

Jane Hutt AC / AM
Y Gweinidog Cyllid ac Arweinydd y Ty
Minister for Finance and Leader of the House



Llywodraeth Cymru
Welsh Government

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Jocelyn Davies AM
Chair
Finance Committee
National Assembly for Wales
Cardiff Bay
Cardiff
CF99 1NA

30th May 2012

Dear Jocelyn,

Thank you for the opportunity to give evidence to the Committee on its Inquiry into devolved funding, and for your letter of 17 May in which you asked a number of important additional questions. I hope that my answers, both in committee and below, provide a helpful contribution to the Committee's work.

Instruments of Debt

- 1. If the Welsh Government were given the power to issue bonds, what control mechanisms would you, as Minister, wish to see put in place?***
- 2. What control mechanisms would you anticipate that the Treasury might wish to see put in place?***

We would want a system that gave Welsh Ministers the flexibility to manage a capital programme in the most appropriate manner, which also ensured that the UK Government was able to manage the macroeconomic position. In one of your questions during the hearing you alluded to the situation in Spain, where the borrowing of autonomous regions had a detrimental impact on the management of national fiscal policy. That is a situation we would steadfastly wish to avoid.

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CF99 1NA

*Wedi'i argraffu ar bapur wedi'i ailgylchu (100%)
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Correspondence.Jane.Hutt@wales.gsi.gov.uk
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The precise way in which the balance of powers would be achieved needs to be negotiated by the two Governments. It is too soon to speculate about exactly what the outcome might be. However, it is clear that there would need to be jointly-agreed constraint on our overall borrowing.

The basis for determining what that constraint, or limit, should be, and the mechanisms for reviewing it over time, would also have to be agreed by the two Governments. Since we fully respect the UK's legitimate role to determine and oversee the national fiscal framework, we see no reason why we should not be able to agree a mutually acceptable set of rules that devolved the power to borrow, including to issue bonds, to the Welsh Government.

Assessment of investment need

3. What are the current processes in place within the Welsh Government, when planning infrastructure investment, to establish 'investment need'?

4. Would you envisage any changes to these processes if the Welsh Government were to be granted borrowing powers?

The Committee has suggested that I would be bringing "an infrastructure plan to the Assembly and asking permission to potentially undertake a particular level of borrowing." I do not think this is an accurate reflection of how the Welsh Government would determine its borrowing. Borrowing would comprise a part of the budget, which would continue to be proposed by Welsh Government Ministers, and put to a vote in the Assembly in the normal way.

There are robust mechanisms in place that provide for Government-wide consultation to help inform Ministers' decisions when selecting and delivering key strategic infrastructure within departmental portfolios.

As I announced when I publicised the WIIP on 22 May, we will be supplementing existing processes and building on previous mechanisms by strengthening cross-departmental procedures, including more rigorous, consistent evaluation and ranking of investment options. We are also establishing a new Committee on Strategic Investment to support Ministerial decisions. These new procedures will be used to inform decisions on allocating around £250 million of capital reserves available in 2013-14 and 2014-15, details of which will be set out in the autumn. The Committee

on Strategic Investment will also play a key role in advising Ministers on the development of new innovative funding mechanisms, and would help advise on borrowing in the future.

Wales Infrastructure Investment Plan

5. How was the figure of £1bn arrived at?

6. Is the £1bn in addition to 'traditional' capital budgets?

7. Over what timescale is the £1bn expected to be generated?

On pages 11 to 13 of my evidence paper, I set out a list of innovate finance initiatives, concluding that "these innovative financial vehicles will generate more than £1bn of capital investment in Wales."

The figure of £1bn is therefore the approximate aggregate total of capital investment to be generated by those projects. Details are set out in the table below, including Welsh Government capital contributions to these initiatives and timescales. This shows that the £1 billion is additional to traditional capital budgets.

PROJECT	TOTAL CAPITAL VALUE (£m)	INVESTMENT PROFILE AND WELSH GOVERNMENT CAPITAL CONTRIBUTION
Local Government Borrowing Initiative	170	<ul style="list-style-type: none"> To 2015
JEREMIE*	150	<ul style="list-style-type: none"> To 2014 Includes £60m WG capital
SME Investment Fund*	40	<ul style="list-style-type: none"> To 2016 Includes an expected £20m WG capital
Ely Bridge Development Company~	62	<ul style="list-style-type: none"> To 2018 Includes £6m WG capital in the form of a loan
Welsh Housing Partnership	46	<ul style="list-style-type: none"> WHP will initially invest over a 10-year period Includes £9m WG capital
Welsh Housing Bond	100	<ul style="list-style-type: none"> To 2016
Waste Infrastructure Programme	758	<ul style="list-style-type: none"> To 2020 Includes £14.25 WG capital
TOTAL	1,326	

* Figures refer to fund capitalisation.

~This figure is based on an early project proposal. Detailed financial appraisal is ongoing and should be completed before the summer.

8. *Has any work been done to estimate the level of savings, if any, which could result from these mechanisms?*

Each mechanism has a different objective, from supporting businesses, through building roads, to providing housing. Each mechanism must be supported by a convincing value for money assessment. For example, benefits for the public sector from our waste infrastructure programme are expected to be substantial. The actual cash saving on our first two Anaerobic Digestion contracts to be awarded is expected to be £1.9 million.

9. *Aside from those covered in the evidence session, which other innovative financial vehicles are being considered for use in Wales?*

In the current economic climate, there is a strong economic and value for money case for boosting the resources we have available for infrastructure investment over and above the level of our capital DEL. First, because of the huge cuts in our capital budget imposed by the UK Government. Second, because of the need for investment to boost jobs and growth in both the short and the long term. Third, because of the economic and other benefits of bringing forward much needed infrastructure projects which would otherwise be delayed by many years, or possibly not happen at all. And fourth, because of the relatively low cost of borrowing that currently prevails.

With each of those factors in mind, we remain committed to working with local government and other partners, such as Registered Social Landlords, to use their borrowing capacity to increase investment in priority infrastructure. In addition, we are actively developing vehicles which use public assets to boost investment, such as the Ely Bridge development. As set out in our Programme for Government, we are considering the full range of potential funding partners – both public and private – and a wide range of instruments and delivery mechanisms, including development of non-dividend vehicles. We aim to complete this work in the autumn.

10. *Are there any lessons to be learned from the development or application of specific funding models in Scotland which could be applied in Wales?*

I have been extremely interested in the work of the Scottish Futures Trust (SFT), and its non profit distributing (NPD) model of investment. As I set out above in answer to question 9, my officials are considering the development of non-dividend vehicles that might be appropriate in our specific circumstances. This work will be completed in the autumn.

Capital Finance Investment Sub-Group

11. Could you provide an update on the work of the Capital Finance Investment Sub-Group in relation to all six of its work strands, but particularly those which relate to alternative funding?

The Capital Finance Investment Sub-Group has met on various occasions to consider papers and advise on the issues raised across the six work strands. In particular it has discussed papers on the development of the Local Government Borrowing Initiative, the Wales Infrastructure Investment Plan, revisions to General Capital Funding Formula and the 21st Century Schools Programme.

12. What involvement did the Sub-Group have, and what account was taken of its work and views, in the development of the Wales Infrastructure Investment Plan?

The Capital Finance Investment Sub-Group received presentations on the development of the Wales Infrastructure Investment Plan at its meetings in September 2011, and in February and March 2012. The Wales Infrastructure Investment Plan was also discussed at the Welsh Local Government Society of Welsh Treasurers meeting on 27 April.

Housing

13. In your paper you mentioned the Welsh Housing Partnership, which has a capital value of £16mn to purchase 150 properties. Do you have any plans to expand this further?

When I published the Wales Infrastructure and Investment Plan (WIIP) on 22 May, I announced my intention to recapitalise the WHP by providing an additional £6 million

of support in 2012-13, which will lever in an additional £24 million from RSLs and private partners. This new investment should deliver around 280 new affordable homes.

14. Could you provide more details about the particular funding model in use for the Ely Bridge Development Company?

EBDC is a social enterprise created by the Welsh Government and the Principality Building Society. It will lead a new venture using an innovative investment model to unlock capital funding to build much-needed housing. EBDC will deliver around 700 homes of mixed tenure, residential accommodation over 5 to 6 years, comprising 100 social rental units, 300 intermediate market units and 300 open market units.

The initiative is based an innovative financial model, which is in part dependent upon the volume of rental income from the non open market homes. This revenue stream will be necessary to attract investment. However, in traditional social and intermediate housing models, rental income alone is insufficient to finance investment. That is why the Welsh Government would typically support the provision of social (and intermediate) housing with a non repayable capital grant.

In the case of the EBDC, the Welsh Government is not providing any grant support. Rather, it is providing a £6 million loan to the EBDC, which will be repaid on a deferred basis after 5 years with interest, and the Ely Mill site. The latter has been sold to EBDC at the open market value, which will be paid on a deferred basis after 5 years with interest payments accrued on an annual basis.

15. You also mentioned in your paper “a number of other innovative approaches in the housing sector that use public sector assets to attract private investment”. Would you provide the Committee with more details of the approaches and the particular funding models being considered?

On page 12 of my evidence paper I referred you to the Ely Mill initiative. In the medium term, we will want to see whether we can replicate that model elsewhere. Officials are now considering whether that might be possible.

In respect of the more immediate future, however, I announced on 22 May a number of initiatives that we have launched to support the objectives of both the WIIP and the White Paper on housing that the Minister for Housing, Regeneration and Heritage published on 21 May. These initiatives include an additional £5 million for the recyclable empty homes fund, which increases our investment in the fund by 100%, and which will contribute to our target of bringing 5000 empty homes back into use during this Government's mandate.

In addition to the new public and private capital injection of £30 million for the WHP referred to above, a number of other initiatives will see the public and private sectors work together in support of our housing objectives. The establishment of a Welsh mortgage indemnity scheme, in partnership with builders and lenders, will increase the supply of affordable homes and increase access to home ownership. Furthermore, a Welsh Housing Bond will see us commit £4 million a year of funding for 30 years to support a Bond issue to Welsh RSLs of over £100m. This new source of funding will finance the delivery of more than 1000 affordable homes over the next 4 years.

Local Government Borrowing Initiative

I set out the position in my letter to the Committee of 14 November 2011. As I said then, the Local Government borrowing can be split into two categories: borrowing supported by Central Government (or supported borrowing); and self-financed borrowing (or unsupported borrowing).

Treasury rules on the budgetary implications of local authority borrowing are set out in Chapter 9 of the Consolidated Budgeting Guidance 2011-12. Supported Capital Expenditure (Revenue) (SCE(R)) is the term used in this guidance for the amount of borrowing which Central Government is prepared to support. A stream of current support to cover Local Authority borrowing to this level is provided as non-ring fenced revenue as part of the Revenue Support Grant and DEL budgets score the capital value of SCE(R), i.e. the amount borrowed. Supported Capital Expenditure by Local Authorities in Wales in 2011-12, funded through General Capital Funding budget lines in the Welsh Government DEL, was around £120m.

Self-financed borrowing by Local Authorities under the prudential borrowing regime that is not supported by Central Government does not score in DEL budgets but scores in Local Authority Self-Financed AME, which is not part of the Welsh Government budget. In 2011-12, Local Authorities in Wales estimate that self-financed borrowing was around £250m.

The LGBI has been established in such a way that it is categorised as self-financed borrowing. The Welsh Government is providing additional revenue funding to assist local authorities in meeting mounting revenue pressures, allowing them to free up resources for self-financed borrowing up to an expected aggregate total of approximately £170 million, exclusively for capital highway improvement investment during the 3-year period 2012- 2015. Revenue funding will be made available over a 22 year period (£4 million in 2012-13, £8 million in 2013-14, £12 million from 2014-15 to 2031-32, £8 million in 2032-33 and £4 million in 2033-34). The funding is distributed via the Road Maintenance Standard Spending Assessment formula.

Best wishes,

Jane

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