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WLGA • CLlLC

Jocelyn Davies AM
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Dear Jocelyn

Thank you for allowing myself, Will McLean and Peter Davies to give evidence to the Finance Committee on the 24 May.

I look forward to seeing a copy of the final report of the Committee on innovative capital funding and unsupported borrowing. In the meantime I am pleased to answer the questions that could not be covered during the course of the evidence session.

Local Government Borrowing Initiative

The Local Government Borrowing Initiative is similar to supported borrowing, particularly from our perspective, but is not scored as capital in the Welsh Government's Budget as it is not part of the General Capital Funding. General Capital Funding is made up of General Capital Grant and Supported Borrowing and the LGBI funding is clearly neither. However like supported borrowing, the financing after the second year will come through the revenue support grant and the Minister has given a commitment to that effect. The Minister has also committed that the revenue funding will continue to be provided within the settlement for a twenty two year period.

In one key respect LGBI is very similar to the supplementary credit approval that existed before the introduction of the Prudential Code in the Local Government Finance Act 2003 in that it provides capital financing for specific projects in this case highways. As with supported borrowing, local authorities will own the asset and the liability.

Local government will always maintain that funding should come

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without conditions but we welcomed this announcement at the time and will continue to do so. The scope for the Welsh Government to further utilise borrowing in this way may be limited by the Statement of Funding of Policy which is agreed with the Treasury. This is one of the key questions for the Silk Commission and we would argue that the Welsh Government should have more discretion over how its own capital and revenue split is determined.

Another potential limit is the wider availability of revenue funding to service the debt – a question of balancing capital investment needs with the need to manage revenue funding pressures in order to continue to deliver local services.

Non-Profit Distributing Model

The limitations of PFI are well documented by Professor Alison Pollock who gave evidence to this Committee in 2007. Under PFI schemes, the options appraisal is weighted towards accepting the PFI option and the risk is seldom transferred to the private sector. An advantage of PFI from the Treasury point of view is that PFI is not reflected in net debt. Though accounting changes brought about in 2009/10 as part of International Financial Reporting Standard (IFRS) convergence ensured that schemes that met the requirements of IFRIC12 were brought on to the balance sheet such that they were reflected in the Whole of Government Accounts but not in net debt

PFI is a form of Public Private Partnership that is supposed to deliver public infrastructure goods with private sector know-how and public sector funding. A criticism by a recent UK PAC is that the borrowing costs were always poor value for money, especially when interest fell dramatically with the onset of the global financial crisis. Local Government would welcome any innovative approach of the type Gerry Holtham is suggesting or improvements to PFI announcement by the Treasury[1].

Tax Incremental Financing

We would welcome any move that gives local government greater freedom to use its resources for to improve the wellbeing of all its citizens. TIF is a label that has been applied to the earmakarking of business rates growth for borrowing. In a similar way you could securitise additional income from council tax on second homes or from empty properties and this requires changes to primary or secondary legislation currently in the gift the Welsh Government.

The Minister may be correct in stating that this currently may not raise significant amounts nationally but for certain authorities, and especially in the context of the work that the Minister for Business, Enterprise and Technology and Science is pursuing around City-Region economic growth then it has the potential to be a useful additional funding mechanism. The review currently being undertaken by Professor Brian Morgan into business rates should be a useful contribution to that debate.

The Community Infrastructure Levy is also a potential model that may need some development but again there are questions about the significance of sums involved over and above 'S106 contributions' achieved under existing arrangements.

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[1] http://www.hm-treasury.gov.uk/press_128_11.htm

Alternative local government funding mechanisms

Some of these alternative funding mechanisms are being pursued collectively by local government. During the course of the evidence session my colleague Will McLean talked about work the WLGA and the LGA had been involved with in setting up an agency to raise financing directly through bond markets, powers that some committee members remembered that local government had in decades gone by.

The lack of freedom to borrow in this way is symptomatic of the decline of local discretion that characterised central-local relations over the course of the latter half of the twentieth century. So in one respect the lack of innovation may be explained by excessive central prescription and the work of innovation, at a strategic level, has to be done nationally and collaboratively through groups like the Capital Financing and Investment Group and through the work of the WLGA and the LGA.

The innovation that is being done by local authorities is usually being done within the constraints of the current system. The evidence we presented shows that whether these schemes range from sophisticated approaches to boosting resources for the Housing Revenue Account to School Reorganisation, local government is making good progress.

In the final analysis, there is nothing about local government borrowing that is different from the choices faced by the average mortgage payer. The amount you can borrow is based on the value of the revenue stream and your existing commitments. For local government, that revenue stream may be tax income, a rental income, grant income, or a cashable efficiency saving. The opportunity cost of that revenue stream is lower Council tax or more funding for current services.

For local government, borrowing costs are long-term and cannot be easily removed from the revenue stream where borrowing concerns assets used in day-to-day service provision. In times of funding restrictions and a very uncertain financial climate due to the on-going Eurozone crisis this is a real concern for treasurers.

I hope this additional information is useful to your evidence gathering.

Yours sincerely

Jon Rae
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