

Grwp yr Economi, Sgiliau a Chyfoeth Naturiol  
Economy, Skills and Natural Resources Group

Dirprwy Ysgrifennydd Parhaol • Deputy Permanent Secretary



Llywodraeth Cymru  
Welsh Government

Mr N Ramsay  
Chair, Public Accounts Committee  
National Assembly for Wales  
Cardiff Bay  
Cardiff  
CF99 1NA

Our Ref/Your Ref:

11 September 2017

**Dear Mr Ramsay,**

**The Welsh Government's initial funding of the Circuit of Wales project**

Thank you for giving me the opportunity to provide additional information in relation to the initial funding of the Circuit of Wales project.

I hope that the depth of the responses provided below will provide you with assurance on the decision making processes undertaken during the funding and assessment of this large, complex project. As requested, I have incorporated the views of Mr McGuire and Mr Munday in the collation of the responses to your comprehensive questions. The responses to your questions are given in Annex 1.

The responses to the questions provided by the Clerk after the PAC session are also provided in Annex 2.

The Committee will see in the supplementary evidence that there are aspects of the handling of the project where, in retrospect, officials could have utilised improved processes. I am making sure that we are learning the lessons and improving those processes. I do hope that the Committee, in considering this evidence, will continue to bear in mind the novelty and complexity of the project, which had the potential to bring benefits to a part of Wales in need of further investment; but at the same time with considerable risks to the public purse.

Yours sincerely

**James Price**

## Overall Value for Money

### Question 1

During the evidence session on 26 June 2017, you stated that:

*“I am persuaded that we have achieved value for money for what we have got, yes, which is a project that is ready, subject to finance, to be delivered. So, yes.”*

**And that £9.3 million represented value for money regardless of whether the Project goes ahead. In light of the Welsh Government decision on 27 June, the Committee would like to know whether you believe this statement remains valid, and your justification for this view.**

The initial funding provided to the Heads of the Valleys Development Company (HOVDC) was to enable the company to develop a detailed business case together with detailed designs, to raise private funding and to obtain appropriate planning permission. Whilst the Welsh Government has made the decision not to provide the guarantee requested, this is still a live project which could be progressed by the private sector.

As mentioned in PAC, the cost of developing the Circuit of Wales project is considered to be appropriate for a project of this complexity and magnitude. Some times costs are incurred in developing projects which don't proceed. It is important to invest sufficiently to determine whether a project is viable; had we not done so then we would potentially have had less robust data on which to base our eventual decision.

When assessing the initial support to HOVDC, the Welsh Government assessed the risks of providing financial support to the Circuit of Wales (CoW) project and the relative potential benefits to the economy. It was determined that the benefit of providing the initial funding would be the advancement of the project and the securing of the economic impacts it would create. This was balanced against the risk of recovery of any costs incurred. Although recognised as a high risk at the time, these benefits were considered to represent value for money. The decision made by Cabinet does not affect the validity of this statement, which was informed by the evidence available at that time.

So yes, I still believe Welsh Government achieved value for money in the round regardless of the decision made on 27 June.

### Question 2

**The Committee would welcome any evidence of value for money in relation to payments made to suppliers on the basis of monthly retainers.**

All Welsh Government funding for the CoW project was awarded to HOVDC to enable the development of a business proposition for the project that could seek private investment. As a single purpose company, HOVDC does not have any direct employees but instead relies on contracting out all of their executive functions.

It is not unusual that professional advisors charge fees based on a fixed monthly retainer rather than charging on an hourly or daily basis rate. This is common practice in the commercial market place.

Expenditure that was claimed under the Property Development Grant (PDG) or the bank guarantee was evidenced by HODVC by the provision of invoices. All of the invoices stated the services supplied to HODVC and the associated costs, of which a number of the invoices were for monthly retainers.

For example, Aventa was paid a monthly retainer of £42,500 per month. Based on an average of 20 working days per month, this retainer equates to £2,125 per day. The Aventa service contract with the HOVDC was for the provision of services including that of Michael Carrick. HOVDC told us that the retainer also covered costs of service provision from a number of individuals with specialist knowledge in the following areas:

- Renewable energy
- Technology and data analytics
- Capital raising
- Finance and reporting
- Communication and marketing
- Construction and negotiation
- Commercial research
- Financial modelling

Other services were invoiced separately and directly by suppliers (other than Aventa) and the costs were claimed separately as part of the PDG or covered by the guarantee.

Welsh Government officials therefore believed that the value of the retainers was appropriate and that the project was being taken forward at a pace which demonstrated the necessary activities were being undertaken.

### **Question 3**

**During the evidence session, you quoted the core assumptions of 1000 jobs from the circuit and 4000 from the subsequent development. In explaining the reason for not deciding to invest further in the Circuit of Wales the Minister stated that:**

***'...once the initial track and directly related development... had reached a steady state of trading around the year 2024, the number of direct full-time-equivalent (FTE) operational jobs would be little over 100. In addition, the circuit development could create around 500 indirect FTE jobs through potential visitor spend, as well as approximately 500 FTE construction jobs while the track was being built.'***

**How do the figures quoted in the meeting reconcile with the figures quoted to support the Welsh Government decision not to fund the Project?**

My evidence to the committee referred to the work done by the University of South Wales in 2012-13 that indicated that they believed the core assumption for the CoW project at that point was just under 1,000 jobs. The report also indicated that there would be around 4000 jobs from the subsequent development. This analysis related to the project as it was envisaged at that time and it should be recognised that since then the project has evolved considerably, partially as a result of dialogue with Welsh Government, and the company's employment proposals further refined.

The changing nature of the project can be illustrated by the fact that in June 2014 the information presented to WIDAB in support of their grant application was based on direct full

time equivalent employees (FTEs) of 304 which was made up of 49 full time permanent employees plus temporary staff for events equating to 255 FTEs.

In reaching the recent decision, the analysis of potential employment was based on the due diligence of the most recent information submitted earlier this year by HOVDC in support of its application and reflects their up to date proposal.

## **The acquisition of FTR**

### **Question 4**

**During the evidence session you stated that you considered the purchase of FTR represented value for money, do you still maintain that this is the case and if so, how does it represent value for money?**

The purchase of FTR was part of the funding provided via the PDG grant to enable HOVDC to develop a business case that would enable them to access private sector funding to construct a thriving motorsport hub as part of the CoW project. The decision to provide funding was taken at an early stage and was considered to be sound at the time.

The rationale for inclusion of FTR as part of the PDG was that the company would move to the CoW site and act as a catalyst for the development of a cluster of like minded companies which could utilise the circuit. If HOVDC had been able to progress the project in the timescale initially suggested then FTR would have been able to relocate to Wales as proposed by HOVDC.

The purchase of FTR was considered to be in line with Phase 1 of the CoW as officials agreed, during the negotiation of the PDG award letter, that the purchase of FTR was a key component in developing the planned business proposition particularly in reference to it being the catalyst around which the targeted Motor Racing and Advanced Engineering Sector cluster could be built. This cluster would bring the greatest benefit in terms of impact on local jobs and the broader Welsh economy.

Unfortunately the delays resulting from the HOVDC being unable to access the required private sector investment meant that the proposed development of a 'Welsh' motorcycle was not undertaken and FTR went into administration.

As a result of these unforeseen circumstances the specific inclusion of FTR as part of the eligible costs for the PDG has not represented value for money in this particular instance.

### **Question 5**

**You also referred to the significant amounts of scrutiny which were being applied to the PDG; we would like to know what specific scrutiny there was of the FTR item?**

The Welsh Government has increased the level of scrutiny applied to PDGs since the time of this award. As I advised the committee in my evidence, the level of scrutiny now applied is significantly more rigorous.

In relation to the FTR item, the rationale for the purchase was verbally questioned prior to agreement that the costs for the purchase would be included as eligible expenditure. Scrutiny of the claim resulted in part of the expenditure relating to FTR being disallowed as it related to working capital, and not to the eligible expenditure for the purchase.

Welsh Government accepts that more scrutiny should have been undertaken at the appraisal stage before inclusion of the purchase of FTR within the PDG eligible costs. As stated at the evidence session we have improved the level of scrutiny in this area.

### **Question 6**

**Despite your assurances at the meeting that the approval for purchasing FTR with PDG funds ‘.was considered in detail and thought through’ and ‘aligns with the project’ the Committee is still unclear about how these conclusions were drawn. Therefore, please could you explain precisely:**

**- how the rationale for HoVDC to acquire FTR aligned with the purposes and the objectives of the PDG scheme? and;**

**- how the rationale for HoVDC to acquire FTR fitted within the purposes of Phase 1 of the CoW Project?**

The Circuit of Wales is a unique property development project for which the company were seeking support to build a business proposition to secure private sector funding and to pursue a planning application. Whilst the CoW is not a standard property project, it is more aligned to property development than any other activity. Welsh Government has the power to provide grants for any purpose but it is preferred, where possible, to utilise a standard grant scheme.

The Property Development Grant (PDG) scheme provides support to business to develop and build property solutions in Wales, whereas investment grants are more targeted at investment into an existing or new business rather than a property.

Consequently PDG was considered to be the best fit for the project as the focus was on developing a successful race circuit. HOVDC had also stated to officials that FTR was as equally important to the success of the Project as the MotoGP Licence. It was agreed that the expenditure would be appropriate to take the project further.

The purchase of FTR was considered to be in line with Phase 1 of the CoW as officials agreed, during the negotiation of the PDG, that the purchase of FTR was a key component in developing the planned business proposition particularly in reference to it being the catalyst around which the targeted Motor Racing and Advanced Engineering Sector cluster could be built. This cluster would bring the greatest benefit in terms of impact on local jobs and the broader Welsh economy.

If the purchase of FTR had been delayed until Phase 2 of the project then the business case being developed to access further private sector funding as part of Phase 1 would have been weakened. Inclusion of FTR in this phase of the project indicated that there was already interest and a level of commitment to the Circuit of Wales and the associated technology park.

### **Question 7**

**The Committee are unclear from your evidence and would welcome clarification on whether the inclusion of an item of £300,000 such as FTR, which the Auditor General stated does not align with a grant scheme’s core purposes, would be considered exceptional, and your reasons for such a decision.**

The rationale behind the inclusion of FTR as eligible costs for the PDG funding was that officials considered that FTR would bring expertise which would be the catalyst for a future

cluster of related businesses around the Circuit of Wales. At that time, the development of the business case for the CoW was at a critical stage and HOVDC explained to officials that both the MotoGP licence and the purchase of FTR were necessary for financial close and fundamental to supporting future revenue to secure the investment.

Looked at in isolation, we can see why the AGW might consider the purchase of FTR could have been considered to be exceptional. However, the provision of the PDG was focused on enabling HOVDC to undertake a property development process to get to financial close: planning consent and fund raising were the key drivers for success. At the time officials considered that the purchase of FTR was in line with the objectives of the HOVDC developments being funded by the PDG and therefore concluded the purchase of FTR was not exceptional.

The scrutiny process for PDG applications has been significantly enhanced since the funding to HOVDC was awarded. An application for PDG funding of £2m would now need to be considered by the Property Leadership Team (PLT), Investment Panel then the Welsh Industrial Development Advisory Board (WIDAB) before a recommendation is made to the relevant Minister. This significantly increased level of scrutiny is likely to ensure items of a potentially exceptional nature are fully discussed and explored.

Hence, if the PDG funding to HOVDC was to be considered under this new process, it is likely that the purchase of FTR would be highlighted as exceptional and would be reported as such in any recommendation to the relevant Minister.

#### **Question 8**

**The PDG was backdated by almost three months (for reasons which the Welsh Government has not yet explained to the Committee) and the FTR transaction took place before the grant was awarded. Please can the Welsh Government confirm whether the Welsh Government reviewed the FTR sale/purchase contract before approving FTR's inclusion the grant, and if not, why not?**

The approval for the PDG funding to HOVDC was given by the Minister on the 9<sup>th</sup> August 2012. Following ministerial approval, officials developed the award letter in conjunction with legal services and met with HOVDC to explain the details of the letter and associated conditions. The final, agreed award letter was subsequently issued to HOVDC on the 11<sup>th</sup> October 2012 and signed by the company on the 16<sup>th</sup> October 2012.

It is not uncommon for the start date of the funding period identified in the award letters to be the date of approval, in this case the 9<sup>th</sup> August 2012. In this case the start date for the funding period was given as the 1<sup>st</sup> August 2012 in the award letter at the request of HOVDC. Such changes are made at the discretion of officials involved prior to formal approval of the project. Any work undertaken between the start date of the funding and the date of approval is undertaken at risk by the company requesting the funding.

In this case, HOVDC did not include any expenditure prior to the 9<sup>th</sup> August in any of the claims made against the PDG offer.

I am unable to confirm that the Welsh Government reviewed the FTR sale/purchase contract before including the purchase of FTR within the grant's eligible costs. Sufficient evidence was provided by Shoosmiths, acting on behalf of HOVDC, to demonstrate that the contract had been signed and was in place prior to the claim being paid. However, in my view, the FTR contract should have been reviewed before the purchase of FTR was included as eligible expenditure or at least before the claim was paid. As detailed

previously, in response to question 7, the scrutiny process for PDG applications has been significantly improved since the funding to HOVDC was awarded.

### **Question 9**

**The Committee has particular concerns around the decision to purchase FTR potentially not being approved by the Minister. We would welcome a response on why there is no evidence of the approval of grant funding for the acquisition of FTR being brought to the Ministers attention? And under what circumstances do you think it is appropriate to bring or not bring such an item to the Minister's attention?**

As answered in the PAC session, when approval for grant funding is requested from the Minister, the associated advice does not normally detail all eligible expenditure that is likely to be included in the award letter.

At the time, officials considered the purchase of FTR to be consistent with the objectives of the PDG scheme, and did not consider the purchase to be exceptional. The provision of the PDG was focused on enabling HOVDC to undertake a property development process to get to financial close, with planning consent and fund raising being the drivers for success. Officials considered the inclusion of FTR to be an important element and as the costs were deemed eligible in terms of PDG, the purchase was not explicitly brought to the attention of the Minister.

In general, Ministerial submissions do not detail all of the expenditure included in a grant application. However, if items are considered to be novel, contentious, repercussive or exceptional in nature they should be brought to the Minister's attention.

As detailed in question 7, if the enhanced approval process for the PDG were to be applied to the CoW application now, there is an expectation that the purchase of FTR would have been considered to be exceptional and would be specifically brought to the attention of the Minister.

### **Question 10**

**The Committee noted the comments from yourself and Ms Mayes about record keeping that 'officials should keep detailed records of all meetings and conversations with funding applicants' and that 'good practice would be the minimum level necessary to demonstrate why you did what you did'. The Committee would like to know what justification there is for the officials not keeping records concerning the decision around FTR and why is there no contemporaneous documentation relating to FTR?**

In this instance it is my view that the standard of record keeping at that time should have been better. However, that error also appears to be an administrative shortcoming largely as a result of the volume of complex information being shared in a significant number of meetings and other discussions between officials and HOVDC; it does not reflect a conscious decision on the part of officials not to produce an appropriate record of the decision process or to retain contemporaneous documentation.

The project was fast moving and any exchanges around the inclusion of FTR would likely have occurred in face-to-face meetings rather than via a sharing of hard copy documentation. Officials were content that the rationale behind the inclusion of FTR in PDG was in line with the grant scheme, and that the purchase of FTR was an integral part of the first phase of the project that would enable HOVDC to move forward.

Since that time, there has been an increased focus within Welsh Government and the department on the need to keep appropriate records to demonstrate the rationale behind decisions being recommended and made, for example I have issued communications to all ESNR officials informing them of the importance of keeping accurate records and it has been discussed in management team meetings and at all staff events.

### **Further questions in relation to oral evidence**

#### **Question 11**

**During the evidence session, you stated that the HoVDC is the second time the Welsh Government has provided a loan guarantee. The Committee would welcome further information on the provision of loan guarantees by the Welsh Government. In particular:**

- what was the first guarantee referred to in evidence?**
- how was the guarantee secured?**
- was it called upon? If so, did the Welsh Government get the money back?**
- have any other guarantees been requested, declined or provided?**

The first loan guarantee provided by Welsh Government was in respect of a Unity Mine overdraft facility from their bank of £2m. The maximum amount of the guarantee was £1.6m and this was agreed in September 2012.

The Unity Mine guarantee was secured on mining assets at the site

The guarantee was called in the financial year 2013/14 after the company entered into administration in October 2013. The amount called and paid to the bank was £1.56m, and £1.57m was recovered following the decision by the joint administrators to sell the mining assets in February 2014. The payment to Welsh Government of £1.57m covered the value of the guarantee called, plus fees and interest, and was made in July 2014.

Unity Mine is no longer trading which is why Welsh Government can provide the detail relating to the guarantee to this company.

Welsh Government has received requests for guarantees from third parties as part of negotiations on other projects, and some of these have progressed beyond exploratory discussions.

#### **Question 12**

**The need for separation of duties in terms of officials involved in supporting funding bids from those responsible for payment authorisation is a fundamental control. The Committee received reassurances from yourself and Ms Mayes at the meeting that the processes exist within the Welsh Government. However, these assurances still seem at odds with the findings within the Auditor General's report that on 11 January 2013 an official instructed his finance colleague to pay a grant claim, even though Welsh Government officials had not seen the relevant parts of the conditional sale contract. We would therefore welcome clarification on how this official's instruction and its execution demonstrate the maintenance of an appropriate separation of duties.**

Welsh Government completely agrees that separation of duties between the finance team and the team who regularly engage with any grant recipient is crucial.

In this case, the team who were dealing with HOVDC on a regular basis received the grant claim and associated evidence from the company. The details of the claim were considered to confirm that evidence of expenditure was provided in line with the award letter. The evidence and the confirmation that the claim was valid were then issued to the finance team for consideration and approval.

In line with their independent assessment of the claim, the finance team required additional information from HOVDC including relevant VAT invoices and confirmation of payment from the relevant legal representatives. Consequently there was considerable email communication between officials in the two teams to clarify exactly what evidence should be provided. This additional information was obtained from HOVDC by the team dealing with the company which is standard practice.

Once this additional information was provided by HOVDC, the evidence was provided to the finance team for consideration and approval. Whilst the email from the officials involved in supporting HOVDC and their funding bid does state 'I therefore would confirm my revised confirmation that the grant claim should be paid', this was not an instruction but a recommendation. As demonstrated earlier in the email trail, the finance team were unwilling to approve payment without sufficient evidence being provided. The payment was approved based on sufficient evidence being provided to the finance team to provide them with the assurance they required.

Whilst none of the officials involved in these processes had seen the whole of the conditional sale contract, sufficient evidence had been provided to demonstrate that the contract had been signed and was in place.

I am therefore content that the email trail demonstrates the maintenance of appropriate separation of duties.

### **Question 13**

**The Auditor General's report identifies that PDG grant payments to HoVDC included reimbursing HoVDC for a deposit held in escrow, and this type of payment would not normally be considered eligible for grant because it represents settlement of a payment not yet defrayed. During the evidence session, Ms Mayes set out that in this instance the Welsh Government believed the Welsh Government was correct to pay to HoVDC the full amount claimed, however it is not clear why this conclusion was drawn. While we accept that a deposit held in an escrow account is not unusual in conditional property sales transactions we also note that such amounts are not normally eligible expenditure - so please can you explain why in this case the Welsh Government considered this grant claim payment to be correct?**

The PDG award letter stated that HOVDC would be paid on a defrayed basis, which means that the payment to suppliers etc. had to have left HOVDC's bank account. The Welsh Government usually considers payment into an escrow account to be eligible for grant as the payment has been defrayed by the grant recipient. There have been a number of instances where grant payments have been made where the expenditure has left the grant recipient's account and been placed in an escrow account.

In this case, the finance team requested specific additional information to demonstrate that the money had been defrayed by HOVDC. Confirmation was received from HOVDC's solicitors that the £200,000 for the land was transferred to the land owner's solicitor on 17 December 2012. In accordance with the contract between HOVDC and the land owner,

£100,000 was held by the land owner's solicitor (in the escrow account) as a deposit whilst the remaining £100,000 was paid to the land owner.

Hence, officials were content that the whole of the £200,000 had been defrayed by HOVDC and, as such, was an eligible element of the claim for payment.

#### **Question 14**

**In response to the Committee questions about why the HoVDC accounts were not audited, Ms Mayes stated that the company accounts were not audited because the companies were not required to do so. We have some significant concerns about this because a requirement of the loan guarantee agreement was for HoVDC to provide audited financial statements to the Welsh Government. Therefore we would like clarification on why this condition to provide audited financial statements was imposed as part of the loan guarantee? And then why this condition was not enforced?**

The guarantee loan agreement between the HOVDC and the Welsh Ministers states in the Conditions Precedent that HOVDC needed to provide a copy of their 'audited financial statements for the period ending 31 May 2014'. This is a standard banking condition and was included in the agreement in order for it to operate under commercial terms in line with Market Economy Operating Principles (MEOP). Considering the status of the company the condition should have been better worded to require the provision of statutory accounts as legally HOVDC were not required to provide audited accounts

The external legal team advising the Welsh Ministers drafted the agreement and also sought the evidence for the Conditions Precedent from HOVDC's lawyers. Subsequently, HOVDC's lawyers confirmed in writing that they were unable to provide audited accounts for May 2014 as there were no audited financial statements prepared for HOVDC. Instead unaudited financial statements for the year ended 31 May 2013 were provided to our lawyers. Management accounts and cash flow forecasts to December 2014 were also provided at that time. Given the fact that the agreement was due to be signed in July 2014 it should not be surprising that accounts for the period up to 31 May 2014 were not available.

Our lawyers subsequently advised officials that sufficient evidence had been obtained from HOVDC to provide assurance that this particular condition had been met and also provided hard copies of the evidence for this and other conditions.

#### **Question 15**

**The Committee questioned the decision not to inform WIDAB about the potential loan guarantee support when they were considering whether to support the £18 million repayable business finance application for this project. We would welcome clarification that, if the same circumstances arose, whether the Welsh Government would now tell WIDAB about the potential loan guarantee?**

The WIDAB guidance has been updated as result of the WAO recommendations from the initial funding to the Circuit of Wales.

The revised Business Finance Guidance states that as part of the recommendation process for a WIDAB case the Head of Sector must ensure that WIDAB is informed about all other Welsh Government support to a project that it is asked to consider, whether or not that support has yet been approved.

As a result of this revised guidance, WIDAB would now be informed about the potential loan guarantee support if the same circumstances arose.

### **Question 16**

**The Committee were particularly concerned about the findings in the Auditor General's report that the Welsh Government's own officials advised that 'providing the loan guarantee in addition to the RBF might be problematic in relation to state aid' and that they were '...unable to offer any reassurance to Ministers that the proposals would stand up to either judicial scrutiny or analysis by the European Commission'. Given the advice provided to the Welsh Government in relation to the risk of providing an unlawful State Aid, we would like further clarification on what basis has the Welsh Government acted as a market investor?**

Prior to recommending that that a guarantee was provided to the HOVDC the Welsh Government satisfied itself that the interest rate was in line with market economy principles. In the determination of the interest to be charged to HOVDC for the guarantee officials considered:

- The interest rate charged by HOVDC's bank for the secured loan for the CoW project;
- The interest rates that Finance Wales would have charged for an unsecured loan to a small company; and
- The European Commission's guidance on determining the reference rate methodology ([http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008XC0119\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008XC0119(01)&from=EN)) for a start up company with a low level of security.

The interest rate charged to HOVDC for the guarantee was greater than the interest rates identified in this research. A detailed legal contract was developed using external legal expertise which included taking security on the assets of the HOVDC (and its subsidiaries) and a significant increase in the interest rate if the guarantee was called in.

The implementation of this methodology provided assurance that the Welsh Government was acting as a market investor.

When providing advice to Ministers, it is imperative that officials advise Ministers of any potential risks associated with any decision. With any state aid, especially in the case of market economy operator principle (MEOP), there is always a risk of challenge. This risk was highlighted in the advice provided to the Minister to enable her to take an informed decision taking into account all the available information and analysis.

### **Question 17**

**The Committee received little clarity on its questions about what certainties the Welsh Government had around the HoVDC ability to pay back the loan guarantee. Given the Welsh Government decision, do you now agree that the Welsh Government has in effect provided risk free finance to HoVDC, which could breach State Aid rules? If you do not agree, why not?**

Security for the guarantee was taken by Welsh Government in the form of a debenture over all of the assets of HOVDC and its subsidiaries, albeit this security was ranked behind a first charge of £2m in favour of the lender for a separate facility. In awarding this loan guarantee, consideration was given to the degree of risk being taken by Welsh Government and the

level of security available and the fee for the guarantee was priced accordingly in-line with the market rate for provision of finance of this type.

In providing a loan guarantee on wholly commercial terms, Welsh Government was acting in line with the Market Economy Operator Principle (MEOP) as defined by the European Commission and which therefore does not confer a State Aid.

Advice was provided to Ministers that this was a high risk transaction and, as in any such case, we also advised Ministers that there was potential for a State Aid challenge (as there always is in MEOP cases).

We do not agree that HOVDC were awarded risk free finance, but rather they entered into, in effect, an unsecured loan facility which was priced accordingly inline with the market and was considerably more expensive than a similar secured facility would have been. The Circuit of Wales is still a live project and it remains a possibility that the guarantee may be paid back, with interest, to the Welsh Government.

### **Clarifications and additional information**

#### **Question 18**

**During the evidence session, you quoted a figure of 20% as the typical proportion of total project cost required to reach financial close, which led to you drawing the conclusion that the Welsh Government's exposure of 2% for the total project cost of circa £400 million to represent good value for money. What is the source for this 20% figure? Please can you clarify the type of project that is used to calculate the figure and also explain why such projects are appropriate comparators for the Circuit of Wales project?**

Grant Thornton UK LLP has highlighted that, in its experience, development costs can be in the order of 20% on property and regeneration deals. Unfortunately individual project details behind this information cannot be provided as Grant Thornton is unable to identify individual projects because of client confidentiality restrictions.

It stated that, as a broad rule of thumb, the total price of a scheme can be split approximately one third land costs, one third construction costs and one third profit, with the latter including the development costs. Assuming profit is in the 10-15% range (which would broadly represent the Weighted Average Cost of Capital for the construction sector) then the development costs are around 20%. Whilst Grant Thornton UK LLP were able to highlight this rule of thumb, they highlighted that they do not have any knowledge of the specific case and therefore are not able to provide a definitive view. The approximation is only able to give an indication of the likely range of costs rather than a firm view.

#### **Question 19**

**We were surprised that you stated that you did not believe the number of related companies or individuals was as high as nine, which was the figure quoted in the Auditor General's Report, given that the report was fact checked with HoVDC. The Committee understands from a Freedom of Information request disclosed by the Wales Audit Office that the names of seven companies [the names of two further individuals were not disclosed] were:**

- Aventa Capital Partners Ltd;
- Stephenson Harwood LLP;
- Insight Infrastructure Ltd;

- Shaun Meadows Marketing Ltd;
- Barton Communications Ltd;
- Kalergo Ltd; and
- Altitude Aviation Advisory Ltd

**Which of the companies in the list disclosed by the Wales Audit Office do the Welsh Government believe are not related and what do you believe is the correct figure for the total number of related companies or individuals who received payments under the Property development Grant or loan guarantee arrangement?**

Welsh Government's due diligence process includes consideration of directors and shareholders of companies requesting funding. Checks are made to determine whether the directors or shareholders have any associated companies and/or county court judgements (CCJs) or whether any of the directors have been banned from being directors at any point in time. Where issues or concerns are raised, then further investigations in these specific areas are undertaken. We would not necessarily consider directors or share holders of related companies as having the ability to influence the company being funded in the normal course of business and so would not look at them, focusing only on those individuals with direct means to influence

Whilst WAO have identified companies with links to HOVDC some of the links are wider than those that Welsh Government would consider to be a related company or individual..

Whilst Welsh Government accepts the WAO list of companies that have some wider links to HOVDC, none of the companies identified below have common directors or shareholders with HOVDC therefore they would not be able to have any effect on the day to day operations of HOVDC:

- Shaun Meadows Marketing Ltd;
- Barton Communications Ltd; and
- Kalergo Ltd.

From the list of companies identified above, the Welsh Government considers that the following companies are related to HOVDC due to the presence of common directors or shareholders:

- Stephenson Harwood LLP;
- Aventa Capital Partners Ltd;
- Insight Infrastructure Ltd;
- Altitude Aviation Advisory Ltd

These companies received payments under the Property Development Grants or loan guarantee arrangements.

In order to ensure that related companies who are providing services to a possible grant recipient are identified, amendments have been made to the Business Finance application form and guidance in line with the WAO recommendation. Additional due diligence is now undertaken if a related company is identified as a supplier on the application form for funding.

Directors and shareholders can change at various points in time and in some instances the organisation applying for funding will not have identified all the suppliers at application

stage. Therefore, the Welsh Government is unable to always mitigate the risk that related companies may be used by grant recipients. Any companies used as suppliers must provide their services on an arms length basis and be able to demonstrate value for money.

### **Question 20**

**During the Committee, you stated that there had been a total expenditure of £55 million by all parties, of which the Welsh Government has an exposure of about £9.2 million. This is a larger figure than the £30 million which was quoted in the Auditor General's report which had been fact checked with HoVDC. You undertook to verify the £55 million sum and provide the information to the Committee. Please can you confirm the amount of private sector investment in the Project which is now at risk in light of the Welsh Government decision? Please also provide the source of this information and what the Welsh Government has done to check its accuracy?**

The £55m figure was taken from a confidential document provided to Welsh Government by HOVDC after publication of the WAO report. The information was not considered as part of the due diligence and did not form part of the Cabinet Paper. Hence, the Welsh Government has not undertaken any detailed checks on the information provided from HOVDC but our high level review suggests the amount of private sector contribution to the project is around £50m.

### **Question 21**

**You made reference to the numbers of businesses the Welsh Government supports and the failure rates associated with them, stating that 'there were 1,000 investments over five years, of which 3.4 per cent have gone wrong'. The Committee would welcome information on the source and accuracy of the figures quoted. Furthermore, the Committee would welcome clarification on what you meant by 'gone wrong' do you mean by business failure, not achieving the intended outcome (e.g. jobs created) or something else? Please clarify how you define success and failure.**

The source of this data is internal records of offers made for support under the Welsh Government's support for Business Finance<sup>1</sup>, during the period of the Fourth Assembly (June 2011 to April 2016). It should be noted this data was collated in a 'snapshot analysis' in November 2016 from historic records and at that time was considered to be a fair reflection of offers made during the 4th Assembly. The number of offers made during this period was 1,264.

To clarify the meaning of "gone wrong", in terms of these offers, 43 projects (3.4%) failed to deliver all the expected outputs under the specific terms and conditions of their individual offers of support. These projects were therefore subject to some form of grant recovery by Welsh Government officials, resulting in the issue of a formal invoice under debt management protocols.

Within the overall total, 32 projects (2.53%) supported were subject to business insolvency, liquidation or administration. In these instances, officials were unable to assist the business prior to its failure and the appointment of an insolvency practitioner.

The remaining 11 projects (0.87%) were subject to some form of recovery activity, due to the failure of the business to meet its ongoing obligations (for job creation/safeguarding

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<sup>1</sup> Business Finance relates to a number of funding schemes that were available during this period including Wales Economic Growth Fund, Repayable Business Finance, Tourism Investment Support Scheme, Digital Development Fund, SMART Cymru.

and/or asset purchase/retention) under the terms and conditions of the offer of support. In all these cases, the individual businesses continued to trade and officials undertook debt management activity to recover funds previously released to the business.

A project is considered to have failed if, after receiving payment in line with its achievements, the recipient fails to maintain the project related assets and jobs for the required length of time stipulated by the terms and conditions of the offer. This failure can occur at any point during the life of the project.

Following release of final payment, every project is required to satisfy the “conditions” period applied to each individual offer. This is the period of time that jobs and assets supported by the project must be retained for.

The applicable conditions periods applied to offers made under Business Support are 3 years (SMEs) and 5 years (non SMEs) respectively, from the date of the last/final payment of support.

A successful project would see these conditions periods satisfied in full.

### **Question 22**

**During the evidence session, the Committee questioned you on whether the due diligence for the programme was rigorous and optimum. Due to the ongoing process, you were unable to provide a full response to this during the meeting but you undertook to provide a note giving more details of the due diligence process following the Cabinet decision, which we would be grateful if you could include as part of the response to this letter.**

In approaching the design of the due diligence process, Welsh Government had regard to the statement made by the Cabinet Secretary for Economy and Infrastructure and to the type of process that a market economy investor would undertake in the context of the nature of the project and the scale of the financial support requested.

Comprehensive and rigorous due diligence was undertaken by external advisors on the application for support from HOVDC. This due diligence reviewed the normal commercial concerns relating to the company business plan, market analysis construction cost and legal contracts. In addition the due diligence team have also reviewed the economic impact claimed by the company, legal position with regard to State Aid, the impact on Welsh Government finances and budgets and has also included a corporate intelligence review of key individuals (fit and proper person test). In line with the recommendations of WAO in their recently published review on the initial funding awarded to the project, the finance experts also looked at related company transactions both in the past and going forward.

To summarise, external due diligence was commissioned in the following areas:

- Financial Due Diligence
- Fit and Proper Person Assessment<sup>2</sup>
- Market Analysis
- Economic Impact Analysis
- Quantity Surveyor Advisors

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<sup>2</sup> In making the appointment in relation to the fit and proper person test officials were mindful of the need to include in this a review of related companies and in particular Aventa Capital Partners. This aspect of the work was considered to be a normal commercial requirement but also recognised the issues raised by the Auditor General in his April report in relation to the initial funding provided to the project

- Legal Advisors on Contracts
- Legal Advisors on State Aid.

Additional internal due diligence was provided in the area of public law.

The Cabinet Secretary for Economy and Infrastructure has stated that the appropriate due diligence information, that can be released, will be published. Officials are considering how much of this advice can be released in light of confidentiality obligations, the Data Protection Act and other legal and commercial considerations. The Welsh Government will publish the relevant information in due course.

**Question 23**

**In the Cabinet Secretary’s Plenary statement of 27 June, he informed AMs that: ‘following discussions with Office for National Statistics and Her Majesty’s Treasury during the due diligence process, it is assessed that there is a very significant risk that the full £373 million debt of the entire Circuit of Wales project would be classified against Welsh Government capital spending.’ The Committee would welcome clarification as to when these discussions took place, and at what point in the due diligence process this accounting problem was first identified**

Welsh Government officials have been having discussions with the Office of National Statistics (ONS) around the classification guidelines since summer 2015. These discussions assisted Welsh Government officials’ assessment of risk in the Circuit of Wales project. The ONS does not provide formal classification advice on potential developments, but on final contracts. However, they work collaboratively with Welsh Government officials to ensure policy decisions are fully informed.

Officials were engaged in discussions about iterations of the Circuit of Wales proposal with the Her Majesty’s Treasury (HMT) classification team on the potential accounting problem since March 2016 and as recently as June 2017. The assessment of the classification risk relating specifically to the final Circuit of Wales proposal was undertaken by Welsh Government officials based on advice from HMT and was informed by the findings from the external due diligence reports in June 2017.

**Question 24**

**The Committee note the reference to an ‘internal governance group’ within the Welsh Government to provide expert challenge. The Committee would like further information on what this Group is, who is on the Group; what challenge they offered in relation to Circuit of Wales, and how did officials respond?**

The Internal Assurance Group was set up in March 2017 to provide an additional level of scrutiny to the decision making process around the Circuit of Wales project. The group met three times to discuss the proposal prior to the submission of the Cabinet paper in June 2017. The role of the group was to assist Economy, Skills and Natural Resources (ESNR) officials to deliver a fair and balanced report to Cabinet which covered all the key areas of concern.

The group consisted of key individuals from across the Welsh Government including the Director of Finance, Director -Communities & Tackling Poverty, the Chief Economist and Director of Legal Services Department. The group also included Directors and individuals with key skills (eg governance, Finance, communications) from across ESNR.

The group provided a significant level of challenge to the due diligence process; ensuring that key considerations had not been overlooked or testing assumptions made by ESNR officials. ESNR officials welcomed the challenge of the Assurance Group.

The due diligence reports were also shared with the group together with appraisal reports of the findings from the external experts. The material issues raised by the Assurance Group were captured within the Cabinet paper on which the Government's decision was based.

## **The Welsh Government's responses to the Auditor General's Report**

### **Question 25**

**As discussed during the evidence session, the Committee were concerned by the Written Ministerial statement which expressed the Welsh Government's 'surprise and disappointment' at the Auditor General's decision to publish his Report during the pre-election period; and stated that they had not had sufficient time to consider and respond to the Report prior to its publication. A subsequent response to written assembly question from Adam Price clarified that officials did know about the intended publication of the report on 17 March 2017. Given that officials knew over a month before the Minister was formally informed, we would welcome clarification on whether the Minister was informally informed of the Auditor General's intention to publish before being formally informed on 24 April?**

Officials have been unable to identify any evidence that the Minister was informally informed of the Auditor General's intention to publish before being formally informed on 24 April.

### **Question 26**

**The Committee were particularly concerned that on a number of occasions throughout the evidence session you inferred that there were factual inaccuracies in the Auditor General's Report. As the Committee understands it, the Auditor General reports are subject to a substantial and rigorous clearance process in order to be as fair and correct as possible, and we rely on these reports to undertake further scrutiny of often sensitive subjects and we take the suggestions of inaccuracies in the report very seriously. Therefore, aside from the error concerning the Economic Efficiency test being a UK and not a Welsh test please can you detail, with supporting evidence, what the other inaccuracies in the report are?**

My remarks about accuracy of the AGW report relate to our concerns that some of the details as presented in the WAO report, without associated context and additional information being given, could lead to a mistaken interpretation of those details or incorrect inference by a reader without any other knowledge of the matters covered.

Essentially, in a number of areas, we had asked the AGW to provide additional information to provide a fuller picture, allowing others to reach a fair conclusion when scrutinising the report. I would be happy to provide the Committee with a copy of my letter to the AGW on these points.

### **Question 27**

**Finally, during the evidence session you referred to having 'learnt lessons as a result of this [the initial funding of the Circuit of Wales], which will allow us to do it better next time around'. Please could you set out what the lessons learnt were and what actions the Welsh Government is taking?**

The Welsh Government is committed to continuous improvements and is always looking to improve its processes. For example, in June 2014 as part of our improvements to the approval process for Commercial Loans, the consideration of sector supported PDGs was included in the Financial Approval process.

The WAO report into the funding of the Circuit of Wales raised a number of recommendations from which the Welsh Government were able to learn lessons:

- There is now a requirement for applicants to declare on the Business Finance application form if any transactions involving Business Finance will be conducted through related companies. The applicant must provide details of these transactions. The information that is provided by the applicant, will be used as part of the Welsh Government due diligence procedures;
- As part of the recommendation process for a WIDAB case the Head of Sector must ensure that WIDAB is informed about all other Welsh Government support to a project that it is asked to consider, whether or not that support has yet been approved. Our internal guidance has been strengthened to reflect this requirement; and
- The importance of keeping a written record of the analysis of a project that includes key evidence, risk analysis and mitigation and rationale for any recommendation to Ministers has been communicated to officials.
- The importance of time for clearance with appropriate officials, who have the detailed knowledge and a clear understanding of timelines etc.

Welsh Government has only considered a guarantee on a very small number of occasions and in each case the circumstances and the details have been very different. Whilst guarantees are only one form of MEOP, this is an area in which officials have gained considerably more experience and have developed a methodology that is much more sophisticated than what was in place at the time of the CoW guarantee. The key lesson learnt from the guarantee relating to CoW is that we now obtain evidence of MEOP from external advisers to provide assurance on the commerciality of the terms of the agreement

## ANNEX 2

### **Response to Questions raised by the Clerk in June 2017**

#### **1. Total expenditure incurred and the funding the Welsh Government has put in to date**

The total expenditure incurred as reported by Heads of the Valleys Development Company (HOVDC), up to early June, is detailed in the response to Question 20 in Annex 1.

The funding the Welsh Government paid out in relation to the Circuit of Wales projects is as follows:

- £2 million: Property Development Grant Fund
- £7.3 million: Repayment of the HOVDC's bank loan under the Welsh Government Guarantee.

#### **2. Internal guidance officials adhere to when assessing grant applications;**

The Welsh Government's Grants Centre of Excellence has developed minimum standards for assessing grant applications. These minimum standards provide best practice for the development; implementation and monitoring of grant schemes across the Welsh Government. Officials use these standards to develop proportionate desk instructions for individual grant schemes.

The minimum standards for application based grant schemes are available on the Welsh Government internet at: <http://gov.wales/funding/grants/contact-us/?lang=en>

These minimum standards would have been utilised in respect of the recent application from the Circuit of Wales.

#### **3. Provide further details, following the Cabinets' decision on funding the Circuit of Wales project, on the due diligence process carried out.**

Details of the due diligence process carried out is provided in the response to Question 22 in Annex 1.

#### **4. Investigate who from the Welsh Government made the comment on a press statement about 'grandstanding' and advise the Chair.**

I have reviewed the press statements issued by Welsh Government on this matter and none contain a comment of that kind.