WRITTEN EVIDENCE TO THE FINANCE COMMITTEE ON WELSH GOVERNMENT CAPITAL FUNDING SOURCES

Introduction

1. The purpose of this paper is to provide written evidence to the Committee on Welsh Government capital funding sources.

2. The UK Government's austerity programme has resulted in less to spend on infrastructure investment in Wales since 2010-11. Despite this, ensuring we maximise the use of all funding sources available has been and continues to be of paramount importance to achieve our ambitions for Wales.

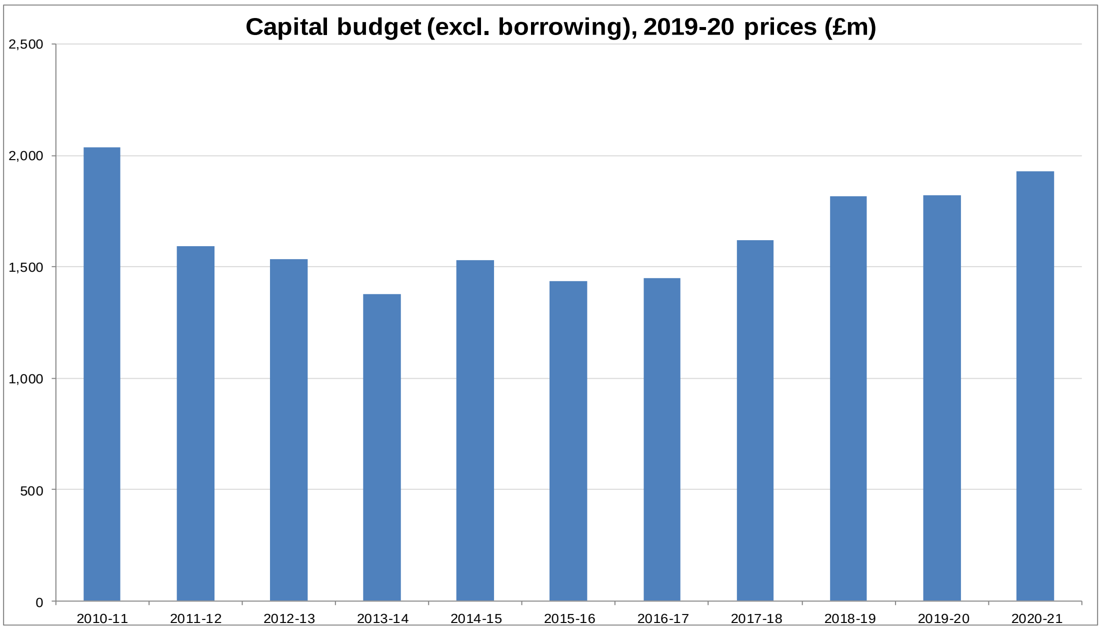
3. As set out in *Prosperity for All: the national strategy* the way we plan our capital investment decisions can have a big impact on the economy, help different organisations to deliver their services in a single place and minimise the individual's need to travel.

4. Guided by the Wales Infrastructure Investment Plan (WIIP) we published in 2012, high quality, modern infrastructure is a key enabler of competitiveness and productivity. Investment can act as a catalyst for wider regeneration and supporting vibrant communities. This investment needs to be intelligently planned and well delivered to have maximum impact.

UK Government Capital DEL funding

5. The main funding source available to the Welsh Government is the annual capital budget received from HMT. On a like for like basis over the last decade our capital budget has been cut by 10% in real terms as a result of the UK Conservative Government's relentless pursuit of austerity. In 2019-20, this means we will have £200m less to spend than we did in 2010-11, but our plans and demand for capital investment in Wales have continued to grow.

Welsh Government Capital Budget since 2010-11



6. It is against this backdrop that the Welsh Government has looked to make full use of all sources of capital funding available, and develop new and innovative sources of funding, including the Welsh Mutual Investment Model.

7. In 2019-20, funding available for capital investment, including borrowing, stands at just under £2.3bn. While we have firm figures for our capital budget to 2020-21, until we know the outcome the UK Government's next Spending Review, we can only estimate the budget for subsequent years, based on the OBR's economic and fiscal forecasts.

Capital DEL - Financial Transactions

8. A growing proportion (currently 15%) of our capital DEL is in the form of Financial Transactions. A key limitation of this funding source is that 80% is repayable to HMT. We also can only use it to make loans or equity investments and only to third parties where lending would not score against public sector net borrowing. This means that we cannot use Financial Transactions to finance the Welsh Government's own capital expenditure, grants, the NHS or Local Authorities.

9. The restrictions placed on this source of funding continue to constrain our freedom to invest in what we otherwise might have wanted to prioritise for investment. Whilst we do not welcome the UK Government's decision to place these restrictions on our capital budget, we are committed to using every pound available to invest in infrastructure and boost economic growth in the long-term. Through significant additional activity we are maximising the opportunities this funding source presents. We are investing in schemes such as Help to Buy Wales and creating various new innovative business and development schemes, many of which are strengthening the support and service we provide to the economy across Wales via the Development Bank of Wales.

Drawing on other funding streams

10. We are continually exploring opportunities to access other funding sources to support our infrastructure ambitions. For example:

UK City Deals

Significant additional UK Government resources (£736m) have been secured, or are in the process of being secured, as a result of successful bids to ensure Wales benefits from the UK Government's city and growth deals policy.

The Cardiff Capital Region City Deal has created an investment fund of £1.2bn over a 20-year period for the region, which covers 10 local authorities in South East Wales. Over its lifetime, it is anticipated that the city deal will deliver up to 25,000 new jobs and will attract an additional £4bn of private sector investment.

The £1.3bn Swansea Bay City Region Deal was the second deal to be signed in Wales which, over 15 years, aims to boost the local economy by £1.8bn and generate almost 10,000 new jobs.

The UK Government has also made a commitment to provide £120m for a North Wales Growth Deal with discussions also ongoing with UK Government, lead local authorities and regional stakeholders in mid Wales to explore how a Mid Wales Growth Deal might transform the economy in region.

European Investment Bank

11. In the Government's White Paper, Securing Wales' Future, we argued that the UK should remain a subscribing partner of the European Investment Bank (EIB). The EIB brings direct benefits to our economy as well as improving economic capacity elsewhere, thus helping the global trading environment which we support. Last February the House of Lords adopted a report where it noted that the UK's infrastructure had been the beneficiary of more than €118 billion of lending from the EIB. It noted the marked decline in funding from the EIB since the referendum and triggering of Article 50; and lamented the fact that despite our losing access to the EIB after Brexit, the Conservative Government had said little about any future relationship with the EIB or possible domestic alternatives.

12. I would prefer the UK to remain a subscribing partner in the Bank. The UK Government, in contrast, has failed to set out any meaningful proposals on a future relationship with the EIB, or domestic alternatives. As an absolute minimum, we will continue to argue that a mandate should be in place for continued EIB lending in the UK after we withdraw from the EU. . Officials have advanced these policies as part of the UK Government's Infrastructure Finance Review; and I have also nominated an independent expert to the panel conducting the review.

European Funding

13. Wales is a major beneficiary of EU funding and current Structural Fund programmes are worth £2bn[1], driving a total investment of nearly £3.2bn over the 2014–2020 funding period.

14. European Structural Funds are the main EU instrument for tackling significant economic, social and territorial disparities across Europe and supporting investment in jobs and growth. Within these, the main source of capital investment comes from the £1bn European Regional Development Fund (ERDF). The current ERDF programmes support investments in four priorities: Research and Innovation, Business Competitiveness, Renewable Energy and Energy Efficiency and Connectivity (transport and sustainable urban development).

[1] Exchange rate of €1.17/£1

15. Under the Connectivity priority the Wales European Funding Office (WEFO) has approved ERDF of some £91m towards road improvements involving the A55 in North and the A40 in South Wales; over £182m on public transport (including some £165m on the South Wales Metro); over £55m on high speed broadband; and over £142m on regionally prioritised infrastructure supporting a regional or urban economic strategy.

16. Of the total structural fund project investment to date, £1.34bn (40%) is supporting individuals, £981m (29%) is helping businesses, £117m (4%) the environment, £839m (25%) strategic infrastructure, and £69m (2%) technical assistance.

17. WEFO's ERDF programmes for the 2014-2020 Structural Fund Programmes are currently 91% committed.

18. The Welsh Government published a policy paper in December 2017 setting out our approach to developing a regional investment policy after the UK leaves the EU. We believe the baseline of the UK block grant payment for Wales must be readjusted at the point of exit from the EU to reflect the real loss of funds in Wales arising from Brexit and taking into account funding which Wales would have otherwise reasonably expected from EU sources. Additionally, any replacement system must respect the devolution settlement, ensuring that regional investment decisions continue to be made in Wales, reflecting our unique policy and legislative landscape.

Government loans (including borrowing limits)

19. The Wales Act 2014 provided the Welsh Government with powers to borrow over the long-term for capital investment. Initially, the Welsh Government could borrow up to £125m per year from 2018-19 within an overall cap of £500m. These limits were increased to £150m per year and £1bn overall as part of the fiscal framework agreement with the UK Government, alongside the introduction of Welsh Rates of Income Tax from 2019-20.

20. The Welsh Government can borrow from the National Loans Fund (via the Secretary of State for Wales) or through a commercial loan (directly from a bank or other lender).

21. Capital borrowing helps us manage our resources in a more efficient way and deliver our infrastructure goals – working alongside our existing capital budget and our innovative funding schemes. However, capital borrowing is not additional money and must be repaid. We have carefully considered how we use these powers, taking a strategic view of Welsh priorities.

22. Interest is payable on any loans taken by the Welsh Government at the rate available at the time the loan is drawn. Repayments of the loan principal are financed by tax receipts into the Welsh Consolidated Fund; repayments of loan interest are a cost to the Welsh Government and financed by revenue funding provided through the block grant.

Repayments of loan principal and interest reduce the level of resources available to spend over the period of repayment.

Bonds

23. On 1st December 2018 the Welsh Government gained new powers to issue redeemable bonds to help fund capital infrastructure projects. At a time when our capital budgets are continuing to fall, these additional powers provide us with the full suite of borrowing levers so we can continue to invest in our ambitious infrastructure plans for Wales.

24. The ability to issue bonds does not increase our ability to borrow. Any funds raised by a Welsh Government bond (or a bond attributed to a wholly owned subsidiary, such as Transport for Wales) would be counted against our borrowing limit. The bonds – in common with other forms of borrowing – must be repaid with interest and will have an impact on the revenue available to the Welsh Government to fund day-to-day public services.

25. At present we have no plans to use this power as the Welsh Government is able to borrow via the National Loans Fund, which, in general, would involve lower interest rates than a Welsh Government bond would attract. However, the power to issue bonds remains important as it means there is another way in which the Welsh Government can borrow money in the event that the UK Government decided to increase our cost of borrowing. Should a future Welsh Government decide to issue Welsh bonds, consideration would need to be given to the mechanisms and processes required to manage them effectively.

Borrowing powers of Welsh Government bodies

26. As most Welsh Government bodies are mainly funded directly by the Welsh Government, borrowing by those bodies is tightly controlled and only allowed in exceptional circumstances. Any borrowing undertaken by Welsh Government bodies within the central government budget boundary will score against the capital resources available to the Welsh Government and included within the Welsh Government's overall borrowing limit as set out above.

Borrowing powers of local authorities (LAs)

27. Although not a Welsh Government body, since 1st April 2004 LAs in Wales have been able to borrow without Government consent when carrying out their duties under Part 1 of the Local Government Act 2003, but are required by the, '*Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003',* to have regard to the Prudential Code published by the Chartered Institute of Public Finance and Accountancy. Section 3 of the Local Government Act 2003 also imposes a duty for LAs to determine, and keep under review, the amount they can afford to borrow; and Empowers the Welsh Ministers

to define that duty in more detail in regulations, which may require LAs to have regard to specific codes of practice.

28. LAs borrow from a number of sources, including other LAs, the Public Works Loan Board (PWLB) and commercial banks. The majority of debt is however with other authorities or the PWLB, where the best rates can be achieved. In addition, each authority will have its own Treasury Management policy and acceptable risk profile. As per the Whole of Government accounts for 2017-18 the total debt in LAs PWLB, bank & other borrowing (excluding overdrafts) is £5.4bn.

29. Local authorities enter into long-term borrowing to finance large-scale investment in a range of projects such as building schools and acquiring equipment to deliver services. It has been used extensively by authorities to accelerate school investment programmes; to fund roads resurfacing; one-off infrastructure projects (e.g. bridge refurbishments) and also generically to support across the board capital programmes where these is a funding gap.

30. The main caveats of undertaking borrowing are that the authority must use its own professional judgements to determine that the funding raised is "Sustainable, Affordable and Prudent" taking into account the authorities overall financial position.

Mutual Investment Model

31. We are committed to delivering three schemes using this form of innovative funding – completing the dualling of the A465; additional investment in the next phase of the 21st Century Schools and Education programme; and the new Velindre cancer centre.

32. Together these schemes have a capital value of more than £1bn, and would not be affordable from our current, denuded capital budgets. Had we not developed the model, projects such as these would have to wait in line until enough capital became available.

33. From the outset, our intention has always been to ensure that the Mutual Investment Model promotes the public interest in the widest possible definition of that term. To that end, the model will deliver positive, additional outcomes in relation to wellbeing, value for money, and transparency; and in so doing will avoid many of the criticisms levied at historic forms of public-private partnership – in some cases, criticisms that the Welsh Government was among the first to raise.

34. The MIM will only be used to finance projects or programmes with a sufficient capital scale that will both attract the interest of funders and constitute value for money for the taxpayer.

35. We will require all MIM schemes to be subject to the rigorous investment appraisal of the *Five Case Model* – an internationally accredited appraisal tool, co-owned by the Welsh Government. The G20 Finance Ministers have adopted the model's principles as the basis for a global standard for infrastructure investment appraisal. We

have also developed a new project assurance tool that all MIM schemes will be subject to – Commercial Approval Point checks.

36. To increase the value for money of our schemes, we have taken a conscious decision not to use the Mutual Investment Model to finance soft services, such as cleaning and catering, which was one of major criticisms of previous PFI contracts. Nor will it be used to finance capital equipment. The Government will invest a small amount of risk capital in each scheme, ensuring that the public sector participates in any return on investment.

37. Following the recognition of United Nations Economic Commission for Europe (UNECE) that the MIM constitutes a People First model of Public Private Partnership, in June the Scottish Government announced that it would adopt the MIM to support its own infrastructure priorities. In doing so, it noted that the value for money and additionality benefits of the model developed in Wales.

Capital receipts

38. Land and property assets are predominantly held by Welsh Ministers for operational / policy requirements. That covers a wide range of activities including administration, transport infrastructure together with support for housing and business. However, while the portfolio is not generally one held with a view to generating a cash return we do recognise the important part it can play in maximising the overall return to the people of Wales.

39. Following the National Assembly for Wales Finance Committee review into asset management in the public sector our corporate governance has moved forward and included the creation of a corporate asset management strategy and departmental asset management plans. Income from property can be broadly categorised under 3 headings (below) and any sums received are recycled to support further policy work within the departments responsible for the asset.

Sales

Assets no longer required to support business and not needed by the wider public sector in Wales (surplus) are sold usually through open marketing. We follow published guidance (both internal and HM Treasury) in order to maximise a return which can sometimes require modest investment in the asset to boost its potential.

Some assets are sold in direct support of a particular policy objective. By example assets previously held by the Land Authority for Wales and the former Welsh Development Agency (WDA) are sold so as to maximise the support they can give to business development or facilitate affordable housing. However, we are still guided by the principles which require a disposal to show overall value for money.

Lettings

To maximise the use of our office space, agreements are in place whereby other public sector bodies occupy accommodation within our buildings. In accordance with best practice this is on a cost recovery basis. There are groups of property which are held temporarily while awaiting operational use. This would include land and buildings we were required to purchase under planning blight legislation in advance of highway works. Until the scheme is ready to proceed, the asset is let (on market terms) which provides an income but equally an occupier ensures the property is secure. To strengthen business development and employment activity some (predominantly) industrial units are held to fill gaps in the property market. Units are let subject to Independent verification of the terms offered.

Clawback / Overage

Some assets have been sold / transferred subject to conditions in our favour that may generate further receipts in the future. Typically improvements in value by changes in use or valuable planning changes would trigger additional payments.

Welsh Government approach to use of capital funding sources

40. The reduction in our capital budget means we need to continue to develop new and innovative ways to fill the capital gap and maximise the use of our existing capital funding sources. The principle which underpins the use of capital in Wales is that we will always exhaust the use of the least expensive forms of capital before moving on to using other sources.

41. We will always use conventional capital, including financial transactions capital first, ensuring we use every penny available to Wales, to fund our infrastructure commitments. The second source of capital funding that we are able to access is the European funds which come to Wales – for example, we are currently working on the basis of a £159m contribution from the European Regional Development Fund (ERDF) to deliver the South Wales Metro as part of the Cardiff Capital Region City Deal.

42. We then use the new borrowing powers which we have secured in Wales – our budget takes account of the capital borrowing available to us over this budget period to 2020-21 to fund our infrastructure programme.

43. Our next source of capital is to support borrowing in other public bodies, including local authorities and housing associations – we will use these sources to help deliver our target of 20,000 affordable homes over this Assembly term.

44. Our final source of capital funding is innovative finance, including the Mutual Investment Model, which has been developed in Wales and which will be used to deliver a further £1bn programme of work, including the new Velindre Cancer Centre, a significant part of Band B of the 21st Century Schools and Education programme and sections 5 and 6 of the Heads of the Valleys road.

Conclusion

45. It is more important than ever that we maximise all the levers available to us to boost capital funding and prioritise our investment in ways that deliver the most benefit in line with our priorities. Ensuring we identify and effectively utilise all capital funding sources available therefore continues to be a Welsh Government primary objective to enable our critical role in delivering major infrastructure projects across Wales.

46. As a direct result of what we have achieved since the WIIP was published in 2012, we have made capital allocations totalling over **£15bn,** been instrumental in enabling significant additional investment to be generated from borrowing, and created the right conditions to attract crucial private sector investment. There is much still to do so we will continue to seek and maximise the use of all funding sources available and engage with key stakeholders to facilitate the most effective future investment, ensuring we make the most of financing opportunities.

Minister for Finance and Trefnydd