

Jocelyn Davies
Chair, Finance Committee
National Assembly for Wales
Cardiff Bay
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Dear Mrs Davies

A call for evidence – Prudential Borrowing and innovative approaches to capital funding.

Thank you for providing us with the opportunity to respond to the inquiry into the use of prudential borrowing by Welsh local authorities and other organisations and innovative approaches to capital funding.

This is clearly an important subject for local government, and we do believe that there are opportunities for us to maximise the impact of prudential borrowing by Welsh local authorities, and the use of new forms of finance that could significantly improve Wales' ability to lever investment.

In terms of our broad response, there are undoubtedly significant issues that inhibit local authorities in undertaking investment by borrowing. Many of these are based upon the fact that, outside of property based projects, there is often little in terms of revenue generated from capital intensive projects. Subsequently it is difficult to make a robust business plan for projects that would require large levels of borrowing, and subsequently large levels of repayments, unless there is a revenue stream dedicate to paying off this borrowing. This means that whilst there may be a significant public good arising from, for example, a major infrastructure investment, such as a new road or rail scheme, the repayment costs could provide too large a burden for the authority to bear.

Similarly, there is clearly a big risk for local authorities when borrowing. In many cases whilst there may be worthwhile projects, with large transport infrastructure being such an example, the risk of borrowing significant levels of finance is often simply too large for the local authority, unless these risks could be shared appropriately with either the private sector or other beneficiaries. There is opportunity in this case to look at other modes of financing major projects that could share risk, or provide means to repay the loans based on the initial investment. This could include Tax Increment Financing, or even the use of project specific bonds. There may also be opportunities to pool resources for regionally significant projects through appropriate regional arrangements. This could cover, for example investment in the public transport infrastructure in South East Wales, or even regionally important preventative programmes.

Cardiff Council is already lobbying for the use of Tax Increment Financing in the city, specifically for the Central Business District development. However, this approach is only really relevant to small area schemes, where the resultant business rate take can be directly attributed to the initial investment. It is more difficult to progress a similar means of financing for wider infrastructure projects, where it is more difficult to align increases in tax revenues with the investment that has taken place.

Furthermore, there is also a need for collaborative projects to be financed accordingly that provides the appropriate incentives for all participants, for example collaboration aimed at increasing efficiencies through joint working that requires up front investment.

In response to the specific questions raised, please see our responses below that has been collated by officers. Please do not hesitate to contact us if you require further information.

Q – The total level of prudential borrowing and your prudential borrowing limit in each year since the inception of the scheme;

The affordable borrowing limit and the level of additional borrowing undertaken by the Council in each year based on its outturn position are shown in the table below:

| Financial Year | Amount of additional borrowing (£m) | Affordable limit for borrowing - CFR (£m) |
|-----------------------|--|--|
| 2004/05 | 3.4 | 417 |
| 2005/06 | 1.5 | 438 |
| 2006/07 | 6.4 | 485 |
| 2007/08 | 10.9 | 497 |
| 2008/09 | 10.2 | 494 |
| 2009/10 | 18.7 | 498 |
| 2010/11 | 30.9 | 534 |
| 2011/12 est. | 39.8 | 509 |
| Total | 121.8 | |

Including the Housing Revenue Account, plans for additional borrowing from 2012/13 to 2016/17 total over £160m.

Q – Details on measures taken to determine and keep under review prudential borrowing limits, including the processes, consideration of revenue implications and how this is undertaken;

Cardiff Council has a number of measures aimed at monitoring prudential borrowing levels, namely:

- In accordance with the prudential code of finance, the Council prepares and monitors required prudential indicators which are set at Council in parallel with the Council's Revenue and Capital budgets.
- For 2012/13 the Council has developed local affordability indicators which will be used to provide Members and officers with consideration of revenue budget affordability over the medium and long term. These indicators are prepared both gross and net of invest to save schemes and identify the level of capital charges as a percentages of the Council's controllable revenue budgets (eg excluding delegated schools, levies, capital financing budgets).
- Business cases and risk assessments on invest to save schemes are developed before schemes are allowed to proceed.
- Schemes involving significant change, complex contractual structures and significant borrowing including options appraisals around financing choices where relevant, have more robust financial and risk management monitoring with additional staff resource devoted to them by Financial Services.
- The Council carefully considers the importance of ensuring a Prudent Provision for the repayment of debt is set and monitored in parallel with additional borrowing undertaken.

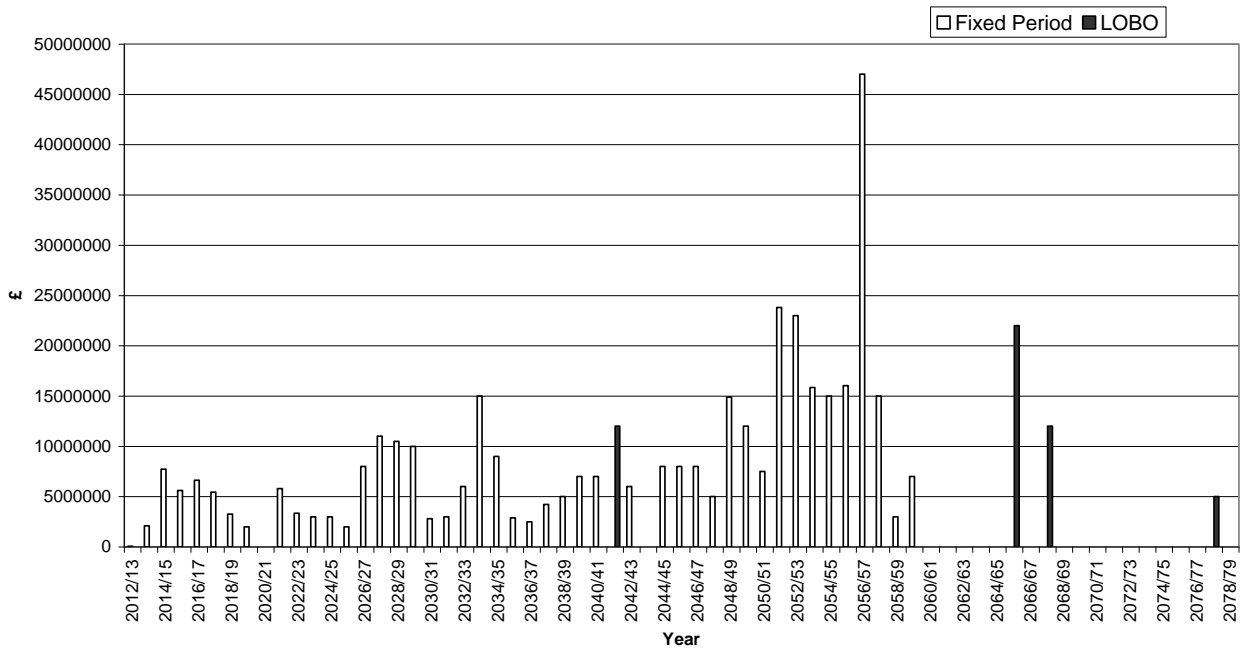
Q – Level of outstanding debt at 31 March 2011 and the implications in terms of annual repayments due in the future;

The level of External borrowing as at the 31st March 2011 is £440m. The implications in terms of repayments of interest and principal will depend on the Council's Treasury Management Strategy e.g when borrowing is undertaken, at what rates, over what periods and from whom etc.

The annual repayments in terms of servicing existing debt and capital expenditure incurred historically is the sum of interest repayments and the prudent provision for debt repayment made annually as set out in line with WG guidance. These are built into the Council's revenue budget and medium term financial plan projections.

The chart below shows when the Council's existing external borrowing is scheduled to be repaid. The Council's borrowing is at an average rate of circa 5.3%.

Maturity Profile of Debt



Q – The average cost of servicing prudential borrowing, in terms of total amount borrowed compared to total amount repaid over the lifetime of the borrowing;

Due to the short time scale further work will be need for response to this question.

It is however difficult to answer the question as the average cost of servicing prudential borrowing cannot be isolated from all other borrowing undertaken by the Council i.e. we have an integrated Treasury Management Strategy. Specific external loans are not taken out for individual projects or separately for prudential as opposed to supported borrowing, however assumptions are made about interest costs and the life of the assets created in order to ensure that the Council sets a prudent annual provision for repayment of debt and recovers interest from schemes whose business cases indicate that interest will be recoverable.

For schemes with a long life e.g 25 years, the interest cost is assumed to be the Council’s average rate of borrowing, whilst for shorter life projects, interest rates at the time of undertaking the scheme are used. Such interest costs and principal are recovered over the determined period.

Q – A brief overview of the nature of projects / purposes for which funds from prudential borrowing have been used;

Cardiff Council has used Prudential / additional borrowing in a number of ways since 2004 and also has significant plans in the medium term. There are two main areas where prudential borrowing has been used and these are shown below under the main headings of General Investment and Costs of Investment to be Recovered.

General Investment – Prudential borrowing has been used to support the Council’s overall capital programme for General investment in Capital assets. This includes, continuation of annual sums such Disabled adaptations, reducing the backlog of maintenance on infrastructure and property assets, enhancements to libraries, waste management and the many other assets used to deliver services. Significant investment has been undertaken in relation to public realm, support for Small to Medium Enterprises, and transforming the authority to meet new service delivery challenges. Prudential borrowing has also been used to bridge the gap resulting from reduced capital receipts and delays in the timing of their receipt.

Within the Housing revenue account, prudential borrowing has been undertaken to ensure the condition of the stock meets the Welsh Housing Quality Standards.

Costs of Investment to be Recovered - These are schemes where investment has been made with any costs of servicing Prudential borrowing to be repaid over time from capital receipts, revenue budget savings or other income generation. Examples include the Council’s School Organisation Plan proposals. These relate to the significant programme of capital investment which aims to reorganise school places in Cardiff thereby using resources more effectively and ensuring that schools are fit for purpose.

The Plan is designed to be self-funding and the particular projects to be undertaken are included in the Council’s Capital Programme as part of a consolidated financial model which is summarised below.

| School Organisation Plan | Funding £m | Expenditure £m |
|---------------------------------|-----------------------|---------------------------|
| Capital Investment Programme | | 176.9 |
| Capital Receipts | 12.9 | |
| Capital Grants | 61.2 | |
| Section 106 Contributions | 0.7 | |
| General Fund Capital Resources | 17.6 | |
| Direct Revenue Financing | 14.3 | |
| Additional Borrowing | 70.2 | |
| Total | 176.9 | 176.9 |

Expenditure previously approved from additional borrowing intended to be repaid from specific resources include:-

- Contribution to the Cardiff International Whitewater Centre to be repaid from revenue income.
- A repayable loan to Glamorgan County Cricket Club. As part of a financial restructuring recently agreed with all creditors of the club, the terms of the former loan have been amended to allow for a further deferment in respect of the repayment of principal and interest.
- Autism facility to provide specialist education for children in Cardiff to be repaid from savings achieved through reductions in the use of independent sector provision.
- Provision of a facility to house the Dr Who exhibition at Porth Teigr which will be recouped from visitor ticket sales.

New capital schemes to be funded in this way include:-

- Rationalisation of office accommodation to utilise savings in operating costs and property disposals in order to undertake significant investment in existing buildings to remove the maintenance backlog.
- The Council's contribution of the development of an ICC as part of Phase 2 of the Central Business District to be repaid from sums identified in the Medium Term Financial Plan over the next few years.
- Implementation of the Local Authority Mortgage scheme, to be repaid from eventual repayment of initial amount invested.
- Further energy initiatives in relation to wind, solar photovoltaic and replacement of inefficient boilers.
- Investment in Schools ICT to be repaid from amounts identified within schools revenue budgets. This will cover internal infrastructure, cabling and increased bandwidth and wireless connectivity to enhance the virtual learning environment.
- Investment in development of new affordable housing.

Q – Any lessons learned or concerns would wish to highlight in relation to prudential borrowing;

- Determining long term affordability is difficult, particularly when resources for revenue budgets are uncertain and based on short term allocations.
- As identified earlier the Council has developed local affordability indicators which will be used to provide Members and officers with consideration of revenue budget affordability over the medium and long term. These indicators

are prepared both gross and net of invest to save schemes and identify the level of capital charges as a percentages of the Council's controllable revenue budgets (eg excluding delegated schools, levies, capital financing budgets). In doing so they seek to clearly identify that as capital financing costs increase a Council's flexibility when making decisions around its remaining revenue resources reduces.

- Capital programme planning is difficult given the short term nature of capital allocations particularly in respect of grants receivable from external bodies.
- Ensuring any additional support provided by external bodies to support borrowing is additional to that which local authorities would normally have received i.e demonstrate additionality.
- The scope in the Council's revenue budget for further additional borrowing is limited without further increases in Council tax or without the impact being felt on non-protected services, which many residents regard as essential services.
- Need to ensure that the monitoring of schemes outcomes, financial position and risks continue after initial scheme implementation. The costs of servicing debt will need to be repaid, irrespective of whether a scheme makes the savings, income originally anticipated.

Q – A brief overview of any alternative mechanisms the authority may be considering to finance capital investment in the future

As well as the usual means of seeking to use revenue savings, or income generation as a means to pay for borrowing, the Councils land and property are used to stimulate investment where possible. Other areas include :-

- Working with the private sector to lever in additional investment and share risk for schemes likely to benefit the City and Region.
- Use of Community Infrastructure Levy in future years.
- The Council is keen to be able to use Tax Increment Financing particularly in relation to major infrastructure projects across the city.
- Looking at how bonds can be used to deliver infrastructure and social projects, and how this can be done in collaboration with other service providers and local authorities in Wales. In particular, undertaken further analysis of the work undertaken to date by the Local Government Association to support Local Authorities to raise capital finance through issuing bonds.

Q – Any views on potential implications on local authorities of the Welsh Government’s stated intention to maximising local authorities borrowing power to boost capital available for infrastructure (as detailed in this statement)

The ability of the Council to undertake further additional borrowing is restricted by revenue budget affordability. There are significant needs for investment in Infrastructure assets that can improve service delivery both locally and regionally, as well as result in economic development. The Council welcomes such support but it is essential that this support is additional to that which councils are to receive over the long term, since if resources are reduced elsewhere to pay for this support the borrowing costs will not be affordable.

What we cannot do is risk elements of our revenue support for the future repayment of investment. It is essential that if we are to increase levels of borrowing that associated finance or ability to share risk is provided – be it through the ability to retain income, uplift, or savings from any investment, or through the ability of external bodies to underwrite debt.

It is also important that we can get value for money when borrowing, and this does not always mean relying on the Public Works Loan Board. If we are able to use alternative sources that could provide more appropriate finance this may be beneficial.

Thank you again for giving us the opportunity to respond. Should you require further information, or would like to speak with officers please feel free to contact me.

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