NATIONAL AUDIT OFFICE

Report by the Comptroller and Auditor General

Department of the Environment: Financial Reconstruction of New Towns in England

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Comptroller and Auditor General

National Audit Office
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Department of the Environment: Financial Reconstruction of New Towns in England

Table 1: Status of New Towns at December 1986

Towns transferred to the Commission for New Towns	Date of designation	Date of transfer to Commission
1st Generation		
Stevenage	1946	1980
Crawley	1947	1962
Harlow	1947	1980
Hemel Hempstead	1947	1962
Hatfield	1948	1966
Welwyn Garden City	1948	1966
Basildon	1949	1986
Bracknell	1949	1982
Corby	1950	1980
2nd Generation		
Skelmersdale	1961	1985
Redditch	1964	1985
3rd Generation		
Northampton	1968	1985
Central Lancashire	1970	1985

Remaining Corporations	Date of designation	Target dissolution date
1st Generation		
Aycliffe & Peterlee[1]	1947 & 1948	1988
2nd/3rd Generations		
Washington	1964	1988
Milton Keynes	1967	1992
Peterborough	1967	1988
Telford	1968	1991
Warrington & Runcorn[2]	1968 & 1964	1989

Notes:
1. Aycliffe & Peterlee Development Corporations were merged in 1985.
2. Warrington & Runcorn Development Corporations were merged in 1981.

Department of the Environment: Financial Reconstruction of New Towns in England

Report

1. In 1986 the Department of the Environment (DOE) revised the financial structure of the New Town Development Corporations and the Commission for the New Towns in England. With Parliamentary approval DOE wrote off £1,688 million of National Loans Fund (NLF) debt held by four of the six remaining Corporations and suspended £249 million of NLF debt held by the other two. (Some suspension of NLF debt held by the Commission may be necessary in future.) DOE also introduced a more rigorous financial regime governing the New Town bodies' activities.

2. This NAO report examines the circumstances of the financial reconstruction, its implementation and likely effectiveness. It also reviews the related measures introduced to improve planning and financial control within the New Town bodies. Those measures were not operating fully in early 1987, so NAO was unable to examine their effectiveness in practice.

Establishment of New Town bodies

3. The New Towns Act 1946 provided for the Government to designate land for New Towns and establish independent Corporations to undertake development. The Corporations were given wide powers to acquire land, develop infrastructure and build industrial and commercial premises and housing under approved development plans. Between 1946 and 1970 21 New Towns were established in England. In the first generation, 11 towns were designated between 1946 and 1950; eight towns were intended mainly to relieve population pressure in London, and three were developed primarily to meet specific employment or housing difficulties and later to encourage regional growth. The second and third generation towns continued this objective of regional development. Table 1 shows the status of the towns at the end of 1986, and the Appendix shows their main objectives.

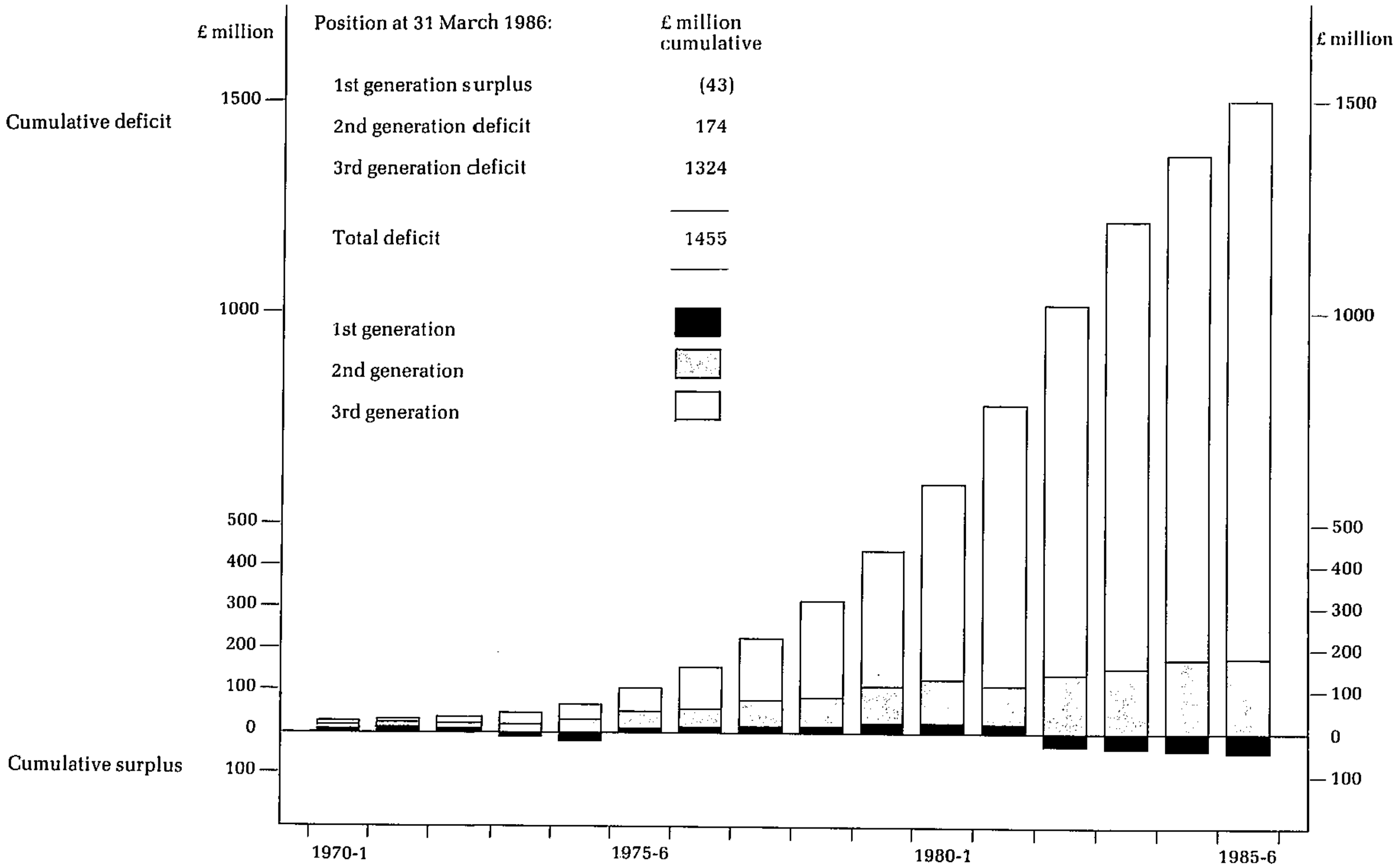
4. In 1961 under the New Towns Act 1959 the Government established the Commission for the New Towns in England to take over and manage the assets and liabilities of those Corporations which had substantially achieved their objectives. By 1 April 1986 the Commission had taken over responsibility for 13 towns. Six Corporations responsible for eight towns then remained, and DOE expect these to be wound up between 1988 and 1992.

Financial objectives and outturn

5. The 1946 Act provided for loans to the Corporations to fund capital expenditure and for grants to defray other expenditure. Although the Act did not set out specific financial duties for the Corporations it required them to prepare annual accounts and reports. It also made borrowing conditional upon development being likely to secure reasonable returns and placed an

Table 2

New Towns' revenue surpluses and deficits 1970-1986



Note: The graph shows the towns' accumulated revenue position at each year end.
It includes both the Commission's and the Corporations' results.

aggregate limit on borrowing. Successive legislation increased this limit, and the New Towns Act 1965 provided for Corporations to borrow to fund revenue deficits.

6. The 1946 Act envisaged that Corporations would in time pay for infrastructure — such as roads, sewerage and amenities — from the surpluses generated by their commercial, industrial and housing developments. The Corporations were expected to incur revenue deficits initially, but to move into surplus as investments matured and rents rose with the growth of the towns.

7. This expectation was met for most of the first generation towns which, in aggregate, achieved a cumulative surplus on general revenue account in 1961. Although some individual towns did not break even in this way until the mid 1970s, ultimately only Aycliffe, Peterlee, Basildon and Hatfield of the first generation towns failed to do so. And in the cases of Basildon and Hatfield capital surpluses on disposal of assets prior to their dissolution more than offset their accumulated revenue deficits. A valuation of commercial and industrial property assets suggested that, as at 1 April 1986 (and excluding Aycliffe & Peterlee), a surplus of about £500 million had accrued from development in the first generation towns and remained to be realised.

8. The second and third generation towns have achieved considerably less financial success. They were generally operating in circumstances offering less favourable returns on property investment, and incurred substantially more capital expenditure and correspondingly greater initial revenue deficits than their predecessors. As a result, the New Town bodies as a whole moved back into deficit on general revenue account in 1969. This aggregate deficit accelerated rapidly from the mid-1970s as investment in the third generation towns peaked. At 31 March 1986 the accumulated revenue deficit stood at £1,455 million, or 38 per cent of their outstanding NLF debt at that date. Table 2 summarises revenue outturns since 1970, and contrasts the financial performances of the first and later generation towns.

9. By 1986 nine of the first generation towns (all except Aycliffe and Peterlee) and four later towns had been wound up and their assets transferred to the Commission. Although the accumulated deficits of the later towns taken over resulted in the Commission moving into aggregate deficit for the first time in 1985-86, overall the Commission's finances remained in a better state than those of the remaining six Corporations. Table 3 (overleaf) summarises the bodies' finances at 31 March 1986.

Causes of financial difficulties

10. In DOE's view the deterioration in the towns' finances was attributable mainly to a number of circumstances outside the Corporations' control, including:

— the less favourable locations of the later towns;

— the more difficult economic conditions (high inflation and interest rates, and lower growth) and the less buoyant property market prevailing during development of the later towns;

— the decision in 1977 to restrict growth in third generation towns by up to one-third after the initial development had been completed, resulting in over-provision of infrastructure (this decision took account of demographic and economic factors, and a change in policy priorities towards the inner cities);

Table 3: Financial position of New Town bodies at 31 March 1986

	Total £m	Commission £m	Corporations £m
Fixed Assets	2,867	1,091	1,776
Net current assets (liabilities)	(56)	12	(68)
Net Assets Employed	2,811	1,103	1,708
Accumulated Revenue Deficit	1,455	180	1,275
	4,266	1,283	2,983
Financed by:			
Loans from the Secretary of State	3,841	922	2,919
Surplus on disposals	251	234	17
Other provisions and reserves	174	127	47
	4,266	1,283	2,983

— the higher costs to Corporations of providing infrastructure as a result of changes in 1974 and 1975 in the funding of investment in roads, sewerage and water supply, and the introduction of "undue burden" payments by third generation towns to compensate County Councils for certain additional costs imposed by New Town development;

— the cumulative effects of financing revenue deficits at the high interest rates prevailing since the mid-1970s.

Consultants, commissioned by DOE to advise on the financial reconstruction, confirmed this analysis.

11. NAO examination broadly confirmed the substantial contribution of these external factors to the deteriorating financial position of the later towns. For example, infrastructure expenditure equated to about 26 per cent of remunerative commercial and industrial investment for the first generation towns but 50 – 60 per cent for the later towns, rising to 84 per cent in one case. And interest rates ranged from $2\frac{1}{2}$ to $6\frac{3}{4}$ per cent up to 1961, but then climbed to a peak of $17\frac{3}{8}$ per cent in 1975.

12. Although DOE had considered some specific features of management in the course of their supervision and monitoring of the Corporations, NAO noted that DOE had not examined systematically how far internal factors such as quality of management and soundness of investment decisions had affected the Corporations' financial performance. Whilst acknowledging the difficulty of unscrambling the effects of external and internal factors, NAO examination identified features such as variations between Corporations' relative property management costs, and in the extent of empty industrial property, which appeared to reflect variations in management performance as well as external factors. In addition, a 1986 valuation of commercial and industrial assets in 18 of the towns revealed surpluses (in some cases, substantial surpluses) over Balance Sheet values in 15 towns, but also suggested a large shortfall — of the order of £60 million — in the other three towns.

Financial reconstruction

(i) Statutory authority

13. In 1980, DOE reviewed the practice of allowing the Corporations to finance revenue deficits by borrowing from the NLF, and whether it was unsound to continue such borrowing in the light of the Corporations' deteriorating financial position and the prospect of continuing deficits for several decades. In January 1981, DOE proposed and Treasury agreed in principle that it might be more appropriate to introduce revenue grant aid for specific infrastructure projects. However it became apparent that such an approach would require legislation and in June 1981 DOE made an alternative proposal for a simplified general grant to support Corporations' revenue deficits using existing statutory powers. The Treasury rejected this proposal, on the grounds that continued NLF borrowing, with some prospect of repayment, was preferable to grant aid which would necessarily have to be borne by the taxpayer and would increase public expenditure totals.

14. In January 1982 DOE accepted a Treasury proposal for a wider review of financing options, and this resulted in the autumn of 1982 in the decision to carry out a capital reconstruction. This was intended to restore solvency by writing-off sufficient NLF debt to enable the Corporations to pay their way. Such action would not increase visible public expenditure, but required legislation. In the meantime, to ensure the propriety of further lending to the Corporations and to stabilize their deficits, in September 1983, using powers secured through the 1983 Finance Act, DOE suspended for three years repayments on £1,155 million (37 per cent) of NLF debt in respect of 11 Corporations.

15. The New Towns and Urban Development Corporations Act 1985 empowered the Secretary of State, subject to Treasury and Parliamentary approval, to write-off up to £1,750 million and suspend up to £1,300 million of New Town liabilities (including those of New Towns in Wales). DOE decided to use these write-off powers to carry out a full scale reconstruction of the four Corporations with significant remaining development tasks (Milton Keynes, Peterborough, Telford and Warrington & Runcorn). But for the Commission (whose finances were sounder) and those Corporations with modest residual development programmes and shorter remaining lives (Aycliffe & Peterlee and Washington) DOE considered that full reconstruction was not worthwhile; instead, they decided to suspend sufficient debt to avoid the need for further NLF borrowing. In order to avoid recurrence of financial difficulties, the 1985 Act also empowered DOE to make capital grants towards remaining infrastructure investment.

16. In May 1986 the Treasury approved proposals for reconstruction and the introduction of a new financial regime for the bodies based on the consultants' recommendations. On 18 July 1986 Parliament approved an Order (1986 No. 1382) providing for the partial extinguishment of liabilities in respect of four of the six remaining Corporations. A subsequent Order (1986 No. 1436) suspended part of the liabilities of the other two Corporations. As a result, the outstanding loan debts of the six Corporations were reduced as shown at Table 4 opposite.

17. In the case of the Commission, DOE concluded that no immediate suspension of debt was required, although some might be necessary later. This decision took account of the Commission's substantial income from disposal of assets, as well as the better financial position which it had inherited from the earlier Corporations. The Commission has also since September 1986 been required to resume repayments in respect of £252 million of debt relating to Corporations whose debts had been suspended in September 1983 (see paragraph 14).

(ii) Write-off of debt

18. DOE's intention was to write-off sufficient NLF debt to allow the Corporations the prospect of eventually breaking even, and to do so without undermining financial discipline. The level of write-off for each Corporation was accordingly based on forecasts of income and expenditure over the next 20 years, appropriately discounted and supported by a revaluation of commercial and industrial properties.

19. NAO examination confirmed that DOE had acted prudently and reasonably in determining their strategy for the write-off of debt and in calculating the individual writes-off. They made good use of the advice of their

Table 4: Write-off and suspension of debt in 1986

Write off Corporation	Liabilities extinguished by Order £m	Residual debt £m
Milton Keynes	510	410
Peterborough	296	172
Telford	465	128
Warrington & Runcorn	417	239
Total	£1,688m[1]	£949m

Suspension Corporation	Debt suspended by Order £m	Residual debt £m
Aycliffe & Peterlee	152	41
Washington	97	90
Total	£249m	£131m

Note:
[1] Representing £1,591 million principal and £97 million accrued interest.

consultants, who had carefully reviewed the forecasts, adjusting them as necessary. NAO's own review revealed no evidence of material error in the Corporations' forecasts.

(iii) Suspension of debt

20. Unlike write-off, suspension of debt left open the possibility of repayment and the 1985 Act allowed DOE to suspend debt for those bodies not benefiting from write-off. Suspension was essentially a short-term measure which was intended to allow the bodies concerned (Aycliffe & Peterlee and Washington Corporations) to continue agreed programmes without further long term borrowing. Wind-up of both Corporations had been planned for March 1985 but in the event was deferred to 1988. Though suspension of debt is also available for the Commission DOE have decided that no such action is at present required although the position is being kept under review (see paragraph 17).

21. From cash flow forecasts prepared by the two Corporations for the period to 1991, DOE concluded that until 1988 surpluses would be insufficient to allow servicing of any non-housing debt. Accordingly, in August 1986 with Treasury approval DOE laid an Order suspending until March 1988 £249 million of the two Corporations' NLF debt, ie. all their non-housing debt. DOE subsequently introduced monthly cash flow monitoring for the two Corporations to keep their financial position under close review.

New financial control regime

22. Although improvements to financial procedures had progressively been introduced, DOE asked their consultants to advise on the Department's management and control arrangements for the remaining New Town bodies. The consultants' report of November 1985 offered comprehensive advice, and also commented on the following management procedures:

(a) corporate planning: although there was a system of management accounts, the absence of corporate plans containing agreed written objectives and financial targets impaired DOE's strategic management;

(b) budgeting: there was a lack of clarity in budgeting and the Corporations and DOE did not always monitor progress against the same budget sums;

(c) project control: the system for controlling capital expenditure ran independently from the management accounts and the monitoring of cash allocations;

(d) performance reporting: there were weaknesses in performance reporting and progress monitoring, and there had been little emphasis on examining the Corporations' performance.

In NAO's view, these comments confirmed that there were serious control and monitoring weaknesses which reflected on the procedures operated at the time by both DOE and the New Town bodies.

23. The consultants made recommendations, which DOE accepted, aimed at remedying the perceived deficiencies in DOE's arrangements. They covered the overall financial management of four Corporations, including the introduction of an integrated system of corporate planning, budgeting and monitoring. The consultants also proposed that the revised financing

structure and control arrangements should extend to the two Corporations whose debt was to be suspended, and to the Commission. This further proposal was accepted by DOE, the Corporations and the Commission.

(i) Corporate planning

24. Acceptance of the consultants' proposals required major changes in DOE's and the bodies' procedures, and the Department have adopted a phased approach to implementing them. After preliminary consultation with the bodies, DOE issued firm guidance in June 1986 on the preparation of corporate plans, and in December 1986 on budgeting and monitoring arrangements. The intention is that the plans should provide performance indicators on such matters as property management and investment.

25. In practice, implementation of corporate planning has proved difficult. Delays have occurred in the submission (due by July 1986) and consideration of the Corporations' plans for the first planning cycle, commencing 1987 - 88; and the Commission's first plan will be for the cycle commencing 1988 - 89. NAO did not review the substance of corporate plans already submitted because these were still evolving at the time of its examination and some major issues of principle had not been resolved. DOE told NAO that, for the Corporations, all the major corporate planning procedures were in place for 1987 - 88. This was also the case for the Commission although the Department had accepted a later date for submission of the first plan because of the greater scale of the Commission's activities; they were continuing to discuss corporate strategy with the Commission, which hoped to produce its first plan by April 1987.

(ii) Form of accounts and financial duties

26. The consultants recommended that, to help measure the extent to which agreed objectives were met, DOE should set high level targets in the form of financial duties:

— requiring the Corporations to break even on revenue account on an annual and cumulative basis within specified timescales;

— requiring the Corporations and the Commission to meet target rates of return each year on commercial and industrial assets employed.

In addition, the consultants recommended that the published accounts should show as a note the current valuations of assets held in the Balance Sheet at historic cost. They did not propose any other changes to the form of accounts but suggested that DOE might undertake a review with the bodies to improve the quality and usefulness of the bodies' published accounts.

27. DOE do not propose to follow precisely the consultants' recommendations that specific target dates should be set for breakeven to be achieved, on the grounds that the Corporations' ability to achieve such targets would be influenced in large measure by factors outside their control. However, they accept that strategic financial objectives are an important discipline and intend to achieve this by imposing on the four Corporations a financial duty to achieve breakeven overall before the end of the economic lives of their assets, and to require them to report publicly their forecast dates for year-by-year and cumulative breakeven. DOE have also decided, with Treasury agreement, not to impose target rates of return on the bodies; they will instead set cash targets for net rental income from commercial and indus-

trial property and for disposal of non-housing assets, which they regard as likely to be more effective. The bodies will be required to report their performance against these targets in their published accounts, and to show the rates of return achieved on property assets.

28. In March 1986 DOE initiated a major review of the form of accounts in conjunction with the bodies. As a result, they expected that major changes would be introduced in the bodies' published accounts, commencing with 1986–87. These changes were to include full incorporation of asset valuations in the Balance Sheet.

(iii) Other changes

29. DOE also accepted proposals to integrate their individual project control procedures with the budgeting process, to allow higher levels of delegation for projects included in the agreed budgets, and to reduce the test discount rate to be applied by the bodies in appraising commercial and industrial investments (formerly 10 per cent in real terms) to bring it closer to the current Treasury rate of 5 per cent. These changes were to be implemented on 1 April 1987, together with others resulting from the Department's recent completion of a wider review of their project control procedures.

30. To assist the bodies to meet capital expenditure on infrastructure, DOE have introduced a scheme offering grants of up to 80 per cent for capital expenditure on roads and other transport investments, which account for most of the remaining infrastructure expenditure. Some expenditure which would be ineligible for grant was also allowed for in the forecasts of income and expenditure on which debt write-off was based.

NAO access to New Town bodies

31. The financial restructuring of the bodies makes it unlikely that in future any of them will in any financial year receive more than half its income from public funds. In consequence, the Comptroller and Auditor General will have no right under Section 7 of the National Audit Act 1983 to examine the economy, efficiency and effectiveness with which any of the bodies have discharged their functions. As the bodies effectively derive their income from publicly-funded assets or grants, and given the large programme of disposals yet to be completed, DOE have agreed, following consultation with the bodies concerned, that continued rights of access should be established by agreements under Section 6(3)(d) of the Act. The necessary arrangements are now being made.

Summary of NAO findings and conclusions

32. The main findings and conclusions arising from NAO examination are as follows:

(a) There was a marked contrast between the generally successful financial performance of most of the first generation towns and that of the second and third generation towns; the aggregate deficit accelerated rapidly from the mid-1970s (paragraphs 7–8).

(b) The deterioration in the towns' finances was mainly attributable to factors outside the Corporations' control, but DOE did not examine systematically how far factors within the Corporations' control, especially variations in quality of management, might also have affected performance (paragraphs 10–12).

(c) The need for measures to improve financial discipline had been recognised by 1980; some steps were taken but a number of factors, including the need for legislation to effect reconstruction, delayed full implementation of other important changes until 1986 (paragraphs 13 – 17).

(d) Once set on that course, DOE acted prudently and reasonably in managing the write-off of debt and in implementing the detailed arrangements (paragraphs 18 – 19).

(e) The remaining lives of four of the six Corporations, ie the four which are expected to be wound-up by 1989, leave little time for the new financial control procedures, including corporate planning, to bite with full effectiveness; these procedures and other new measures should however bite on the other two Corporations and the Commission.

(f) In responding to DOE's request to review the control and monitoring arrangements for the New Town bodies, consultants noted what NAO regards as serious weaknesses which reflected on both DOE's and the bodies' procedures (paragraph 22).

(g) DOE have introduced revised procedures, but these have met some difficulties and delay. The bodies have not fully met DOE's timetable for preparation of the first corporate plans, although the major corporate planning procedures are in place for 1987 – 88 (paragraph 25).

(h) DOE have not adopted their consultants' recommendations on setting specific target dates for the achievement of breakeven or on target rates of return. Instead, DOE intend to impose on four of the Corporations a financial duty to break even over periods related to asset lives, and to set cash targets in key areas of performance (paragraph 27).

(i) Major improvements in the bodies' published accounts are planned to be introduced for 1986 – 87 (paragraph 28).

(j) Action is being taken to ensure continued NAO rights of access to the remaining Corporations and the Commission (paragraph 31).

33. The write-off or suspension of debt cannot guarantee future financial health, and the New Town bodies should therefore continue to be closely monitored. More generally, it is now clear that from the mid-1970s most of the then remaining Corporations were placed in an unsatisfactory financial position and were locked into a situation which in important respects it was largely outside their power to control or indeed significantly influence. In NAO's view this is likely to have affected financial discipline to a significant if unquantifiable degree. Some steps were taken and further essential improvements have now been introduced, including corporate planning, but it is difficult to avoid the conclusion that some of these changes (for example, improved budgeting and monitoring arrangements) should have been introduced much earlier, in advance of the legislation needed for the full scale financial reconstruction. While there should still be time for the new and much tighter financial regime to bite on the Commission, NAO notes that it is being introduced after 13 of the 21 original Corporations have already been wound up and within 2 – 6 years of the expected dissolution dates of the remaining Corporations.

Glossary of abbreviations and terms

NAO	National Audit Office
DOE	Department of the Environment
NLF	National Loans Fund
Corporations	The New Town Development Corporations in England
Commission	The Commission for the New Towns in England
New Town bodies	The Corporations and the Commission, collectively
Write-off	The extinguishment of £1,688 million of principal outstanding and interest accrued on certain advances made by the Secretary of State to the Milton Keynes, Peterborough, Telford and Warrington & Runcorn Development Corporations, as provided for by the New Towns (Extinguishment of Liabilities) Order (1986 No. 1382).
Suspension	In 1983, the suspension of repayments of principal outstanding, totalling £1,155 million, and payment of interest on certain loans made by the Secretary of State to the Corporations, as provided for by the New Towns (Suspension of Loan Repayment) Order (1983 No. 1377). In 1986, the suspension of repayments of principal outstanding, totalling £249 million, and payment of interest on certain loans made by the Secretary of State to the Aycliffe & Peterlee, the former Peterlee and the Washington Development Corporations, as provided for by the New Towns (Suspension of Loan Repayment) Order (1986 No. 1436).

Appendix

Objectives of the New Towns

Town	Ultimate planned population Original	Revised 1977	Purpose
1st Generation (designated 1946 – 1950)			
Aycliffe	45,000	—	House workers from a former ordnance factory. Encourage regional growth (later).
Basildon	133,000	—	London overspill. clear and redevelop shack areas.
Bracknell	60,000	—	London overspill.
Corby	80,000	—	House and widen job opportunities for steelworkers. London overspill.
Crawley	80,000	—	London overspill.
Harlow	90,000	—	London overspill.
Hatfield	29,000	—	London overspill. House and widen job opportunities for aircraft workers.
Hemel Hempstead	80,000	—	London overspill.
Peterlee	30,000	—	House and widen job opportunities for coalminers. Encourage regional growth (later).
Stevenage	105,000	—	London overspill.
Welwyn Garden City	50,000	—	London overspill.
2nd Generation (designated 1961 – 1964)			
Redditch	90,000	—	West Midlands overspill.
Runcorn	100,000	—	Housing and jobs for Merseyside.
Skelmersdale	80,000	—	Housing and jobs for Merseyside.
Washington	80,000	—	Provide for regional growth. Housing and jobs for Tyneside and Wearside.
3rd Generation (designated 1967 – 1970)			
Central Lancashire	430,000	285,000	Provide for regional growth and improve existing infrastructure. Manchester and Merseyside overspill.
Milton Keynes	250,000	200,000	Provide for regional growth.
Northampton	230,000	180,000	Provide for growth from the South East.
Peterborough	190,000	160,000	Provide for growth from the South East.
Telford	220,000	150,000	West Midlands overspill. Improve existing infrastructure and reclaim derelict land.
Warrington	200,000	170,000	Provide for regional growth and improve existing infrastructure. Manchester and Merseyside overspill.