Dear Simon,

At the Committee session on the First Supplementary Budget I promised to provide further information on two issues raised by Members.

As I outlined at the Committee, this budget allocated £20 million of our revenue reserves to support Social Services, with £8 million being added to the budget of Social Care Wales. The Supplementary Budget also contains a number of transfers within the MEG and between the various Social Services Actions. Following a review of budgets, and as a number of budget lines were not fully committed, balances were transferred within the Health budget. An additional £1 million was transferred within Social Services to further increase the Social Care Wales Action; and £2 million transferred to the Delivery of Targeted NHS Services Action.

I am attaching a separate note of the main classification issues we considered when developing the Mutual Invest Model.

I hope you and the Committee finds these details useful.

Yours sincerely

Mark Drakeford AM/AC
Ysgrifennydd y Cabinet dros Gyllid a Llywodraeth Leol
Cabinet Secretary for Finance and Local Government

21 July 2017
Mutual Investment Model (MIM)

The NPD model

1. When the previous Welsh Government decided to use a PPP model to finance investment in the Velindre cancer centre, completing dualling of the A465 and in the next phase of the 21st century schools programme, the intention had been to use the Non-profit Distributing (NPD) model developed in Scotland. The NPD model sought to alleviate concerns about the private financing of public infrastructure through both the exercise of public control over the private partner (Project Co), and the capping of earnings on equity invested in Project Co.

2. However, the control and profit capping provisions of NPD proved not to be viable following a series of classification decisions taken by statisticians at the Office of National Statistics (ONS), backed by Eurostat.

3. How PPPs are classified is a consequence of decisions taken by the ONS based on the relevant EU legislation: the European System of Accounts 2010 (ESA2010). Where a PPP is classified to the private sector, its debt does not impact on the budget of the public sector authority with which it is contracting. However, where a PPP is classified to the public sector under these rules, its debt is considered on balance sheet for the relevant public authority and as such, under the UK’s budgeting rules¹, the full value of the scheme scores against the Government’s capital budget.

4. In July 2015, the ONS classified an NPD scheme – the Aberdeen Western Peripheral Route (AWPR) scheme – to the public sector. Other NPD schemes followed, with the result that the Scottish Government has had to provide around £1 billion of capital budget cover for these schemes. The ONS decision found that the controls exercised by the Scottish Government were such that the ostensibly private partner delivering the scheme must, for budgetary purposes, be considered public, with its debt scoring against the Government’s capital budget. The analysis also found that the capping of equity earnings too was an exercise of government control over the private partner, incompatible with a private sector classification.

5. The reasoning behind these decisions was codified in March 2016 with the publication of the revised Manual on Government Deficit and Debt (MGDD) – the ESA2010 guidance document published by Eurostat, which now rules out explicitly a number of the control provisions that had featured prominently in NPD².

6. Bearing these developments in mind, the Welsh Government has developed a new model – the Mutual Investment Model (MIM) – which is intended to maximise benefits to the public sector while ensuring the private sector classification of MIM schemes. To achieve this, a number of significant revisions were made to the NPD model, while seeking to retain the core elements of NPD, such as risk transfer and availability payments, which promote the public good and are not problematic from a classification perspective.


Public Interest Directors – exercising influence (but not control)

7. The NPD model foresaw a Public Interest Director (PID) appointed by the Government (but not employed by the Government) on the board of PPP Project Companies (Project Co). The PID was entrusted with veto powers exercised through a golden share.

8. In the MIM, the public sector will retain the right to appoint a PID. While the PID, will not exercise veto powers over the operational decisions of Project Co (which would lead to public classification of the PPP), he or she will be empowered through unrestricted access to information, secured through transparency obligations.

The Capital Structure – sharing (but not capping) profits

9. NPD deals did not include dividend-bearing equity. Equity was replaced with fixed priced debt – hence the model's being known as non-profit distributing. Any earnings above the fixed price cap – for example, arising from efficiencies in operation of the asset (such as lower than forecast maintenance costs or refinancing gains) – were expected to return to the public sector in the form of surpluses.

10. In the MIM, equity will play a role in the overall financing, given that the NPD capital structure described above results in public sector classification. However, the public sector will be able to exercise an option to share in the earnings of a PPP by taking up to 20 percent of this equity. This would create a flow of dividends back to the public sector, in place of surpluses.

ONS and Eurostat consideration of the MIM

11. Development of the MIM was informed by ongoing classification discussions (around MGDD 2016) in the European Investment Bank-Eurostat working group, in which Welsh Government officials were heavily involved. Content, in light of these discussions, that the MIM met the requirements of MGDD 2016 for private sector classification, the Welsh Government made a request to the ONS for an indicative classification decision in October 2016. In so doing, the Welsh Government provided the ONS with standard form contracts for roads and accommodation projects (each around 500 pages in length), a standardised shareholders’ agreement, and a MIM user guide. This suite of documents was subsequently presented to the ONS before the latter's deliberations began in earnest.

12. A response from the ONS, confirming that the MIM would in principle provide for private sector classification, was received in December 2016. However, it is important to bear in mind the ONS will have an interest in the classification of specific MIM schemes, as the standardised MIM documents are customised for specific projects. Particular care will be needed at this time to ensure that changes are not made that inadvertently give rise to classification concerns. In addition, Eurostat will continue to monitor the development of innovative models such as the MIM.