National Audit Office

Learning from commercial activity in local government

Abdool Kara, Executive Director, NAO

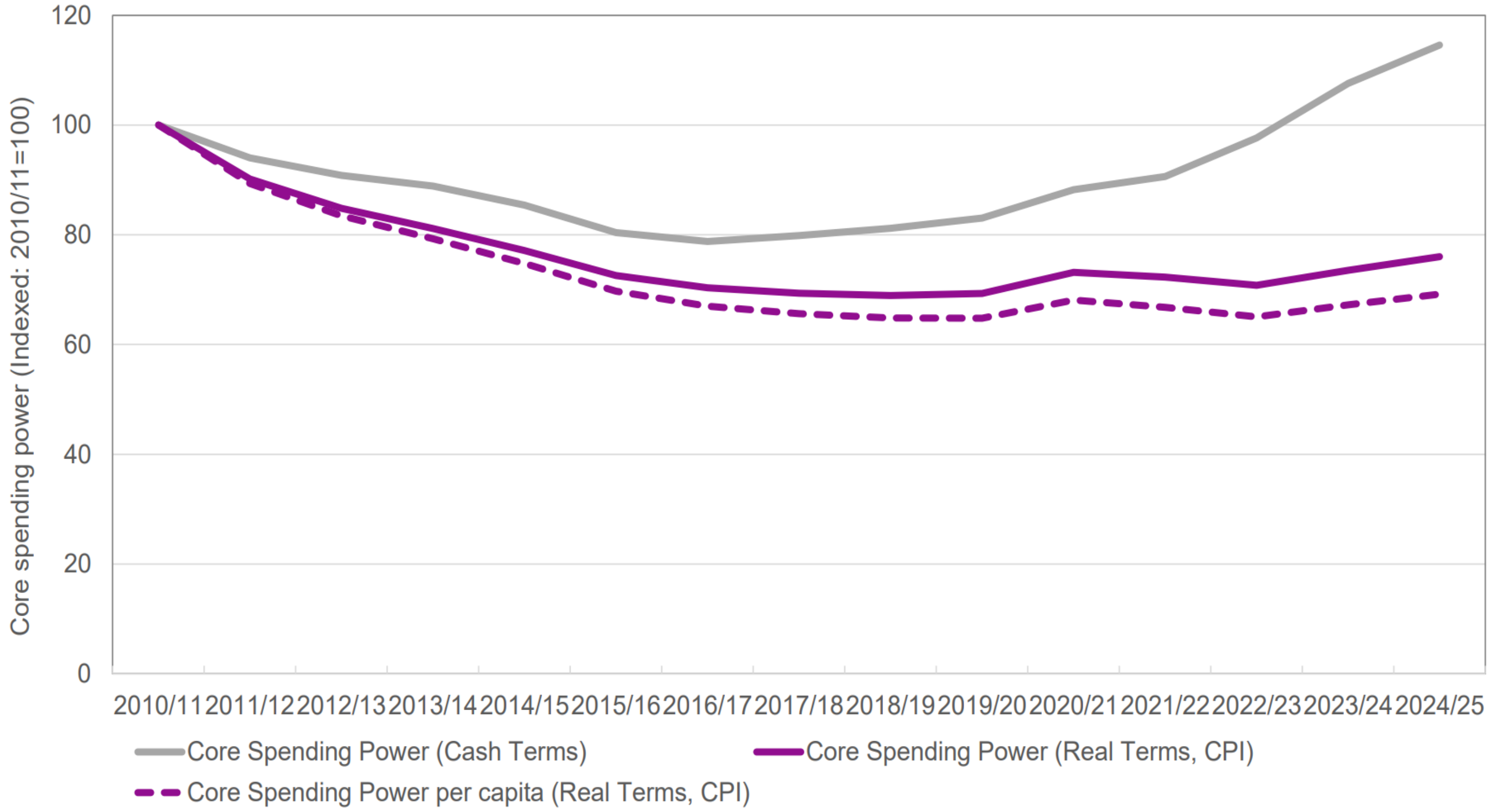
APSE Future Focus seminar 2024
8 October 2024

What I have been asked to cover today

- The delivery landscape
- Commercial activity in local government
- Emerging themes from a new government
- Good governance in managing risk

A challenging delivery landscape

Spending power has not kept pace with inflation and demand pressures ~ increasing reliance on local revenue raising powers



- Recent funding increases for local government have not kept pace with rising costs and service demand
- Funding gaps – LGA estimate £6.2bn over next two years
- Public spending constraints
- Limited local revenue raising options and not without risk
- Significant variation in terms of need and spend, plus outdated funding allocation methods
- Govt aiming to move from single year to multi-year settlements to provide stability and incentivise longer-term investment
- Backlogs in local audit regime hampering scrutiny and accountability to support good decision making

What is commercialisation?

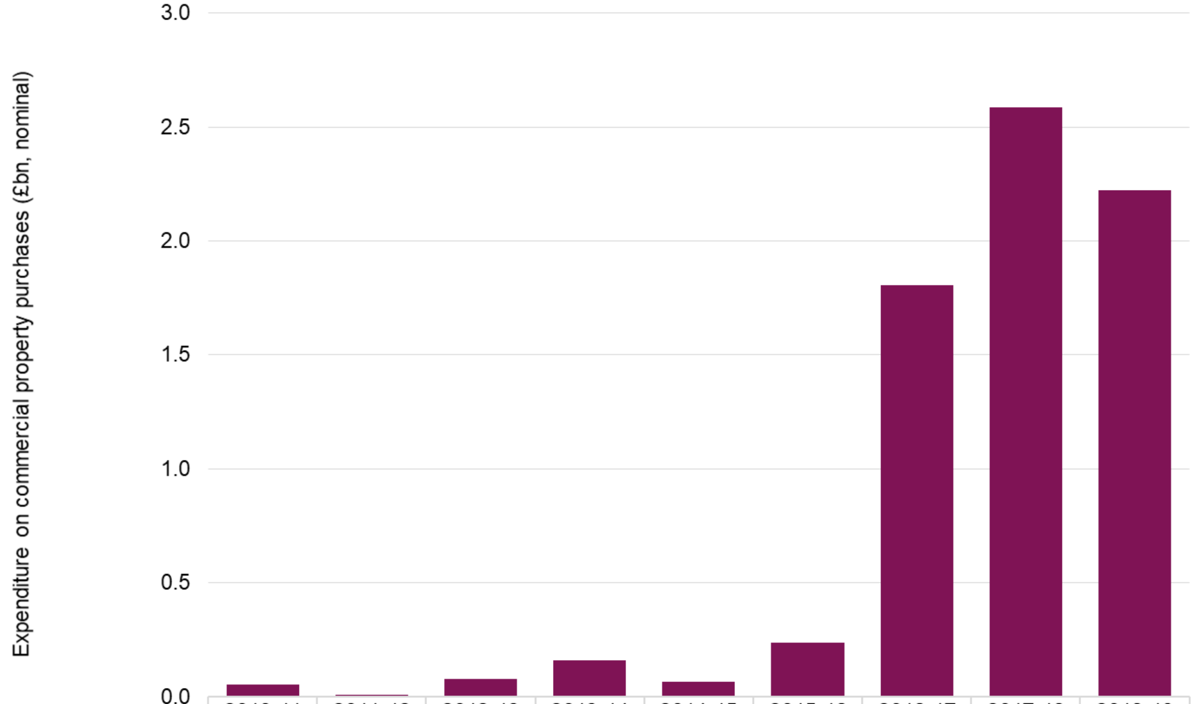
Being commercial is not just about commercial investment or chasing the shiny and new

It is an organisational mindset and philosophy

Funding reductions led to increasing commercial activity

NAO past reports on capital, property and financial sustainability highlighted emerging risks of some authorities' commercial approaches

Commercial property purchases by English local authorities, 2010/11 to 2018/19

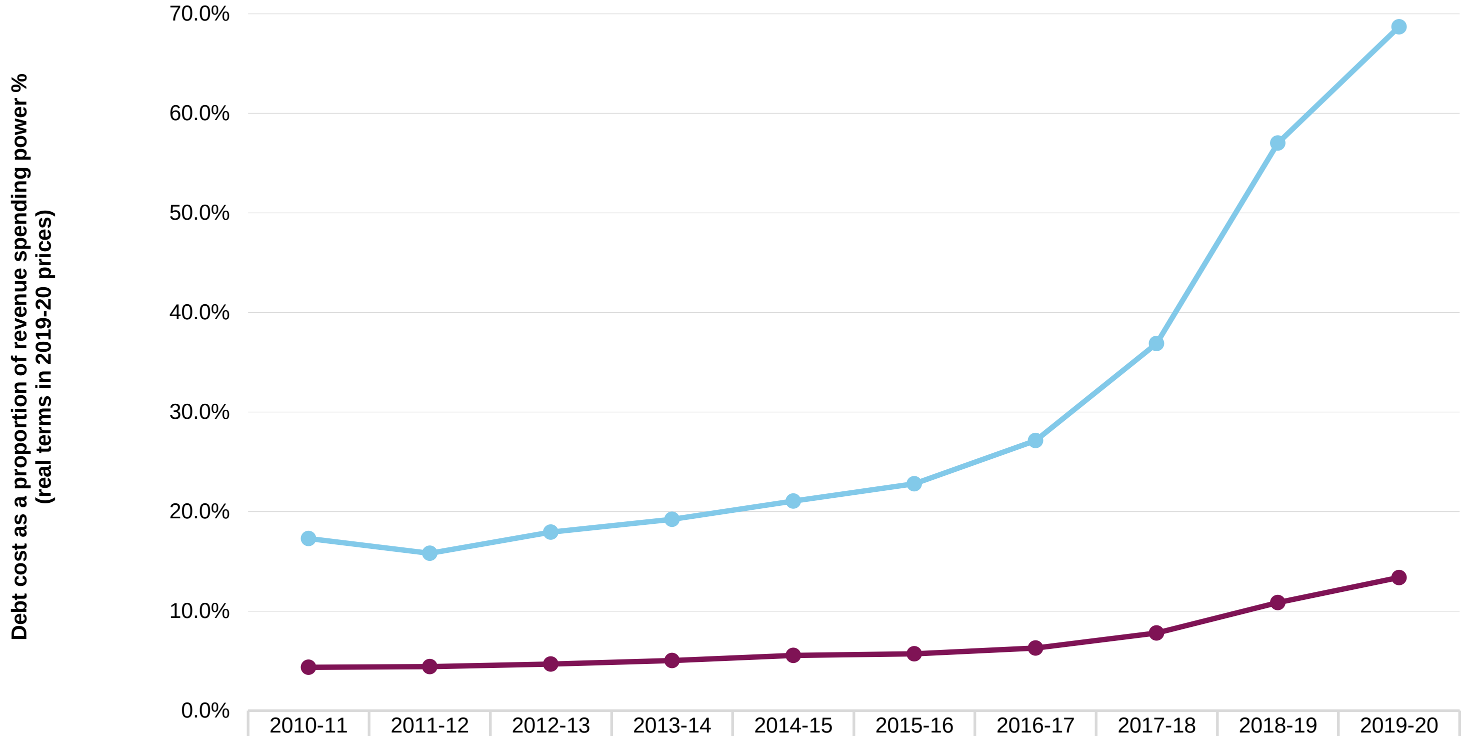


Year	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Spend on acquistions (£bn)	0.1	0.0	0.1	0.2	0.1	0.2	1.8	2.6	2.2
Local authorities active in year (count)	11	14	18	28	30	41	83	107	107

- LAs spent £6.6bn in three years 2016/17 to 2018/19 - **14.4 times more than the previous three years**
- The bulk of activity by a relatively small group of LAs
- **District councils** spent more than other types of authority
- Regionally, authorities in the **south east** accounted for over half of all acquisitions

Commercial activity came at a high cost for a few

Debt costs in English district councils as a percentage of spending power, 2010/11 to 2019/20



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
All districts debt cost as % of spending power	4.4%	4.4%	4.7%	5.0%	5.6%	5.7%	6.3%	7.8%	10.9%	13.4%
Top 20 districts in each year as % of spending power	17.3%	15.8%	17.9%	19.2%	21.0%	22.8%	27.1%	36.9%	57.0%	68.7%
Single tier and county council social care spend as % of spending power	52.3%	54.9%	57.1%	59.5%	62.7%	68.3%	72.8%	74.9%	77.3%	79.7%

Year

- We see a dramatic change among a small group, who are now very highly leveraged in relation to the size of their core activities
- These levels of activity increase risks for the authorities in question, and raise questions for the whole sector

When commercialisation goes wrong

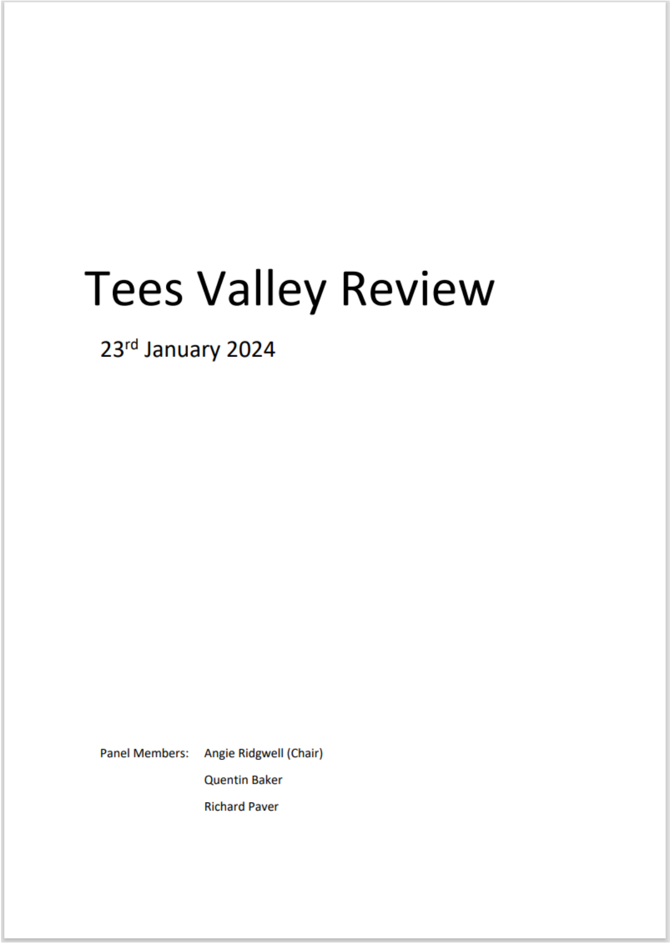
“authorities need to ensure that they have robust risk management arrangements in place when making commercial investments to generate new income, and that oversight and accountability are clear when entering into shared service or outsourced arrangements in order to deliver savings” ***NAO report on Local authority governance (2019)***	*“the accumulated debt associated with these investments remains a risk as commercial property prices typically experience large falls during economic downturns, and recent interest rate rises have added further pressure to debt-servicing cost”* ***OBR, fiscal risks and sustainability report, July 2023***

Some recent high profile and cautionary tales…

- Between 2016 and 2022 Thurrock borrowed large amounts (c.£1.5bn - £0.9bn from other LAs) to fund investments but failed to understand and control the risks of this strategy - £452m deficit in 2022/23 and £184m in 2023/24
- Woking Borough Council’s investment and borrowing decisions were disproportionate to its ability to manage complex commercial activity. Its current debt is around £2bn vs core resources of £15m

Ensuring sufficiency of transparency and oversight when managing public funds

- Teesworks redevelopment - supported by combination of central government grants, borrowing, and a joint venture company (90:10 private: public partnership)
- An independent review was commissioned in 2023 amidst public reporting of allegations of corruption, wrongdoing and illegality
- The review found no evidence to support the allegations, but significant issues of governance and transparency were highlighted, including decisions which do not meet the standards expected when managing public funds
- 28 recommendations were made with the aim of increasing the combined authority’s and development corporation’s oversight


Tees Valley Review

23rd January 2024

Panel Members: Angie Ridgwell (Chair)
Quentin Baker
Richard Paver

A new government – relevant messages

- Mission-led government
- **Emphasis on growing the economy**
- **Leveraging more private investment**
- Planning system reforms to deliver infrastructure
- Commitment to national and local reform
- Greater devolution

1) Kickstart economic growth

to secure the highest sustained growth in the G7 – with good jobs and productivity growth in every part of the country making everyone, not just a few, better off.

2) Make Britain a clean energy superpower

to cut bills, create jobs and deliver security with cheaper, zero-carbon electricity by 2030, accelerating to net zero.

3) Take back our streets

by halving serious violent crime and raising confidence in the police and criminal justice system to its highest levels.

4) Break down barriers to opportunity

by reforming our childcare and education systems, to make sure there is no class ceiling on the ambitions of young people in Britain.

5) Build an NHS fit for the future

that is there when people need it; with fewer lives lost to the biggest killers; in a fairer Britain, where everyone lives well for longer.

*"..economic growth is the only way to sustainably improve our public services and sustainably improve our public finances. So, **we will use the Spending Review to prioritise specific areas of capital investment that leverage in billions more in private investment**" New Chancellor of the Exchequer, July 2024*

Numerous local growth funding pots over the years

Figure 1

Regular changes in initiatives for local growth

Sucessive governments have implemented policies to stimulate growth, swinging between local and regional-level implementation

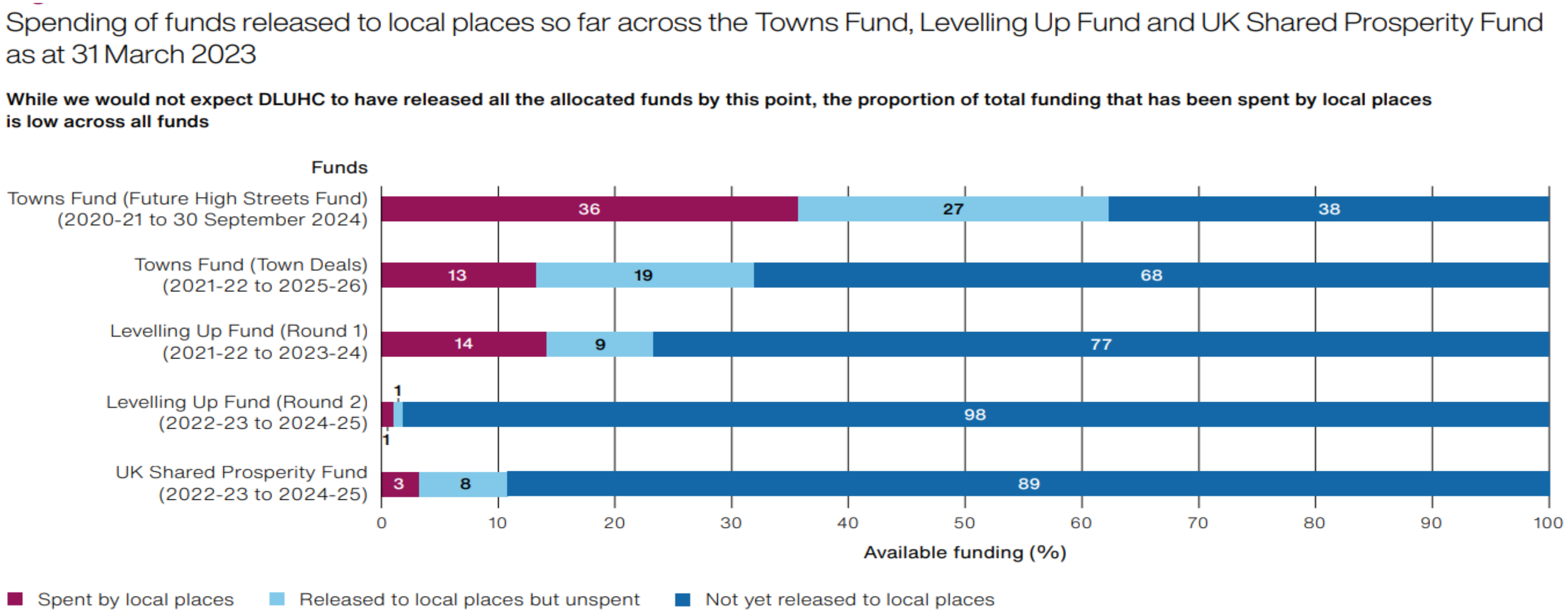
Ended prior to 2010
Ended since 2010
Currently active

1 Urban Programme (expansion)
2 Urban Development Corporations
3 Urban Development Grant
4 Derelict Land Grant
5 Regional Development Grant (revision)
6 City Action Teams
7 Urban Regeneration Grant
8 City Grant
9 Inner City Compacts
10 Regional Enterprise Grant
11 Action for Cities
12 Training and Enterprise Council
13 City Challenge
14 English Partnerships
15 Single Regeneration Budget
16 Enterprise Grant Scheme
17 Selective Finance for Investment
18 Government Offices for the Regions
19 Regional Development Agencies
20 New Deal for Communities
21 Urban Regeneration Companies
22 Neighbourhood Renewal Fund
23 Local Strategic Partnerships
24 Neigbourhood Management Pathfinders
25 Local Authority Business Growth incentive
26 Housing Market Renewal Pathfinders
27 Working Neighbourhoods Fund
28 Local Area Agreements
29 Local Enterprise Growth Initiative
30 City/Economic Development Companies
31 Multi-Area Agreements/City Region Pilots
32 Future Jobs Fund
33 National Coalfields Programme
34 Business Improvement Districts
35 Grants for Business Investment
36 Homes and Communities Agency
37 Commnity budgets
38 Enterprise Zones (new phase)
39 Regional Growth Fund
40 Local Enterprise Partnerships
41 Growing Places Fund
42 Combined Authorities
43 City Deals
44 Business Rates Retention
45 Tax Increment Finance
46 Devolution Deals
47 Local Growth Fund
48 Coastal Communities Fund
49 Mayoral Development Corporations (outside London)
50 Combined Authority Mayors
51 Industrial Strategy White Paper
52 UK Shared Prosperity Fund (announcement)

Source: National Audit Office analysis

The NAO mapped 52 in 40 years 1978 to 2018!

Applying the lessons from previous growth initiatives



From NAO report, [Levelling up funding to local government](), 2023

- NAO and PAC emphasise the importance of evaluating the funds and applying the lessons learnt to improve
- £12bn Local Growth Fund to LEPs between 2015-16 and 2020-21 but no specific objectives were set or plans made to formally evaluate its success
- We reported in 2023 how MHCLG had since improved its approach to evaluation, but not secured funds for long term evaluation
- Government is reviewing outstanding funds and future of UKSPF and Towns Fund – due to be confirmed at Budget
- LGA has asked for the growth funding landscape to be stabilised and UKSPF (due to end in March 2025) to be extended for a year to avoid a “funding cliff edge” for many projects

Managing private investment

- Nationally there are around 700 PFI contracts with a combined value of c£60bn and significant annual charges continuing into the 2040s (totaling c£200bn)
- PFI has many potential benefits: facilitates investment when capital budgets insufficient; provides cost certainty; improved operational efficiency
- But there are risks to be managed, including higher costs, ensuring flexibility in operation, asset condition, and contract end
- Leveraging in private investment via JVs can also work – but it is important to: balance returns for investors and the public sector; consider risks and benefits in setting up corporate governance; coordinate corporate governance and stewardship with service/project delivery requirements
- NAO has produced an insight 'Guide to corporate finance in the public sector' – see panel. A further lessons learned report on private finance for infrastructure investment is due 2025

Guide to corporate finance in the public sector - NAO insight

Private finance

Questions to ask based on lessons from NAO reports

Rationale

- How well is the required return on investment, its expense and the use of private finance understood and evaluated, for example, using a shadow bid model?
- How well has the organisation specified the benefits, which are expected to compensate for the higher cost relative to public finance? Benefits can include private management, expertise and commercial incentives.
- Does the organisation consider that it will have the capacity within its budget to fund the construction of the asset when construction commences?

Implementation

- How well does the organisation understand the regulated asset bases, and return on capital allowances?
- How clear are the roles and responsibilities of each party?
- How transparent is data on the cost of debt?

Risk

- Does the organisation understand any explicit and implicit transfers of risk onto taxpayers or consumers?

Price

- How have costs and accompanying schedules been reviewed and audited?
- Have complex derivatives been accounted for appropriately?

Monitoring

- Is there enough information available to make informed decisions on how to manage ongoing private finance arrangements?

Review and exit

- How has the organisation prepared for the end of the agreement?

Government’s response to increasing commercial risks

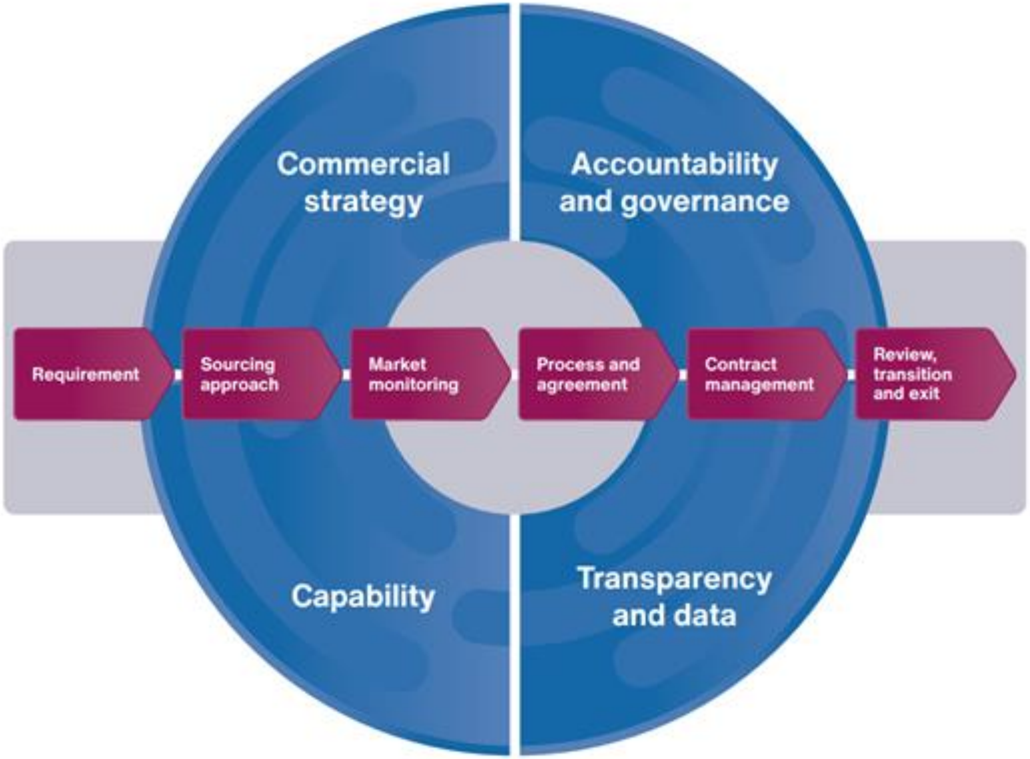
> *“The Department must be more active in its oversight of the prudential framework and strike a better balance between supporting localism and ensuring that local authorities act within the frameworks that underpin local freedoms…[it] needs to develop, and rapidly deploy, interventions that target extreme risk taking.”*
> ***Committee of Public Accounts, 2020***

- HMT introduced restrictions to accessing PWLB (three-year capital plans, S151 assurances thatt borrowing was not for yield, MHCLG review of compliance with lending terms)
- MHCLG introduced statutory guidance on **local government investments** and **minimum revenue provision** (note further consultation on MRP launched in December 2023)
- CIPFA launched **new Treasury Management** and **Prudential Codes** in 2021-22, with full compliance required for 2023-24
- New powers through the Levelling Up and Regeneration Act for MHCLG to intervene if it identifies significant investment and borrowing risks (including eg debt to CSP, under-provision of MRP, proportion of commercial investments, and novel loans – MHCLG consulted on metrics, awaiting outcome)
- Developing MHCLG analysis to spot risks and support earlier engagement with local authorities

Getting commercialisation right

- Local authorities must abide by the prudential framework that underpins local freedoms, and commercial decisions should be:
  - Underpinned by a commercial policy, financial plans and risk strategies
  - Subject to appropriate internal and external scrutiny and challenge
  - Subject to periodic review
- Coupled with increasing external oversight and scrutiny…
  - Enhanced statutory guidance on Best Value Standards and Intervention – includes the expectation that councils' stewardship function reviews commercial operations
  - Introduction of Oflog and its role in the local government accountability framework, including relevant metrics (eg total debt, amount of MRP)
  - CIPFA expanding its Resilience Index to include balance sheet metrics
  - Moving back to a functioning external audit regime for local government

The good practice guidance for managing the commercial lifecycle



[Good practice guidance: Managing the commercial lifecycle (nao.org.uk)]

See also ***Local Partnerships' commercial guidance and toolkit*** designed to support councils undertaking commercial activity [Commercial guidance and toolkit - Local Partnerships]

National Audit Office

Thank you

For more information about the work of the NAO

Visit our website
www.nao.org.uk

or follow us on twitter
@NAOorguk