposal, but it was not deemed positive enough to be taken forward to the pilot stage.

[66] **Mr West:** We are one of the pilot authorities. My understanding is that originally there were three projects—in Edinburgh, Glasgow and North Lanarkshire—and that there were a further four pilot schemes on top of that; our project is one of those. At this stage, we are in the process of putting together the full business case for it. We see it as being very much at the initial stages of looking into the merits of the project and testing whether there is a likelihood of future incremental increases in non-domestic rates income sufficient to fund the ongoing borrowing costs.

[67] **Ieuan Wyn Jones:** Is it possible for you to give us a timeline? I am wondering about the timescale of the committee and your timeline; if they correspond, perhaps you could update us at some point—if it is within the next couple of months or so.

[68] **Mr West:** With regard to developing the full business case, our timescale is to have that completed by March 2013, so we are probably about nine months away from having that completed. There is a significant amount of work to be done on the detailed scoping of the project, putting together outline designs and costings and also, perhaps more significantly, some economic and financial assessment of what this investment will bring in the way of additional business activity leading to additional non-domestic rates. This requires the factoring in of the potential for there to be some displacement, so that, while you might increase rates in one area, it is as a result of a reduction in other areas. We think that there is a significant bit of work for us to get through in the next six or seven months before we come to the stage of developing the full business case. The important thing for us in doing this business case is to test the proposal robustly, and if it does not stack up in financial and risk terms, not to proceed with it.

[69] **Julie Morgan:** My next question, about calculating the affordability and prudence of borrowing levels, has been partly covered. That is what you will look at in your current exercise, I presume.

[70] **Mr West:** Yes.

[71] **Paul Davies:** The tax increment financing structure gives the local authority directly any increase in domestic rates from commercial development in future to repay the debt that it raises, and the non-domestic rate is a tax devolved to the Scottish Government rather than local government. Can you tell us how local government has ensured that its payback share of future non-domestic rates is ring-fenced and handed over to local government?

[72] **Mr West:** In the TIF scheme proposals, each project needs to identify what is known as a 'red-line area'. On a map of the TIF project area, you can draw a red line around the area

and then you can baseline the non-domestic rates from the business and commercial properties within that red-lined area, and you can look at the future increases in non-domestic rate income from that same area. Any non-domestic rates income above the baseline will be shared between the Scottish Government and the local authority.

[73] **Peter Black:** I am interested in how you have evaluated the level of risk involved in planning these TIF projects. Local councils have a mixed record on promoting commercial developments, as, often, they are subject to the vagaries of the market and there tends to be long-term planning involved. Sometimes, the market can dip, and authorities walk away from a project. Are there a lot of consultants involved? What guidelines are available to you to make market assessments that will give you some confidence that the private sector will take up the opportunities?

[74] **Mr West:** It is probably fair to say that, at this stage, we are just dipping our toe into the water as far as that goes. All the factors that you have just mentioned are the things that we need to tackle in the next six or seven months.

[75] **Jocelyn Davies:** We will move on now to the national housing trust. Ann has the next question.

[76] **Ann Jones:** What has been local government's response to the national housing trust initiative?

[77] **Mr Black:** Around 50% of local authorities have either progressed with the national housing trust in the first tranche, or, in the second tranche, expressed an interest to take that forward. So, there has been a fairly widespread level of interest. As I understand it, approximately 600 properties are in the pipeline, as projects through tranche 1. So, it has had some success, but perhaps it is not hugely significant in the overall scale of the housing needs across Scotland. However, it certainly has been of some benefit.

[78] **Christine Chapman:** In view of the figures that you have quoted, do you think that local authorities are content to take on borrowing for this purpose, given the guarantee, rather than some form of revenue backing from the Government?

[79] **Mr Black:** Revenue backing from the Government would obviously be more favourable. The Government in Scotland has provided some subsidy for new-build property that would be directly owned by the local authority. Again, prudential borrowing would allow the balance of the construction costs to be funded from the additional rental stream and from other resources within the housing revenue account. My authority, for example, looked at the national housing trust, but in my area there is a particularly acute shortage of housing land and it was felt that our best interests would be served by maximising new-build affordable housing to be owned by the local authority.

[80] **Mike Hedges:** Is there any reluctance on the part of local authorities to tie up future revenue budgets in this way? What is the advantage of funding it via local authorities rather than directly through housing associations?

[81] **Mr Black:** The terms of the national housing trust are that there is, on the face of it, minimum risk for local authorities at the point where the properties are sold on in five to 10 years' time. There is a risk, but the feeling is that the economy will have picked up within that longer term timescale. On your second point, I am not sure that I fully caught it.

[82] **Mike Hedges:** Why are they funding this housing via local authorities? Why not fund it directly via registered social landlords or housing associations?

[83] **Mr Black:** I think that it was partly because of the difficulty that RSLs were experiencing in raising private finance. Although they are a strong borrowing commodity, they also felt a lot of the shrinkage in the finance market. In Scotland in particular, the Royal Bank of Scotland and the Dunfermline Building Society were heavily exposed in that area. As their lending reduced, RSLs experienced some difficulty raising finance; hence, the ability for local authorities to step in was deemed to be a favourable option.

[84] **Mr West:** To supplement that, a local authority can access borrowing from the Public Works Loan Board, which an RSL cannot. Next to the UK Government borrowing directly through gilts, that is really the cheapest source of funding available to the public sector. That probably helps to make the whole proposition financially viable.

[85] **Mike Hedges:** I have reached a degree of confusion, which I am sure you can end for me. We have a situation whereby the Scottish Futures Trust is set up and borrows money for schools at a more expensive rate than the Public Works Loan Board but, when you are building housing, you are using the Public Works Loan Board. How was the decision made on what to fund from which source?

[86] **Mr West:** I do not think that the Scottish Futures Trust is borrowing funding directly. The schools project that we are involved in has Scottish Futures Trust support, and we will get a revenue grant from the Scottish Government to meet part of the cost of the element of that that requires capital funding. We will borrow from the Public Works Loan Board for the remaining part of the cost, which we need to bear ourselves as a local authority.

[87] **Jocelyn Davies:** Thank you. We have run out of time before we have run out of questions. We had one or two more on securitisation, but if it is okay with you we will send those to you in writing. Thank you very much for your evidence today and for sticking with us through the technical difficulties. There will be a transcript of the meeting, which we will send you to check for factual accuracy.

1.44 p.m.

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

[88] **Jocelyn Davies:** We now welcome the next set of witnesses. You were kind enough to send us a paper in advance, which Members will have read. Please introduce yourselves for the record, and then, if it is okay with you, we will go straight to questions.

[89] **Mr Rae:** My name is Jon Rae, and I am the director of resources at the Welsh Local Government Association.

[90] **Mr McLean:** I am Will McLean, and I am the strategic partnerships and engagement lead for Monmouthshire County Council.

1.45 p.m.

[91] **Mr Davies:** I am Peter Davies, the assistant head of finance, and deputy section 151 officer at Monmouthshire County Council.

[92] **Jocelyn Davies:** I will ask the first question. To what extent has the regime of prudential borrowing successfully replaced centralised control?

[93] **Mr Rae:** I will kick things off. The old system of borrowing, which had its origins in the Local Government and Housing Act 1989, was characterised by prescription. It was also characterised by a system of what were called credit approvals. They were either unhypothecated limits to borrowing, called basic credit approvals, or they were supplementary credit approvals, which tended to be targeted at a specific service area. Another area of prescription under that regime was the fact that certain capital receipts had to be set aside against the repayment of debt. What characterises the prudential code is freedom and flexibility. We make the point in the paper that the code is a lot more than just unsupported borrowing.

[94] **Jocelyn Davies:** Has it successfully replaced the old regime?

[95] **Mr Rae:** I hesitate to focus on unsupported borrowing, but you can see in some of the figures how it has been taken up since 2004-05. Originally, in the first year, there was about £30 million-worth of borrowing, and we are forecast to get around £0.25 billion of borrowing in the current financial year. It is not just about that. It is about transformational change, incorporating capital planning into the corporate planning process, better assets management, and sharpening up the business planning, options/investment appraisals. I would say that, in general, that has worked.

[96] **Ann Jones:** What do you see as the Government control remaining over local government borrowing?

[97] **Mr Rae:** There are two levels to that. There is a UK aspect to this, and you have heard evidence from Stephen Jones, director of finance and resources at the Local Government Association, who probably talked about the Public Works Loan Board. The board obviously has a cost of borrowing, which was increased by, in the jargon, 100 basis points, which, to you and me, amount to 1%. So, you can borrow 1% above the long-term gilt rate. There is some evidence to suggest that that reduced overall UK borrowing, although there are many more other factors at play there. Historically, the PWLB would lend at 0.13% to 0.2% above the long-term gilt yield, which was quite a marked step change in the cost of borrowing for local authorities.

[98] **Peter Black:** Before I ask my main question, I want to ask a question to the Monmouthshire finance officers, as they are here. I am just looking at the table of unsupported borrowing, and there are a number of authorities that use it quite extensively, with Monmouthshire probably at the lower end of the scale. Is there any particular reason why you have refrained from using it as extensively as, say, Cardiff, Swansea or Carmarthenshire?

[99] **Mr Davies:** I would challenge that, in part. As a relatively small authority among the 22, we have made reasonable use of prudential borrowing on a number of our key schemes. Most recently, we are going through a regeneration project in Abergavenny, and as part of the financing mechanism, we are using prudential borrowing to allow that to happen in advance of the capital receipts materialising. Another aspect is our county hall relocation, as part of the rationalisation of our wider office accommodation. We are using prudential borrowing again, but in a different way, by utilising savings. So, we have made reasonable use of prudential borrowing and I hope that that will continue with the agenda that we have in front of us.

[100] **Peter Black:** Okay, so I need to read the figures in the context of your overall budgets and the size of the authority.

[101] **Mr Davies:** Yes, that is absolutely right.

[102] **Peter Black:** That is a fair comment. On the indicators, then, what changes, if any, would you make to the prudential indicators? That question is to anyone of you.

[103] **Mr Davies:** I will start off on that question. The prudential indicators serve a purpose, and they probably serve the right purpose. There has been a disaggregation recently by the Chartered Institute of Public Finance and Accountancy between what was known as the prudential indicator suite. There is now a clear separation between those that are prudential indicators and those that oversee the management of the underlying need to borrow for capital purposes. So, they have separated those, away from what we would see as treasury management indicators.

[104] The ones that are specific to the prudential code have served their purpose; they have ensured that authorities are looking carefully at their forward planning processes and that the limits that they set, as echoed through the prudential code, are prudent, affordable and sustainable. Those three words echo everything about what the indicators strive to do. So, there is no real need for drastic change. Discretion is allowed within the prudential code for authorities to review the need to tailor their own prudential indicators. That is a discretion that they are offered, so they can supplement the indicators if they wish to do so.

[105] **Jocelyn Davies:** Does anyone feel that there needs to be changes, or are you comfortable to sign up to that? I see that you are.

[106] **Christine Chapman:** To follow on from that, should there be some guidance on the the acceptable parameters, particularly for each indicator, with upper and lower limits?

[107] **Mr McLean:** As with so many of these things, an awful lot comes down to that local position and the professional approach taken by the finance director in that authority to understand the context, the risk that that authority carries at any one time, the political ambition of that administration and to weigh them up appropriately and set those limits where they think they need to be.

[108] **Christine Chapman:** So, it is done on an individual authority level.

[109] **Mr McLean:** Yes, absolutely. Anything prescriptive would fetter the professional judgment of those finance directors.

[110] **Jocelyn Davies:** That would then undermine the whole purpose of the prudential code.

[111] **Mr McLean:** Yes, indeed.

[112] **Julie Morgan:** Has the prudential regime operated as a driver for improved asset management and value for money?

[113] **Mr Rae:** I definitely think that it has. There is some evidence for that when you look at certain case studies of how unsupported borrowing has been used. A capital programme may not wholly be funded by unsupported borrowing; it might be part of a finance package, where the finance may come from grants, general or specific, or from an authority’s internal borrowing. There is certainly some evidence in case studies. For example, I was looking recently at what Wrexham has been doing with its photovoltaic cells scheme, whereby it is to put solar panels on about 2,600 buildings in Wrexham. It is going to borrow something of the order of £9 million in prudential borrowing. The benefits of that are twofold. First, there are benefits for the householders, who get lower electricity bills and, secondly, it will generate a surplus for the housing revenue account of something like £15 million. Another example is Newport City Council’s Project 21, which, not dissimilar to the local government borrowing

initiative, borrows to fund road maintenance work, which saves on the annual pothole filling. So, the invest-to-save aspect is an important aspect of unsupported borrowing.

[114] **Paul Davies:** We touched on borrowing trends earlier and current forecasts indicate that local government unsupported borrowing in Wales rose by 77% in 2011-12, whereas in England it fell sharply. Do you expect local government unsupported borrowing to continue to increase in future years and do you have any views on why the experience in England is so different to that in Wales in 2011-12?

[115] **Mr Rae:** First, thinking about high-level finances, because of the way that the health service budgets were protected in England, local government in Wales had a relatively better settlement than its counterpart in England. That will be reflected in how much flexibility there is to channel revenue streams to finance unsupported borrowing. In Wales also, the figure 1 graph in our evidence paper, I think, shows a slight blip and then a rise, but the rise is only based on a forecast, so it will be important to see what the outturn is. It is difficult to predict.

[116] **Mr McLean:** There is the potential for it to increase, because, as we note in the evidence paper, for initiatives such as the twenty-first century schools and for those authorities that have either decided to keep their own stock or have not been successful at ballot, there will be a need to find additional resource to invest in those two substantive service areas. There is a high probability that there will continue to be a need for an increased level of unsupported borrowing to meet those needs as we go into the future.

[117] **Mike Hedges:** The WLGA states in its evidence that debt management represented 4.7% of net revenue expenditure in 2010-11. Do you deem the 4.7% level to be a prudent, affordable and sustainable amount, and what is the capacity to undertake more borrowing?

[118] **Mr Rae:** Overall, it goes back to the question about local democracy. It is a question that needs to be answered by the authority. I do not think that there is anything prescriptive about the prudential indicators. In addition, you have to see the percentage that you quoted in the context of financing for overall borrowing, and overall borrowing for local government in Wales—this is a rough, ballpark figure—is something of the order of £4 billion. Paying off the capital elements and the interest would make the financing of that something of the order of £400 million. There is always a danger that if you increase your borrowing and have to finance that, you will end up silting up your revenue budget.

[119] **Mr McLean:** That has been one of the recurring concerns, namely if people express a view that there is potential to borrow, they will always have to recognise the fact that there is a revenue tail, which is the consequence to the borrowing, so their ability to borrow will, as Jon said, silt your revenue spending. If you are looking for reductions in your revenue budgets already, and we are expecting a sharper fiscal contraction, it will be difficult to have factored in even more borrowing in that sense.

[120] **Ieuan Wyn Jones:** Pa mor gyfarwydd ydych chi â’r terfyn cenedlaethol ar brotocol benthyca awdurdodau lleol? Os ydych yn gyfarwydd ag ef, pa mor ymarferol ydyw fel mecanwaith i reoli benthyca?

Ieuan Wyn Jones: How familiar are you with the national limit on local authority borrowing protocol? If you are familiar with that, how practical is it as a mechanism to control borrowing?

[121] **Mr McLean:** While I was with the WLGA, we spent a long couple of meetings discussing the borrowing protocol with colleagues from the Welsh Government. It was drawn together as a mechanism that would be ready for Welsh authorities to use should a very severe economic event happen that would require the Westminster Government to make a significant decision about borrowing levels at an immediate point in time. It was constructed in a way that allocated an element of borrowing on the basis of a formula that was to be

determined. I think that this was an appropriate mechanism to do that. The discussions between representatives of the finance community and Welsh Government officials were conducted in a very positive way, and there was a good, open and timely exchange of information and views to make sure that the protocol worked and was effective. It is something that we hoped would stay on the shelf.

2.00 p.m.

[122] **Jocelyn Davies:** Are there any supplementary questions? I see not. Do I take it, then, that this was something that you expected might happen in extraordinary circumstances or in a crisis of some sort, or something that was not planned for in the long term, but which happened and meant that you had to react quickly?

[123] **Mr McLean:** Absolutely, if there were to be another cataclysmic kind of economic incident.

[124] **Mr Rae:** If I might add, Chair, there is some evidence, which follows on from the question about how prescriptive the system is perhaps becoming, that the Treasury is maybe taking a bit of a harder line. We know that, in England, where they have reformed their housing revenue account subsidy system, and it is now a self-financing system where English local authorities can go and borrow against their income, that Treasury has imposed a cap that has meant that those authorities with housing stock are limited in what they can go out and borrow. There is some evidence that the UK Government is taking a harder line on these limits and prescriptions.

[125] **Jocelyn Davies:** We have some questions later about the housing revenue account, but I will now turn to Julie.

[126] **Julie Morgan:** I think that Jon has already referred to the Public Works Loan Board and the increase in the interest rate in 2010 and 2012. Could you expand on the impact on the affordability of local authority borrowing in the future as a result of those changes?

[127] **Mr Rae:** There is some evidence—and I rely on UK statistics for this—that up until the change in the PWLB rate, which was around the time of the 2010 spending review, monthly UK borrowing was something of the order of £0.5 billion, and after that period it dropped quite precipitously. I cannot quite remember the figure, but, as I have said, there would have been other factors in play there as authorities were a lot more prudent, if you do not mind me using that word, in exactly what they did borrow in the aftermath of the global financial crisis.

[128] **Julie Morgan:** Has it had an impact on local authorities' ability to make long-term investment decisions?

[129] **Mr Rae:** It definitely has, because the cost of borrowing on a project that has a lifespan of 25 to 30 years is determined by the rates at that time, so it will have had an impact on that type of long-term decisions. I should say as well that the long-term trend for capital expenditure in Wales since the early 1990s has been on an upward curve: at the start of 2000 it was something like £550 million, but by the time we got to 2007-08 it peaked at £1.2 billion. Then there was this blip with the financial crisis, when it dropped to around £900 million, and the forecast for the next couple of years is that it will come up to something just over £1 billion, although the forecast only takes us up to 2011-12, which, strangely, is the current financial year—we do not have a long-range forecast on that.

[130] **Mr McLean:** The other thing to consider is that the decision to raise the differential between the gilt rate and that charged by PWLB was taken by the new Government, and I

think that it was taken for a host of reasons to do with its political perspective and what it wanted to achieve by way of consolidation and so on. What it led to was local authorities looking in a more innovative way at where they sourced their finance from. So, immediately there was a response from the Local Government Association in trying to pull together an initiative that allowed local government to act collectively to raise bonds to the market directly. There are a number of finance directors and others in Wales who know better than I do about securing very competitive rates from commercial banks such as the Co-op, notwithstanding the PWLB decision.

[131] **Mike Hedges:** On the issue of bonds, local authorities did look at them, and then there were changes made to the Public Works Loan Board rates, and bonds were considered less of a good idea. If the Public Works Loan Board rate was to increase again, would you be able to look at providing bonds? Also, have you learnt anything from Transport for London, which is effectively a local authority body and which had a bond issue that was oversubscribed?

[132] **Mr McLean:** On the issue of bonds, an awful lot of work was undertaken, led by the LGA, which the WLGA and the society of Welsh treasurers were fully supportive of. Local authorities have the ability individually to raise and issue bonds as things stand. The issue for that particular project was whether they had the ability to cross-guarantee each other's debt. As it transpired, we were given the legal advice that a cross-guarantee was not necessary; it could have been developed into what I think would have been a very positive development for local government, not only in the ability to raise debt directly with the market, but also to look at it as a potential investment vehicle in the future.

[133] The immediacy of the political decision in the last budget kind of showed some of the risks around it as a project, where the margins were tight. I think the Eurofin model that has been done in France and Scandinavia had a lot of lessons for us to take from it.

[134] **Mike Hedges:** I have one simple question and then a more complicated one. Really, we are moving back to the 1960s, because in those days, local authorities would use bonds as a method of borrowing. It started to be frowned upon in the 1970s and the 1980s, and it drifted out of fashion. Due to the low rate of interest that they get on investments, local authorities tend to use internal borrowing. Do you want to say any more about the mechanism for that and its benefits?

[135] **Mr Davies:** It is absolutely true to say that, across the UK, most authorities are trying to reduce their credit risk at the moment, particularly in the current climate that is continuing. To that end, they are looking to run their investments down, so they are not going externally to the market to borrow, which is what their capital plans are showing. We have to distinguish here between accounting borrowing and actual borrowing, which needs to be seen in a different light. That has afforded authorities a lot of opportunities not only to mitigate the risk, but also to generate savings by not having to incur costly external borrowing costs.

[136] The thing that we are keeping a very close eye on at the moment is ongoing market developments, because each individual authority will have a different tipping point. That is, when it hits the wall, so to speak, and moves from an internal borrowing position, where it can run its cash balances down to what would be seen as a safe level, to having to externalise. All the yield curves currently show rates starting to creep up as we move outwards in time. As different authorities drop out, when they move from an internal to an external borrowing position, that will directly impact their revenue accounts. So, it is a concern for treasurers and they have to watch that position carefully to make sure that they are planning adequately for it.

[137] **Peter Black:** I may not fully understand the process, but on that internal borrowing

mechanism, when you invest money externally, you invest for the short term, the medium term and the long term depending on your capital cash flow, but I would guess that most of your borrowing tends to be over the longer term. How do you manage your cash flow in that regard? Clearly, you are limited by what you can invest internally in that way.

[138] **Mr Davies:** Yes. Most authorities are in constant communication with their treasury advisers, and I would probably expect the vast bulk of authorities, if not all of them, to have independent treasury advisers. That ongoing communication centres on an ongoing analysis of the external debt portfolio and as to when certain debts are maturing over time. That applies equally to the split between variable and fixed-rate debt, and relates to the ability to hedge against interest movements on your investments. Investment is a bit of a difficult one at the moment because, given the current climate, I would have thought that the vast bulk of authorities have their investments in a pretty much short-term liquid status. Looking at some benchmarking data that I had through recently on clients that are with our treasury adviser, I could see that the vast bulk of authorities had all their moneys locked up between overnight and three months. I think that there has been quite a shift even in recent weeks, given the eurozone situation with Greece.

[139] **Peter Black:** And that restricts your capacity for internal borrowing review.

[140] **Mr Davies:** As I said, each individual authority will assess what that break point is and identify what it sees as a suitable amount of investment to allow it to manage its working capital position. It needs to be very careful about how far it runs dry before it moves out into the market for external borrowing.

[141] **Peter Black:** What other instruments of debt are local authorities permitted to access and what, if any, restrictions do they face?

[142] **Mr Davies:** In our authority, traditionally, we have maintained a position whereby the vast bulk of our borrowing has been with the PWLB. It is very competitive. I know that Will has touched on other avenues that authorities can take out there in the market through commercial loans and so on. The bottom line is that, even with the 1% hike, PWLB remains very competitive. It forms a large proportion of not just our portfolio, but those of a lot of other authorities. Beyond that, LOBOs are another area where authorities have placed their debt—

[143] **Jocelyn Davies:** Sorry, what are LOBOs?

[144] **Mr Davies:** I will try to get this right. I think that it stands for ‘lender’s options, borrower’s options’. That is where you will enter into an agreement for a loan, perhaps for 40 years, and there will be set points in the agreement at which an interest rate can be called. Therefore, you obviously run the risk of where things go with those.

[145] **Mr Rae:** I should add that, nationally, and, I suppose, historically, the greater proportion of loans have come from the Public Works Loan Board, and I think that that proportion is somewhere in the order of 75% to 80%.

[146] **Jocelyn Davies:** We will move on to the issue of the housing revenue account buy-out, which you mentioned a bit earlier. What do you see as the key benefits and limitations for local authorities for the prospective housing revenue account self-financing changes? Of course, this does not apply to Monmouthshire because you have already transferred your stock, so you can relax for the rest of this question. [*Laughter*.]

[147] **Mr Rae:** One of the great benefits here is that, at the moment, there is what is referred to as a negative subsidy, to use the lingo.

[148] **Jocelyn Davies:** You do not need to explain that. We are all almost experts in the housing revenue account subsidy system by now. [*Laughter*.]

[149] **Mr Rae:** I had to look it up. [*Laughter*.]

[150] **Jocelyn Davies:** Part of the rent is clawed back by the UK Treasury and that is likely to stop—

[151] **Mr Rae:** Indeed, it is of the order of £74 million. I think that the LGA has less prosaically described it as 'a tenant tax'. One of the great advantages of reforming that system is that the current system is seen as burdensome and overly complicated, and it is certainly not very well liked. One of the advantages of settling up with the Treasury and local authorities in Wales then borrowing to fund that settlement is that, if it goes down the same path as in England, the Public Works Loan Board would make available its old borrowing rates, which, as I think I said earlier, were between 0.13% and 0.2% above the long-term gilt rate. Another advantage is that the system becomes self-financing. Local authorities could then go out and borrow to fund their current maintenance or backlog maintenance. That would help them meet, in a short time, the Welsh housing quality standard.

2.15 p.m.

[152] **Ann Jones:** What is the likely impact that the ability to borrow against rental income will have on debt levels and rent levels going forward?

[153] **Mr Rae:** Debt levels will undoubtedly increase. We have already seen that happen in England. It was an unprecedented settlement—I think that the settlement was something in order of £13.4 billion. In Wales, we would expect to see a commensurate increase in borrowing. As I said before, because it becomes a self-financing system, the issue of rent becomes very important. I am not an expert on housing finance, but the new housing White Paper has provisions in it for limiting rents or having an average rent in Wales. That would have to be worked into the financial modelling because it will have a big play in the long-term calculations that stretch over 30-odd years. I am not sure whether the effect would be the other way; if we reformed the housing revenue account subsidy system in Wales, I am not sure whether it would affect the rents themselves. However, if we follow the same track as England, hopefully, local authorities would have the headroom to invest in their housing stock.

[154] **Peter Black:** As I understand it, in England there is rent control and a cap on the level of borrowing that they can undertake, whereas that is not the case in Scotland, as we have just heard. What is the situation now? Do we have full prudential borrowing capacity within the housing revenue account at the moment, and would you expect that to continue under a new regime?

[155] **Mr Rae:** Within the housing revenue account you can utilise unsupported borrowing. Many authorities have already done so. Carmarthenshire stands out as one authority that uses it effectively. However, what is being utilised at the minute would still be a small proportion of the overall amount of any settlement from the Treasury. Without knowing what that settlement figure looks like, I cannot tell you the proportion. On your other question on rents, I am not an expert on housing finance.

[156] **Peter Black:** But, you will be looking for a new settlement with a buy-out to continue the process of having full prudential borrowing capacity.

[157] **Mr Rae:** Yes, absolutely. I mentioned earlier the idea that the Treasury has. I do not

think that we quite understand why we have prudential borrowing when it is down to local decision making with input from section 151 officers, where we have a localised approach within the prudential code, but the Treasury wants to limit it—as it has done in England with the way in which HRAS was reformed—and we do not understand why it wants a limit because that limit works in a very uneven way. Some authorities that still have housing stock in England cannot borrow very much more because of the way in which the Treasury has set the limit. Some can, and they have been quite fortunate, but others cannot and they have been unfortunate. Westminster was one; quite a few London authorities have been affected by that decision.

[158] **Jocelyn Davies:** You have sparked some excitement. You might not be an expert, but we have two people here who are. You could be asking questions of these two, I think. Mike, you will have to be brief because we have 10 minutes left and a number of other areas to cover. The witness has already said that he is not an expert in this area, although he has given quite a robust answer so far.

[159] **Mike Hedges:** Do housing benefit limits have an effect on the ability to borrow?

[160] **Mr Rae:** Do you mean the limits on the benefit itself?

[161] **Mike Hedges:** The limit to which you put rents up in order to borrow. There has been talk about regional pay, so there may be talk of regional housing benefit.

[162] **Jocelyn Davies:** I do not think that the witnesses are in a position to answer a question like that.

[163] **Mr Rae:** It is certainly a very difficult question, but I think that the answer is that you might be right, because caps are being introduced for certain benefits, so that would have an impact. I shall make a note of that.

[164] **Jocelyn Davies:** I think that it is fair to say that the housing benefit limits are way above what people are currently paying for council properties. So, I doubt that that will have an impact on this particular issue. Christine has a question on the Scottish Futures Trust; a different topic.

[165] **Christine Chapman:** You have probably read some of the evidence that we received from the Scottish Futures Trust, which talked about the benefits of being a centre of expertise in relation to pursuing and developing innovative approaches to capital investment. It stated that its operational independence was important, as it allows it to pursue options regardless of Government priorities. Do you think that it would be a good idea for us to have a similar centre in Wales?

[166] **Mr McLean:** On the question about centres of expertise, the WLGA commissioned a piece of work in 2006 to look at how successfully we manage projects and programmes specifically relating to capital investment. I think that it would be fair to say that good practice was not noted across the piece. So, we were looking to find a way to build that resource. There are positives to the approach and to bringing in that level of expertise. Throughout the last three or four years, the WLGA has had ongoing discussions with the Confederation of British Industry about ways to improve the standards of delivery and ways to engage the public and private sectors more effectively. Throughout that piece, concerns were raised about some of those skill levels in the delivery of projects. Sometimes, where people entered into negotiations with the commercial sector, there were concerns about people being exposed by their inexperience of those commercial negotiations. So, I suspect that there is a need for some kind of development—that is not to question the practices that take place today, but if you are looking to different models in future, there will clearly be a

need to develop people's skills, capacity and capability to meet those different models. Whether it is a matter of holding something centrally, I am not sure. I think that there could be something more virtual in order to share the good practice that already exists in Wales across the different authorities. That would be a more practical and cost-effective solution.

[167] **Paul Davies:** You talked about the development of skill sets and you mentioned in your written submission to us that the introduction of the prudential code required the development of a new skill set. What sort of professional skills are required within local government to support its borrowing activities?

[168] **Mr Rae:** The piece of work that Will mentioned, which was commissioned from PricewaterhouseCoopers, recognised that we really needed to build capacity with regard to sharpening up business cases, undertaking proactive risk management, in concert with the principles of the prudential code as a whole. It was about general change management and stakeholder management as well. So, that piece of work picked up the key skills that we need in local authorities to help to make the code a success.

[169] **Ieuan Wyn Jones:** Hoffwn ofyn cwestiwn am ddefnydd awdurdodau lleol o hawliau benthyca pellach, yn sgîl y ffaith bod y Llywodraeth wedi gweld cwtogiad o 40% yn ei chyllideb. Ni fydd rhai cynlluniau y byddai awdurdodau lleol wedi disgwyl i'r Llywodraeth eu cyllido, fel adeiladu ysgolion newydd, yn mynd rhagddynt. I ba raddau y mae awdurdodau lleol yn defnyddio pwerau benthyg i wneud yn iawn am ddiffyg cyfalaf gan y Llywodraeth o ran adeiladu ysgolion, er enghraifft?

Ieuan Wyn Jones: I would like to ask a question about the use that local authorities are making of further borrowing rights, in light of the fact that the Government has seen a 40% reduction in its budget. Some plans that local authorities might have expected the Government to fund, such as building new schools, will not take place. To what extent are local authorities using borrowing powers to compensate for a lack of capital from the Government with regard to building schools, for example?

[170] **Mr McLean:** I will make a couple of comments on that. There is evidence that, in relation to the twenty-first century schools initiative, it is expected that local authorities will have to use unsupported borrowing to close that gap. At the moment, unsupported borrowing is talked about as the most common approach to that. I know that certain other authorities have talked about potential revenue solutions involving the private sector, but I do not think that we have seen any of those come to fruition as yet. Therefore, I suspect that it will be the case that unsupported borrowing has to be used.

[171] **Ieuan Wyn Jones:** Mae disgwyl y bydd Llywodraeth Cymru yn cael pwerau benthyg, er nad oes dim wedi'i gadarnhau hyd yn hyn. Os caiff Llywodraeth Cymru y pwerau hynny, i ba raddau y byddai angen i'r Llywodraeth ddefnyddio pwerau benthyg awdurdodau lleol yn y dyfodol?

Ieuan Wyn Jones: There is an expectation that the Welsh Government will be granted borrowing powers, although nothing has been confirmed as yet. If the Welsh Government is granted these powers, to what extent would the Government need to use the borrowing powers of local authorities in the future?

[172] **Mr Rae:** I think that you are referring to the Silk commission. This week, we saw the publication of the Welsh Government's infrastructure and investment plan. One thing that stands out—if it is not in that plan, I have certainly seen it in a presentation—is how capital funding for the Welsh Government falls away. There is a shaded part of the relevant bar chart where there is an attempt to fill in, or at least stabilise, that reduction in capital spending. I suspect that local government will have a big part to play in stabilising or increasing that capital spending. Indeed, local government, through the society of Welsh treasurers and through the capital finance and investment group, played some part in the publication of the infrastructure and investment plan.

[173] As Will said, that will happen in a number of areas, not only in respect of making up the gap on twenty-first century schools. In our evidence paper, we listed quite a few areas where—drawing on the evidence that is available now—local authorities are borrowing for leisure facilities, education, energy-efficient premises and invest-to-save schemes, for example. These are not small amounts of money. The other day, we had some information from Cardiff Council that, in respect of its school organisation plan, which is a big capital programme of about £200 million, half of that money will come from unsupported borrowing. What was going to happen to capital funding was set out in very stark terms to local authorities, namely that it was going to fall from 40% from its peak in 2009. So, it was made clear that if we wanted to deliver schools and other types of investment for people in our communities, we were going to have to step into the breach, to a certain extent. The infrastructure and investment plan is also a living document, so we would expect that engagement to continue over the coming years, as the details of the plan come out.

[174] **Jocelyn Davies:** We only have a minute left, so we will not move on to any other questions. I think that there are about eight questions left. The housing revenue account issue is to blame for that. It always happens: when that issue crops up, we always get diverted. [*Laughter.*] If it is okay with you, we will send you the remaining questions in writing, and we would be very grateful for a response. Thank you for coming today and for sending us the paper in advance. That evidence was very useful. We will send you a transcript of the meeting, so that you can correct it if you find that there are any factual inaccuracies.

2.29 p.m.

Papurau i'w Nodi
Papers to Note

[175] **Jocelyn Davies:** We now move on to the next item. We have had correspondence on devolved funding from HM Treasury. Have Members all noted that paper?

[176] **Ieuan Wyn Jones:** Can we ask for information that we would like to have?

[177] **Jocelyn Davies:** Of course. In fact, there is an offer for further help if we find that the committee needs more information.

[178] **Ieuan Wyn Jones:** I will see if I can find what I am looking for.

[179] **Jocelyn Davies:** As it is a paper to note, it will be at the back of your papers pack.

2.30 p.m.

[180] **Ieuan Wyn Jones:** It is not there. I will explain the issue on which I would like clarification. We have been discussing this issue, and there may be political differences over it. I would like some clarification on the extent to which borrowing is linked to tax-raising powers—there is an implication here that the two are linked. I am not making a political point but, just for clarity, is the Treasury linking them together? In other words, does one follow the other, or are they entirely separate? Do you know what I mean? Can you have borrowing if there are no tax-raising powers? That is what I want to know. Clarity on that would be helpful.

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

[182] **Peter Black:** The letter also makes the point about the transfer of risk in respect of tax-raising powers as time goes on. To what extent is that transfer of risk linked to future

borrowing powers?

[183] **Jocelyn Davies:** Is everybody content with that? Mike, you had a point to make.

[184] **Mike Hedges:** We hear that Northern Ireland has had borrowing powers for a long time, limited to £200 million since 2003-04. Are we going to talk to them?

[185] **Jocelyn Davies:** Let us deal with this letter first.

[186] **Mike Hedges:** It is in the letter.

[187] **Peter Black:** It is in the letter with regard to the money for local government being on top of that £200 million.

[188] **Jocelyn Davies:** Okay; we will reply to the letter, thanking them for the evidence and asking for clarification on one or two things. Mike, you would also like us to include some communication with Northern Ireland about the use of its borrowing powers. Is everybody happy with that? We do not have time to invite witnesses, and video-conferences are not my thing, as you can tell. I would prefer not to do it. I think that all Members would be happy if we had some evidence in relation to Northern Ireland.

[189] **Ieuan Wyn Jones:** One thing that you have to remember, though, is that, in Northern Ireland, because their local authority system is different from ours, it makes up for it rather than adds to it, if you see what I mean. It is not a massive sum.

[190] **Jocelyn Davies:** No, and for example, it is the Northern Ireland Executive that owns houses, so it acts in many ways like a local authority. However, we will get the evidence and come to our conclusions after we have received it.

[191] **Mike Hedges:** Will we?

[192] **Jocelyn Davies:** Yes, we will. [*Laughter.*]

[193] Are Members content to agree the minutes of the previous meeting? I see that you are.

2.32 p.m.

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

[194] **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.

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

Derbyniwyd y cynnig.
Motion agreed.

Daeth rhan gyhoeddus y cyfarfod i ben am 2.32 p.m.

The public part of the meeting ended at 2.32 p.m.