



## LOCAL AUTHORITY COMMERCIAL INVESTMENT

Issued 6 May 2020

ICAEW welcomes the opportunity to submit written evidence to the inquiry on **Local Authority Commercial Investment** opened by the Public Accounts Committee on 20 April 2020.

The Committee plans to question officials from the Ministry of Housing, Communities & Local Government on gaps in commercial skills in local government, and the extent to which the Ministry formally monitors commercial activity and long-term exposure to risk.

Our evidence is intended to support the Committee with its inquiry. In particular, we believe the Committee should consider:

- The potentially significant losses that councils may be currently experiencing
- Structural issues driving debt-financed 'mini sovereign wealth funds' in one asset class
- How monitoring of risks in local authority balance sheets can be improved
- The benefit of mandatory audit committees that include independent members
- The Government's role as an 'insurer of last resort' and how its implicit guarantee is priced
- Improving transparency to local residents and their elected representatives
- The extent to which the coronavirus pandemic has weakened local authority finances

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1. We are responding to the Committee of Public Accounts' call for evidence on investment in commercial property by local authorities in England and how this is monitored by the Ministry of Housing, Communities & Local Government ('the Ministry' or 'MHCLG').
2. Our comments are solely intended to support the Committee with its inquiry and in its questioning of officials. ICAEW has not conducted an investigation or detailed analysis of its own into commercial property investments by local authorities.
3. ICAEW is a body whose mission is to promote the public interest and whose members are accountable under a code of ethics. In that context we seek to play and want to play a constructive role in supporting the Government and Parliament and would be willing to provide further detail in understanding any of the issues we raise in our submission.
4. We refer in our submission to the National Audit Office [report on local authority investment in commercial property](#) dated 13 February 2020 (the 'NAO report') and to the Ministry's [post implementation review of changes to the local authority capital finance framework](#) dated 27 April 2020 (the 'framework review').

## KEY POINTS

5. We support the conclusions of the NAO report, in particular its recommendations that the Ministry improves the relevance and quality of data and analysis it undertakes and that it works with HM Treasury to assess the investment risks that the local government sector as a whole is exposed to.
6. We also welcome the commitments by MHCLG in the framework review to continue to monitor the capital finance framework, to take action if local authorities continue to disproportionately borrow and expose themselves to undue level of risks, to improve the transparency of investment strategies, to enhance training for and develop resources to support elected representatives, to consider the external audit framework, and to consider a mandatory requirement for audit committees with independent members.

## INVESTMENT LOSSES

7. The coronavirus pandemic will have resulted in significant losses in many local authority commercial property portfolios, adding to the pressure on their finances at a difficult time. It is possible that some of these losses may be permanent, with income from investments falling below the interest payable on loans used to finance them.
8. The Committee could ask MHCLG about whether it has stress-tested the ability of local authorities to absorb losses on investment properties and how this affects its assessment of their financial viability.
9. The Committee may also wish to ask MHCLG as to whether in the light of the pandemic they have a view on councils seeking to continue with pre-existing plans to invest in commercial property.

## STRUCTURAL ISSUES

10. The Committee may wish to consider the structural issues that have driven local authorities to establish debt-financed 'mini sovereign wealth funds' that predominately invest in one particular asset class, rather than spreading risk across multiple types of investment.
11. In particular, the Committee could ask whether constraints on other forms of investment result in encouraging local authorities to overinvest in commercial property even when this might not be the best approach from a risk diversification perspective.

- a. Councils have greater powers to invest in property than they do in other asset classes.
  - b. The funding model for many local authorities means that they are constrained in their ability to finance investing without resorting to borrowing.
12. The Committee might also want to ask how greater investment in local infrastructure can be encouraged given that this may involve taking on more risk.
  13. It is important that any tightening of rules that might be recommended by the Committee not prevent local authorities from investing in their local communities. Such investments can be critical to encouraging business activity and employment, as well as unlocking private sector investment.

#### MONITORING OF RISKS IN LOCAL AUTHORITY BALANCE SHEETS

14. The primary responsibility for monitoring and assessing risks in local authority balance sheets lies with the local authorities themselves. It is therefore important that local authority officers and finance teams have the necessary financial and commercial expertise and experience to understand the risks that councils are entering into and how to manage risks effectively.

The Committee may wish to ask how the Ministry monitors skill levels amongst local authority officers and finance teams.

15. ICAEW strongly supports proposals for mandatory audit committees and that they include independent members. We believe that the role of elected representatives in scrutinising local authorities will be strengthened by involving external individuals with the financial and commercial expertise to ask the right questions and challenge officers and external auditors appropriately on financial decisions made and how they are reported.
16. Adequate monitoring by the Ministry of risks in local authority balance sheets by and of the financial viability of local government more generally requires a combination of dedicated resource, an appropriate framework for measuring and assessing risk, and staff with adequate skills to carry out risk assessments.

The Committee may want to request more information about the level of resource dedicated by the Ministry to monitoring financial risks in local government and the extent to which qualified financial professionals are involved.

17. One challenge for the Ministry is that it has to monitor a total of 343 local authorities with a range of different characteristics (county councils, district councils, unitary authorities, metropolitan districts and London boroughs). This contrasts with the more manageable numbers overseen by the devolved administrations in Scotland, Wales and Northern Ireland (32, 22 and 11 respectively).
  - a. The Committee may want to question officials as to what steps the Ministry takes to monitor risks across such a large number of organisations, in particular given their very different characteristics.
  - b. The Committee might also want to consider whether regional tiers of government could be enlisted to support the Ministry in monitoring local authorities, for example by requiring them to formally report on a regular basis on balance sheet risks in the public bodies in their area.

18. The Committee may also want to question the Ministry on the quality, extent and timeliness of the data it obtains from local authorities on commercial property investment.

Are they able to see balance sheet data on a monthly or quarterly basis, including the amount invested in commercial property? How quickly after the end of each financial year do local authorities report updated valuations and the level of investment gains or losses? Is the

Ministry routinely provided with details of material investments or do officials need to ask for more information on an ad hoc basis?

## THE GOVERNMENT'S ROLE AS AN INSURER OF LAST RESORT

19. The Government has a key role as an insurer of last resort, with the ability to step and intervene where necessary and – ultimately – to step in and rescue local authorities in financial difficulty.

The Committee may want to ask the Ministry how it 'prices' this implicit guarantee provided to local authorities and how this price varies according to the degree of financial risk assessed in local authority balance sheets and in their revenue and cost streams.

## IMPROVING TRANSPARENCY

20. We concur with the views of finance officers reported by the Ministry in paragraph 13 of the framework review of the importance of simplicity in the presentation of information to transparency and to ensuring that decision makers are adequately equipped to act on an informed basis.
21. The Committee may want to ask how the Ministry intends to encourage and/or require local authorities to improve their reporting of commercial property investments to elected representatives and to local residents and taxpayers. It is important that this covers both before and after material transactions are entered into, as well as how risks associated with investing can be communicated effectively.

## THE EFFECT OF THE CORONAVIRUS PANDEMIC ON LOCAL AUTHORITY FINANCES

22. The Committee should ask the Ministry for its latest assessment of the effect of the coronavirus pandemic on the financial position of local authorities and whether additional funding beyond the £3.2bn already announced will be required.
- a. Councils across the country are reporting significant cash flow difficulties, with the Local Government Association claiming that without a guarantee of funding some councils may be subject to section 114 'bankruptcy' notices freezing all non-statutory expenditures.
  - b. Council tax receipts are falling as householders in lockdown cancel their direct debits, while income from fees and charges, including car parking, planning fees, leisure facilities and local markets, have all but dried up in most cases.
  - c. Meanwhile spending has soared as councils have sought to support vulnerable residents and the homeless, as well as continuing to run public services in a very different and more complex environment. Councils are not eligible for the Government's furlough scheme and so continue to bear the full cost of staff that can't be redeployed to other activities, while a substantial number of staff are self-isolating, putting further pressure on those that are working.
23. The Committee might ask about the extent to which local authorities have provided advance funding to suppliers unable to provide services in accordance with the Procurement Policy Note issued by the Cabinet Office on 20 March 2020 and whether this has been sufficient to prevent critical suppliers from failing.
24. The Committee may also wish to ask whether any local authorities are reporting to the Ministry that they are considering section 114 notices.