



Financial Transactions Capital

Welsh Treasury / Financial Control Evidence Paper

18/09/2024

Financial Transactions Capital (abbreviated as FTC, or sometimes just as FT) is a ring-fenced section of the Welsh Government's capital budget, provided by the UK Government to boost state-led investment in private and third sector entities.

This document sets out the rules surrounding FTC, the Welsh Government's approach to its use, and what changes are already underway to reform that approach moving forwards.

1. Background on FTC

Financial Transactions Capital is a form of capital that can only be used for loan or equity investments to an entity outside of Welsh Government accounting boundaries.

UK Level

1. When considering options for the future of Financial Transactions Capital in Wales, it is important to accurately identify the competencies and ownership of each respective layer of government and the role of the private sector.
2. The overarching rules governing FTC are determined by the UK Government and are set out in Chapter 8 of the UK Consolidated Budgeting Guidance.
3. The UK Government also determines the total amount of FTC that the Welsh Government receives through the process set out in the Statement of Funding Policy, which determines the allocation of Barnett Consequentials.
4. Allocations must also align with subsidy control principles. These have been set out in the UK Government's Subsidy Control Act 2022 and are determined at the UK wide level.
5. These limitations are reflected in the portfolio of projects that are approved utilising FTC. Each proposal must:
 - a. generate a financial return
 - b. be repaid
 - c. only be given to entities outside of Welsh Government accounting/budgetary boundaries
 - d. align with state aid rules

Alignment to UK Rules

- 6.** While there is scope for the Welsh Government to shape and prioritise projects, the Welsh Government is also responsible for scrutinising any proposals for funding to ensure that the entity receiving FTC can appropriately utilise it for the purpose in question in line with the restrictions set out above.
- 7.** The Welsh Government is also expected to return at least 80% of gross FTC funds to HMT. Given most proposals contain an element of risk, this requires the total portfolio of projects to charge additional interest to offset this risk.
- 8.** Finally, the Welsh Government requires a willing partner who wishes to be in receipt of FTC and who is eligible to receive it to propose viable projects.
- 9.** This can be challenging, as FT loans can be as expensive as commercial loans and take longer to access as the Welsh Government have specific scrutiny requirements to ensure proposals align with UKG guidance and can cover the wider FTC portfolio. Moreover, given that FT is designed to supplement not displace private investment, the typical bid FT attracts has lower financial returns but high social returns, hence we have an even smaller margin of error to cover losses from bids which fail to repay. Consequently, it is necessary to charge market rates for higher risk spending, while also implementing multiple stages of scrutiny via our legal, commercial and financial teams.

Welsh Government Allocations

- 10.** The Welsh Government's priority is to assign FTC in line with the above requirements to maximise delivery of Ministerial priorities, optimise value for money and ensure positive outcomes for the people of Wales.
- 11.** FTC has primarily been allocated towards a mixture of economic and housing investments. It has also been used to finance Welsh Government equity stakes in Mutual Investment Model projects in the A465, schools and the new Velindre Cancer Centre.
- 12.** These areas have been chosen for investment because they are priorities but also because they are considered more reliable in terms of being able to develop an effective pipeline of projects with key delivery partners in line with the requirements and repay investments at the scale needed. Some other priority areas for investment do not have the properties to make them suitable for use of FTC.

- 13.** Given the inherent risk in the nature of loan and equity investments it is inevitable that some repayment profiles will need to be amended, with some investments returning earlier than expected, others requiring delays. To manage this process, the Welsh Government undertakes an annual reconciliation exercise to ensure repayments balance the overall FTC position.
- 14.** It is also common that proposals that are developed and allocated funding are delayed even after funding is allocated due to wider market conditions or practical challenges with project delivery.

Current FTC Portfolio

- 15.** Based on the latest published data the Welsh Government has received a gross total of £1,377.639m FTC to date, which has since been fully allocated.
- 16.** As of 2022-23, the Welsh Government has received £333.894m in FT repayments and repaid a total of £372.150m of FTC to HMT. Data for FTC repayments received, and the FT repaid to HMT in 2023-24 is not yet available and will be published in the weeks following the completion and publication of the WG Consolidated Annual Accounts in November/December.
- 17.** Given the nature of the current arrangements, it is not possible to determine the allocation of recycled funding on specific projects. After funding has been repaid to UKG, residual funding forms part of the overall envelope when making allocations and is utilised to finance proposals published in our Budgets.
- 18.** Examples of some of the projects within our FTC Portfolio includes
- a. Help to Buy: £63m additional funding was allocated in 23-24 to extend our help to buy scheme until March 2025, bringing total investment to £780m since 2013. The scheme provides financial assistance to support people who would like to buy their own home
 - b. Help to Stay: £100m has been allocated towards measures to help people struggling to pay their mortgages stay in their homes and to support social housing which aims to help people avoid homelessness, prevent repossession and create more social housing
 - c. £20m developing a Further and Higher Education Decarbonisation Scheme providing educational institutions across Wales access to funds for renewable energy projects and to modernise infrastructure to reduce energy demand.

- d. £12m of funding has provided to DBW to help provide small businesses, sole traders and social enterprises in Wales with microloans.
- e. £7.7m has been made available to support the commercialisation of excess capacity of the rail fibre network
- f. Support for Mentor Mon Morlais Ltd: £4.8m has been allocated to help support energy harnessing tidal stream devices.

Strengths of FTC

- 19.** The primary benefit of FTC is its recyclable nature. FTC provides an opportunity for the Welsh Government to recoup investments and potentially reallocate funding multiple times, compounding the value added through the intervention.
- 20.** This can also make it more sustainable, enabling the prioritisation of projects that would otherwise not be fully funded in an effective and reliable format.
- 21.** When projects are suitable for FTC, then the value of its use over grants is clear from the perspective of Government in terms of the delivery of superior outcomes and the return of investment to Welsh and UK Governments, which strengthens the value for money case.

Challenges in deploying FTC

- 22.** While the repayable nature of FT has advantages, it also creates particular challenges.
- 23.** Bids for FT tend to inherently be either riskier or provide lower financial returns compared to wider investments, as otherwise they would use private sector loans which are often easier to access and less expensive.
- 24.** The lower financial returns means that if a bid fails to repay its funding, it would compromise the wider Welsh Government FT portfolio, requiring losses to be covered by returns from other bids. This places a greater burden on the Welsh Government to assess bids diligently with legal, financial and commercial experts. This can make the bidding process for securing FT bid much longer than a grant or a commercial loan, as it is essential we only fund projects which will be able to repay its funding.

- 25.** Additionally, even after being awarded FT funding, policy officials need to work with legal and commercial teams within WG to develop contracts for funding partners. It can take time to upskill staff for this task, which is then complicated if proposals have unique or complicated repayment terms and conditions.
- 26.** This increased level of scrutiny and assurance needed for FTC investments can disincentivise the development and submitting of bids compared to regular grant funding. Consequently, most new funding proposals considering the option for FTC generally do so as they have exhausted all alternative funding options for their proposal, not because the proposal in question is designed optimally for the use of FTC.
- 27.** Moreover, repayable loans create an administrative responsibility within government and increases budgetary risk for both the MEG that the bids falls within and for the centre of government who are responsible for repayments to HMT.
- 28.** Providing appropriate levels of scrutiny to bids can be particularly challenging given the short turnaround between Autumn Statements, where the FTC funding has been allocated in recent years by the UK Government, and the Draft Budget in December. This has led to a reliance on a small number of policy areas which are more used to utilising FTC, as they are most effective at managing and mitigating risk.
- 29.** To improve this process, the Welsh Government are considering options for reforming how we manage and allocate FTC which will impact from the 2026-27 Budget Process onwards, and which will respond to the recommendations of this Finance Committee review.
- 30.** The Welsh Government proactively engaged with HMT and other Devolved Governments when the Statement of Funding policy was being redrafted in 2020. Many of our representations concerned efforts attempting to simplify processes and increase the flexibilities of the Welsh Government in attempting to manage FTC, this includes returning to the old accounting rules which allowed DBW to receive and manage FT funding. We intend to continue to make the case for reforming processes to reduce bureaucracy moving forwards.