Chapter 6 Department of the Environment, Heritage and Local Government

6.1 Urban and Village Renewal

A continuing programme of urban and village renewal and regeneration is sponsored by the Department of the Environment, Heritage and Local Government and funded by a combination of European Structural Funds (ERDF and EAGGF[34]), Exchequer, local authority and contributions from other participating bodies. EU involvement is through Sub-Programme 3 of the Operational Programme for Local Urban and Rural Development 1994 – 1999 (OPLURD) which was designed to support a wide-ranging programme of urban and village renewal and encourage social and economic development at local level. The programme was categorised under 5 measures.

- Flagship projects in the five main cities for the economic and social regeneration of their central areas.
- Landscaping, pedestrianisation and physical improvements to streets and the eradication of derelict sites in urban centres throughout the country.
- Village renewal measures, including general amenity improvements and the development of focal meeting points as well as a range of other improvements designed to underpin the economic future of the villages concerned and the agriculture-based community on which they are dependent.
- Assistance to civic trusts, local authorities and other local development bodies to rehabilitate the built environment in urban areas, through the conservation and restoration of urban architecture and heritage buildings.
- A programme of cultural initiatives in the Temple Bar area of Dublin.

The Urban and Village Renewal Measure of both the Border, Midland and Western and the Southern and Eastern Regional Operational Programmes continues and expands the work undertaken with OPLURD assistance under 4 categories over a planned period 2000 to 2006. Works on physical, social and economic rejuvenation of the Dublin Docklands replaced Temple Bar in this programme.

Funding for the programme in the period 2000 to 2006 is provided from Exchequer and local sources and, to a lesser extent than the 1993-1999 programme, by the ERDF. The programme is managed by the Border, Midlands and Western and the Southern and Eastern Regional Assemblies. The individual projects are carried out under contract to the relevant local authorities and other promoting bodies. Exchequer and EU funding for the projects are channelled through the Vote for Environment, Heritage and Local Government.

EU regulations require that a minimum of 5% verification checks be made on expenditure incurred on projects under each Sub-Measure. These checks are undertaken by the Department's EU/Internal Audit Unit at Implementing Body level and are in addition to the annual audits carried out by the Local Government Audit Service, which is charged with the responsibility for auditing local authorities.

Table 6.1 gives an overview of Vote funding for years 1998 to 2002 – the period covered by my examination.

[34] European Regional Development Fund and European Agricultural Guarantee and Guidance Fund.

Table 6.1 Overview of funding and expenditure on the combined programmes 1999 - 2002

Year	Original Estimate €m	Expenditure €m	Saving on Original Estimate €m	Supplementary Estimate €m	Surplus surrendered by the Vote €m
1999	27.45	14.65	12.80	(10.16)	7.05
2000	28.64	13.19	15.45	(13.46)	1.72
2001	25.88	15.26	10.62		0.76
2002	56.44	29.36	27.08		47.57
	138.41	**72.46**	**65.95**	**(23.62)**	**57.10**

Shortcomings in the Estimating Process

Analysis of these figures indicates that the Estimates provision under this subhead has been consistently far in excess of the outturn over the period 1999-2002.

I asked why the slow rate of draw-down by beneficiaries has apparently not been factored into Annual Estimates calculations and what measures the Department is taking to align the Annual Estimates provisions with the expected outturn.

The Accounting Officer informed me that despite evidence of strong demand from local communities for funding under the urban and village renewal measures of the programme, take up under the schemes has been slow, leading to the savings under the relevant subhead for the period from 1999 to 2002. It appears that a combination of factors affected the start up of the new regional programmes, and to a lesser extent, OPLURD

- There was a lack of continuity between OPLURD and the current Operational Programmes because of the delay in securing EU approval for the new programmes
- Urban renewal projects tend to be of a relatively small scale, and there were difficulties engaging contractors prepared to undertake such projects, at a time when the construction industry was operating to full capacity
- The public consultation process concerning these schemes has become increasingly protracted – in particular, the major initiatives in the five main cities entailed a lengthy period of preparation and consultation
- High tender prices gave rise to delays - with less competition, tenders received in some instances were above the range anticipated by the local authorities and a further call for tenders was considered necessary.

He stated that new programmes tend to start slowly and gather momentum. In this regard, he pointed out that overall outturn expenditure rose from 34% to 70% of the revised estimates provisions over the years 2001 and 2002.

He gave the following more detailed observations concerning the years in question.

- In **1999**, there was no one specific reason for the under-spend under OPLURD. Due to a variety of circumstances - including the timescale necessarily involved in public consultation and securing planning approvals, and difficulties in engaging contractors or finding suitably experienced craftsmen - not all of the 1999 allocations under OPLURD were drawn down by local authorities or conservation bodies. In many cases work was ongoing on these urban and village renewal and conservation projects at year-end. In particular, two of the major initiatives were slow to draw down their expenditure and a number of the smaller village renewal projects proved difficult to get underway in time to draw down moneys by year-end.
- Local authorities were not in a position to enter into contracts unless funding for the urban and village renewal projects was allocated, yet under the EU's programme closure rules, contracts had to be entered into for urban and village renewal and conservation projects by 31 December 1999.

Consequently, it would not have been possible to allocate anything less than the balance of the outstanding moneys profiled in the programme, without jeopardising EU aid commitments. Under OPLURD, there were a few local authorities that were unable to complete their expenditure by the end of 2000, for reasons similar to 1999. Under the applicable EU programme closure rules, payments were allowed by Implementing Departments up to 30 June 2001 in circumstances where funding had been contractually committed to projects by 31 December 1999.

- In **2000,** the bulk of the under-spend related to the urban and village renewal measures under the Regional Operational Programmes, 2000-2006. When the 2000 estimates were being drawn up (in 1999), it was anticipated that the negotiations between the Government and the European Commission would be completed in a timely manner and it was considered reasonable to include provision for spend in 2000. In the event, the programme was not approved by the Commission until the end of November 2000, and it was not possible to approve projects for funding until the final outcome of the negotiations (in particular the level of local funding required) was known.
- Accordingly, **2001** was effectively the start-up year for the urban and village renewal measure under the Regional Operational Programmes. When the estimates were provided, it was not anticipated that there would be such a loss of momentum between OPLURD and the new programmes. The operational guidelines published by his Department required all city and county councils to draw up strategy plans outlining proposals for the towns and villages and major city initiatives to be selected for funding over the life of the programmes. Allocations issue each year and details of specific elements of the projects are submitted for approval. Workshops were held to facilitate local authority staff involved in the planning and administration of the schemes. All of this took time and it was not possible for all the local authorities to draw down their full allocation in 2001.
- The initial **2002** estimate sought funding of €41.147m, which included the amount profiled for 2002 in the programmes and the balance of 2000 and 2001 moneys (€19.62m). However, even at that stage it was not envisaged that local authorities would be in a position to spend such an increased allocation in 2002. It was pegged at this high level to catch up with the agreed expenditure profile for the Regional Operational Programmes. A provision of €32.17m was further reduced early in 2002 to €24.286m. Of this allocation to local authorities, a spend of some 76% was achieved, a considerable increase on the previous year.

The Accounting Officer considered therefore, that the initial estimates were based on the best expectation of expenditure in any given year. These estimates are monitored on an on-going basis and are revised as required. Local authorities are requested to indicate if they are in a position to draw down their full allocation – if not, this can be re-allocated on the basis of capacity to spend. For example, the city initiatives all indicated that following protracted preparation, planning and consultation, they will require considerable spend this year. Expenditure in 2003 is expected to align closely with the Estimates provision.

Budgetary Control

My examination noted that for the years 1999 to 2001 cumulative under-expenditure from this subhead amounted to almost €39m. The total sum surrendered by the Department to the Exchequer amounted to €9.5m. In 1999 and 2000, the savings were reallocated to other subheads in the Vote by Supplementary Estimates passed by Dáil Éireann late in both years. In 2001, the saving was reallocated to other subheads of the Vote by 'virement', approved by the Department of Finance. In 2002 the savings of €27m were surrendered as part of the overall surrender of €47m. It will be noted that Government had demanded significant savings from a number of major spending Departments as a result of the worsening budgetary position.

As I was concerned that the principles of budgetary control may have been circumvented by the persistent use of savings on the subhead as a reserve fund to offset excess expenditure in other areas of the Vote in the years 1999 to 2001, I asked the Accounting Officer for his observations.

The Accounting Officer stated that the provisions included in the Department's estimates for the EU co-financed urban renewal programme were sought having regard to best expectations as to what would be expended in the years in question. It was never the Department's intention to use the programme, or any other programme, as a reserve fund.

He argued that the Department's ability to exercise budgetary control is best evaluated in the context of the overall Vote, as there will always be some individual programmes on which savings are realised or excesses are incurred. The extent to which funds have been vired between different programmes has not been large in the context of the overall funding provided to the Department, and outturns have been brought in close to overall spending limits without any excess over gross or net voted spending.

Receipt of EU Funding

In response to my inquiry as to whether any EU moneys had been lost to the Exchequer under OPLURD as a result of failure to meet EU deadline, the Accounting Officer informed me that in all, the Urban and Village Renewal sub-Programme of OPLURD came in at 0.67% (€0.533m) under-spend of EU funds. Measures 1 and 5 came in slightly over the forecast while, in the other measures, the eligible spend in a number of the final projects came in under the amounts allocated. A number of approved conservation projects could not meet the 31 December 1999 deadline for contracts, largely due to lack of availability of skilled craftsmen and contractors experienced in conservation works.

6.2 Financial Difficulties in Kilkenny County Council

Background

The Local Loans Fund (LLF) was the vehicle used by central government up to 1987 to provide Exchequer moneys to finance certain capital programmes by local authorities, including the provision of loans for house purchase to eligible persons. From 1988 onwards, funds for the provision of such loans were made available to local authorities through the Housing Finance Agency (HFA).

Typically, funds were provided by either the LLF or the HFA at the prevailing fixed interest rates and were on-lent by local authorities to house purchasers at a slightly higher fixed rate – in order to cover administration expenses. Loan repayments by householders were intended to finance local authorities' repayment of LLF/HFA loans.

Until 1989, loans from the LLF and HFA together with loan redemptions from borrowers and a percentage of the proceeds of the sale of local authority houses were used to finance loans for new eligible persons. From 1989 onwards, all new loans by local authorities to house purchasers are sourced from the HFA.

By the late 1980s, very substantial reductions in interest rates, the introduction of the variable interest rate and the ready availability of mortgage finance from commercial lending agencies, led to the redemption by a great many mortgagees of their loans with the local authorities. Local authorities, on the other hand, were not in a position to redeem their loans from the LLF without a financial penalty at that time. The unprecedented rate of redemptions undermined, at least partially, the principle of self-financing of local authority housing loans, as redeemed funds, borrowed at high fixed interest rates, were re-lent at considerably lower interest rates.

In February 1989, following agreement with the Department of Finance, local authorities were permitted to redeem loans, without penalty, to the LLF on condition that there should be a match between LLF loans and the individual housing loans redeemed, *e.g.* redemption moneys in respect of a 10% house purchase loan could only be used to redeem a 9.5% LLF loan.

Management of Housing Loan Redemptions

The Department of the Environment, Heritage and Local Government noted in early 1994 that Kilkenny County Council was experiencing difficulty when they sought sanction to refinance €5.27m with the HFA to repay 12% fixed rate LLF loans. At that time, (May 1994) the gap between the amount outstanding to the LLF/HFA and the amount outstanding from borrowers was €7.24m. The Council accepted that they should have redeemed to the LLF considerably more early redemptions from borrowers in the previous five years and they were now seeking to rectify this situation by refinancing. Refinancing of £2.5m with the HFA was approved at that time. The Accounting Officer informed me that the Department had indicated to the Council that the circumstances that gave rise to the need for the refinancing should be avoided. It had also pointed out that using high fixed rate redemption money to finance new variable rate mortgages carried a risk of serious loss to the Council and that the use of routine housing loan capital repayments for revenue purposes should be avoided in the interests of sound financial management; at that point in time the accounting policy was to credit both the principal and interest repayments to the local authority revenue account.

Kilkenny County Council made further requests to refinance and redeem in October 1994 (€1.9m) and in December 1998 (€7.6m). These requests were approved. In the Department's letter of approval of 1 December 1998 it was again pointed out that using high fixed rate money to finance variable rate loans carried a risk of serious loss to the Council.

In November 1999, the Council sought further approval to the redemption of all its HFA and LLF fixed rate loans (a total of €10.9m) and to refinance part of these loans at a variable interest rate. Their request highlighted the difficulty they were in and referred to the fact that there was a mismatch in tenures in the borrowing *i.e.* while their LLF loans were drawn down over 30 and 35 years, they were subsequently re-lent by the local authority over a shorter period, of 15 or 25 years. At that time, of the €10.9m owed to the LLF/HFA, only €5.8m was owed in turn by borrowers to the local authority. The Department sanctioned redemption of €5.0m.

The Accounting Officer, in response to my enquiries, observed that while the mismatch of the tenure of the loans in the early 1990s resulted in a short-term financial benefit to Kilkenny County Council, the implications of the mismatch would not have been evident to the Department at that time from the annual accounts. Mismatches would not necessarily be apparent until the level was such that it created a significant and identifiable imbalance or deficit.

Up to 2001, the accounting systems of local authorities operated on a straightforward cash and expenditure basis. The then Annual Financial Statement (Abstract of Accounts) did not provide the information capable of identifying the problems experienced by Kilkenny County Council.

He informed me that a billing module in the new financial management system, which is nearing full implementation in local authorities, will provide a comparison between the principal outstanding on loans receivable and loans payable at year end and set out clearly any instances where there is an imbalance between the repayments due to local authorities and those in turn due to the lending institutions. The financial statements will record any such imbalance.

Action taken by the Department

The Accounting Officer outlined some of the more important interventions made by the Department since 1994 when it became aware of the difficulties with the finances of Kilkenny County Council.

- In September 1994 the Department met Kilkenny County Council officials to discuss its financial position
- In August 1995 the Department raised its concerns with County Manager
- In September 1995 the Department sought a report on the Council's finances and the measures to be taken to eliminate the then revenue deficit on a phased basis
- In November 1996 the County Manager undertook to seek the Council's agreement to take a number of steps to improve the finances of the Council
- In July 1998 the Department again asked the County Manager to comment on the revenue position and his proposals to reduce the revenue account deficit
- In October 1998 the County Manager outlined the circumstances of the deterioration of the revenue position in 1997 and undertook to take certain measures to improve the revenue deficit, including the application of an additional grant from the Local Government (Equalisation) Fund directly to the revenue deficit in 1998, to maintain improvements made in collection areas and to carefully monitor all areas of expenditure to ensure that no overexpenditure occurred in 1998
- Again in August 2000 the Department asked the reasons for expenditure in excess of the annual estimates in 1998 and the Council's plans to reduce the revenue deficit
- In October 2000 the Council made further commitments to reducing the revenue deficit and also outlined the decision of the elected members to take debt reducing actions
- In a follow up letter dated 24 November 2000, the Council requested approval to take out a 15 year loan to redress the revenue deficit and to redeem capital debt. Approval was given on 11 December 2000. This action put a structure on the revenue deficit and provided for the balancing of the loans mismatching over the period
- Finally in June 2002, the Council requested Departmental agreement to refinance non-housing related borrowings of €15.7m having regard to falling interest rates. The Department provided its agreement on 18 November 2002.

Rate Caps

Departmental papers indicate that despite the fact that the *'rate in the £'* for Kilkenny County Council fell significantly short of the average for all local authorities, the Minister refused to approve an increase for the council above the global cap on increases in 2001 and 2002.

I asked the Accounting Officer if he was satisfied that the failure to lift the 'cap' in this instance was justified.

He stated that decisions in relation to the capping of rates were, and are, the prerogative of the Minister and, in the years referred to, the Minister decided to cap rates in line with the Government's commitments to local government contained in "An Action Programme for the Millennium".

Elimination of Deficit and Loans Mismatch in Kilkenny

The Accounting Officer provided updated information on the position in Kilkenny County Council.

- The loans mismatch amounts to €8.4m as of 31 December 2002 - down from €9m in mid 2002 - and is being provided for in the Council's annual budgets in equal annual instalments of €643,000 over approximately 14 years.
- Similarly, the 15-year loan raised in 2000 for the purpose of funding and eliminating the then Council revenue deficit is being provided for in the Council's annual budget in equal annual instalments (€460,000).
- The accumulated revenue deficit has been reduced from €6.2m at the end of 1999, to €3.5m at the end of 2002.

He further stated that one of the first areas to be tackled in achieving a balanced budget is the financing of any loan charges due to be paid by an authority. After this, the other expenditure elements of a local authority budget must be provided for on a priority needs basis having regard to the resources available. It is the intention of Kilkenny County Council in future budgets, to continue to make provision for the net expenditure for loan charges to eliminate the imbalance in the loans and the revenue deficit based on the structure put in place by the Council with the Department's agreement in 1999.

Kilkenny County Council, taking advantage of current low interest rates, re-financed the Council's non-mortgage related borrowings in 2002 resulting in interest payment savings of approximately €155,000 in 2003 and an estimated €1.4m over the remaining loan terms.

Similar Difficulties in Other Local Authorities

The Accounting Officer informed me that while references have been made in a number of other Local Government Audit Service audit reports to the redemption of amounts due to the LLF and HFA, to redemption moneys on hands in the local authorities and to the need for local authorities to review the matching of loans and corresponding debt, apart from the Kilkenny County Council report, there were no specific references to problems created by mis-matched funding.

A Value for Money study carried out by the Local Government Audit Service in 1998/9 noted that at the time of its preparation, details of the principal amounts outstanding (in respect of each local authority) on loans due by borrowers to the local authority, by the local authority to the LLF and by the local authority to the HFA were being collated for detailed examination and would provide useful information on the position of each local authority.

As the information available to me suggested that this exercise has not yet been completed and is unlikely to be completed in the near future I sought the Accounting Officer's views.

He informed me that the Value for Money Report covered a wide range of topics related to treasury management practices and policies in local authorities. As it was considered desirable to gather information on imbalances on housing loan repayments and capital debt in the other local authorities all local authorities were requested in letters to Finance Officers on 16 April 1999 to provide accurate information in the context of finalising the publication of the Value for Money Report. While a substantial number of returns were received, the information was not collated in sufficient time for inclusion in the final report. The returns received did not highlight any problems on the scale of that experienced by Kilkenny County Council, and thus did not warrant any further action. That said, approval has issued, from time to time, to other authorities for refinancing with the HFA.

In July 1999 all local authorities were informed by circular of the procedures to be followed in applying to redeem loans to the LLF and extended those procedures to the redemption of HFA fixed interest rate loans. These procedures included a requirement to complete a table which showed the balance due from individual borrowers to the Council in respect of LLF/HFA loans and the amounts due by the authority to both the LLF and the HFA. Early redemptions would not be approved where the total amount of fixed rate loans outstanding to the Council at the redemption date exceeded the total amount of fixed rate borrowings from the HFA/LLF.

In May 2003, the Department requested that local authorities should as far as possible ensure that their loan books are matched in terms of interest rates and tenure of such loans.

Available Sanctions

I also asked the Accounting Officer what sanctions were available to his Department to deal with problems of this nature.

He informed me that responsibility for proper financial management in individual local authorities lies, in the first instance, with local authorities themselves and that while there is no specific sanction available to the Department where they incur deficits or realise surpluses, they are required to adopt balanced budgets annually. The Local Government Act, 2001 provides that

- In each local financial year, each local authority shall prepare a draft local authority budget setting out for the next local financial year:
    - The expenditure estimated to be necessary to carry out its functions
    - The income estimated to accrue to it
- the members of a local authority shall adopt the draft budget.

Where local authorities do not adopt budgets or adopt budgets that are so insufficient to enable the local authorities to perform their functions or meet expenditure requirements, there are specific powers available to the Minister under the 2001 Act. The Minister for the Environment, Heritage and Local Government can require an authority to amend its budget and do so within 21 days. Failing compliance, the Minister may remove the members of the authority from office.

Separate to specific legislative powers, where it is apparent to the Department that local authorities are incurring significant revenue deficits, it is open to it to seek, in conjunction with the local authority concerned, to have plans drawn up and measures taken that will eliminate such deficits. The action taken in the case of Kilkenny County Council was to take out a loan to reduce the revenue deficit and put a structure in place to address the mismatch on the housing loans over a period. There are no specific legislative sanctions available to the Department in relation to local authorities using loan redemptions or repayments of short tenure loans to finance current services.

Local Government Fund General-Purpose Grants

I asked the Accounting Officer whether the difficulties experienced in this instance would be likely to result in a charge in future years on the Local Government Fund.

He stated that Local Government Fund general-purpose grants are not made available specifically for deficit reduction or to fund any particular financial arrangements or programmes. General-purpose grants from the Local Government Fund are, by their nature, block grants that go towards bridging the gap between local authorities' expenditure requirements on their day-to-day operations and the income they generate from other sources of revenue. Income from general-purpose grants, just like any other income, is not hypothecated to any service. The question of linking such funding to individual expenditure headings does not arise.