Construction Employers Federation submission to the Committee for Finance on its scrutiny of the draft Executive Budget for 2024-25, May 2024

Introduction

The Construction Employers Federation (CEF) is the sole certified representative body for the second largest industry in Northern Ireland, the construction industry. We represent approx. 70% of construction in NI and around 800 businesses of all sizes employing over 30,000 staff directly and 65,000 in the wider supply chain.

Comments on the draft Executive Budget 24/25

Given the timing of the Executive's return – and the additional complication of both the date of the UK Government's Budget and the challenging financial picture that was presented within this – it is to have been expected that this year's one-year Budget would not be agreed in time for the commencement of the financial year.

With that said, however, it is nonetheless a recurrent problem that Government Clients such as Translink and NI Water, may still have to wait until early June before their annual capital allocations are confirmed.

This, as it has done in many years previous, has significant implications for both the pipelines of said clients but also the construction industry which remains dependent on public sector works.

Given that the capital budget, setting aside the RRI contribution, is as low this year as it was some 17 years ago it is critical that the Executive maximises the economic value of every pound of its capex.

While clients are covered for those contractually committed works by virtue of the Budget Act which received Royal Assent on 14th March, having a near three-month hiatus from that point in confirming final allocations for 2024/25 is a scenario that the Executive must do all in its power to avoid in the years ahead.

Specifically on the matter of the RRI contribution, it is welcome to see the Executive proposing to utilise the full revised limit of £220 million in the current financial year. This, given the significant infrastructure challenges that face us, is the most obvious additional tool to be utilised and the intent is therefore promising.

We would however strongly encourage the Committee to maintain a watching brief on this as the financial year passes. Recent years have seen the previous £200 million limit being proposed to be utilised to its fullest extent – only for this not to actually happen. With the power to utilise the £220 million completely within the Executive's control, it is critical that it does so.

Linked to this, and in the context of the constrained capex picture, we would ask that the Committee continue its robust approach to the in-year monitoring rounds so to ensure that the Department and wider Executive maximise the economic value of the capital budget that is available. It, as it has always done, remains vital that we do not approach the January Monitoring Round with significant underspends (nor indeed overspends) and the Committee's scrutiny role will be critical in that regard.

Finally, and while we again acknowledge that the Executive was only restored in February, it remains of concern that we have seen little tangible progress on the publication of a draft Programme for Government or draft Investment Strategy.

To have an agreed draft Budget in the absence of your strategic policy drivers (nevermind the enhanced detail that we would be hoping for in documents like a Housing Supply Strategy) stands out as unique within these islands.

As we approach the mid-point of this mandate, it is therefore to be questioned how much progress can now tangibly be made on some of the critical challenges that face us such as the newbuild housing crisis that we are undoubtedly in.

Comments on the 'earmarked Capital allocations' in the draft Budget

As the Committee will be aware, we have had long-standing concerns as to how the various Executive 'Flagship' schemes of recent years have been treated in budgetary terms.

While not questioning the need for their delivery, we have often felt that the allocations made against schemes at the start of a number of financial years have been wholly unrealistic due to, as would have been clearly understandable at the time, the likelihood of the progression of the projects to the extent of the budget that had been ringfenced.

Given this, and in our best appraisal of the current status of those projects today vis-à-vis the amount of money that Executive has agreed to 'earmark', this draft Budget appears significantly more realistic in its approach and that, given the constrained capex budget available, is to be welcomed.

It will however remain important that such projects, from a financial allocation point of view, are monitored closely by the Committee through the monitoring rounds that are to come.

Budget planning for 25/26 and beyond

For many well-rehearsed reasons, we are in full agreement with the Executive that the ideal is that budgets are set on a multi-year basis.

However, as we look towards the last two financial years of this mandate and seek the enhanced financial certainty that will enable our members and the Government Clients plan out a clear and deliverable pipeline of works, we fear that even a restored Executive will not, in the short term, make this any more likely.

If we consider that, post the most recent UK General Elections, the timeline from the triggering of a Comprehensive Spending Review to its actual report to Parliament is at least four months, then it is highly unlikely that the 2025/26 Executive Budget will be set in any more timely manner than this year's.

That, of course, is not the fault of the Executive but, rather, the reality of the political calendar in which we are set.

However, we would encourage the Committee to work with the Department and wider Executive to impress upon whoever forms the next UK Government the importance of giving each of the Devolved Nations – not just Northern Ireland – early clarity on their forthcoming years' spending so to allow us the best opportunity possible to maximise the allocations that we are given.

While this is a point to be impressed upon the next UK Government, we would like to take this opportunity to reiterate the views we made to the Department in our response to their *'Financial context for revenue raising consultations'*.

Although appreciative of the fact that these consultations were instructed to be undertaken by the Secretary of State, we retain the view that the Block Grant capital expenditure as it is in this current financial year (and as it is proposed in the medium-term Treasury forecasts) can in no way meet the magnitude of our need.

The implementation of a fiscal floor that also covers capital expenditure will likely be of benefit to Northern Ireland – but it is highly unlikely that it can completely compensate for the infrastructure deficit that we face.

Therefore, and accepting a number of caveats that are contained within our submission on matters such as the short-term deliverability of multi-year budgets due to Westminster's electoral cycle, we reinclude as an Annex our submission to the Department's revenue raising consultation in January.

Irrespective of the timing of an Executive-led consultation on its 25/26 Budget, we believe the subjects that we addressed in this submission do need to be considered in full as a means to complement whatever level of Block Grant capex the next UK Government makes available to the Executive.

ANNEX

Construction Employers Federation response to Department of Finance consultation 'Financial context for revenue raising consultations', January 2024

While this consultation exercise is welcome, the challenge from our perspective is that it focuses chiefly on revenue raising for the purposes of the day-to-day resource budget. This, in itself, is important given the difficulties the resource budget faces; however, it is critical that an incoming NI Executive also considers how it would drastically grow its capital budget so to meet the needs of our community.

In context, it will come as no surprise to the Department that the construction sector in Northern Ireland remains heavily reliant on public sector capital expenditure (capex). Over the course of the last 15 years, that reliance has averaged at 55-65% of overall construction output once we include that delivered by the private sector.

As we look to the last year of the current Comprehensive Spending Review period, however, 2024/25 will see a reduction in the Executive's capex from £2.1bn to £1.8bn. This is the same in cash terms as 2007/08, some 17 years ago.

In simple terms, the Executive's 'bang for its buck' is drastically reduced by elapsed time inflation. This is hugely exacerbated by the unprecedented inflationary challenges within the sector of the last 24-36 months.

Additionally, as we approach the UK General Election, it is unlikely that we will have legislative clarity on future years capex until some point in mid to late 2025 thus making it effectively impossible for Government Clients to plan for the long term.

When we then seek to break that £1.8bn down, the long-term estimate is that around 60% of any one year's capex is spent on 'actual' construction. Further, we are also now facing into a decade-long (at least) ramping up of investment in NI Water.

Where its average capex over the last decade has been around £100m per annum – in order to meet PC21 (and likely PC27 and PC33), that needs to move to £600m per annum recurrently. The likelihood of this investment now moving into two further price control periods clearly reflects how much inflation has eaten into NI Water's PC21 plans.

It is patently unsustainable for that need to be met from the confines of the existing capex budget at the Executive's disposal. If you increase NI Water's capex budget to £600m per annum, and the overall Block Grant capex only continues to increase modestly, the NI Executive cannot afford to deliver the full extent of its proposals with respect to major road schemes nor the required growth of the Social Housing Delivery Programme (SHDP) nor any proposed major extension of the railway network nor the huge investment that is required in our education estate.

Given this, we believe there are a number of areas where urgent action is required on the part of a returning Executive:

<u>Delivering fundamental reforms to the funding and governance models of NI Water and the NI Housing Executive (NIHE) – mutualisation.</u>

Where this series of consultations will consider the introduction of water charges for the purposes of increasing the resource budget, we believe that, in the context of the constrained *capex budget, the goal should instead be the reduction of the amount of capex that the Executive has to put into NI Water in any one financial year. In our view, this could be achieved by moving to a mutual model which, along with other reforms to the existing sub-optimal governance model, would enable NI Water to borrow (effectively funding their capital plans in the same way that the Executive does with the existing SHDP).*

Crucial to this will be giving NI Water a defined income stream. We do not believe that this requires the introduction of individual household billed water charging nor, indeed, any uplift in the existing rate bills paid for by domestic consumers. Rather, from existing rate bills, a directly hypothecated income stream to NI Water could be created thus, along with additional legislation in respect of their governance model, enabling them to borrow against their assets. Short of this type of fundamental reform, we fail to see how the NI Executive can, sustainably, fund NI Water's capex needs given their crucial need to wider economic activity such as homebuilding.

This argument for mutualisation extends to the NIHE and seeks to deliver on the ambition that was laid out by the then Communities Minister in November 2020. With an ageing stock – one which also needs significant retrofit investment to meet the requirements of our 2022 Climate Change Act – there needs to be an urgent focus on meeting its capex needs. Much like NI Water, it is highly unlikely that we can meet that need through the Block Grant alone and reform of the existing structure is long overdue. Such a reform could also lead to the raising of bonds – such as the Just Transition Bond proposal mooted in the LSE policy paper of July 2022.

<u>Put in place multi-year capital budgets.</u>

For over a decade, the benefits of moving beyond a one-year capex settlement have continued to elude us. While, as we move into a period ahead of a UK General Election, that may remain challenging in the short term, it is critical that the Executive seeks to address this once the next Comprehensive Spending Review is undertaken. Presently, it would be relatively safe to assume that such an arrangement would cover the 2025-28 period. This would also provide the market the assurance in the Executive's pipeline of works that it would need as we come closer to the next Assembly election in 2027.

These changes would then, in-part, enable the proposed Executive 10-Year Infrastructure Investment Plan and Medium-Term Infrastructure Finance Plan that were detailed in the draft Investment Strategy consultation of spring 2022.

<u>Achieve agreement with the Treasury regarding enhanced end-year flexibility for capital budgets.</u>

While we remain in the context of one-year budgets (and even in a multi-year scenario) there remains a strong argument for a much greater tolerance to be given to the Executive in terms of end-year flexibility. For all manner of well-rehearsed reasons, capex projects often do not run to plan or can be subject to budget issues created by challenges such as the unforeseen inflationary pressures of the last three years.

<u>Agree ringfenced capex funding with the Treasury for specific areas of investment.</u>

Linked to the matter of greater end-year flexibility is also the need to consider widening the use of ringfenced capital for specific areas of investment. An example of this would be the £500m 10-year fund, agreed in the Fresh Start Agreement, for shared education and housing. This gives the Executive a longer lead-in team to plan investment in areas of specific focus while also ensuring all parties that the finance is spent in the way it was originally planned. Too often, in-

year additional capex allocations have been spent without achievement of maximum economic potential. The model proposed here can be a means to get round this – much as the approach to funding the Belfast Region City Deal also ensures.

Building on the Irish Government's commitments in the New Decade, New Approach deal.

Additional to the above ringfencing of capital with respect to Block Grant and additional UK Government capex investment, it is important that the Executive extends this approach to any contributions made by the Irish Government, linked back to the New Decade, New Approach agreement, and subsequent Shared Island Initiative. Given the remaining uncertainty over exactly when, for instance, the A5 scheme will commence it will continue to be important that the contribution from the Irish Government can be accessed as and when required. Much like ongoing engagement with the UK Government, it will also be critical that an incoming Executive seeks to further advance the co-funding of projects with the Irish Government where they specifically address infrastructure challenges on the island.

Utilise the full extent of the Executive's RRI borrowing facility per annum.

Recent years have since the reintroduction of the utilisation of the £200m RRI facility, and this is to be welcomed. Additionally, as proposed in the UK Government's statement of 19th December 2023, raising its ceiling by £135m over the next five years would be of significant benefit to a returning Executive. However, and much like the challenging history of the now dwindling FTC allocation, it is important that its full extent is utilised per annum – especially as it remains one of the easiest tools available to the Executive in terms of adding to the Block Grant capex. At the point at which its full extent is being taken forward each year, there should then be a fuller discussion between the Executive and Treasury as to whether the annual limit should again be extended and/or a new mechanism explored.

Revitalise previous plans for local councils to co-fund/part-fund NI Executive projects (eg very localised road projects) using their own borrowing powers.

We would be keen for the Executive to revisit plans it had proposed in the draft 2017/18 budget which didn't come to fruition due to the collapse of the Executive in January 2017. Here, a proposal

was made that legislation would be brought forward which would seek to enhance the existing ability of the eleven local councils to borrow against their rates income for the purposes of localised investment. Such borrowing would be, understandably given the current challenges facing many English councils, set at an affordable and realistic level but could, in a certain scenario, be employed to assist in the completion of Executive-led projects which have a very specific local benefit.

As an example of such a project, we would note the completion of the Millenium Way in Lurgan in 2017. This £6m project was entirely funded by DfI Roads where, in the scenario we have proposed and in the context to the specific benefit of the scheme to Lurgan (less so ABC Council itself), it could be argued that the council could have utilised its new powers to co-fund such a project.

Reform the existing business case structure for capital projects.

Given the inflationary context of the last three years, it is crucial that reform is sought to how Government Clients deal with such unforeseen fluctuations. To that end, the current 10%

tolerance rules just do not work when contractors are being asked to price fixed price, multi-year contracts and this is something that requires early Executive engagement with the Treasury on.

Reconsideration of road tolling.

Although this has been previously ruled out, we believe that in the scenario where substantive upgrades are made to existing connectivity and infrastructure, road tolling should be considered as a means to fund the delivery of a project in the long-term. Precedents on these islands have been very clearly set and accepted and, if implemented at benchmarked and affordable costs, should not be seen as a barrier to the investment in infrastructure that is needed. Importantly, however, we would see such tolling as a means to fund specific schemes as opposed to being part of wider revenue raising measures for the purposes of the Executive's resource budget.

Establish an independent Infrastructure Commission for NI to ensure better long-term decision making and planning.

Although not in itself a direct means for growing the Executive's capex budget, it can undoubtedly be argued that seeing through the establishment of an NI Infrastructure Commission would enable us to make better long-term decisions which, in the fulness of time, would mean our capex budget being spent in as economic a manner as possible. The lack of medium and long-term decision making has often blighted our ability to maximise the resources we have at our disposal and a wholly independent body would likely act as a key driver in reversing this trend.

Finally, reflecting on the work of the NI Fiscal Commission in 2022, we believe the Executive should – as medium-term priorities – seek the devolution of two specific tax raising powers which would be better considered in a local context:

- *Apprenticeship Levy (potential take of c.£60m per annum). This is of particular note as local contractors and homebuilders receive no direct benefit from the national levy collection as its income is directly subsumed into the Block Grant. Given that those in the construction industry already pay a statutory levy to CITB NI, and in the context of the significant skills challenge that our sector faces, it would be much better to consider the impact of the Apprenticeship Levy in a wholly 'NI' context.*
- *Stamp Duty (potential take of c.£80m per annum). Given that average house prices in NI are significantly lower than most other UK regions, there is a clear need to consider the Duty in an NI context and whether its banding needs alteration to take account of this.*