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The Welsh Government's acquisition and action to dispose of the former River Lodge Hotel, Llangollen



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I have prepared this report for presentation to the National Assembly under the Government of Wales Act 2006.

The Wales Audit Office study team that assisted me in preparing this report comprised Gillian Body, Paul Dimblebee and Ian Hughes.

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National Assembly for Wales on 14 June 2012**



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Summary

The Welsh Government bought the former River Lodge Hotel, Llangollen, in March 2007 for the sole purpose of facilitating the Powys Fadog community development initiative

- 1 The River Lodge Hotel (the River Lodge) was established some 30 years ago on a site of approximately two acres fronting Mill Street, Llangollen. The property comprises a lodge-style building with some 18 letting bedrooms, two reception areas, a restaurant, a function room, a three-bedroom self-contained house and a four-bedroom self-contained flat. The buildings and grounds occupy a prominent position on the Eastern approach to the town. Since the River Lodge ceased trading around 10 years ago the buildings have progressively fallen into disrepair.
- 2 In December 2005, a report by the former Welsh Development Agency (WDA) set out proposals to purchase the River Lodge for not more than £1 million and to grant an exclusive 25-year lease to an organisation known as Powys Fadog. The first year of the lease was to be rent-free to allow Powys Fadog to undertake the necessary repairs and refurbishment of the property. Powys Fadog's business plan was for a community venture that would provide an estimated 15 sustainable full-time and part-time jobs within three years¹.
- 3 The WDA approved the proposal and negotiations with the vendor took place over the following two months. However, the two parties could not agree a price for the property within the approval limit of £1 million set by the WDA.
- 4 On 1 April 2006, the WDA merged with the Welsh Government and became part of the (then) Department for Enterprise, Innovation and Networks. Meanwhile, Powys Fadog had continued to develop its business plan and became incorporated as Powys Fadog Community Development Centre Ltd, a company limited by guarantee, in May 2006.
- 5 The Welsh Government officials who had developed the 2005 WDA proposal to purchase the River Lodge revived the community development initiative involving Powys Fadog in mid-2006. Attempts by the vendor of the River Lodge to secure a private sale had proved unsuccessful and the property was still for sale. The Welsh Government completed the purchase of the River Lodge in March 2007 for £1.6 million. Negotiations then began over transferring the site to Powys Fadog so that it could establish the Powys Fadog community development initiative.

¹ The purpose of the venture was to create a local centre for health, healing and learning, and a focal point for different groups from within the community. A social centre would be built around a cafe, crèche, hotel and other facilities. An associated aim of the project was to establish the first Shaolin Martial Arts Centre outside China.

Powys Fadog was unable to fulfil the terms of an agreement to lease the property and the Welsh Government has been looking at alternative uses

6 In June 2009, the Welsh Government and Powys Fadog signed an Agreement for Lease, whereby the Welsh Government would grant a lease if Powys Fadog could satisfy certain defined conditions before June 2011. Powys Fadog was unable to satisfy the first of the defined conditions, which was to secure the finance to undertake the repairs and refurbishment to the River Lodge and demonstrate its ability to meet rental payments due under the proposed Lease, and the Agreement for Lease expired in June 2011. During 2010, a number of alternative proposals were put to the Welsh Government that would have enabled Powys Fadog to take an interest in the property, but the terms of these proposals were unacceptable to the Welsh Government.

7 During 2009 and 2010, senior Welsh Government officials became increasingly concerned about the probity, robustness and value for money of previous decisions in respect of the River Lodge. The Welsh Government commissioned two internal reviews – a review of the extent to which the Welsh Government’s policies and processes that were extant at the time of the decisions had been complied with (Compliance Review), which was followed by a review by the Welsh Government’s Internal Audit Service (Internal Audit Review). The Welsh Government subsequently carried out an appraisal of options for the property, including the options associated with Powys Fadog.

8 The appraisal identified options for the property that were consistent with the priorities emerging under the Welsh Government’s new Economic Renewal Programme. It did not include an assessment of the costs and benefits of alternative options, but concluded that if the site was not required for strategic regeneration purposes, it should be treated as surplus for disposal in line with the requirements of *Economic Renewal: A New Direction*.

9 Following expiry of the Agreement for Lease with Powys Fadog in June 2011, the Welsh Government advertised the River Lodge to other public bodies on the UK Government’s Cabinet Office website. The only expression of interest was from Betsi Cadwaladr Local Health Board, and negotiations between the two parties are continuing.





Five years on from the acquisition in 2007, the property is still vacant, has become derelict and has cost the taxpayer considerable money

- 10 Over the five years since the Welsh Government purchased the River Lodge it has fallen into a state of disrepair. The central heating was turned off, which led to burst pipes and water damage. The degradation of the property attracted vandals and numerous break-ins took place. The estimated costs of repair and refurbishment are now considerable and may exceed £1 million.
- 11 In addition to the purchase price of £1.6 million, between 2007 and 2012 the Welsh Government has incurred costs associated with owning the property amounting to £200,000. Included are the costs of maintenance, security and business and water rates.

There has been considerable public interest in proposals for use of the site

- 12 There has been considerable public interest in the relationship between the Welsh Government and Powys Fadog, and concerns about how the Welsh Government has managed the project, the transparency of the decisions made, and ultimately value for money. Much of the public interest was generated by Powys Fadog and its supporters when they became aware in April 2010 that the Welsh Government intended to carry out an appraisal of options for the use of the River Lodge in response to a recommendation arising from the Internal Audit report. The organisation and its supporters made numerous requests for information under the terms of the Freedom of Information Act, engaged in correspondence with Welsh Ministers and senior officials, complained to the Public Services Ombudsman and threatened to request a judicial review. Former and current Assembly Members, both supporting and against the Powys Fadog project, have also been active in raising issues of concern and lobbying Welsh Ministers and officials.
- 13 The public interest has generated many press articles and internet blogs about the River Lodge and Powys Fadog. As a result, there is a lot of information in the public arena.

Wales Audit Office examination

- 14 Concerns about the acquisition of the River Lodge and proposals for its use were first brought to the attention of the Wales Audit Office in January 2010 by a former Assembly Member, who had represented her concerns to Ministers on a number of occasions but had not been satisfied with the information she had been given in response. In examining these concerns the Wales Audit Office became aware of the Welsh Government's Compliance Review, which was ongoing at the time, and maintained a watching brief over the Compliance Review, the subsequent Internal Audit Review and the Welsh Government's responses to the reviews' recommendations.
- 15 In September 2011, the Permanent Secretary of the Welsh Government wrote to the Auditor General to request an independent examination of the decisions made in respect of the River Lodge, in the light of continuing public anxiety over the decisions and what the Permanent Secretary believed to be the significant misinformation that was in the public domain. The Auditor General agreed to the request and determined that the examination should seek to answer the question: 'Did decisions made by the Welsh Government, in respect of the acquisition of River Lodge Llangollen and its subsequent use, provide good value for money?'
- 16 At the outset, the Auditor General disclosed to his review team matters predating his appointment to the office of Auditor General that might be construed as him having a potential conflict of interest. In order to avoid any challenges that his independence or objectivity might be impaired, the Auditor General authorised Gillian Body, Assistant Auditor General, to act on his behalf in relation to this examination.

- 17 The methods used by the Wales Audit Office in carrying out this examination are set out in [Appendix 1](#), a timeline of key events is in [Appendix 2](#) and map showing the prominent location of the River Lodge within the town of Llangollen is shown in [Appendix 3](#).

Overall conclusion

- 18 The decisions made by the Welsh Government, in 2007 to purchase the River Lodge for £1.6 million and in 2009 to enter into an Agreement for Lease with Powys Fadog, were flawed and did not represent good value for money. In light of this, and the increasing likelihood that Powys Fadog would be unable to fulfil the conditions of the Agreement for Lease, the Welsh Government's decision in 2010 to carry out an appraisal of options for the disposal of the property was both prudent and necessary, although the appraisal did not include a full evaluation of the costs and benefits of feasible options. In our view, to ensure value for money, fully-costed options appraisals should have been integral elements of the decisions, in the first place to acquire the River Lodge, and then to agree to lease the property to Powys Fadog.
- 19 The Welsh Government had been slow to react to external and internal concerns about the probity and value for money of its earlier decisions. By the time that action was eventually taken, substantial sums of public money had been spent, and much of it wasted, both on the purchase of the River Lodge and the associated costs of ownership, and to date the Welsh Government has gained nothing in return for its substantial investment. As at May 2012, the River Lodge remains in the Welsh Government's ownership and urgent action is needed to find a use for or to dispose of the property.



Part 1 - The Welsh Government's decision in 2007 to purchase the River Lodge for £1.6 million was flawed and represented poor value for money

The purchase price of £1.6 million was not supported by a full valuation, but the available evidence suggests that the Welsh Government paid more than the property was worth

- 1.1** The former WDA had approved a proposal in 2005 to purchase the River Lodge, but had been unable to agree terms with the vendor. The WDA retained the project on its schedule and included provision for the project in its budget for the 2006-07 financial year. Following the merger of the WDA into the Welsh Government, the Welsh Government revived the project in mid-2006. The proposal remained unchanged from that previously approved by the WDA. The purchase was for the exclusive delivery of the Powys Fadog community development initiative from the River Lodge.
- 1.2** Although the vendor had not succeeded in selling the property on the open market, the purchase price of £1.6 million agreed by the Welsh Government in December 2006 was £600,000 higher than the amount set by the WDA as a ceiling some 12 months earlier. The £1.6 million price is also substantially higher than the £120,000 price that Land Registry records show the vendor as having paid to buy the property in October 2000.
- 1.3** The Welsh Government agreed the purchase price of £1.6 million prior to a valuation of the property being established independently by the District Valuer. On the day after agreeing the terms for the purchase of River Lodge at £1.6 million in writing with the vendor, the Welsh Government issued instructions to the District Valuer to provide a market valuation. The letter of instruction asked the District Valuer to consider the residential development potential of the land in arriving at the valuation.
- 1.4** The District Valuer's reply stated that £1.6 million was a fair reflection of the market value of the River Lodge. In reaching this valuation, the District Valuer had regard to comparable sales nearby in 2005 and 2006, and considered that a residential development value of £1 million could be supported for part of the site. The District Valuer noted that his advice did not constitute a formal open market valuation in accordance with the Royal Institute of Chartered Surveyors' *Appraisal and Valuation Standards Manual* (the Red Book), but he indicated that he would be happy to provide a formal report if required. He was not requested to do so subsequently.
- 1.5** It is clear from the advice provided by the District Valuer that he was aware of the £1.6 million price that had been agreed for the property, and that his valuation was based on the residential development value of a substantial part of the site. However, the potential for residential development was not integral to the proposed Powys Fadog community development initiative, and the presumption of residential development underpinning the valuation resulted in a higher valuation for the property than would otherwise have been the case. In effect, the Welsh Government paid the market price for the property (that is, the best price obtainable by the seller), which was higher than the value of the Welsh Government's proposed use of the property. Also, the valuation did not represent a formal valuation in accordance with Red Book requirements.

At the time of purchase, the Welsh Government had no agreement with Powys Fadog in place and had not undertaken a robust assessment of risk

- 1.6** Disposal of the River Lodge to Powys Fadog was the sole reason for the Welsh Government buying the property, and the Welsh Government had not identified and evaluated any alternative uses for the site other than a fallback position of residential development. The project approval authorising the acquisition of the property did, however, state that Powys Fadog would not require an undeveloped area of the site, which could be disposed of at a future date for residential or other development. However, at the time of purchase the Welsh Government had no agreement with Powys Fadog in place and had decided to defer any due diligence compliance checks of Powys Fadog's viability until it was in a position to agree a lease with the company. The Welsh Government was aware that Powys Fadog was a new company with no trading record, and it knew from Powys Fadog's business plan that the organisation had no capital resources of its own and was dependent on securing a loan of £150,000 from Finance Wales. Therefore, the company was entirely dependent on external sources of funding that were not then in place to get its community development initiative off the ground.
- 1.7** The Welsh Government did not carry out a full and independent risk assessment of the project. The Welsh Government's assessments of risk (as presented in Ministerial briefings) were generally positive in terms of Powys Fadog's ability to acquire the property and fund its community development activities. However, the Welsh Government's assessments of risk were at significant odds with subsequent independent assessments undertaken in the context of Powys Fadog's applications for Welsh Government grants.
- 1.8** The only assessment of risk by the Welsh Government at the time of purchase was carried out by the official leading the purchase. It concluded that 'There is a risk that the Company may fail; however, the risk is small as the Company has a strong management structure, already has a successful pre-trading record, will be fully funded and will benefit from strong business support from the Assembly and other public bodies.' This was clearly a very partial assessment of the project's risks. For example, the assessment that the company had a strong management structure was at odds with the key risk that Powys Fadog itself had identified in its business plan, which related to Powys Fadog's dependence on one individual. Also the risk assessment simply assumed that further funding and other support would be provided by the Welsh Government and other public bodies. In the event, external funding was not secured as Powys Fadog's applications did not satisfy the funding organisations' evaluation criteria, which included assessments of risk.
- 1.9** The company had just been incorporated, it had not traded as a going concern, it had no capital, and the scheme was untested and highly innovative. In our view, the risks to the Welsh Government associated with the purchase of the River Lodge with public funds of some £1.6 million for the sole purpose of disposing of the property to Powys Fadog were substantial. The decision to defer a due diligence review of Powys Fadog at this time was, in our view, a significant failing.



The Welsh Government did not put in place effective compensating controls to mitigate a conflict of interest, and other governance around the decision to purchase was weak

- 1.10** The Welsh Government official who was handling the project had declared a personal interest in the project, but her managers did not put in place effective mitigating action and compensating controls. The official concerned was senior (Civil Service Grade 7) and professionally qualified. She played a key supporting role in the WDA's development in 2005 of proposals to purchase the River Lodge for subsequent lease to Powys Fadog, and led the negotiations, on behalf of the Welsh Government, for the purchase of the property in 2007.
- 1.11** The origins of the WDA's interest in the River Lodge and the Powys Fadog community development initiative lay in the Welsh Government official concerned becoming acquainted with Powys Fadog as a consequence of family members attending classes run by the organisation. Denbighshire County Council had previously suggested that the WDA might acquire the River Lodge as the property had caused the Council problems over a number of years, primarily in respect of breaches of planning control by the former owner.
- 1.12** The WDA official was persuaded of Powys Fadog's vision and believed that the WDA, Powys Fadog and the Council might all benefit if the WDA purchased the River Lodge and leased it to Powys Fadog. It was not unusual for organisations to approach the WDA to ask if it would be willing to become involved with a site acquisition. The WDA official introduced her managers to Powys Fadog to enable the organisation to promote its vision and seek financial support for the acquisition of the River Lodge for the Powys Fadog community development initiative. Regional management were persuaded of the case and initiated the project to acquire the River Lodge. Denbighshire County Council also supported the project because of its contribution towards the Council's corporate objectives.
- 1.13** Although she was not responsible for leading the project, the WDA official who initiated the WDA's interest in the River Lodge was required to assist the Regional Director with preparatory work and was involved in some of the negotiations with the vendor. The official declared her interest in Powys Fadog to her managers and, following their request, and on the advice of her Human Resources Department, recorded the declaration in the WDA's Register of Interests. The decision to seek to acquire the River Lodge for a sum not exceeding £1 million was made by the Regional Director of the WDA's Land Division North and Mid Wales.
- 1.14** When the Welsh Government revived its interest in the River Lodge later in 2006, the official who had initiated the WDA's interest in the property in 2005 had become a director of, and the Company Secretary for, Powys Fadog and was recorded in its business plan as the management team member responsible for buildings. Consequently, although she declared this interest in December 2006 by means of an internal memorandum, she had significant and concurrent roles with both Powys Fadog and the Welsh Government's Land Division in North Wales.
- 1.15** The official concerned clearly had a significant personal interest in the project, and from her perspective she had made appropriate declarations of interest at the time. However, although the official's managers were fully

aware of her dual interests, when the Welsh Government revived the project in 2006 her line manager asked her to negotiate terms with the vendor on behalf of the Welsh Government, on the grounds that she was the most senior remaining member of the former WDA staff in North Wales who had knowledge of the project.

1.16 The Welsh Government's Compliance Review² found no evidence of impropriety or deliberate wrongdoing by the official concerned in the Welsh Government's purchase of the River Lodge, but considered that there had been a breach of the Welsh Government's Staff Code of Conduct in relation to her appointment as a Director of Powys Fadog. Whilst the official had been open about her involvement with Powys Fadog and had declared her interest, she did not, as required by the Code of Conduct, seek formal approval from either her Human Resources Department or her line manager before accepting the appointment as a Director of Powys Fadog.

1.17 The Welsh Government's Internal Audit Review considered that there was a direct link between the official's conflict of interest and the lack of a thorough appraisal of the options, before and after the acquisition of the property, to secure best value for money from the asset. It concluded that the conflict of interest had contributed to failing to ensure that the interests of the Welsh Government had primacy in terms of securing best value for money from the asset.

1.18 Both Welsh Government reviews were highly critical of the role played by the official's managers in the North Wales region in failing to mitigate the conflict of interest to an acceptable level. The Compliance Review of the project considered that the decision to allow the official to conduct the negotiations for the acquisition on behalf of

the Welsh Government was fundamentally flawed. The Internal Audit Review considered that the handling of the conflict of interest by North Wales regional management was wholly inadequate. In their view, there was a clear conflict of interest, and the official concerned should have been barred from any involvement in the River Lodge property transaction, both from a Welsh Government and a Powys Fadog perspective.

1.19 The rapid speed with which the project was established in departmental systems, appraised and approved, together with the lack of a prior independent valuation for the property, suggests that the project was not subject to robust and impartial evaluation. Although there is no indication that the purchase needed to be concluded urgently, the Welsh Government official leading the purchase told us that the available budget provision needed to be spent before the end of the financial year. Accordingly, the terms of the purchase needed to be agreed in time to allow contracts to be exchanged before 31 March 2007.

1.20 On the same day that the purchase price was agreed with the vendor, the Welsh Government official leading the project created a record in the system that was then used for managing such projects. The system records the project appraisal and allows officials to record their recommendations, managers to review a project, and the 'Delegated Authority Holder' to approve the project, all online. In this instance the Delegated Authority Holder, who had authority to approve capital projects to the value of £4 million, was the Regional Director of North Wales.

1.21 The system shows that the official leading the project submitted the project for review and approval on 12 December 2006, the day after the purchase price had been agreed with

² In July 2009, the Welsh Government's (then) Director of Economic Development commissioned the Head of Property Funding to undertake a review of the project (the Compliance Review), to ascertain whether all appropriate procedures and guidelines had been followed by the project officers and management concerned. The review was completed in February 2010.



the vendor. All review stages, which included the decision to defer due diligence checks on Powys Fadog and the recommendation to proceed by the official's line manager, were completed on the same day. The Regional Director of North Wales approved the project three days later, on 15 December 2006.

1.22 A further governance matter of concern relates to the accuracy of briefings provided to Welsh Ministers by officials dealing with the purchase of the River Lodge. The Welsh Government's Internal Audit report had also raised some concerns in this regard.

1.23 In February 2007, before the Welsh Government had completed the purchase of the River Lodge, a (then) Assembly Member began a series of correspondence with Welsh Ministers in which she raised concerns about the potential conflict of interest of the Welsh Government official leading the acquisition of the property and the proposed use of the property. The correspondence led to the Welsh Government officials responsible for the project providing advice and briefings to Ministers.

1.24 Some of the information in a briefing provided to the Minister for Enterprise Innovation and Networks by the conflicted official's managers, which were subsequently forwarded to the Assembly Member who had raised concerns, was unbalanced and misleading. In our view, the way the briefing was written could have given the Minister greater assurance than the facts supported, and it reinforces our view that there was insufficient objectivity and impartiality in the handling of the purchase of the River Lodge. In particular:

- The advice provided by the District Valuer had not constituted a formal valuation in accordance with the Red Book, but was more of a franking of the purchase price made on the assumption that a substantial

part of the site had residential housing potential. However, the briefing provided to the Minister stated that 'The District Valuer was instructed to provide an open market valuation of the property in accordance with the provisions of the RICS 'Red Book'.

- With regard to the potential conflict of interest, the briefing is transparent in disclosing the official leading the project as a director and the Company Secretary of Powys Fadog. However, it went on to say that 'There has been absolutely no conflict of interest in the way your officials have dealt with this matter'. This statement was made on the basis that the senior official concerned had made appropriate declarations of interest within the Welsh Government. However, the simple declaration of an interest does not, on its own, mitigate the conflict. In our view the conflict of interest was both clear and significant and, although it was known at all levels of management, the Welsh Government had failed to manage the conflict in a way that protected its interests.

Part 2 - The Welsh Government's decision to enter into an Agreement for Lease with Powys Fadog was unwise

An Agreement for Lease took more than two years to negotiate and allowed Powys Fadog a further two years to satisfy the financial precondition of the Agreement

- 2.1** Following the Welsh Government's acquisition of the River Lodge in March 2007, extensive negotiations between the Welsh Government's Legal Services Department (Legal Services) and Powys Fadog's solicitors took place over the terms of the disposal of the property to Powys Fadog, to allow the organisation to move forward and implement its community development initiative. Legal Services also advised the Welsh Government on a range of options for disposing of the property to Powys Fadog, and there were extensive discussions about the State Aid implications of the proposed disposal³. In all, the negotiations took more than two years to conclude and an Agreement for Lease was eventually signed in June 2009.
- 2.2** The original proposal at the time the Welsh Government bought the property in March 2007 was for some of the land to be retained by the Welsh Government for residential development. However, the Agreement for Lease included all of the land for use by Powys Fadog.
- 2.3** The Agreement for Lease was legally binding on both parties and provided that Welsh Ministers would grant a lease if Powys Fadog could satisfy the financial precondition by no later than 17 June 2011 and complete the refurbishment work within a further two years. Providing all conditions were satisfied, the Agreement required the Welsh Government to grant Powys Fadog a 25-year full repairing and insuring lease commencing on satisfactory completion of the building restoration works by Powys Fadog.
- 2.4** The Agreement for Lease therefore allowed Powys Fadog a period of up to four years within which it needed to satisfy in full the terms of the Agreement. However, it also restricted the extent to which, within that period, the Welsh Government could develop alternative options for the site should Powys Fadog be unable to meet the terms of the Agreement.
- 2.5** The rental was agreed at £27,000 per annum, subject to rent review to open market value every five years. However, to allow Powys Fadog to build up its business, it would be required to pay just a nominal rent during the first three years of the lease (£1,200 in year one; £2,400 in year two; and £3,600 in year three). In the fourth year, the rent was to revert to the full agreed rental of £27,000 per annum.
- 2.6** A condition of the Agreement for Lease was that Powys Fadog had to produce evidence that it had secured sufficient funding to undertake a detailed programme of repair and improvement works, and that it had sufficient financial resources to pay the rents due under the lease. In the two years since the Welsh Government had acquired the River Lodge, its condition had deteriorated substantially. At the time the Agreement for Lease was signed, the Welsh Government estimated that the cost of the repair and improvement works would be more than £800,000.

³ State Aid is a European Commission term which refers to forms of assistance from a public body or publicly-funded body, given to undertakings engaged in economic commercial activity on a selective basis, with the potential to distort competition and affect trade between member states of the European Union.



2.7 A further condition of granting the lease was that a number of restrictions should be placed on the use of the property. In essence, use of the property would be restricted to ‘charitable and social enterprise purposes’. The restrictive covenant had an impact on the rental and freehold valuations, which were determined following independent advice and a full market (Red Book) valuation from the District Valuer.

2.8 The Agreement for Lease included an option for Powys Fadog to acquire the freehold interest of the property for the open market value of the site and premises, on the assumption that it was subject to the same restrictions on use and user and was in the pre-refurbishment condition. The freehold value was to be calculated as at the date of exercise of the option. The value of the freehold interest on this basis was assessed by the District Valuer at £265,000. Partly because of the restrictions on use, this valuation was significantly lower than the £1.6 million the Welsh Government had paid for the River Lodge two years earlier. However, should Powys Fadog subsequently dispose of its freehold interest, the Welsh Government had a right of first refusal to repurchase the property. The repurchase would also be at a price reflecting the market value at the time of the repurchase, and again be subject to the restrictions on use and on the basis that the property was in its pre-refurbishment condition.

2.9 The terms of the Agreement for Lease protected the Welsh Government’s interests should Powys Fadog have taken the option to purchase the property and then, subsequently, dispose of it. However, the impact of the restrictive covenant on use on the rental and freehold valuations of the property meant that the Welsh Government would have been subsidising the Powys Fadog community development initiative for as long as Powys Fadog was able to continue to satisfy the conditions of the lease.

The Welsh Government entered into the Agreement for Lease despite advice from its own legal advisers not to do so

2.10 The Welsh Government’s Legal Services Department had concerns about the terms of the proposed disposal of the River Lodge to Powys Fadog. These concerns related to whether the terms of the disposal would amount to unlawful State Aid and whether they provided value for money for the Welsh Government.

2.11 The Welsh Government’s Legal Services articulated its concerns in June 2008 and June 2009 in memoranda to the Welsh Government officials who were then responsible for agreeing the terms of the disposal to Powys Fadog. Legal Services argued that the covenant on the use of the property did not appear to be restrictive at all, and that it could be viewed as a means of reducing the price which, in turn, could give rise to claims of unlawful State Aid. Legal Services noted that the Welsh Government had paid £1.6 million for the property and questioned why, if the property had such potential, it was being disposed of in the manner proposed. In effect, the Welsh Government would be providing a net subsidy of more than £1.3 million to allow Powys Fadog to use the property.

2.12 Given the nature of some of the activities proposed in Powys Fadog's business plan that would be facilitated by the Welsh Government's intervention, including a crèche, a hotel and a restaurant, Legal Services questioned whether a public subsidy of £1.3 million was appropriate. Legal Services also noted that a more restrictive form of covenant would have prevented such commercial uses, better reflecting the value of the lease and providing protection against any risk of unlawful State Aid. A more restrictive covenant would also have reflected the fact that the Welsh Government was electing not to gain a full market return on the value of the property.

2.13 Internal Welsh Government correspondence in respect of the terms of the lease, between the officials responsible for the disposal and Legal Services, continued until 16 June 2009, when the Regional Director for North Wales approved the Agreement for Lease. Legal Service officers expressed their disappointment that the Agreement had been completed despite their questions remaining unanswered and concerns unresolved.

2.14 On 16 June 2009, the Welsh Government official who was then leading the negotiations with Powys Fadog submitted a briefing to the (then) Deputy First Minister to inform him of the decision officials had taken to enter into the Agreement for Lease. The briefing provided an update on progress with Powys Fadog's applications for funding, needed to fulfil the conditions of the Agreement for Lease. It set out full details of the background to the project, including the previous role of the Welsh Government employee who was also a director of Powys Fadog.

2.15 The briefing informed the Deputy First Minister that Legal Services had advised that it would be prudent to refrain from entering into the Agreement for Lease. It also set out the reasons for the decision to proceed, and concluded that officials were of the view that it was necessary for the Agreement to be exchanged as soon as possible.

2.16 It is clear that the Welsh Government's Legal Services held significant concerns about the Agreement for Lease, and there was considerable uncertainty over the funding of the project. The Welsh Government's 2010 Compliance Review concluded that the decision to conclude the legal agreement was 'premature'. Whilst the Welsh Government officials concerned had made a risk-based decision, and had highlighted the risk issues in the Ministerial briefing, the review considered that it would have been prudent for the officials concerned to have at least sought agreement with Legal Services on the nature of the risk, and to have developed strategies to manage and reduce it.

At the time the Welsh Government entered into the Agreement for Lease, Powys Fadog had no financial backing and was entirely dependent on public funds, which had not then been approved, to meet the conditions of the Agreement

2.17 Powys Fadog's applications for various grants were under consideration at the time the Welsh Government approved the Agreement for Lease. The briefing to the Deputy First Minister set out the status of the funding applications needed to meet estimated development costs of £881,000. It anticipated that the Welsh European Funding Office (WEFO) would refuse an application for grant funding of £326,000, and that the application for a £565,000 loan from Finance Wales would also be turned down. A decision on an application for a grant of £608,000 submitted in April 2009 under the Communities Facilities and Activities Programme was awaited. Powys Fadog did have an in principle offer of support in respect of an Environmental Improvement Grant application for £255,000.



2.18 The Welsh Government did not carry out a due diligence review of Powys Fadog, which had been deferred from the time of the purchase of the River Lodge in June 2007, before signing the Agreement for Lease. It did, however, review Powys Fadog's business plan. The review concluded that 'whilst there may be a potentially viable business plan for the future, the organisation was in a very weak financial position with, in the context of the project, negligible financial resources'.

2.19 The applications to WEFO and the Community Facilities and Activities Programme were each rejected in July 2009, just one month after the Agreement for Lease was signed. Powys Fadog submitted a further application for a £300,000 Community Facilities and Activities Programme grant in October 2009, but this was turned down in February 2010. The Finance Wales loan application was rejected in September 2009. The application for an Environmental Improvement Grant of £255,000 was approved in October 2009, subject to Powys Fadog being able to secure funding to match the grant by January 2010.

The Welsh Government did not carry out any appraisal of alternatives to the Powys Fadog proposal

2.20 The two-year period of negotiations, between the Welsh Government's purchase of the River Lodge and its approval of the Agreement for Lease, presented a further opportunity to re-evaluate the costs and benefits of the project. The Welsh Government's 2010 Compliance Review considered that a new, or at least a revised, project appraisal should have been undertaken prior to the grant of the Agreement for Lease. This could have reassessed fit with the then prevailing policy aims and Ministerial priorities as well as reassessing delivery options and value for money.

2.21 The 2010 Internal Audit Review drew similar conclusions. It noted that at no point prior to or since the acquisition of the property had the North Wales Infrastructure team conducted a thorough appraisal of the options which may have been available in respect of the property in order to secure best value for money from the asset.

The Welsh Government had not resolved fully the conflict of interest and other governance issues that were of concern at the time of purchase

2.22 Given the interest that had been declared by the Welsh Government official who had been responsible for negotiating the purchase of the River Lodge, one of her colleagues was given the responsibility for representing the Welsh Government's interests in the lease negotiations. However, despite the conflict of interest, the official continued to make representations on behalf of Powys Fadog during this period. In doing so, she made extensive use of her Welsh Government e-mail account, albeit with the knowledge of her line managers.

2.23 The 2010 Compliance Review of the project considered that the actions of the official during this period represented a clear, and potentially substantial, breach of the Welsh Government's ICT Usage Rules. It argued that the nature and extent of the official's personal use of her Welsh Government e-mail account in relation to the business of Powys Fadog had the potential to mislead or, at best, be an embarrassment to the Welsh Government. The review recommended that the Welsh Government should consider whether any disciplinary proceedings needed to be taken as a consequence of this breach.

2.24 The 2010 Compliance Review considered that the correspondence from the Assembly Member provided evidence that a perception of wrongdoing or impropriety had arisen in this case. Although the creation of that perception had its root in the failure by the official's line managers to adequately separate the official from both sides of the transaction, the review considered that a significant contribution was made by the official's heavy personal use of a Welsh Government e-mail account. The official concerned had also undermined her independence from the Welsh Government's negotiations when she contacted Legal Services in March 2008 to discuss various aspects of the disposal of the River Lodge to Powys Fadog.

2.25 Internal Audit arrived at similar conclusions in April 2010. It considered that the Welsh Government's handling of the conflict of interest after it had been declared had been wholly inadequate.





Part 3 - It became increasingly apparent that Powys Fadog would not be able to raise the finance to enable it to satisfy the terms of the Agreement for Lease, and alternative proposals put forward by Powys Fadog and its partners did not represent good value for money and were unacceptable to the Welsh Government

Powys Fadog was unable to satisfy the terms of the Agreement for Lease

3.1 Powys Fadog needed substantial external financial support to enable it to satisfy the terms of the Agreement for Lease by no later than 17 June 2011. In the two years since the Welsh Government had acquired the River Lodge, its condition had deteriorated substantially and the cost of repair and improvement works was estimated at more than £800,000.

3.2 Powys Fadog's applications for grants from WEFO and the Community Facilities and Activities Programme were rejected in July 2009. WEFO had assessed Powys Fadog's application for grant support as weak in the context of meeting market needs, partnership engagement, funding certainty, and organisational competence and capacity. WEFO turned down the Powys Fadog application on the following grounds:

- In a climate of high levels of competition for limited funding, WEFO could not justify the levels of risk involved with funding the project.
- In comparison with other projects that were competing for funds, the potential contribution of the Powys Fadog community development initiative to the Programme Objectives was not sufficient to justify its prioritisation.
- Powys Fadog was at a disadvantage compared to established businesses, in

that the viability of the organisation had to be judged on assumptions and financial projections alone. The fact that the funding package was not entirely in place and there was no funding facility for potential deficits was also a factor. Whilst WEFO does support new organisations, in respect of Powys Fadog it considered the level of risk in relation to the expected benefits to be too high.

- A WEFO grant to Powys Fadog had the potential to contravene State Aid rules because of the low levels of private funding associated with the project.

3.3 Powys Fadog's applications for grants from the Community Facilities and Activities Programme were turned down on the following grounds:

- insufficient evidence of support by the community;
- a lack of a demonstrable need for the proposed project;
- the project did not provide good value in relation to the amount of public money requested;
- lack of a firm timescale to use the grant requested;
- insufficient clarity about the financial sustainability of the project in the future; and
- a lack of clarity about the lasting benefits to the community.

- 3.4** At the time the Agreement for Lease had been signed in June 2009, Powys Fadog was also awaiting a decision on a loan application for £565,000 it had submitted in June 2008 to Finance Wales. Initially, Finance Wales had been very supportive of the application and encouraged Powys Fadog to submit a loan application significantly above the £150,000 set out in its business plan. However, despite this initial support and encouragement, the loan request was declined in September 2009.
- 3.5** The reason given for the decision by Finance Wales related to Powys Fadog's viability. Finance Wales considered that Powys Fadog would be taking on too much debt, had insufficient management experience and its market research was weak, and there was no demand for further hotel accommodation in the area. The organisation was also projecting losses for the first three years of trading.
- 3.6** These independent assessments – by WEFO, the Community Facilities and Activities Programme and Finance Wales – of the viability of the Powys Fadog community development initiative contrasted starkly with the risk assessment for the project carried out in December 2006 by the Welsh Government official who had been responsible for the purchase of the River Lodge.
- 3.7** Powys Fadog did succeed in obtaining an offer of an Environmental Improvement Grant for £255,000 against estimated project costs of £850,000. Following an application in February 2009, the offer was made in October 2009. Powys Fadog was required to accept the offer, with evidence that it could raise funding to match the amount of the grant, by no later than 29 January 2010. In the event, Powys Fadog was unable to demonstrate that it had the match funding in place and the offer lapsed.

Alternative proposals put forward by Powys Fadog and its partners did not represent good value for public money and were unacceptable to the Welsh Government

- 3.8** At all times the Welsh Government made it clear that the Powys Fadog community development initiative could proceed if the organisation could satisfy the conditions of the Agreement for Lease by the due dates. Prior to the expiry of the Agreement a number of alternative proposals were put to the Welsh Government that would have allowed Powys Fadog to progress its community development initiative.
- 3.9** In January 2010, Clwyd Alyn Housing Association (part of the Pennaf Housing Group) put forward a proposal for the River Lodge, which would have involved the Welsh Government entering into a new Agreement for Lease with the Association, in place of the existing one with Powys Fadog. The Association would then sublet the property to Powys Fadog. However, the Association's proposal was reliant upon additional financial support of £490,000 from the Welsh Government.
- 3.10** Clwyd Alyn Housing Association had understood that, when Powys Fadog was seeking to secure funding to match the Welsh Government's Environmental Improvement Grant offer of £255,000, it had secured an in principle offer of £150,000 grant funding from Menter Môn⁴, subject to approval of a separate application by Menter Môn for grant funding from WEFO. However, had this funding been secured it would have been insufficient to meet Powys Fadog's needs, and Powys Fadog approached Clwyd Alyn Housing Association to seek the Association's

⁴ Menter Môn is a programme and project delivery agent, designing, implementing and evaluating European and other public sector programmes.



support in taking forward its community development initiative.

- 3.11** The Association told us that it was first approached by the conflicted Welsh Government official, who made it clear that she was acting on Powys Fadog' behalf. The Association was aware that the official was employed by the Welsh Government at that time. The River Lodge was familiar to the Association since it had tried to buy the property some years previously but had not been able to agree a price with the vendor.
- 3.12** On 20 January 2010, the Housing Association's Board approved a proposal to put to the Welsh Government. The proposal required written confirmation from the Welsh Government on grant levels and conditions, the satisfactory outcome of a due diligence exercise on Powys Fadog and satisfactory lease arrangements. Although the Housing Association had not carried out a due diligence exercise at the time, a report to the Housing Association's Board in December 2009 expressed confidence in the management capacity and experience of Powys Fadog.
- 3.13** The proposal approved by the Housing Association's Board was that the Welsh Government would transfer the River Lodge to the Association under a 60-year head lease at no initial premium and a peppercorn rent. The Association would then grant a sublease to Powys Fadog in return for an annual rent of £30,000. The Environmental Improvement Grant of £255,000, earmarked for Powys Fadog, had to be transferred to the Association to help fund the renovation work. The Welsh Government would also be required to provide additional grant funding of £235,000, bringing its total contribution to £490,000. This left a balance of £240,000 to be met by Clwyd Alyn Housing Association itself.
- 3.14** The proposal did not represent a significant risk to the Association. A successful community development initiative at the River Lodge would have supported Pennaf Housing Group's community involvement and partnering objectives. Its capital investment should be recovered, through rents, in less than 10 years. And, should the scheme fail for any reason, then the Association would have had the right to utilise the land and property for social housing purposes or an alternative community investment scheme.
- 3.15** Securing the Welsh Government funding package of £490,000 was critical to the Association's proposal going ahead. The Welsh Government had agreed in discussions with Powys Fadog that the Environmental Improvement Grant could be transferred to the Housing Association. The Housing Association had also confirmed with the Welsh Government that any claw back of the Environmental Improvement Grant would be net of all outstanding costs incurred by the Association provided they were outside its control.
- 3.16** The Welsh Government official dealing with the Clwyd Alyn Housing Association proposal (who was not the official who had the conflict of interest) prepared a Ministerial Briefing dated 15 January 2010, which noted the intention to enter into a head lease with Clwyd Alyn, on the terms that were subsequently approved by the Housing Association's Board, under the authority that had been delegated to Welsh Government officials. This briefing was withdrawn as it had not been cleared by Legal Services. The then Director of Economic Development, in consultation with the Director General, also withheld the submission of an updated briefing pending the completion of the Welsh Government's Compliance Review, which was expected in February 2010. In the event, completion of the Compliance Review in February was followed

by a request from the Permanent Secretary of the Welsh Government in March 2010 for Internal Audit to carry out an investigation into the acquisition of the River Lodge and the subsequent negotiations between the Welsh Government and Powys Fadog.

3.17 The Internal Audit report in April 2010 recommended that, amongst other things, the Welsh Government should instigate an options appraisal for future use of the property, including the proposal to transfer the Agreement for Lease from Powys Fadog to Clwyd Alyn Housing Association. As a result, the proposal from Clwyd Alyn did not proceed to any form of legal agreement. In July 2011, after the Agreement for Lease had expired, the Welsh Government wrote to Clwyd Alyn Housing Association to formally notify the Association that its proposal had not been accepted, based on a lack of congruence with prevailing Government policies and value for money considerations.

3.18 In our view, the proposal put forward by Clwyd Alyn Housing Association represented significantly poorer value for money for the taxpayer than the terms of the Agreement for Lease the Welsh Government had already agreed with Powys Fadog. The proposal would have involved substantial further investment of public funds to deliver the Powys Fadog community development initiative. In addition to the £1.6 million the Welsh Government had already paid to buy the property, it would be required to provide additional financial assistance of nearly £500,000. The Welsh Government would also have had to forgo any rental income for 60 years, worth a further £1.6 million based on the rental terms set out in the Agreement for Lease with Powys Fadog.

3.19 In February 2011, Powys Fadog put forward to the Welsh Government two other options that might have allowed its community development initiative at the River Lodge to proceed. The first was an extension to the Agreement for Lease expiry date of 17 June 2011, to give Powys Fadog more time to secure the funding needed to satisfy the conditions of the Agreement. This request was declined because the Welsh Government considered it inappropriate for existing legal arrangements to be varied in advance of a review of assets then being carried out under the Welsh Government's new economic policy. Powys Fadog also asked the Welsh Government to fund the capital costs of repairing and renovating the River Lodge. These had been estimated in 2009 to be around £800,000. The Welsh Government also turned down this request, on the basis that the Powys Fadog initiative was no longer within the policy priorities established by the Welsh Government under its *Economic Renewal: A New Direction* policy, and on the basis of value for money to the public purse.





Part 4 - The lack of progress with the Powys Fadog proposal and concerns about the robustness and probity of previous decisions prompted the Permanent Secretary of the Welsh Government to intervene and commission an Internal Audit Review and a full appraisal of options for the property

Internal Welsh Government reports criticised the decisions to acquire the River Lodge and enter into an Agreement for Lease with Powys Fadog, and prompted the Permanent Secretary of the Welsh Government to suspend work on the property proposals

4.1 The reports in early 2010 of the Welsh Government's Compliance Review and the Internal Audit Review instigated a change in the Welsh Government's relationship with Powys Fadog. Up until this time Powys Fadog had enjoyed considerable support and assistance from the Welsh Government officials in North Wales and Welsh Ministers it had been dealing with, who had been very enthusiastic about the organisation's plans for the River Lodge. However, although the sole reason for the Welsh Government acquiring the River Lodge in 2007 was to dispose of the property to Powys Fadog, the only legally binding agreement between the Welsh Government and Powys Fadog was the Agreement for Lease, the financial precondition of which Powys Fadog had been unable to fulfil.

4.2 Amongst the conclusions reached by the Compliance Review in February 2010 were that:

- the original appraisal of the project was weak, since it did not include a robust analysis of delivery options or a value for money challenge;
- the cost of the project relative to the outcomes and benefits outlined in the project appraisal appeared to be exceptionally high;
- a new, or at least a revised, project appraisal should have been undertaken prior to the grant of the Agreement for Lease – this could have reassessed fit with the then prevailing policy aims and Ministerial priorities, as well as reassessing delivery options and value for money; and
- the decision to proceed with the Agreement for Lease with Powys Fadog was premature, as there had been no agreed resolution of the various issues raised by Legal Services.

4.3 The overall conclusions from the Internal Audit Review, which reported in April 2010, were that:

- at no point prior to or since the acquisition of the property had the relevant officials conducted a thorough appraisal of the options which may have been available in respect of the property in order to secure best value for money;

- the conflict of interest on behalf of a Welsh Government official contributed to the failure to ensure that the interests of the Welsh Government had primacy in terms of securing best value for money; and
- handling of the conflict of interest by the North Wales management team had been wholly inadequate.

4.4 Internal Audit recommended an options appraisal for the future use of the River Lodge, including the proposal from Clwyd Alyn Housing Association. It also recommended the instigation of disciplinary procedures against the conflicted Welsh Government official and her line manager, and a review of the legal position regarding the Agreement for Lease to protect the Welsh Government's interests.

4.5 On receipt of the findings of the internal reviews, senior Welsh Government officials took stock of what had taken place and reassessed the position going forward. At this time it was also clear that, although the Welsh Government was committed to the Agreement for Lease with Powys Fadog, it was unlikely that Powys Fadog would be able to fulfil the financial precondition of the Agreement before it expired in June 2011.

4.6 Together the two reviews led to the Welsh Government suspending the conflicted official and her line manager from office in April 2010, pending the outcome of a disciplinary investigation⁵. The Permanent Secretary also accepted Internal Audit's recommendation for an options appraisal to be carried out, and in April 2010 commissioned the Director General for the Department for the Economy and Transport to carry one out.

The decisions to suspend the two Welsh Government officials and commission an options appraisal led to a deterioration in relations between Powys Fadog and the Welsh Government

4.7 When the Welsh Government decided in April 2010 to suspend two of its officials and to instigate an options appraisal of alternative uses for the River Lodge, Powys Fadog and its supporters reacted with dismay, suspicion and mistrust. Starting in May 2010, Powys Fadog and its supporters submitted more than 93 requests for information under the terms of the Freedom of Information Act 2000, to try and find out what was happening within the Welsh Government.

4.8 The number and frequency of information requests had a considerable impact on the workloads of the Welsh Government officials concerned. The Welsh Government received seven information requests in the first week, and the requests continued for well over a year. Associated with the requests were complaints made about officials' handling of the responses, both through the Welsh Government's internal complaints procedures and through the independent Information Commissioner⁶. The unprecedented intensity of information requests and the work required to deal with them prompted the Welsh Government to set up a working group to identify lessons learned and how it can better manage a similar situation in future.

⁵ Following disciplinary proceedings, the Welsh Government dismissed the official and issued a written warning to her line manager. Following unsuccessful internal appeals, the official is challenging the decision to dismiss her at an Employment Tribunal. These proceedings are currently ongoing. The line manager took early retirement in December 2010.

⁶ The Information Commissioner agreed with most of the Welsh Government's information release decisions, but in some instances ordered the disclosure of additional information. The Commissioner did, however, criticise the Welsh Government's slow speed of responses to information requests, and there are two outstanding complaints currently under consideration by the Commissioner. In March 2012, the Information Commissioner reported on the speed of response to Freedom of Information requests by Government departments in England and Wales. Six departments, including the Welsh Government, were told to speed up their response times.



4.9 Powys Fadog also complained to the Public Services Ombudsman about the Welsh Government's handling of the matter, although the complaint was not upheld. And in May 2011, Powys Fadog wrote to the Welsh Government stating its intention to commence judicial review proceedings against the Welsh Government prior to the Agreement for Lease period coming to a close. The proposed grounds for judicial review put forward by Powys Fadog included, amongst other challenges, the Welsh Government's alleged failure to consider alternative proposals put forward by Powys Fadog in the context of it trying to satisfy the conditions for the Agreement for Lease. The Welsh Government responded to all the issues raised by Powys Fadog in May 2011. A formal judicial review application to the courts was not pursued by Powys Fadog.

The options appraisal identified the River Lodge as being surplus to the Welsh Government's requirements, but almost 12 months after the expiry of the Agreement for Lease the property is still owned by the Welsh Government

4.10 The options appraisal was carried out by a Regional Director from within the Welsh Government's Department of Economy and Transport. The objective of the options appraisal was to identify the options available to Welsh Ministers for alternative uses of the property that were consistent with the priorities emerging under the Welsh Government's new Economic Renewal Programme. The options appraisal began in July 2010, at around the same time the Welsh Government published

its new policy, *Economic Renewal: A New Direction*. This policy required the Welsh Government to review its land holdings to ensure their use aligned with wider economic renewal objectives, specific regional priorities and key sector needs. Any sites not meeting the new policy priorities were to be considered as surplus for disposal, with the proceeds being reinvested in the new priority areas.

4.11 The options relating to the Powys Fadog community development initiative were already known. Given the new policy priorities, Powys Fadog was invited to set out its rationale for how its proposals would meet the new policy direction. The appraisal also considered the alternatives other than the Powys Fadog community development initiative that were available to the Welsh Government. These were broadly categorised into options that would see the Welsh Government retaining ownership of the property or options whereby the Welsh Government would dispose of the property.

4.12 The options appraisal report was produced in October 2010. The report made clear that it had been prepared only to provide a basis for identifying feasible options, in terms of the extent to which they were consistent with the Welsh Government's new economic renewal objectives. It did not include an assessment of the costs and benefits of alternative options, but stated that a more detailed analysis was required, to include investment appraisals, to determine the most appropriate of the feasible options. Using this approach, the appraisal report did not support the options relating to Powys Fadog, because of their lack of congruence with the new economic policy priorities. The submission made by Powys Fadog had been assessed as not meeting the new policy requirements.

4.13 The options appraisal did not make any specific recommendations on a preferred option, and made clear that additional work was needed before a decision could be made by Welsh Ministers. However, it did conclude that if the site was not required for strategic regeneration purposes, it should be treated as surplus for disposal in line with the requirements of *Economic Renewal: A New Direction*. Under such circumstances, the options available were to liaise with other public bodies, including Betsi Cadwaladr Local Health Board which had previously expressed an interest in the site, to assess whether demand exists for any other public use of this land, or to dispose of it on the open market.

4.14 In accordance with the conclusions of the options appraisal, following expiry of the Agreement for Lease with Powys Fadog in June 2011, the Welsh Government advertised the River Lodge to other public bodies on the UK Government's Cabinet Office website. The only expression of interest was from Betsi Cadwaladr Local Health Board, and negotiations between the two parties are continuing. A final decision relating to the future of the River Lodge is still awaited, but any decision needs to be supported by a thorough investment appraisal of all feasible options to ensure that the most cost-effective option is selected.

4.15 More than 18 months after the options appraisal was undertaken, and almost 12 months after the expiry of the Agreement for Lease, and the River Lodge remains in the Welsh Government's ownership. In the meantime, the Welsh Government continues to incur the costs associated with ownership, and has gained nothing in return for its substantial investment in the land and property. Whilst the changes in the Welsh Government's policy and priorities have helped identify the options available to Welsh

Ministers, urgent action is needed to find a use for or to dispose of the property. In doing so, the Welsh Government must ensure that it has fully learned the lessons from its previous decisions in relation to the River Lodge, particularly the need to engage fully with all interested parties, and to demonstrate that the final outcome is the best available in terms of value for money for the taxpayer.





Part 5 - The Welsh Government has overhauled its governance arrangements and management processes, which should improve the robustness of its decision making

- 5.1** There have been important lessons for the Welsh Government to learn from this case. The Welsh Government considers that the changes it has made in recent years to its organisation, culture, governance and decision-making processes should reduce the risk of poor-quality decisions, such as that made in 2007 to purchase the River Lodge and that made in 2009 to enter into an Agreement for Lease with Powys Fadog.
- 5.2** The culture of the WDA was significantly different to that of the Welsh Government today. The WDA had substantial commercial freedom to pursue broad objectives, and there was greater delegation to relatively junior staff than there is today. Much of the custom, practice and business processes of the WDA effectively continued for some time after its integration into the Welsh Government in April 2006. Many of the WDA staff who transferred across to the Welsh Government in 2006 found the transition difficult, and many who subsequently left the Welsh Government cited cultural differences among their reasons for leaving. Nearly all of the senior officials involved with the 2007 and 2009 decisions relating to the River Lodge have since moved on to other roles or have left the employment of the Welsh Government altogether.
- 5.3** The changes in culture, organisation and processes within the Welsh Government that have taken place since the merger into it of the WDA have sought to strengthen governance arrangements and make good governance central to the business of the organisation. Changes have included the creation of departmental corporate governance committees chaired by independent non-executives. More recently, the Permanent Secretary commissioned an independent review of corporate governance in the Department for Economy and Transport (the predecessor of the Department for Business, Enterprise, Technology and Science), which reported in June 2011. Following the review, a new management group to support governance and the Department's corporate governance committee has been established, with a clear focus on risk and financial management. Financial systems and procedures are also being modernised to reflect best practice.
- 5.4** A key weakness in the decision to purchase the River Lodge was the ability of a single official to approve capital projects to the value of £4 million without wider scrutiny or peer review. Such delegation to officers is no longer in place in the Department for Business, Enterprise, Technology and Science, and more robust and centralised approval procedures have been introduced.
- 5.5** More widely, the Permanent Secretary has introduced initiatives to embed the principles of good governance and value for money across the Welsh Government. She has also introduced a programme of delegation for budget holders, supported by systematic training, as part of a wider programme to develop the finance and governance function within the Welsh Government.

Appendix 1 - Study methods

In carrying out our work we used the following methods:

Interviews

We interviewed current and former Welsh Government officials who had been involved with the purchase of the River Lodge and negotiating the Agreement for Lease, the Compliance Review and the Internal Audit Review, and in decisions taken in response to these internal reviews, including the Permanent Secretary to the Welsh Government.

We met, interviewed and examined documentation supplied by a number of individuals who have been involved or associated with the subject of this review. They included:

- current and former Assembly Members;
- representatives from Powys Fadog;
- representatives from Clwyd Alyn Housing Association; and
- the former Welsh Government official who also had a personal interest in Powys Fadog.

Document review

We examined documentation supporting the Compliance Review and the Internal Audit Review, and received responses to requests for additional information. We also reviewed other relevant Welsh Government documents, including option appraisal reports, Ministerial Briefings, correspondence, legal advice and Freedom of Information requests. In addition, we obtained representations from organisations who had received requests for grant and financial support in relation to the Powys Fadog community development initiative.

Site visit

We visited the site of the River Lodge in Llangollen to assist us understand the significance of the building and site in the context of the issues we were examining.



Appendix 2 - Timeline of key events

Timeline	Within Powys Fadog	Within WDA and Welsh Government	Financing and grant decisions	Assembly Member interest
2005	<ul style="list-style-type: none"> Support sought from WDA for the Powys Fadog community development initiative at River Lodge 			
January 2006		<ul style="list-style-type: none"> WDA Land Division Management Team in North Wales decide to pursue the purchase of River Lodge for a sum not exceeding £1 million 		
April 2006		<ul style="list-style-type: none"> WDA merges with the Welsh Government 		
May 2006	<ul style="list-style-type: none"> Powys Fadog becomes incorporated as a Company Limited by Guarantee 			
December 2006	<ul style="list-style-type: none"> Powys Fadog develops a business plan for its community development initiative 	<ul style="list-style-type: none"> Price of £1.6 million agreed with the vendor District Valuer's advice sought Project established within Welsh Government files 		
January 2007		<ul style="list-style-type: none"> District Valuer confirms the proposed purchase price 		

Timeline	Within Powys Fadog	Within WDA and Welsh Government	Financing and grant decisions	Assembly Member interest
February 2007	<ul style="list-style-type: none"> • Powys Fadog write to Finance Wales requesting financial support but no amount specified 	<ul style="list-style-type: none"> • Ministerial Briefing produced which refers to interest being shown by Assembly Member (1) 		<ul style="list-style-type: none"> • Assembly Member (1) writes to Minister asking questions about the Welsh Government's involvement with the River Lodge
March 2007	<ul style="list-style-type: none"> • Powys Fadog seeks funding to deliver the business plan as River Lodge has been purchased by Welsh Government for implementing the scheme 	<ul style="list-style-type: none"> • River Lodge purchased by Welsh Government for £1.6 million • Negotiations commence between Welsh Government and Powys Fadog over terms of site transfer 		
June 2008	<ul style="list-style-type: none"> • Powys Fadog requests a loan of £565,000 from Finance Wales 			<ul style="list-style-type: none"> • Assembly Member (1) writes to Minister seeking an update on the position
October 2008				<ul style="list-style-type: none"> • Assembly Member (1) writes to Minister asking for a copy of the Powys Fadog Business Plan
December 2008		<ul style="list-style-type: none"> • District Valuer advises Welsh Government on disposal values in context of various options 		
January 2009	<ul style="list-style-type: none"> • Powys Fadog applies for WEFO grant funding of £326,000 • Powys Fadog applies for Environmental Improvement Grant funding of £255,000 from the Welsh Government 			



Timeline	Within Powys Fadog	Within WDA and Welsh Government	Financing and grant decisions	Assembly Member interest
March 2009			<ul style="list-style-type: none"> WEFO defers decision on Powys Fadog grant application pending receipt of further information 	
April 2009	<ul style="list-style-type: none"> Powys Fadog's applies for a Community Facilities and Activities Programme (CFAP) grant of £608,000 			
June 2009	<ul style="list-style-type: none"> Welsh Government and Powys Fadog enter into an Agreement for Lease 	<ul style="list-style-type: none"> Welsh Government and Powys Fadog enter into an Agreement for Lease Ministerial Briefing produced in respect of Agreement for Lease 		
July 2009		<ul style="list-style-type: none"> Compliance Review of project commences at the request of the Director of Economic Development 	<ul style="list-style-type: none"> WEFO write to Powys Fadog declining any offer of grant CFAP write to Powys Fadog declining any offer of grant from the April 2009 round 	<ul style="list-style-type: none"> Assembly Member (1) writes to First Minister complaining about ongoing lack of explanations and information relating to Powys Fadog's plans and its relationship with the Welsh Government
September 2009			<ul style="list-style-type: none"> Finance Wales decline Powys Fadog's loan application for £565,000 	<ul style="list-style-type: none"> Assembly Member (1) writes to First Minister again asking for a comprehensive review of the Welsh Government's involvement with the site from beginning to present

Timeline	Within Powys Fadog	Within WDA and Welsh Government	Financing and grant decisions	Assembly Member interest
October 2009	<ul style="list-style-type: none"> Powys Fadog submit a further application to the Community Facilities and Activities Programme, for a grant of £300,000 		<ul style="list-style-type: none"> Environmental Improvement Grant of £255,000 offered to Powys Fadog, subject to Powys Fadog obtaining match funding 	
December 2009	<ul style="list-style-type: none"> Powys Fadog and Clwyd Alyn Housing Association propose a revised Agreement for Lease, whereby the Association leases the property from the Welsh Government and sublets to Powys Fadog 			
January 2010		<ul style="list-style-type: none"> Draft Ministerial Briefing produced recommending acceptance of Clwyd Alyn Housing Association proposal 	<ul style="list-style-type: none"> Clwyd Alyn Housing Association approve Powys Fadog community development initiative proposal 	<ul style="list-style-type: none"> Assembly Member (1) writes to the Auditor General asking for an independent review
February 2010		<ul style="list-style-type: none"> Compliance Review report finalised and forwarded to senior management 	<ul style="list-style-type: none"> Community Facilities and Activities Programme write to Powys Fadog declining any offer of grant from the October 2009 round 	
March 2010		<ul style="list-style-type: none"> Permanent Secretary requests Internal Audit Review 		



Timeline	Within Powys Fadog	Within WDA and Welsh Government	Financing and grant decisions	Assembly Member interest
April 2010		<ul style="list-style-type: none"> • Internal Audit report their findings to the Permanent Secretary • Two officials involved with the Powys Fadog project are suspended without prejudice pending a disciplinary investigation 		
May 2010	<ul style="list-style-type: none"> • Powys Fadog submits the first of many information requests to the Welsh Government 			
July 2010		<ul style="list-style-type: none"> • Welsh Government publishes its new Ministerial priorities under <i>Economic Renewal: A New Direction</i> 		
August 2010		<ul style="list-style-type: none"> • First draft of options appraisal is produced reflecting the new Ministerial priorities 		<ul style="list-style-type: none"> • Assembly Member (2) corresponds with Welsh Government officials in respect of delays in dealing with Clwyd Alyn Housing Association proposal
October 2010	<ul style="list-style-type: none"> • Powys Fadog Chairman writes to all Assembly Members expressing concerns about ongoing delays 	<ul style="list-style-type: none"> • Final draft of options appraisal published 		<ul style="list-style-type: none"> • Assembly Member (1) writes to the Welsh Government's Permanent Secretary asking for answers to the questions she has been raising since 2007

Timeline	Within Powys Fadog	Within WDA and Welsh Government	Financing and grant decisions	Assembly Member interest
February 2011	<ul style="list-style-type: none"> • Powys Fadog puts alternative options to the Welsh Government that involved either an extension to the Agreement for Lease expiry date, or additional Welsh Government funding to pay for repairs and refurbishment costs 			
May 2011	<ul style="list-style-type: none"> • Powys Fadog writes to the Welsh Government setting out grounds for a proposed judicial review 	<ul style="list-style-type: none"> • Welsh Government officials respond to the pre judicial review letter submitted by Powys Fadog 		
June 2011		<ul style="list-style-type: none"> • Agreement for Lease expires • Welsh Government seeks expressions of interest for the River Lodge from other public bodies 		
September 2011		<ul style="list-style-type: none"> • Permanent Secretary writes to Auditor General for Wales asking for an independent review 		<ul style="list-style-type: none"> • Assembly Members (2) and (3) call for a public inquiry into the Welsh Government's handling of the Powys Fadog community development initiative



Appendix 3 - Location map

