Northern Ireland Assembly

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European Investment Bank: Financial Assistance for UK Local Government

This paper supplements RaISe briefing NIAR 219-14 (dated 1 May 2014) for the Committee for Finance and Personnel (the Committee). It is provided in response to the Committee's request for further information about European Investment Bank (EIB) loans to local government in the United Kingdom. The paper also provides information that is relevant to the Committee's consideration of the Department of Finance and Personnel's view about the use of EIB loans by Executive departments in Northern Ireland.

Introduction

This briefing paper is prepared for the Committee for Finance and Personnel (the Committee). It supplements an earlier RaISe briefing on the European Investment Bank (NIAR 219-14, dated 1 May 2014). The Committee sought further information about key financial assistance opportunities to support local government infrastructure investment throughout the United Kingdom (UK) *via* the European Investment Bank (EIB). In addition, the Committee sought information on the Department of Finance and Personnel (DFP) view that Northern Ireland (NI) Executive departments cannot access EIB funding directly because it would score as Government borrowing, which under the prevailing financial framework of the current devolution arrangements would trigger a reduction by Her Majesty's Treasury (Treasury) for the same amount in NI's Capital Departmental Expenditure Limit (DEL) budget.[1]

The funding opportunities that the Committee seeks to further understand are defined by borrowing powers proscribed under prevailing legislation, as well as rules and practices of the Treasury, the UK Government and the devolved administrations. At section 1, this briefing provides an overall picture of government borrowing powers in the UK under the current arrangements. Further contextual information is outlined in section 2 about Treasury rules that are central to government borrowing; highlighting relevant extracts from Treasury's *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland: Statement of Funding Policy.*[2]

Thereafter, section 3 presents an overview of local government borrowing in Great Britain (GB), summarising its legislative basis and related rules. Section 4 then looks at key past, present and future examples of EIB borrowing by GB local government. Section 5 moves onto NI. It outlines what appears to be the legislative basis for public sector borrowing in NI at local government and Executive levels, with particular relevance to EIB finance, including some discussion about potential EIB loan use for local government in NI. In closing, section 6 concludes, setting out key findings from the research undertaken by RaISe to date, including the scrutiny points noted throughout the paper for the Committee's consideration.

1 UK Public Sector Borrowing

This section provides an overview of government borrowing powers throughout the UK, as defined by the prevailing financial framework under the current devolution arrangements (the "Public Finance Framework"). This Framework arises from the prevailing devolution legislation in the UK – namely the *Scotland Act 1998*[3], the *Northern Ireland Act 1998*[4] and the *Government of Wales Act 2006.*[5] Under this

[1] E-mail correspondence from Committee for Finance and Personnel received by RaISe on 4 June 2014.
[2] HM Treasury (2010). *Statement of Funding Policy*: http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf
[3] *Scotland Act 1998*: http://www.legislation.gov.uk/ukpga/1998/46/contents
[4] *Northern Ireland Act 1998*: http://www.legislation.gov.uk/ukpga/1998/47/contents

legislation, devolved administrations across the UK are empowered to borrow for the purpose of managing short-term cash flow. However, NI is the only devolved administration with full borrowing powers at central (Executive) **and** local government levels.[6] It seems therefore that there is no legislative barrier to the NI Executive borrowing directly from the EIB for capital projects.[7] At present in Scotland and Wales, only **local government authorities** are empowered to take advantage of such EIB loans. (For detail about local government powers, see section 3 below).

The following sub-sections set out the current government borrowing powers of each devolved administration and highlight imminent changes, where relevant.

1.1 Scotland

Central government in Scotland currently does not have the necessary borrowing powers to avail of EIB loan finance. However, under the *Scotland Act 2012,* from 2015*,* Scottish Ministers will be empowered to borrow for capital purposes up to a cumulative maximum of £2.2 billion.[8] Treasury have made clear that such borrowing in any one year must not exceed 10% of the Scottish Government's Capital DEL budget.[9] The *Scotland 2012 Act* also gives enhanced fiscal powers to Scottish Ministers. From 2015, Scottish Ministers will be empowered to vary the rate of income tax and establish a Scottish system of Stamp Duty and landfill tax.[10] Treasury view these new devolved tax powers as providing an independent source of revenue to potentially support increased Scottish central government borrowing:

> *Scottish Ministers will be responsible for raising around £6bn of devolved taxes from April 2015 onwards. This provides an independent source of revenue which Scottish Ministers can adjust as necessary to support Scottish borrowing.* [11]

1.2 Wales

The Welsh Government is currently seeking broader devolved borrowing powers from Westminster, which will empower its government departments to fund capital projects

5 *Government of Wales Act 2006*: http://www.legislation.gov.uk/ukpga/2006/32/contents

6 National Assembly for Wales: Finance Committee. (2012). Borrowing *Powers and Innovative Approaches to Capital Funding*: http://www.senedd.assemblywales.org/documents/g1047/Public%20reports%20pack%20Thursday%2024-May-2012%2012.50%20Finance%20Committee.pdf?T=10

7 NI Assembly Question AQW 28025/11-15 . Answered on 14 November 2013:http://aims.niassembly.gov.uk/questions/oralsearchresults.aspx?&qf=0&qfv=1&ref=AQO%204541/11-15

8 *Scotland Act 2012*: http://www.legislation.gov.uk/ukpga/2012/11/part/3/crossheading/borrowing

9 HM Treasury (2012): *The Scotland 2012 Act: a consultation on bond issuance by the Scottish Government*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81566/condoc_scotlandact2012_bond_issuance.PDF

10 Devolution delivering more powers for Scotland: https://www.gov.uk/government/news/devolution-delivering-more-powers-for-scotland

11 National Assembly for Wales. Finance Committee.(2012) Correspondence from HM Treasury – Devolved Funding. Finance Committee Document Pack: http://www.senedd.assemblywales.org/documents/g1047/Public%20reports%20pack%20Thursday%2024-May-2012%2012.50%20Finance%20Committee.pdf?T=10

from financial institutions like the EIB, without incurring future reductions in capital DEL.[12] Under the *Welsh Development Agency Act 1975,*[13] *the* Welsh government has restricted borrowing powers for functions relating to the environment, economy and social development.[14] However, in response to the Welsh Finance Committee report on *Borrowing Powers and Innovative Approaches to Capital Funding*[15], in 2012, the Welsh Finance Minister said:

> *At present Treasury rules prevent us from exercising these powers in a way that would benefit Welsh Citizens.*[16]

The Welsh Finance Committee provides further explanation:

> *This is because if the Welsh Government were to use the borrowing powers available to it under the Welsh Development Agency Act 1975, it is expected that there would be a corresponding offset against the Welsh block grant.*[17]

1.3 Northern Ireland

For NI Executive's current government borrowing powers, refer to section 5 below.

2 Treasury Statement of Funding Policy

The following section outlines key extracts from Treasury's *Statement of Funding Policy* about expenditure financed by devolved administrations' borrowing.

2.1 Borrowing Rules

Key extracts on such borrowing rules include the following:

> *7.1 The devolved administrations have the reserve power to set maximum capital expenditure for capital investment by local authorities (District Councils in Northern Ireland) and other public bodies. Borrowing*

[12]National Assembly for Wales: Finance Committee. (2012). Borrowing *Powers and Innovative Approaches to Capital Funding*: http://www.senedd.assemblywales.org/documents/g1047/Public%20reports%20pack%20Thursday%2024-May-2012%2012.50%20Finance%20Committee.pdf?T=10

[13] *Welsh Development Agency Act 1975:* http://www.legislation.gov.uk/ukpga/1975/70/contents

[14] National Assembly for Wales: Finance Committee. (2012). Borrowing *Powers and Innovative Approaches to Capital Funding*: http://www.senedd.assemblywales.org/documents/g1047/Public%20reports%20pack%20Thursday%2024-May-2012%2012.50%20Finance%20Committee.pdf?T=10

[15] National Assembly for Wales: Finance Committee. (2012). Borrowing *Powers and Innovative Approaches to Capital Funding*: http://www.senedd.assemblywales.org/documents/g1047/Public%20reports%20pack%20Thursday%2024-May-2012%2012.50%20Finance%20Committee.pdf?T=10

[16] Welsh Government Minister for Finance (2012) Response from the Welsh Government to the Finance Committee report: *Borrowing Powers and Innovative Approaches to Capital Funding*. http://www.senedd.assemblywales.org/documents/s7678/FIN4%2007-12%20-%20Paper%201%20Devolved%20Funding%20-%20Welsh%20Government%20-%20Annex%202.pdf

[17] National Assembly for Wales: Finance Committee. (2012). Borrowing *Powers and Innovative Approaches to Capital Funding*: http://www.senedd.assemblywales.org/documents/g1047/Public%20reports%20pack%20Thursday%2024-May-2012%2012.50%20Finance%20Committee.pdf?T=10

counts towards the Public Sector Net Cash Requirement (PSNCR) and hence, is included within the devolved administrations' total budgets each year as a control mechanism, so that any increases in borrowing must be offset by reductions in other spending. The effect is to reduce the level of grant from the United Kingdom Government and hence to restore the United Kingdom borrowing position.

And:

7.2 Generally the financing costs of higher borrowing are met locally - either from the assigned budget itself, from local taxation or through higher charges for services. Local authority capital is funded through a balance of borrowing, where financing costs must be met by local authorities, and capital grants, where financing costs are met by the United Kingdom Exchequer. In cases of a significant shift in the balance between borrowing and capital grants, the ***Treasury reserves the right to adjust the assigned budget for the financing costs of this shift.***

And continues:

7.3 Each Secretary of State may lend the devolved administration sums required for meeting temporary excess in expenditure over income or providing the devolved administration with a working balance. The Treasury may issue to the Secretary of State such sums out of the National Loans Fund. These loans should be repaid by the devolved administration to the Secretary of State at such times, methods and interest rates as the Treasury determines. Sums received by the Secretary of State will be paid into the National Loans Fund. The aggregate outstanding amount of principal loans made shall not exceed £500 million for the Scottish Executive and the Welsh Assembly Government and £250 million for the Northern Ireland Executive. The Secretary of State, with the consent of the Treasury, can substitute these statutory limits by order. These rules governing lending are laid out in Sections 66, 67, 68, 71 and 72 of the Scotland Act 1998, Sections 82 and 83 of the Government of Wales Act 1998 and Sections 61 and 62 of the Northern Ireland Act 1998. In addition there is a statutory limit of £3 billion for NLF borrowing by the Northern Ireland Executive in the NI (Misc Provision) Act 2006.

And:

7.4 Prudential borrowing regimes for local authorities in England, Scotland and Wales (and for the Northern Ireland Executive in the case of Northern Ireland) have been introduced in 2004-05. Following the 2004 Spending Review, increases in supported local authority borrowing (which replace credit approvals) continue to be classified as DEL. Increases in *self-financed unsupported borrowing are classified as AME. Appropriate borrowing limits for increases in unsupported borrowing may be introduced if necessary in the light of the overall fiscal position.*[18]

The Committee could ask both DFP **and** Treasury to explain the specific relevance of the above rules within the context of EIB loans. This would help to ensure that the Committee has a clear and accurate understanding of this area, which could further inform the Committee's future discussion and decision-making in this area.

Moreover, the above rules suggest that Treasury has discretionary power to adjust a devolved administration's capital expenditure calculations, when Treasury decides a local government's use of borrowing is disproportionate.

The Committee could ask Treasury about the assessment criteria it uses to make determinations in this context, including both written and unwritten criteria.

3 Local Government borrowing in GB

This section outlines prevailing legislation that facilitates local government borrowing of EIB loans.[19] A summary of the use of traditional local government borrowing in GB *via* the Public Works Loans Board (PWLB) is also provided to present a comparative perspective of PWLB loans and those of the EIB.

3.1 England and Wales

Local authorities in England and Wales typically borrow approximately £5 billion annually, to pay for capital infrastructure such as roads, houses, schools and leisure facilities.[20] The *Local Government Act 2003* (the 2003 Act) introduced powers to permit local authorities[21] in England and Wales to access loans for capital programmes without the consent of central government.[22] Section 1 of the 2003 Act states the following:

A local authority may borrow money—

(a) for any purpose relevant to its functions under any enactment, or

(b) for the purposes of the prudent management of its financial affairs.[23]

[18] HM Treasury (2010).*Statement of Funding Policy*: http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf

[19] The roles and responsibilities of local government in GB differ significantly from those in NI. To provide background information on these varied powers and to provide a contextual framework for this paper, the structure and responsibilities of local government in UK are summarised in Annex 1.

[20] Local Government Association.(2012) *Local Authority Bonds*.http://www.maproductions.se/wp-content/2012/10/local-authority-bonds-LGA.pdf

[21] Local Authorities are defined in Section 23 of the *Local Government Act 2003*: http://www.legislation.gov.uk/ukpga/2003/26/section/23

[22] *Local Government Act 2003*: http://www.legislation.gov.uk/ukpga/2003/26/contents

[23] *Local Government Act 2003. (Section1):http://www.legislation.gov.uk/ukpga/2003/26/section/1*

The 2003 Act also codified a prudential borrowing framework, establishing that the total amount a local government authority can borrow is governed by the requirements of the Chartered Institute of Public Finance & Accountancy's (CIPFA) *Prudential Code for Capital Finance in Local Authorities (the Prudential Code).* The *Prudential Code* requires local government authorities to ensure that they have the financial capacity to repay debts, specifically because their borrowing is unsecured by assets.[24]

Section 13 of the 2003 Act prevents authorities from using their property as collateral for loans.[25] Each authority must set a total borrowing limit in accordance with the affordability principle of the *Prudential Code*. In addition, the borrowing limit is linked to the revenue streams available to the local authority, with which it can repay the debt. The principle and limit are stated as follows:

> *The fundamental objective in the consideration of the affordability of the authority's capital plans is to ensure that the total capital investment of the authority remains within sustainable limits, and in particular to consider its impact on the authority's 'bottom line' and hence council tax or district rates (Northern Ireland). Affordability is ultimately determined by a judgement about acceptable council tax or rates levels.*[26]

3.2 Scotland

Under the *Local Government in Scotland Act 2003* (the 2003 Scotland Act), local government can borrow, without central government's approval, to finance capital expenditure.[27] As in England and Wales, the 2003 Scotland Act specifies that Scottish local authority borrowing is governed by CIPFA's *Prudential Code*.

With the above in mind, the following two types of borrowing are available to local authorities in Scotland:

- Supported borrowing (financed through loan charge support from the Scottish Government); and,
- Unsupported self-financed borrowing (financed through the local government authority's own resources).

In terms of the classification of both above types of borrowing, the Scottish Government states:

> *Increases in supported local authority borrowing (which replaced credit approvals) score against the SG's [Scottish Government] departmental expenditure limit* ***while increases in self- financed unsupported borrowing is classified as annually managed expenditure*** *within the*

[24] Bailey, Stephen (2012). *The UK's Prudential Borrowing Framework: Professional Discipline and Control*. Local Government Studies.Vol.38, No.2 pp211-229.

[25] *Local Government Act 2003 (Section 13):* http://www.legislation.gov.uk/ukpga/2003/26/section/13

[26] CIPFA.(2011) *The Prudential Code for Capital Finance in Local Authorities.*

[27] *Local Government in Scotland Act 2003:* http://www.legislation.gov.uk/asp/2003/1/contents

SG's total budget. Appropriate borrowing limits for increases in unsupported borrowing may be introduced if necessary in the light of the overall fiscal position. The SG would be responsible for administering any limit applied to Scotland.[28]

The above excerpt from the Scottish Government's website explains how unsupported self-financed borrowing for local government authorities is classified in the Scottish budget as AME (Annually Managed Expenditure).[29] This unsupported borrowing is therefore not part of the assigned budget, and consequently does not influence future public finance capital allocations from Westminster.

In light of the above, the Committee may clarify with the Scottish Government about how loans from **EIB** to support capital projects are classified within its total budget.

3.3 Public Works Loan Board

The following sub-section summarises the role of the Public Works Loan Board (PWLB) in providing finance for GB local government capital projects. It seeks to enhance the Committee's general knowledge and understanding of local government borrowing, underscoring that this is different to borrowing involving EIB loans.

The majority of local authority borrowing for capital projects in GB has traditionally been from the PWLB.[30] An independent and unpaid statutory body, the PWLB was established to provide public bodies with loans from the National Loans Fund.[31] It consists of up to 12 Commissioners who consider loan applications from local authorities for capital projects. The Commissioners must be satisfied that local authorities provide sufficient security for its repayment before making a loan.

PWLB interest rates are determined by Treasury,[32] and are generally marginally above the cost at which the UK Government itself can borrow.[33] Before 2010, PWLB interest rates had been traditionally offered at just 0.15-0.20% above the UK Government's borrowing costs: however in October 2010 this differential increased to 1%.[34] In 2012, for local authorities availing of PWLB loans for long-term infrastructure projects, Westminster introduced a "*certainty"* discount rate of 0.80%. A further discount rate of

[28] Scottish Government: *Borrowing, Lending and Investment*: http://www.scotland.gov.uk/Topics/Government/Finance/spfm/borrowingetc

[29] AME is a sub-division of Capital and Resource Expenditure. It is the more volatile aspect of departmental budgets as it is subject to demand-led changes, e.g. social security benefit payments.

[30] House of Commons Library. (2014) *Local Government in England: Capital Finance:* http://www.parliament.uk/Templates/BriefingPapers/Pages/BPPdfDownload.aspx?bp-id=SN05797

[31] National Loan Fund makes loans to various statutory public sector bodies and provides the finance needed by the PWLB for its loans to prescribed bodies, mainly local authorities.

[32] A comprehensive explanation of PWLB interest rates can be found at: http://www.dmo.gov.uk/index.aspx?page=PWLB/PWLB_Interest_Rates

[33] Independent Commission on Funding & Finance for Wales. (2010) Fairness and accountability: a new Funding settlement for Wales: http://wales.gov.uk/docs/icffw/report/100705fundingsettlementfullen.pdf

[34] House of Commons Library.(2014) *Local Government in England: Capital Finance:* http://www.parliament.uk/Templates/BriefingPapers/Pages/BPPdfDownload.aspx?bp-id=SN05797

0.60% was introduced in November 2013 for borrowing regarding an infrastructure project nominated by a Local Enterprise Partnership.[35]

The following excerpt from correspondence between RaISe and the Scottish Government highlights the appeal of PWLB loans for local authorities in Scotland:

> *Local authorities can borrow from the Public Works Loan Board (PWLB) which provides them with loan finance at attractive interest rates and does not require the loan to be tied to specific projects. EIB loans would need to compare favourably with PWLB loans.*[36]

The following excerpt from correspondence between RaISe and the EIB potentially refutes the attractiveness of PWLB loans for local authorities. An EIB representative stated:

> *…we have financed a large number of UK LAs [United Kingdom Local Authorities] in the past (mainly Scottish, mainly schools, 10 to 20 years ago). As our rates have now become more attractive than PWLB's (by 20-40 bps*[37]*) [EIB] are now resuming our lending to (mainly English) LAs. We have two recent examples (still under due diligence) with Croydon (for schools) and GLA [Greater London Authority]/ London Boroughs for energy efficiency and social housing. Transport projects have also been recently financed by the EIB (with Greater Manchester for instance).*[38]

The above correspondence seems to indicate that the EIB are confident that its rates of interest offer better value than those of the PWLB.

4 EIB Financial Assistance to Local Government in GB

The following section provides key past, present and future examples of EIB financial support to GB local authorities for capital infrastructure projects.

4.1 England

4.1.1 Greater London Authority

In 2011, the Greater London Authority set up two energy efficiency projects *RE:FIT* and *Decentralised Energy,* with assistance of €2.9 million from the European Local Energy Assistance (ELENA) programme for each project. ELENA support covers a share of

[35] Public Works Loans Board. *Interest Rates*: http://www.dmo.gov.uk/index.aspx?page=PWLB/PWLB_Interest_Rates
[36] Email correspondence from Scottish Government. Received by RaISe on 19 May 2014.
[37] BPS refers to *Basis Point*, a unit of measure in finance to describe the percentage change in the value or rate of a financial instrument. 1 basis point is equivalent to 0.01%.
[38] Email correspondence from EIB. Received by RaISe on 13 May 2014.

the cost for technical support (such as market studies and energy audits), which is necessary to prepare and implement an investment programme.[39]

A Framework Loan of €600 million for the Greater London Authority is also currently under appraisal[40] (April 2014) to finance sustainable urban renewable projects *via* the London Green Fund.[41] A "Framework Loan" funds multi-component, multi-annual investment programmes for national or local government projects, focussing on improving infrastructure, transport, energy efficiency or urban renovation.

4.1.2 London Borough of Barking and Dagenham

Under the London Green Fund Co-Financing Loan (see above), a loan of €49 million is currently under appraisal (April 2014) for the London Borough of Barking and Dagenham.[42] The loan aims to support the demolition and redevelopment of social housing in Barking town centre.

4.1.3 London Borough of Croydon

A loan of €119 million for the London Borough of Croydon is currently under appraisal (March 2014) by the EIB.[43] The loan is to be used to upgrade and modernise the primary and secondary schools estate in the Borough. It is intended to assist the refurbishment financing for 31 primary and secondary schools and 18 special educational needs facilities. The loan is also aimed at helping the financing of constructing six new schools.

4.1.4 Bristol City Council

In 2012, Bristol City Council received a £2.5 million grant from the EIB to help finance the costs of developing an energy services company and investment programme.[44] The finance was offered under the ELENA initiative.

4.2 Wales

The following is a recent example of a Welsh local government EIB supported capital project:

4.2.1 Torfaen County Borough Council

[39] European Investment Bank (2011) *EIB and UK Public Sector – Lending Activities and Other Financial Products*.

[40] Before financing approval by the EIB Board of Directors, and before loan signature, projects are under appraisal and negotiation, and therefore data provided on the project is indicative only.

[41] London Green Fund Co-financing Loan: http://www.eib.org/projects/pipeline/2013/20130689.htm

[42] London Borough of Barking and Dagenham. *London Green Fund Co-Financing Loan:* http://www.eib.org/projects/pipeline/2014/20140148.htm

[43] London Borough of Croydon. *Croydon Schools*: http://www.eib.org/projects/pipeline/2013/20130382.htm

[44] Bristol City Council. *EIB supports green energy in Bristol:* http://www.eib.org/about/press/2012/2012-010-european-investment-bank-supports-green-energy-in-bristol.htm

In March 2008, EIB signed a finance loan of up to £70 million for the refurbishment of around 8,100 social housing units in County Borough of Torfaen.[45] The aim of the project was to improve the condition and standard of the social housing stock owned by the local authority.

4.3 Scotland

RaISe requested information from the Scottish Government about Scottish local authorities availing of recent EIB loans. The following reply was received in May 2014:

> *The EIB presented to the Scottish Treasury Management Forum in 2012. In addition the EIB met with some of the largest Scottish local authorities.*
>
> *[The] Head of Public Sector & Utilities Lending Operations in Western Europe, and his Deputy […..], visited several Local Authorities* ***but as far as we are aware, no authority have used them to fund any projects as a result of their visit.*** *The EIB do not publish rates in the way that the PWLB do, but the indicative rates which were discussed during their visit to Scotland did* ***not match the prevailing PWLB ones****. They were joined by […] of the Jessica Initiative for their presentation to the Forum. It is likely that some authorities will have used Jessica funding or some of the other smaller funding streams available.*
>
> *In the past some Local Authorities have had borrowing from the EIB and we [Edinburgh] have only just finished paying off some loans that were disaggregated between ourselves, Scottish Water, Midlothian and West Lothian at Local Government reorganisation in 1996.Some Councils may also have used EIB loans to help fund PPP [Public Private Partnership] projects, where the comparison is with bank funding rather than the PWLB, and where the cheaper EIB funding may have helped bridge affordability gaps.*[46]

It appears from the above correspondence that EIB loans for local authorities in Scotland are not currently utilised to any great degree. One recent example is a Scottish local government EIB supported capital project, as highlighted below:

4.3.1 Dumfries & Galloway Council

In January 2008 EIB signed a €70 million loan for the construction and refurbishment of ten schools in the Dumfries and Galloway district.[47] The project was procured under Public Private Partnership (PPP) arrangements.

[45] Torfaen Urban Renewal: http://www.eib.org/projects/pipeline/2007/20070337.htm
[46] Email correspondence from Scottish Government. Received by RaISe on 22 May 2014
[47] Dumfries & Galloway Schools PPP: http://www.eib.org/projects/pipeline/2006/20060301.htm

5 Public Sector Borrowing in NI

This section outlines what appears to be the current legislative framework for all borrowing in NI by the Executive and local government. A summary of the potential for local government in NI to avail of EIB loans is also provided.

5.1 NI Executive borrowing

The NI Executive has borrowing powers under section 1 of the *Northern Ireland (Loans) Act 1975.*[48] Sub-section 2 of the 1975 Act set an overall limit on borrowing at £2,000 million. The *Northern Ireland (Miscellaneous Provisions) Act* 2006 extended this borrowing limit to £3,000 million.[49] **This borrowing provision essentially permits the borrowing of funds by the NI Executive**. It is not currently available to other UK devolved administrations.

5.1.1 Temporary Borrowing Provision

The central governments of Scotland and Wales are currently only empowered to borrow from the UK National Loans Fund, to meet temporary shortfalls in their budgets. Similar temporary borrowing provision for the NI Executive is codified in section 61 of the *Northern Ireland Act 1998* (the 1998 Act) as follows:

> *The Secretary of State may advance to the Department of Finance and Personnel sums required for the purpose of—*
>
> *(a)meeting a temporary excess of sums to be paid out of the Consolidated Fund of Northern Ireland over sums paid into the Fund; or*
>
> *(b)providing a working balance in the Fund.*[50]

The funds are issued from the *National Loans Fund*[51] under terms agreed by Treasury.[52] Section 61of the 1998 Act also sets the aggregate outstanding amount of principal loans at £250 million.[53]

5.1.2 Reinvestment and Reform Initiative

Introduced in 2002, the Reinvestment and Reform Initiative (RRI) provided the NI Executive with an additional borrowing facility of up to £200 million a year, to fund

[48] *Northern Ireland (Loans) Act 1975*: http://www.legislation.gov.uk/ukpga/1975/83/section/1
[49] *Northern Ireland (Miscellaneous Provisions) Act 2006*: http://www.legislation.gov.uk/ukpga/2006/33/section/22
[50] *Northern Ireland Act 1998: http://www.legislation.gov.uk/ukpga/1998/47/section/61*
[51] National Loan Fund makes loans to various statutory public sector bodies and provides the finance needed by the PWLB for its loans to prescribed bodies, mainly local authorities.
[52] Northern Ireland Audit Office.(2014) *Future impact of Borrowing and Private Finance Commitments*: http://www.niauditoffice.gov.uk/future_impact_of_borrowing.pdf
[53] *Northern Ireland Act 1998: http://www.legislation.gov.uk/ukpga/1998/47/section/61*

capital investment from the National Loans Fund.[54] The NI Executive Budget 2011-15 describes RRI as follows**:**

> *Announced in May 2002, [RRI] included a new borrowing power intended to support a very substantial infrastructure investment programme in Northern Ireland. This borrowing is subject to annual limits determined by HM Treasury and at present this limit is £200 million per annum.*[55]

The additional borrowing under the RRI initiative is broadly equivalent to the local authority prudential borrowing powers in the rest of the UK. It addresses the fact that the NI Executive retains control over a range of functions that are normally the responsibility of local government in GB. DFP states that borrowing for this initiative is covered by the *Northern Ireland (Loans) Act 1975* and the *Northern Ireland Miscellaneous Provisions Act 2006.*[56]

5.2 Local Government borrowing in NI

Under Part V of the *Local Government Act (Northern Ireland)* 1972*,* councils were allowed to borrow for any purposes relevant to their functions, subject to department approval.[57] The *Local Government Finance Act (Northern Ireland) 2011* (the 2011 Act) retains the power for a council to borrow for purposes relevant to its functions; but removes the requirement for approval by the department.[58] The 2011 Act also introduces a prudential borrowing framework. Explanatory notes for section 13 of the 2011 Act state the following:

> *Councils will have to comply with regulations made by the Department, and have regard to codes of practice specified in regulations, when determining an affordable borrowing limit.*[59]

5.3 EIB borrowing in NI

Both local government and Executive departments in NI possess the necessary borrowing powers to avail of EIB loans. The Strategic Investment Board (SIB) for NI recently stated that EIB investment typically exceeds £100 million, and that project size can act as a constraining factor for NI.[60] However, SIB has also suggested that EIB may be prepared to consider smaller projects for NI:

[54] Spending Review 2013 confirmed a temporary additional borrowing limit of £250 million support investment in shared housing and education projects.

[55] Northern Ireland Executive (2011).*Budget 2011-15*: http://www.northernireland.gov.uk/revised_budget_-_website_version.pdf

[56] E-mail correspondence from DFP. Received by RaISe on 11January 2014.

[57] *Local Government Act (Northern Ireland)* 1972: http://www.legislation.gov.uk/apni/1972/9/part/V

[58] *Local Government Finance Act (Northern Ireland) 2011*: http://www.legislation.gov.uk/nia/2011/10/contents

[59] *Local Government Finance Act (Northern Ireland) 2011*: Explanatory Notes: http://www.legislation.gov.uk/nia/2011/10/notes/division/5/4

[60] Information provided to RaISe by SIB on 29 April 2014.

Project size can act as a constraining factor for Northern Ireland. However, as a result of ongoing engagement from both DFP and SIB, in the case of NI the EIB are prepared to consider making investments in projects of lower value.[61]

With the above in mind, the Finance Minister has stated that the larger local councils envisioned post-Review of Public Administration may be in a position to avail of EIB loans in the future:

The new reformed RPA structure creates opportunities for new, larger councils to engage in collaborative procurement and shared service undertakings. Organisations like the European Investment Bank are keen to assist in developing our infrastructure but the previous local authority structure and HM Treasury rules frequently hindered such developments advancing.[62]

As previously reported in RaISe briefing NIAR 219-14 (dated 1 May 2014), the NI Finance Minister is keen to promote the use of EIB loans to local government and not Executive departments:

There is no legislative barrier that prevents the Executive borrowing directly from the EIB. However, any such direct borrowing would score against Public Sector Net Debt and HM Treasury would therefore reduce the Executive's Capital DEL accordingly. This means that the Executive would in fact be worse off because we would have to pay interest on the borrowed capital.[63]

The Finance Minister is of the view that the use of EIB loans by NI Executive departments would have the overall effect of raising the UK Public Sector Net Debt and therefore would be taken back by Treasury in terms of reduced future capital allocations. Potential future public finance consequences arising from the use of EIB loans by NI Executive departments are further explained by the Finance Minister as follows:

There is a technical but nonetheless significant difference in how I and my Department would deal with loans from EIB versus those from RRI. With RRI, we are allowed to borrow from £200 million a year up to a total of £3 billion in Northern Ireland, and we are very close to that at the minute. ***It is repayable but, significantly, does not score against our balance sheet as a loan coming in and does not come away from the capital departmental expenditure limit that we receive from the Treasury on an annual basis****.*

[61] Information provided to RaISe by SIB on 29 April 2014.

[62] NI Assembly Question AQW 4541/11-15. Answered on 5 September 2013:http://aims.niassembly.gov.uk/questions/oralsearchresults.aspx?&qf=0&qfv=1&ref=AQO%204541/11-15

[63] Assembly Question AQW 28025/11-15. Answered on 14 November 2013: http://aims.niassembly.gov.uk/questions/writtensearchresults.aspx?&qf=0&qfv=1&ref=AQW%2028025/11-15

And:

> *There is a significant difference with EIB funding. If the Executive were to borrow money from the EIB for a hospital project, education project or even a transport project, the problem is that the Treasury would take what we borrow from the EIB directly from our capital departmental expenditure limit and we would still have interest to repay on the loan.*[64]

And continues:

> *I am keen to explore opportunities with the likes of* ***local government****, those who are in ownership of our regulated asset base, like the energy sector, and elsewhere in the university sector to see whether they,* ***because they do not fall foul of the same Treasury rules****, would be keen to look at EIB or, indeed, some of the other financial instruments that are out there.*[65]

In the above, the Finance Minister appears to suggest that EIB loans to local government are not covered by the same Treasury rules as EIB loans to Executive departments. On the information currently available, it is unclear whether EIB loans are completely outside Treasury rules, i.e. outside the financial framework under the current devolution arrangements – the Public Finance Framework. Or whether different Treasury rules exist and apply to EIB loans, dependent on whether they are used by Executive or local government departments.

To clarify, the Committee could ask DFP about how EIB loans to Executive departments and local government in NI are classified under the financial framework of the current devolution arrangements?

6 Concluding Remarks

Unpacking the rules and practices governing the devolved administrations' borrowing powers under the prevailing financial framework under the current devolution arrangements requires reliance on a number of governmental offices. Research undertaken by RaISe to date reveals there is a lack of clarity about both: the classification of EIB loans in terms of UK public expenditure; and, the reasons why the use of EIB loans by Executive departments in NI could lead to a reduction in future capital expenditure allocations from Westminster by Treasury.

Throughout the UK, local authorities can access capital funding for infrastructure investment from a variety of sources. The structure of local government in each jurisdiction varies, as does the size and number of councils in each administration.

[64] NI Assembly Oral Question (AQO 5729/11-15): http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Reports-13-14/10-March-2014/#AQO%205729/11-15

[65] NI Assembly Oral Question (AQO 5729/11-15): http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Reports-13-14/10-March-2014/#AQO%205729/11-15

Consequently local government borrowing across the UK does not follow a consistent path. Traditionally most GB local authorities have borrowed from the PWLB (non-EIB borrowing) at favourable rates of interest. Currently, PWLB loans account for 75% of all GB council borrowing.[66] An increase in the PWLB interest rate in 2010 potentially led some local authorities to investigate alternative sources of funding. Amongst those sources have been loans from financial institutions such as the EIB.

Correspondence received by RaISe from EIB suggests that EIB loans may present better value for local authorities than loans from PWLB, as noted in section 3.3 of this paper. But further research reveals contrasting views in this regard. According to the EIB, interest rates on those loans are 0.02-0.04% more attractive than PWLB loans.[67] However, correspondence from the Scottish Government (as stated in section 4.3) appears to refute this assertion. It suggests that EIB lends only to projects that adhere to the policy objectives of the European Union (EU); whereas PWLB loans do not have such restrictions.

Each UK capital infrastructure project financed by EIB typically exceeds a total investment of £100 million.[68] For NI, project size appears to be a constraining factor in light of GB local government experience in this regard. Size may go some way to explain why a clear majority of GB local government borrowing from EIB in the last five to ten years appears to be from local authorities in England. The relatively smaller budgets of Scottish and Welsh local authorities may not be sufficient to avail of EIB project loans. This may help to explain the apparent lack of EIB borrowing within these jurisdictions.

The NI Finance Minister's view that the use of EIB loans by Executive departments could have a detrimental effect on future capital expenditure allocations requires some clarification. Understanding how the use of EIB finance is classified in terms of the Treasury rules, which form part of the Public Finance Framework in NI, is central to this issue. Is borrowing from EIB viewed by Treasury as increasing the NI Executive Capital DEL above the previously agreed spending review limit? Or is it the case that under the rules Treasury views the use of EIB loans by NI Executive departments as having the overall effect of raising the UK Public Sector Net Debt in contravention of Borrowing Rule 7.1 of the *Statement of Funding Policy* (see subsection 2.1)?

In Answer to a NI Assembly Question in June 2014, the Finance Minister announced a future draft borrowing strategy for NI.[69] If agreed by the Executive, the proposed future borrowing strategy may provide more clarity on how EIB loans to Executive departments and local councils in NI are classified under the financial framework of the current devolution arrangements.

[66] Local Government Chronicle (April 2014). *Municipal Bonds could save Local Government more than £1bn*: http://www.lgcplus.com/briefings/municipal-bonds-could-save-local-government-more-than-1bn/5070194.article

[67] Email correspondence from EIB. Received by RaISe on 13 May 2014.

[68] Information provided to RaISe by SIB on 29 April 2014.

[69] NI Assembly Question AQO 629511-15. Answered on 09 June 2014: http://aims.niassembly.gov.uk/questions/oralsearchresults.aspx?&qf=0&qfv=1&ref=AQO 6295/11-15

Annex 1

Responsibilities of Local Government in UK

The following section briefly summarises the structure and responsibilities of local government in UK.[70]

England

The following 3 tiers of local government are currently operational in England:

- County councils (responsible for services across the whole county area);
- District, borough or city councils (covering a smaller area than county councils); and,
- Unitary Authorities (single tier of local government providing all local services).

The following table summarises the services that each tier of local government is responsible for in England:[71]

County councils services	District, borough or city councils services	Unitary authorities services
• Education; • Transport; • Planning; • Fire and public safety; • Social care; • Libraries; • Waste management; and, • Trading standards.	• Rubbish collection; • Recycling; • Council Tax collections; • Housing; and, • Planning application.	In some parts of England, Unitary authorities provide all local services. In London and metropolitan areas some services, like fire, police and public transport, are provided through 'joint authorities' (in London by the Greater London Authority).[72]

Scotland

Local government in Scotland consists of 32 unitary local authorities responsible for the provision of public services. Their powers include the following:[73]

- Mandatory powers (education, fire services and social work services);
- Permissive powers (economic development, and recreation services); and,
- Regulatory powers (trading standards, environmental health and licencing for taxis and public houses.

[70] Northern Ireland Local Authority borrowing powers are presented in *Local Government Finance Act (Northern Ireland*) 2011: http://www.legislation.gov.uk/nia/2011/10/contents
[71] Table produced by RaISe relying on information supplied by Gov.UK.
[72] *Understand how your council works*: https://www.gov.uk/understand-how-your-council-works/types-of-council
[73] Scottish Government.*What Local Government Does*: http://www.scotland.gov.uk/Topics/Government/local-government/localg/whatLGdoes

Wales

Wales has a two-tier local government system of county or county borough councils, and community and town councils. County or county borough councils have responsibility to provide services such as education, environmental health, social services and town and country planning for their entire county. Community and town councils typically provide the following services:[74]

- Public information signs and noticeboards;
- Public seating and bus shelters;
- War memorials; and,
- Community centres and indoor recreation facilities.

Northern Ireland

Local government in Northern Ireland is currently made up of 26 councils. These councils provide a range of services, such as sport and leisure centres or waste collection. A reform programme is under way which will see 11 new councils take over from the current 26 on 1 April 2015. The new larger councils are listed below:

- Antrim and Newtownabbey District;
- Armagh, Banbridge and Craigavon District;
- Belfast District;
- Causeway Coast and Glens District;
- Derry and Strabane District;
- Fermanagh and Omagh District;
- Lisburn and Castlereagh District;
- Mid and East Antrim District;
- Mid Ulster District;
- Newry, Mourne and Down District; and,
- North Down and Ards District.

[74]Welsh Government. *LocalGovernment.Frequently asked Questions*: http://wales.gov.uk/topics/localgovernment/communitytowncouncils/faqs/?lang=en