The case for cancelling local authority debt

Rob Whiteman the Chief Executive of the Chartered Institute of Public Finance and Accountancy has warned of councils facing "a tsunami of reduced income and increased costs" as a result of the coronavirus crisis. Yet local government has not benefited much from the largesse of central government in response to the coronavirus crisis. It has received £1.6 billion assistance plus £1.8 billion in compensation for the decision to stop charging for business rates this year. At the same time the government has facilitated local authorities taking on a significant amount of extra debt; increasing their collective borrowing limit by £20 billion, with the option to increase it by another £20 billion.

*Rather than facilitating more debt, which has to be serviced, there is a compelling case for **cancelling local authority debt held with the PWLB**. This would give councils an approximate **extra £4.5 billion a year** income.*

The impact of the Coronavirus crisis on councils

"Despite the fact that councils have been able to maintain resilient financial positions amid deep budget cuts, the absence of a long-term funding solution already implied that this position will not be sustainable for the future. But now a financial tsunami of reduced income and increased cost is heading in councils' way. While it's vital that our health service is given everything it needs to fight this disease, we must not forget the crucial role of services like public health, social care and all community services."
Rob Whiteman Chief Executive CIPFA

Even before this crisis emerged, CIPFA's Resilience Index indicated that 10% of councils show signs of risk to their financial stability. There can be no doubt that the unprecedented crisis resulting from coronavirus will worsen the funding shortage of local authorities. They are having to spend first and think about paying for it later. Whereas the government has thrown money around like confetti local government has not benefited from the same largesse. They are providing an extra £1.6 billion plus £1.8 billion to cover the business rates which will not now be collected this financial year.

As well as CIPFA's alarm signal, councils are warning that the costs of organising in relation to coronavirus are putting them under increased financial stress. City of York Council Leader Keith Aspden told *Public Finance* that dealing with the crisis could leave it £20 million short.

"The government's announced £1.6 billion of emergency funding to local authorities is necessary and welcome. However, the scale of this crisis means that the funding allocated to York, and other councils, is insufficient to support our communities' and business needs over the coming months..."

"Locally, we have already committed to creating a local emergency fund to support our residents and businesses... We have also moved Council resources to establish new volunteer and help hotlines, so we can focus our efforts on supporting the most vulnerable in the city."

Councils have warned that a number of services are being stopped or scaled back as they focus on dealing with the Covid-19 pandemic. The County Councils Network has set aside hundreds of millions of pounds to purchase thousands of new beds to help provide care for patients being released from hospital to free up beds. It said that changes to other services will help save thousands of lives and protect staff from the spread of the coronavirus. David Williams, chairman of the County Councils Network, and leader of Hertfordshire

County Council, said:

"In these momentous times, our two clear priorities are ensuring that our residents are kept as safe as possible, and that we can continue to deliver our services. Unfortunately, the unprecedented nature of the Coronavirus outbreak means that it is impossible to do both."

CCN listed a number of services which are being scaled back, including household waste, road repairs, libraries, birth registrations, funerals, fostering events, adult education, and parks and open spaces.

The Welsh Local Government Association leader has also said that services will be scaled back in order to deal with the coronavirus crisis.

"It's likely that council services in the coming week and months will have to be scaled back, and potentially in some areas services may have to be suspended as we continue to support those areas at most risk."

CIPFA Associate Director Andy Burns told *Public Finance*

"The main service area facing increased pressure is adult social care. To qualify for social care support, people have to be vulnerable, with care needs, and relatively poor. The coronavirus crisis is creating more people who are potentially vulnerable – everyone over 70 could fall into this category and many of them might need to be supported.

At a lower level, councils believe that some home home-help services which had previously been rationed might need to be re-established. In some cases, family members who had previously helped their vulnerable relatives out with care are now unable to do so because they are self-isolating. In other cases, someone who was helping pay towards their parents' care could have lost their income and be struggling to contribute now. Many district councils, who do not provide social care services directly, are leading the coordination around volunteering and homelessness. They are also increasing resources to support local resilience forums, which bring together public agencies to keep services running and implement public health guidance on staying safe.

Many authorities are making payments earlier than normal to suppliers to ensure their financial health and to ensure they don't collapse and can continue to provide services."

Like businesses councils are seeing some of their income fall through the floor.

"The government has announced that it will compensate councils for income lost through the business rates holiday announced in the Budget and afterwards.

However, income from fees and charges is already falling through the floor. Many district councils rely on income from services like car parking and leisure centres which are no longer producing income. Many councils who are commercial landlords face decisions about what to do in response to tenants who say they are unable to pay their rent. Those who were expecting returns may find out they will not get them this month."

Because the crisis is happening in the last month of the current financial year, some may be forced to make unplanned raids on their reserves to fund any year-end overspending. Assumptions made in budgets for 2021/22 may not now be achievable. Costs are going to be much higher in the first quarter of the year due to demand pressures caused by coronavirus. This will probably have a knock-on effect.

The state of local government

It's no secret that local government has suffered badly from 10 years of austerity. In March 2018 the National Audit Office published a report, *Financial sustainability of local* *authorities 2018*. It reported a 49.1% real terms reduction (i.e. taking account of inflation) in government funding of local authorities between 2010-11 and 2017-18. It also reported a 28.6% reduction in spending power (income from government funding plus local council tax) over the same period. Despite the concentration of funding on social care it suffered a real terms reduction of 3% between 2010-11 and 2016-17. Non-social care service suffered a real terms reduction of 32.6% over the same period. *Council's have had less money to spend on rising demand*.

- From 2010-11 to 2016-17 the number of households assessed as homeless and entitled to temporary accommodation under the statutory homeless duty increased by 33.9%
- The number of looked-after children grew by 10.9%
- The estimated number of people in need of care aged 65 and over increased by 14.3%
- Local authorities have also faced other cost pressures, such as higher national insurance contributions, the apprenticeship levy and the National Living Wage
- They also suffered a decline in the value of their council tax income because of a six year freeze.

The shift to spending on social services meant that spending on planning and development fell by 52.8% in real terms, spending on housing services and highways and transport fell by 45.6% and 37.1% respectively. Spending on cultural and related services fell by 34.9%

"In adult social care, the number of users accessing services fell steeply in the early years of funding reductions, and there is evidence that funding pressures in local authorities are adding to pressures within the wider health care system and adult care provider markets. Service provision in some non-social-care services has changed, including reductions in weekly domestic waste collection (a 33.7% reduction in the number of households receiving at least a weekly service between 2010-11 and 2016-17), miles of subsidised bus journeys (a 48.4% reduction from 2010-11 to 2016-17 in England outside of London) and libraries (a 10.3% reduction in the number of service points from 2010-11 to 2016-17)."

The NAO commented that the situation had "deteriorated markedly" since their 2014 report (See Breaking the link between funding and social needs). As funding declined some councils had to use up their reserves to cope. The cuts have had a bigger impact on local authorities where property values are lower because their income from council tax is lower.

As councils have seen their government funding decline some of them have sought to replace the lost income by commercial investments which they hoped would provide a replacement income stream. This has included setting up council owned businesses some of which have bought commercial properties whilst others have sought to become house builders in order to provide a rental stream. As you can see from the table below investment increased by more than £10 billion over the last 18 months to September 2019. The National Audit Office estimates that local authorities bought £6.6 billion of commercial property between 2016-17 and 2018-19.[1] The investment in commercial property increased by 14 fold! Over the three years the increase in borrowing overall was £12.7 billion.

1 Some 80% of the cumulative spend in the sector over the period 2016-17 to 2018-19 is accounted for by only 49 local authorities (13.9%). However, 105 authorities had spent at least £10 million on commercial property in this period. District councils are disproportionately active relative to their size. There is also a strong geographical skew: authorities in the South East accounted for 52.9% of acquisitions by value from 2016-17 to 2018-19 (paragraphs 2.10 to 2.13 and Figures 5 to 8).

Meg Hillier, chair of the Public Accounts Committee, said: “Given local authorities have faced such big cuts, it is understandable that many might take part in risky investments to get more money in. However, a fourteen-fold increase in spend on commercial property raises serious alarm bells.”

“Local councils are set to lose the property game”

In an editorial entitled *“Local councils are set to lose the property game”* (April 2017) the Financial Times warned of the dangers of this development.

“The return from this manoeuvre is very welcome at the councils. Government spending cuts have made it very difficult to fund local services, from social care to libraries to child care. Yes, the loans are long term, but the yields on the investments – offices, parks, residential developments, and so on – are not guaranteed. Prices fall. Rents go unpaid or are negotiated downward. Accentuating the risk, council finances are already leveraged, through tax receipts, to the local economy. When the loan to value ratios of the loans are 100%, as some are, the leverage is amplified further. It would not require a big correction in the real estate market to *turn these investments from a source of funding into an absorber of it*.” (Our emphasis)

At the extreme end of these developments was Spelthorne which borrowed £380 million to fund the purchase of the BT campus in Sunbury on Thames. This is four times the size of all its other assets combined. The FT suggested that the PWLB should simply refrain from lending for anything other than local capital projects.

“Equally the government itself needs to have a hard look at the local council credit expansion and recognise that it is a symptom of budgets being driven to breaking point. Speculation cannot solve the crisis in social care. But if the government ties its own hands on revenue increases, local councils, left with few other options, will give speculation a try....The Treasury should put a stop to the local council credit bubble before it grows even larger.”

In 2018 CIPFA warned of the “unecessary or unquantified risk” of many commercial investments. Today the coronavirus crisis may well turn these investments “from a source of funding to an absorber of it”, eating up money which should be available for services.

“it diverts money from core services”

Less than two years on the government announced a review on stopping councils borrowing for commercial investments. The Treasury complained that

“...a minority of councils have used this cheap finance to buy very significant amounts of commercial property for rental income, which reduces the availability of PWLB finance for core local authority activities. To address this, the government will consult on revising the terms of PWLB lending to ensure [local authorities] continue to invest in housing, infrastructure and front-line services.”

The Treasury consultation document is right to say

“The case for this ‘debt-for-yield’ activity can be compelling for the individual local authority. But it introduces risks locally and nationally. At the local level, it exposes ratepayers to the risk that the income does not materialise, leaving the local authority with an inflexible commitment to keep up with the repayments on their loans. Within the wider public sector, it diverts money from core services such as schools, hospitals, and roads.”

It proposes restricting PWLB requirements to stop lending for councils seeking to purchase supermarkets outside their areas, as well as business campuses and complexes combining homes, shops and offices.

It adds that “access to the PWLB would in principle be allowed for land release, housing delivery, or subsidising affordable housing”.

However, there's a weakness in the Treasury's position because some councils are planning to use their private companies to build homes for the private rental market specifically to provide revenue stream from rent. One of the reasons that these private companies have been set up to build council housing is because of the absence of grant for new building in the framework of the Housing Revenue Account.[2] Councils should be barred from being developers or builders (except council housing through the HRA). If government grant for building council housing was available they wouldn't be using these “special purpose vehicles”.

Increasing debt or debt cancellation?

In light of the additional financial difficulties that councils are facing, the government has decided to increase their collective borrowing limit (from the PWLB) by £20 billion to £115 billion, with the power to increase it to £135 billion. That doesn't meant that councils will necessarily rush to take on more debt since they have to repay the loans and annual interest charges. Given the scale of the emergency and the under-funding which has resulted from a decade of deep cuts, taking on more debt is no solution. *In a situation where revenue is falling the cost of servicing increased borrowing means that the money available to pay for services will fall*.

There is likely to be a serious spike in rent and council tax arrears as countless people, especially those with no savings, will be unable to pay all their bills, whilst struggling to feed their families. Millions of people are losing their jobs or their income if they are stood down, and Statutory Sick Pay is too low to sustain them. Around 2 million people do not even qualify for it and the rate has not been raised a penny.

In contrast to increasing the debt burden, debt cancellation can free up money quickly. Repayment of loans or part of them is usually made at the end of the financial year, interest charges half-yearly. Cancellation of the debt owed by local authorities to the PWLB would provide a huge increase in spending power because there would be no debt to service. If councils know they won't have to make that payment they can spend that money which will no longer have to go to the PWLB.

In 2018-19 local authorities paid around **£4.5 billion** to the PWLB servicing this debt. They currently have around £82 billion of debt held with it. Such a proposal might have seemed 'extreme' before the Covid-19 crisis erupted. However, £82 billion is small beer compared to the hundreds of billions in the government's emergency measures.

Housing Revenue Account

Included in the £82 billion local authority debt is that held by housing revenue accounts. This is the bogus debt[3] that Labour was committed to review in its General Election Manifesto. Around £26 billion of it is held by the PWLB. This is not genuine borrowing but the result of Treasury 'creative accounting'. Council tenants have paid more rent than the historic borrowing costs for past building programmes.[4] Cancellation of this debt would

2 If grant was available for HRAs to build council housing on a large scale then part of the rationale for setting up private companies would disappear. Those councils interested in building council housing were attracted by the fact that if they are built outside of the HRA then Right to Buy would not apply. However, the government has threatened to close this loophole.

3 Labour leadership candidate Rebecca Long Bailey has committed to cancelling the HRA debt if elected.

4 See The Case for Cancelling Council Housing Debt by Swindon Tenants Campaign Group

mitigate against the impact of the coronavirus economic crisis – many tenants may find their income collapsing as a result of the close down and be unable to pay their rent. Currently council housing departments are only doing emergency repairs work so there will be a very big backlog of work building up.

Debt charges for HRA debt are around £1.297[5] billion a year for English local authorities. Debt cancellation would make this amount of money available to them. All their rent income could be spent on existing homes and for some new building. This extra money would be no substitute for central government grant for house building but it would significantly improve their finances. Grant to the level of Labour's commitment of £10 billion a year would be needed for a large scale council house building programme. Such a programme would not only be socially useful but would put back to work building workers who have been laid off.

Whilst such radical action as debt cancellation might have seemed 'extreme', in the current situation it is eminently achievable. Indeed it makes more sense than increasing borrowing which is likely to be used as a justification for a return to austerity.

Conclusion

Rob Whiteman of CIPFA is right that a long term funding solution has to be found for local government. The re-establishment of central government grant based on an estimate of social needs in each locality, uprated annually to take account of inflation and changes in social need, is necessary. Without this, quality of services will continue to deteriorate and some services will disappear. For an increasing number of people, especially in social care, this will be a personal tragedy because they either will not get the care they need or it will be insufficient for their needs. It will increase their isolation and shorten their lives.

We are living in a period in which events outstrip current thinking and orthodoxies. The whip of events has forced the Tories to abandon their orthodoxies, to do things which they would never have imagined they would do, against all their instincts. What was yesterday considered to be impossible can today become necessary. In such circumstances radical demands cannot so readily be dismissed.

Given the unprecedented emergency situation we face, an emergency measure is required. Cancelling the £82 billion debt is such a measure. It would open the way to councils being able to stabilise and begin to grow their services in line with social needs.

Fundamentally councils are service providers and not businesses. They need to be funded by central government and local taxes to provide services which are commensurate with the varying social needs of the population in each local authority area. Cancellation of the debt held by the PWLB and, at some stage a return to funding based on annual estimates of social needs, would open the way to improving services which have been declining for a long time; providing services for those who need them rather than predominantly by rationing only for the most 'severe' cases. It would give councils the resources to employ more staff in what are now seen to be critical services, . Failure to act will produce a social disaster.

Martin Wicks

April 2nd 2020

5 Local Government Financial Statistics, England No 29, 2019. This shows another £839 million “interest payable and similar charges” though it doesn't clarify what these are.

Outstanding local authority borrowing and investments by category as at end March, 2014-2019 and end September, 2019, United Kingdom

Borrowing							£ million
	end-Mar 2014	end-Mar 2015	end-Mar 2016	end-Mar 2017	end-Mar 2018	end-Mar 2019	end-Sep 2019
Short term borrowing							
Banks	60	66	59	46	51	18	17
Building societies	0	4	0	0	10	6	0
Other financial intermediaries	301	418	315	326	392	406	374
Public corporations	82	92	102	86	155	29	80
Private non-financial corporations	10	14	16	17	34	27	30
Central government	6	0	0	1	2	9	8
Household sector	49	23	39	25	62	54	35
Other sources [a]Other sources (a)Other sources (a)	40	48	53	47	17	6	3
Total	**548**	**667**	**585**	**547**	**721**	**555**	**546**
Longer-term borrowing							
Negotiable bonds & commercial paper	3,298	3,866	4,400	4,756	4,465	4,340	4,288
Other listed securities	1,009	1,008	1,276	1,273	1,265	1,233	1,193
Public Works Loan Board [b]Public Works Loan Board (b)	62,801	63,633	64,388	66,097	69,589	77,414	82,538
Banks UK	10,690	10,491	10,289	10,318	10,334	9,033	8,735
Building societies	5	4	4	4	4	4	3
Other financial intermediaries	471	554	633	609	750	687	667
Public corporations	7	10	6	6	14	26	49
Private non-financial corporations	121	151	152	159	163	167	171
Central government	114	140	152	204	208	736	1,054
Household sector	6	5	5	5	2	3	2
Other sources [a]Other sources (a)	5,527	5,873	6,254	6,677	8,208	8,903	8,850
Total	**84,049**	**85,734**	**87,559**	**90,108**	**95,003**	**102,546**	**107,553**
Total borrowing [d]Total borrowing (d)	**84,597**	**86,401**	**88,144**	**90,655**	**95,724**	**103,101**	**108,099**

Investments							£ million
	end-Mar 2014	end-Mar 2015	end-Mar 2016	end-Mar 2017	end-Mar 2018	end-Mar 2019	end-Sep 2019
Deposits: banks	16,509	14,418	13,319	12,083	10,300	11,099	14,742
Deposits: building societies	2,130	2,894	2,668	1,782	1,063	1,061	1,950
Treasury bills	1,783	2,052	2,185	671	530	759	1,299
Certificates of deposit: banks	396	1,016	1,015	742	846	512	752
Certificates of deposit: building societies	8	8	37	23	80	51	137
British Government (Gilt-edge) securities	1,227	597	600	481	198	125	304
Other financial intermediaries	48	46	28	37	52	72	75
Public corporations	200	285	715	1,040	1,222	1,458	1,651
Debt Management Account deposit facility	614	490	269	495	642	644	592
Money market funds	3,812	4,887	5,319	6,272	7,094	7,600	9,063
Other externally managed funds	1,795	2,034	1,879	2,367	3,018	3,616	3,651
Other investments [c]	3,256	4,564	4,281	3,425	2,910	3,654	4,190
Total investments [d]	**31,779**	**33,291**	**32,314**	**29,419**	**27,955**	**30,649**	**38,403**
Net borrowing [d]	**52,819**	**53,110**	**55,830**	**61,236**	**67,769**	**72,452**	**69,696**

(a) Other sources include items authorities report as rest of world banks and source not known.

(b) All our figures are as reported by local authorities so may differ from levels published by other sources. PWLB figure includes Northern Ireland authorities' borrowing at PWLB-equivalent rates from the Department of Finance and Personnel

(c) Other investments include items authorities report as rest of world banks, other securities and other investments.

(d) Excludes borrowing and lending between local authorities. The reported amounts of these can be found in the quarterly data tables.