

The Perfect Storm – the greatest challenge to local government finances in a generation

Summary

There is widespread agreement that there is an impending crisis in public sector finances. The impact on Local Government will be significant, with many predicting a correction of between 25% and 30% of the cost base.

Pressure is coming from a number of directions and the cumulative impact means that traditional responses will not be sufficient. At the same time, the role, shape and structure of Local Government is changing. It is inevitable that some tough decisions will need to be made.



You never want a serious crisis to go to waste. And what I mean by that is an opportunity to do things you think you could not do before.

Rahm Emanuel,
President Barack Obama's chief of staff



This is a time for strong leadership, when the role of the Chief Executive in Local Government becomes pivotal to economic recovery. Our survey of Chief Executives emphasises the importance of taking action now.

Who will sink and who will swim?

Why are we here?

When Central Government sneezes, as the saying goes, Local Government catches a cold.

The UK budget deficit is heading towards 12.4% of GDP in 2009/10 with total debt reaching 80% of GDP by 2015 – twice the previous target level; UK public finances are being hit from both a revenue and expenditure side. One issue alone, the impact of ageing, has the potential to block most efforts at correcting this position.

PricewaterhouseCoopers LLP (PwC) estimate that the required fiscal tightening (cuts and taxes) to 2017/18 could be 10% of GDP or over £5,500 per household per annum (if the costs of ageing are included). Re-establishing public finances to get public debt back to previous targets could take 20-40 years.

For local government, our own analysis shows a significant alignment of bad news, creating a "Perfect Storm" for the Local Government sector by 2013.

The size of this challenge is significant and many leading authorities are already starting to work through the implications and prepare for the worst.

Financial pressure is not new to the sector but this time it's different - the magnitude will force even the best authorities to consider radical solutions and challenge "sacred cows".

The Perfect Storm – the greatest challenge to local government finances in a generation

What is needed?

Cost reduction programmes will be essential, entity wide and sector wide solutions will need to be considered, and all of this happening at a time of electoral tension.

Even taking all of these measures into account, we believe that, in many cases, there will still be an affordability challenge and that is where the brave thinking starts.

When other sectors have been faced with this level of challenge some have succeeded and others have failed. Whilst we are a long way from seeing a Local Authority go bankrupt, the lessons learned from those who have faced and survived financial crises should be understood.

This is the time for the Chief Executive to step forward and show leadership like never before.

Our fiscal and commercial skills put us at the centre of the financial survival debate. Our deep understanding of the Local Government agenda and our work on the future shape of local government, as it faces up to the competing challenges of service quality, value for money and sustainable delivery lead us to be a natural partner to the Chief Executive navigating these troubled waters.

Where are the priorities?

Over the last few months, we have been discussing the Perfect Storm with Leaders and Chief Executives from major authorities, as well as with the Department, HMT and political leaders.

We explored the views of Chief Executives at a number of leading authorities across the UK. Their views confirm the level of concern over the size of the challenge faced by local government. These fell into the following categories (see back page for full list of issues discussed):

- Pressures from local funding and income generation
- Impact of the downturn on citizens and businesses
- Pressures on capital and reserves
- Pressures on central funding
- Timing issues
- Demographic and policy issues
- Pressures on partner organisations

Top 5 issues with the greatest impact

- 1 Scale of the structural budget deficit and the flow through into Local Authority settlements
- 2 Exploding burden of care costs
- 3 Loss of revenue from property sales as prices continue to be depressed
- 4 Pressure for cost reductions and efficiency gains, but less cash to use in 'spend to save'
- 5 A need to top up final salary pension scheme deficits due to higher actuarial forecasts

Our actuarial analysis supports this, with care costs and pensions top-ups alone having the potential to add over 20% to on-going costs.

Top 5 issues with the most urgent timing of impact

- 1 Loss in income from investments and placement of deposits, as available interest rates collapse
- 2 Less revenue and income from charges and discretionary items, as public curb spending
- 3 Loss of revenue from property sales as prices continue to be depressed
- 4 Short term costs, such as redundancy and transition, as transformation projects highlight long term efficiency opportunities but have short term costs
- 5 Loss of commercial rates as businesses fail and the high street empties

Top 5 issues that authorities are LEAST prepared to deal with

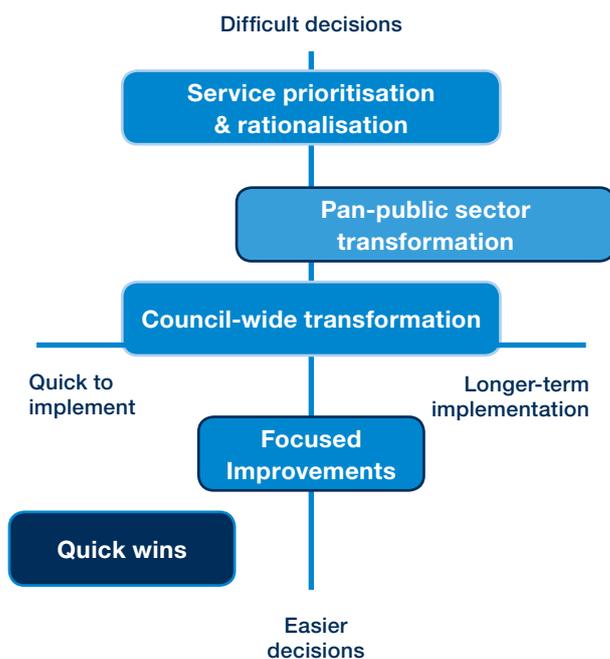
- 1 Move from private to the public sector in education, care and transport as people tighten their belts
- 2 Grant awarding bodies scrutinising their funding to LAs closely as they come under pressure themselves
- 3 Unemployment placing greater demand on support and community services as people seek to fill their days
- 4 Supplier / supply chain failure, or suppliers not being able to accept enhanced procurement arrangements
- 5 Scale of the structural budget deficit and the flow through into Local Authority settlements

What does the future look like?

Additionally, it is evident that the shape of Local Government in future is likely to be very different from today:

- more cross sector collaborative working, supported by the insight from Total Place;
- a greater focus on early intervention, to anticipate and prevent issues, rather than the costly option of dealing just with the symptoms;
- ideas around a more agile centre taking on a commissioning and place shaping role.

What is clear that the future will not simply be an extension of the past.



So what next?

In addressing today's challenges, it is necessary to have a vision of the future role and model of Local Government. This will help to avoid reworking solutions and assist with breaking the constraints on change.

Inevitably, a mixture of responses will be necessary, ranging from quick wins through to the need for tough decisions on fundamentals such as the rationalisation and prioritisation of services.

The key thing is to get going. We believe that any delay on the easier decisions will simply increase the scope of the challenge to be addressed by the tougher ones.

What should be in the 100 day plan?

Actually, we suspect that the ship will have sailed within 100 days. So this is a 10 day agenda, starting today.

Many Chief Executives are already on top of these issues. But just to make sure, here is what we believe you should be doing immediately:

- 1 Make clear that you are in charge and dealing with the challenges head on. The objective is to bring stability and confidence where there was chaos.
- 2 Set up a formal initiative on Perfect Storm. Appoint a good Corporate Director to take the lead. Assemble your top team and set out the challenge.
- 3 Get a handle on the size and timing of the challenge and how will it arise. Accelerate the journey helping people transition from denial, acceptance and action.
- 4 Establish an immediate communication plan. Clearly articulate the benefits of the plan, the size of the challenge and the tough decisions that will need to be made.
- 5 Review all current programmes and projects and prioritise them. Identify those that are 'essential' to action now versus the 'nice-to-have' which can be deferred.
- 6 Get control of the cash. Review controls over expenditure, approval levels, delegated authorities and compliance controls over procurement spend. Challenge discretionary spend; establish a recruitment freeze; defer refurbishment or other infrastructure spend that does not recognise the impact of the impending changes.
- 7 Get key stakeholders on board. Engage with members, staff representatives and key suppliers to get buy into a common agenda.
- 8 Launch a quick wins programme. Identify revenue enhancement opportunities in areas with the potential to generate short term success eg; procurement. Set a target of an additional 10% off budget allocations.
- 9 Launch an elective severance programme. It may seem expensive but you will know where the opportunities exist for rationalisation.
- 10 Launch a programme to define your vision of the shape and style of your organisation in 3 years time. Start making decisions now on people, partnerships, investments and priorities.

Perfect Storm checklist

Driver	Outcomes
Pressure from local funding and income generation	<input type="checkbox"/> Cap or reduce Council Tax <input type="checkbox"/> Lower collection performance on Council Tax and other charges <input type="checkbox"/> Reduce spending by the public results in less revenue & income from charges
Impact of the downturn on citizens and businesses	<input type="checkbox"/> Pressure on support, community and free services caused by difficult personal financial circumstances, family distress, unemployment or increased antisocial behaviour <input type="checkbox"/> Shifts from private to reliance on public services (e.g. education) <input type="checkbox"/> Increasing admin costs due to volume of Council Tax relief and other benefit claims <input type="checkbox"/> Reduced productivity due to increased in sickness absence Increased rent arrears, both domestic and commercial <input type="checkbox"/> Loss of commercial rates as businesses fail and the high street empties <input type="checkbox"/> Loss of Council Tax on unoccupied properties <input type="checkbox"/> Loss of income from charge-avoidance e.g. fly-tipping <input type="checkbox"/> Increased demand for carer services as those who have provided these services for free are forced to seek employment or take on other responsibilities <input type="checkbox"/> Greater demand for social housing <input type="checkbox"/> Higher levels of fraud and theft <input type="checkbox"/> Greater take up of business rate relief <input type="checkbox"/> Debts more difficult to repay (and collect) <input type="checkbox"/> Greater supplier failure <input type="checkbox"/> Increasing utility and fuel charges
Pressures on capital and reserves	<input type="checkbox"/> Increase in facilities management and maintenance costs as surplus property assets cannot be sold <input type="checkbox"/> Loss of revenue from property sales as prices continue to the depressed <input type="checkbox"/> Loss in income from investments and placement of deposits <input type="checkbox"/> Write off of irrecoverable funds placed with Icelandic banks etc
Pressures on central funding	<input type="checkbox"/> Requirements from central government to reduce dependency on grant support through spending reviews and the Operational Efficiency Programme Return of ring-fencing and other restrictions on the use of central funding <input type="checkbox"/> Greater scrutiny of grant funding
Timing issues	<input type="checkbox"/> Top-up of final salary pension schemes <input type="checkbox"/> Short term costs in investing in change <input type="checkbox"/> Use of September inflation indices in the calculation of government grants <input type="checkbox"/> Uncertainty due to local or general elections Impact of equal pay claims (single status) <input type="checkbox"/> Legacy of under-investment in infrastructure <input type="checkbox"/> Increase in procurement costs by outsourcing functions to realise long term efficiency savings
Demographic and policy issues	<input type="checkbox"/> Exploding burden of care costs <input type="checkbox"/> Personalisation creating entitlement visibility <input type="checkbox"/> Changes to the NI regime <input type="checkbox"/> Increasing costs of inbound migration <input type="checkbox"/> Additional costs of "10 day settlement" <input type="checkbox"/> Lower passenger transport levy increases <input type="checkbox"/> Pay grade inflation due to ageing workforce <input type="checkbox"/> Unwillingness to realise people savings <input type="checkbox"/> Increased short term costs as early intervention programmes are launched <input type="checkbox"/> Implications of generous redundancy settlements <input type="checkbox"/> Short term investments in re-enablement and independent living initiatives <input type="checkbox"/> Ageing workforce within local government frustrating efficiency gains <input type="checkbox"/> Impact of external regulation, such as waste recycling targets <input type="checkbox"/> Impact of the introduction of landfill tax <input type="checkbox"/> Investment in localism <input type="checkbox"/> Decrease in collaborative behaviour, as the focus moves to meeting local targets <input type="checkbox"/> Increase in subsidies provided to local businesses
Pressure on partner organisations	<input type="checkbox"/> Reduction in environmental development activity due to lack of confidence and liquidity Pressure on 3rd sector funding

Contacts

Steve Beet
 – National
 +44 161 247 4193
 steve.w.beet@uk.pwc.com

Paul Woolston
 – North East & National
 +44 191 269 4205
 paul.woolston@uk.pwc.com

Pete McIntyre
 – North West
 +44 161 247 4126
 pete.mcintyre@uk.pwc.com

Michael Kitts
 – Midlands
 +44 1509 604 025
 michael.kitts@uk.pwc.com

David Padwick
 – South East & London
 +44 7804 3289
 david.padwick@uk.pwc.com

Scott Bailey
 – South West & Wales
 +44 117 928 4257
 scott.bailey@uk.pwc.com

Mike Greig
 – Scotland
 +44 131 260 4498
 mike.greig@uk.pwc.com

www.pwc.co.uk