National Audit Office

Report
by the Comptroller
and Auditor General

Ministry of Housing, Communities & Local Government

Local authority investment in commercial property

HC 45 SESSION 2019-20 13 FEBRUARY 2020

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

National Audit Office

Ministry of Housing, Communities & Local Government

Local authority investment in commercial property

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 11 February 2020

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

Gareth Davies
Comptroller and Auditor General
National Audit Office

10 February 2020

HC 45 | £10.00

Our report examines whether the framework overseen by the Ministry of Housing, Communities & Local Government allows for the management of risks to the financial sustainability of local authorities from investment in commercial property.

006571 02/20 NAO

Contents

The National Audit Office study team consisted of:
Alex Burfitt, Robindra Neogi, Cameron Paton and Oliver Sheppard, with the assistance of Hasna Choudhury, Sabah Iqbal and Eduardo Pelegrinello, under the direction of Aileen Murphie.

This report can be found on the National Audit Office website at www.nao.org.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Enquiries: www.nao.org.uk/contact-us

Website: www.nao.org.uk

Twitter: @NAOorguk

Key facts

£6.6bn
estimated local authority spend on commercial property from 2016-17 to 2018-19

49
out of 352 local authorities accounted for 80% of commercial property spending during 2016-17 to 2018-19

17.5%
of all commercial property acquisitions by value in the South East during 2016-17 to 2018-19 were made by local authorities

28.7%	real-terms reduction in local authorities' spending power (government funding and council tax) from 2010-11 to 2019-20
14.4 times	more spend on commercial property acquisitions by local authorities in the period 2016-17 to 2018-19 compared with the preceding three years
38.0%	of local authorities' commercial property acquisitions by value in the period 2016-17 to 2018-19 were outside their boundary
£2.3 billion	spent by local authorities on retail properties in the period 2016-17 to 2018-19
£14.3 billion	increase in the stock of external borrowing held by local authorities between the end of March 2016 and end of March 2019
100 basis points	added to Public Works Loan Board lending rates in October 2019 by HM Treasury in response to increased borrowing in preceding months

Summary

1 In response to substantial falls in funding since 2010-11, local authorities have made reductions in revenue spending on services. Increasingly, authorities have also sought to offset funding reductions by generating new income through a range of strategies. A key component within these responses has been a rapid expansion in the acquisition of commercial property, often funded by borrowing.

2 Buying commercial property can deliver benefits for local authorities including both the generation of income and local regeneration. However, as with all investments, there are risks. Income from commercial property is uncertain over the long term and authorities may be taking on high levels of long-term debt with associated debt costs, or may become significantly dependent on commercial property income to support services. At the national or regional level, local authority activity could have an inflationary effect on the market or crowd out private sector investment.

3 Local authority spending on commercial property takes place in the context of the prudential framework, made up of both powers and duties created by legislation and a set of statutory codes and guidance to which authorities must have regard. The framework gives local authorities significant autonomy over their capital spending and resourcing. Local authorities can borrow to support capital spending and the framework allows each authority to borrow within the overall level they decide is affordable. The codes and guidance seek to restrict borrowing purely in order to profit from investing the borrowed money. There are no restrictions where commercial property purchases are resourced by capital receipts or revenue funding.

4 The Ministry of Housing, Communities & Local Government (the Department) has overall policy responsibility for the prudential framework. It is also responsible for the wider local government finance system. The Department's responsibilities include:

- ensuring that the prudential framework is functioning as intended, and making effective changes where necessary;
- understanding the risks to local government finance from changes in local authorities' borrowing and investment activities; and
- maintaining a framework that gives assurance about how local authorities use their resources, including risks of financial failure.

5 HM Treasury (HMT) is in practice accountable for funds loaned by the Public Works Loan Board (PWLB) to local authorities. PWLB is an independent statutory body that has delegated its day-to-day operations to the Debt Management Office, an executive agency of HMT. HMT decides the cost of the loans, which currently are set relative to government borrowing costs, but PWLB's commissioners (effectively its board) retain a number of powers over lending terms. PWLB loans are quick and straightforward for local authorities to access, and the rates are not dependent on an assessment of an authority's specific credit risk. HMT is accountable for the source of PWLB loans: the National Loans Fund, central government's main borrowing and lending account. HMT also has an interest in the functioning of the wider economy and the government's fiscal framework. The Chartered Institute of Public Finance and Accountancy (CIPFA) is responsible for producing elements of the prudential framework. The Department retains ultimate policy responsibility for the prudential framework and accompanying legislation.

Our report

6 Our report examines whether the framework overseen by the Department allows for the management of risks to the financial sustainability of local authorities from investment in commercial property. We expect the Department to have clear objectives for the system and enough information and assurance on its functioning. We also expect the Department to make effective changes when required.

7 The report addresses this question in four parts:

- Part One sets out the framework within which local authority spending on commercial property takes place.
- Part Two examines recent trends in local authority commercial property acquisition.
- Part Three examines the extent to which authorities are exposed to different risks because of their commercial property acquisitions, and the steps they are taking to mitigate risk.
- Part Four examines how the Department is discharging its responsibilities for the system for local capital spending in relation to investment in commercial property.

8 Our report does not directly assess either national or local risks to value for money from local authorities' acquisition of commercial property. The report focuses on the ability of the Department and HMT to assure themselves about risks to value for money. We include local data and case study material to inform our review of the Department's and HMT's work. We make no assessment of whether these local activities represent value for money or if they involve excessive risk.

Scope of our work

9 Local authorities have undertaken a wide range of income-generating activities in recent years, from revising their fees and charges strategies to investing in renewable energy schemes or setting up companies to provide traded services. However, in this report, we focus solely on the acquisition of non-residential commercial property. This means property for business use generally let to tenants for a commercial rent. While our primary interest is in investments focused on yield (financial return) rather than regeneration and place-shaping, we recognise that many purchases will have multiple objectives. Given this, we do not restrict our scope to a legal definition of investment or the accounting definition of investment properties. Instead, we consider acquisition of commercial property more widely.

Key findings

Local authority investment in commercial property

10 The acquisition of commercial property has become a significant area of activity for some authorities in recent years. While local authorities have held properties for investment purposes for many years, the period 2016-17 to 2018-19 saw a step-change in scale. We estimate that authorities[1] spent £6.6 billion on commercial property from 2016-17 to 2018-19: 14.4 times more than in the preceding three-year period (paragraphs 2.5 and 2.6, and Figure 3).

11 The bulk of commercial property acquisition is undertaken by a relatively small, albeit growing, group of authorities. 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).

12 Local authorities acquire commercial property for a variety of reasons, but yield is currently an important factor. In our review of 45 authorities' capital strategies, all but three identified yield as a significant objective underlying their commercial property acquisitions. Furthermore, a substantial amount of spending is on property outside authorities' boundaries, including 47.9% of all acquisitions by value in 2018-19. In general, spending within an authority's boundaries may have local policy objectives in addition to generating yield. In contrast, out-of-area acquisitions are more likely to be predominantly for yield. Data on the net yields achieved by authorities is limited. Of the 13 strategies where we could identify net yields which accounted for authorities' full debt costs, 11 reported net yields of no higher than 2.6% (paragraphs 2.14 to 2.25, 3.24 and Figures 9 to 11).

1 We define 'local authorities' as principal councils. These include metropolitan borough councils, unitary authorities, London borough councils, county councils and district councils. We include the Isles of Scilly. However, we exclude the City of London. See Appendix Two.

Risks and risk management

13 **There are inherent potential risks associated with the acquisition of commercial property.** These include 'specific risk' associated with each individual property such as the length of the lease or the financial strength of the tenant. Local authorities also face 'systematic risk', which reflects movements in markets; in the last recession UK commercial property values and market rental values both fell. In recent years, systematic risk is apparent in the performance of the retail sector with the shift to online sales, among other factors, leading to growth in vacancy and void rates. The implications of these risks, should they materialise, will depend on the level of exposure of individual authorities' finances to their property portfolios, and the capacity of their governance to mitigate these risks (paragraph 3.12).

14 **Borrowing has played an important role in supporting the acquisition of commercial property but it is not possible for the precise extent of this to be quantified.** Authorities' capital programmes are resourced as a whole from multiple sources, rather than by linking individual purchases to specific funding or financing lines. Consequently, it is not possible to identify the amount of borrowing used to support commercial property acquisition across the sector. However, for the £6.6 billion spent on commercial properties from 2016-17 to 2018-19 we estimate that between a maximum of £6.0 billion (91.2%) and a minimum of £2.5 billion (38.5%) of this spend was financed by prudential borrowing. Prudential borrowing includes external borrowing, and also 'internal borrowing'; a treasury management practice whereby an authority temporarily uses cash it is holding for other purposes (paragraphs 1.5 to 1.7 and 3.2 to 3.5, and Figure 12).

15 **External borrowing to support commercial property investment is likely to have accounted for a proportion, but not all, of the growth in the stock of external borrowing across the sector in recent years.** Local authorities' stock of external borrowing increased by £14.3 billion from 2015-16 to 2018-19, taking total external borrowing held to £74.6 billion. The stock of borrowing from PWLB increased by £10.3 billion in this period. However, borrowing for commercial property investment alone does not account for the increase in the stock of borrowing across the sector since 2015-16. For instance, single-tier and county councils spent £3.2 billion on commercial property from 2016-17 to 2018-19, but their stock of external borrowing increased by £10.1 billion over the same period. It is not clear what is driving this additional borrowing. Both the Department and HMT are currently assessing the underlying reasons, however (paragraphs 3.5 to 3.9 and Figure 14).

16 **In October 2019 HMT announced a one percentage point increase in the cost of new PWLB loans due to substantially increased use of PWLB lending in previous months.** HMT wanted to ensure that there was sufficient headroom within PWLB's statutory limit for authorities to continue to borrow over the medium term. HMT told us the rise is not connected specifically to local authorities' borrowing for commercial property investment. However, in our view some authorities who had been planning to use PWLB lending to support future commercial property acquisition might now reconsider their plans (paragraphs 3.11 and 4.16).

17 A small group of authorities have seen significant increases in their external borrowing and debt servicing costs linked to the acquisition of commercial property. Authorities that have acquired commercial property in recent years are more likely to have seen increases in their stock of external borrowing and debt servicing costs than those that have not acquired commercial property. However, in general these increases are not especially marked. A notable exception is the small group of district councils (8.5% of district councils) that have been most active in the acquisition of commercial property. This group saw their stock of external debt increase by £88.8 million at the median, and median gross external borrowing levels grow from 3% to 756% of their spending power from 2015-16 to 2018-19. However, in the absence of detailed information on the contribution made by commercial property to authorities' revenue budgets and their contingency arrangements, it is hard to assess fully the financial risks to which authorities are exposed (paragraphs 3.5, 3.13 to 3.17 and Figures 13 to 18).

18 There are potential market distortion and value-for-money risks generated by local authorities' acquisition of commercial property. We estimate that local authorities accounted for 4.9% by value of commercial property acquisitions from 2016-17 to 2018-19 in England. However, over this period, authorities accounted for an estimated 9.4% of all commercial property acquisitions outside of London, including 17.1% of retail and 27.1% of office acquisitions in the South East. The geographic and sectoral concentration of authorities' acquisitions could have market-distorting effects, including distorting prices for other authorities. A further potential value-for-money risk is that the relatively low rates available to authorities through PWLB might have led to authorities being able to pay a premium above the market rate to acquire property (paragraphs 3.28, 3.29, 3.31 and Figure 20).

19 External auditors we spoke to considered there are clear areas for improvement in some authorities' governance and risk management arrangements for their commercial property acquisitions. There was evidence from our case study and workshop discussions that authorities had taken steps to manage the risks of their commercial property acquisitions. Separately, auditors said that they had observed authorities demonstrating good practice in governance, but also weaknesses in some authorities including insufficient transparency and reporting to elected members or the public; limited internal challenge to decision making; reduced governance to enable faster decision-making; and limited capacity and skills at officer level. They did not express acute concern about these arrangements across the sector though. In two instances, auditors have qualified their conclusions on an authority's value-for-money arrangements in relation to acquisition of commercial property (paragraphs 3.32 to 3.35).

The government's stewardship role

20 **The Department is responsible for a statutory framework, including codes and guidance, that set the parameters for local authority borrowing and capital spending.** Local authorities' borrowing and investment activities take place within the prudential framework, made up of legislation supported by four sets of statutory codes or guidance. The Department produces two sets of guidance. CIPFA is the author of the prudential and treasury management codes. The then Secretary of State chose to specify these codes in regulations and therefore the Local Government Act 2003 requires authorities to "have regard to" them. Ultimately, the Department is responsible within government for the prudential framework legislation, which includes the requirements for authorities to have regard to the statutory codes or guidance (paragraphs 1.9 and 1.15, and Figure 1).

21 **The Department needs to improve its evidence base on both the nature and scale of local authorities' commercial property investments and any associated risks, and framework compliance.** The Department needs sufficient and proportionate data and analysis to allow it to understand sector-wide patterns relating to risk and framework compliance, and to allow it to focus on particular practices or authorities if necessary. The Department has data on local authority debt levels and costs and it has used these to support its work on the financial sustainability risks of commercial investments. However, there are a range of other areas such as trends in buying out of area, the contribution of commercial income to service expenditure, and the scale of contingency funds where the Department needs better and more timely data and analysis. The Department could look to review the data it collects nationally, as it has in the recent past, or alternatively engage with third-party providers or encourage the routine provision of certain data within authorities' capital strategies. The Department has also not yet addressed other potentially significant issues sufficiently, including potential sub-regional and sectoral market distortion (paragraphs 4.3 to 4.12 and 4.28).

22 **The Department and CIPFA changed key aspects of the codes and guidance two years ago in response to rapid growth in spending on commercial property and in levels of borrowing, among other changes.** The Department's actions were partly in response to a Committee of Public Accounts report in November 2016. Both CIPFA's and the Department's changes aimed to reinforce the existing point that "Authorities must not borrow more than, or in advance of their needs purely in order to profit from the investment of the extra sums borrowed". The implication of this is that authorities should not borrow to invest solely for yield. However, while an authority must have regard to the codes and guidance, it can choose not to follow them. In such cases the authority must still assure itself that it has appropriate legal powers to support its actions and has met its statutory duties, and it must now explain the rationale for the approach in its capital strategy (paragraphs 4.15 to 4.19 and Figure 21).

23 The Department has not yet fully tested whether the changes to the framework have had an impact on the nature and scale of risk in the sector. The Department is reviewing the impact of the changes to its guidance, which is positive, but in our view the review does not go as far as it could have done as it took a purely qualitative approach and defined the impact the Department wanted to achieve in terms of decision-making behaviour, as this was the intended direct effect of the guidance changes. The Department did not have clear measures to test the impact of the changes on risk from commercial property investment and did not carry out new quantitative analysis of commercial investment activity in the sector. The Department has told us it has subsequently decided this work will form a first phase of its review and that this work was scoped to provide an initial review of early progress. The Department will review trends in the sector in later phases of its review work (paragraphs 4.15, 4.18 and 4.21).

24 Levels of spending on commercial property at the sector level have remained largely unchanged following the recent changes to the framework. Our analysis shows that the level of commercial property acquisitions remained largely unchanged up to September 2019, 18 months after the first elements of the new guidance came into force and six months after the last element came into force. We estimate that local authorities spent £2.2 billion on acquiring commercial property in 2018-19 and a further £1.0 billion in the first half of 2019-20. Some 47.9% of this spending in 2018-19 was on property outside authorities' areas. We estimate that between 89.2% and 48.0% of authorities' spend on commercial property in 2018-19 was financed by prudential borrowing. The Department told us it did not expect an immediate, significant change in response to the new guidance and that the Department's objectives are focused on improving decision-making behaviour (paragraphs 2.5, 2.23, 3.3, 3.7 and 4.21, and Figures 3, 10 and 21).

25 Recent trends and practices in commercial property investment raise questions about aspects of the prudential framework and its oversight in the current context. Affordability, a key duty underpinning the borrowing arrangements at the heart of the prudential framework, is no longer effective in constraining each authority's overall borrowing by keeping it linked to their ability to fund borrowing costs from government grant or local tax. Currently, some authorities are taking on general fund debt in high multiples of core spending power and view it as affordable because of the income their commercial property investments generate. Equally, the framework's permissive nature is now being tested. The experiences of recent years have shown that in the context of sustained financial pressure, some authorities, perhaps inadvertently, will test the limits of compliance. This shift in borrowing for income-generating opportunities requires greater changes to the Department's oversight of the effectiveness of, and compliance with, the framework at the sector level than we have seen to date. Furthermore, the nature of the framework means that it can be slow to change. While commercial behaviour changes emerged in 2016-17, it took until 2018-19 before the codes and guidance changes started to come into effect, with the Department not expecting an immediate change in behaviour in that year (paragraphs 1.9, 1.10, 2.18, 3.13, 4.15, 4.23 and 4.29, and Figures 15 and 21).

Conclusions on value for money

26 The acquisition of commercial property can enable authorities to generate income in the context of financial pressure, while also supporting regeneration. However, the scale of investment of public funds in this activity in the last three years, the concentration of this activity in a relatively small group of authorities, and the use of borrowing to finance such investments is striking. The benefits from this investment therefore must be considered against the potential financial sustainability and value-for-money risks that have emerged.

27 The Department as steward of the prudential framework, alongside CIPFA, has sought to address the implications for the framework of emerging risks from these activities. It has been alive to the financial sustainability risks for a small number of authorities and has made system changes in response. However, the Department is only expecting gradual change in those authorities' behaviour despite the Committee of Public Accounts first highlighting concerns in November 2016.

28 The position set out in this report raises questions about the extent to which the Department and HMT can rely on the prudential framework in its present form to support value-for-money decision-making in the current legal and financial context. The permissive nature of the prudential framework has been tested by new behaviours in the sector, and the Department has not yet responded in a timely way that also reflects the marked variations in activity across the sector. To protect against risks to value for money, the Department must take steps to ensure that authorities' actions are in line with the principles underlying the framework. To support this, it should strengthen framework oversight and develop methods for more timely, flexible and targeted intervention when required.

Recommendations

a **The Department should improve the relevance and quality of data and analysis it has on authorities' acquisition of commercial property to understand more fully any associated risks and to provide greater assurance on framework compliance.**

b **The Department, with HMT as appropriate, should broaden its analytical work on local authority commercial property acquisition to:**

- assess potential market-distortion effects;
- understand any value-for-money risks associated with access to PWLB borrowing; and
- assess the investment risks that the sector as a whole is exposed to through the national 'portfolio' of investment properties.

c **The Department needs to articulate clearly both the nature and scale of behaviour causing it concern in relation to both borrowing in advance of need and disproportionate borrowing.** It should:

- monitor trends more actively at sector level to understand compliance; and
- assure itself that it has sufficiently flexible forms of intervention supported by robust evidence to enable it to target particular behaviour.

d **The Department, working with CIPFA as appropriate, should review the prudential framework, its oversight and intervention arrangements, and underpinning data to ensure they remain fit for purpose in the context of an increase in local authority commercial activity.** In doing this the Department should:

- examine whether varying interpretations of the authorities' borrowing and investment powers in the sector are having an impact on the resilience of the prudential arrangements; and
- review recent changes in local authorities' investment and borrowing activities and their underlying motivations to understand fully:
  - the drivers behind recent changes in behaviour in different types of authority, and the relative importance of each driver;
  - the extent to which authorities have undertaken activities that test the limits of the framework such as borrowing to invest solely for yield;
  - the extent to which changes to the codes and guidance have genuinely changed behaviour or whether other factors such as the recent rise in the PWLB rate might have been more significant; and
  - whether recent changes to the codes or guidance have had any unintended consequences that may have increased risk.

Part One

The framework for investment in commercial property

1.1 This section sets out the framework governing local authority spending on commercial property, including the ability to borrow to finance such investment.

Powers and funding

Powers

1.2 Local authorities have a range of powers to acquire property that can be operated on a commercial basis. The use of these powers will depend on individual circumstances. The purpose of any acquisition is important in the selection of powers, and gives rise to two general principles:

- the acquisition of a property that will make an investment return alongside delivering other policy objectives is likely to be possible under authorities' land and property acquisition powers; and
- the acquisition of an investment that happens to be a property is likely to be possible under authorities' investment powers.[2]

1.3 If an authority relies on its investment powers to buy commercial property, it is legally less straightforward to use its borrowing powers to finance the purchase. According to the Chartered Institute of Public Finance and Accountancy (CIPFA), borrowing solely to make an investment return more than the authority's cost of borrowing has traditionally been presumed to be unlawful. However, local authority companies can invest solely for yield. Some authorities borrow and then lend to, or buy equity in, a company they own.

1.4 Legalities are always case-specific. Furthermore, authorities resource their capital programmes as a whole, rather than by associating individual investments with specific funding or financing sources. Accordingly, the analysis in this report on the borrowing and investment activities of local authorities makes no assumptions about the legal underpinnings of these acquisitions and their resourcing.

2 Chartered Institute of Public Finance and Accountancy, *Prudential property investment*, November 2019.

Resourcing commercial property investments

1.5 Local authorities can fund commercial property acquisitions using money from asset sales (capital receipts) or by using revenue funding. Alternatively, authorities sometimes choose to finance property purchases through borrowing and meet debt servicing costs from revenue funding.

Prudential borrowing

1.6 Local authorities can choose freely between different sources of external borrowing. In practice, authorities often use the Public Works Loan Board (PWLB), an independent statutory body that has delegated its day-to-day operations to the Debt Management Office (DMO), an executive agency of HM Treasury (HMT).[3] Of the stock of local authority external borrowing at the end of 2018-19, 73% was from PWLB, which lends at rates linked to the government's borrowing costs. PWLB loans are quick and straightforward for local authorities to access, and the rates are not dependent on an assessment of their specific credit risk.

1.7 Local authorities can also use 'internal borrowing' to finance acquisitions. This is a treasury management practice whereby an authority temporarily uses cash it is holding for other purposes until the original expenditure planned for the 'borrowed' cash arises. The authority will then borrow externally to replenish the cash it has spent, unless another source of funding is available. Taken together, internal and external borrowing are classed under 'prudential borrowing'.

1.8 Where authorities use prudential borrowing, they must set aside money annually to repay the principal, so that the costs of these repayments do not fall wholly on future council taxpayers. This is known as Minimum Revenue Provision (MRP). It is an important means by which the cost of borrowing is reflected in current spending.

The prudential framework

1.9 Local authorities' borrowing and investment activities take place within the prudential framework (**Figure 1** on pages 16 and 17), with legal powers and duties supported by more detailed sets of statutory codes or guidance. Authorities must have regard to these codes and guidance. The framework was created by the Local Government Act 2003 to:

- shift control over borrowing decisions to the local level, promoting local accountability;
- reduce bureaucracy; and
- ensure better capital spending decisions in line with local priorities.

3 While PWLB has had separate statutory existence during the period for which we report PWLB loan or interest rate information, in practice the PWLB function has been administered by the DMO since July 2002 and it operates under a policy framework set by HMT (subject to statutory constraints).

Figure 1

The prudential framework and other accountability or control arrangements relevant to local authority borrowing and investment

Parliament

Passed the Local Government Act 2003 (2003 Act)

Passed (and has regularly amended) the Capital Finance and Accounting Regulations 2003 (Regulations)

HM Treasury (HMT)

Advise the Department on any national economic reasons for overall cap

HMT approval needed for non-sterling borrowing by authorities

Sets the interest rates at which Public Works Loan Board (PWLB) lends

Accountable to Parliament for the source of PWLB loans, the National Loans Fund

Debt Management Office (DMO)

Executive agency of HMT

Conducts the day-to-day operations of:

Public Works Loan Board

Separate statutory body

Main source of local authority borrowing

Ministry of Housing, Communities & Local Government (the Department)

Policy lead within government for the 2003 Act and Regulations

Advises ministers about potential changes to the framework

Advises ministers about any use of reserve powers to:

- cap overall local authority borrowing (unless Parliament disagrees); or
- cap individual local authority borrowing.

Issues statutory guidance on investments and minimum revenue provision (MRP)

Sits on CIPFA Treasury and Capital Management Panel

Chartered Institute of Public Finance and Accountancy (CIPFA)

Sets expectations of good financial management for authorities

Sets the Prudential and Treasury Management Codes, which support local authorities in meeting their duties under the framework

Through its Treasury and Capital Management Panel, considers and consults on changes to the Codes

Regulates professional conduct of members

Local authorities

Elected members approve key decisions and strategies, including framework for delegation

Must set a borrowing limit they think is affordable (duty under 2003 Act)

Within this limit, free to borrow in sterling without specific permission (2003 Act)

Must make prudent levels of MRP for the repayment of debt (Regulations)

Prudential framework documents

Local authorities must "have regard to" the documents within the prudential framework when fulfilling duties or exercising powers relating to borrowing or investment (2003 Act and Regulations):

- CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code)
- CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (the Treasury Management Code)
- The Department's *Statutory Guidance on Local Government Investments* (the Investment guidance)
- The Department's *Statutory Guidance on Minimum Revenue Provision* (the MRP guidance)

Section 151 officers

Chief financial advisers to local authorities

Statutory responsibility for proper administration of financial affairs

Individual duty to report unlawful financial activity to the authority and external auditor

External auditors

Provide opinion on accounts and conclusion on value-for-money arrangements

Will consider commercial or borrowing issues where these are material or a significant risk

Local electorate

Elect members to council

Hold council to account

Setting the statutory framework

Scrutiny/holding to account

Advice/engagement

Roles or organisations that sit within other organisations while retaining separate statutory powers or responsibilities

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government, HM Treasury and Chartered Institute of Public Finance and Accountancy information

1.10 This approach makes individual authorities responsible for identifying how the purposes of their activity relate to their borrowing powers. Each authority must set a limit on its own borrowing, based on its judgement on what it can afford, having had regard to the requirements of the prudential framework including the principles in the prudential code and the guidance on determining prudent MRP.[4]

1.11 Under the framework, local authorities are responsible for their own investment decisions, including considering risk at the point of investment and appropriately managing risks thereafter. Risks need to be balanced against benefits, which may not be primarily financial. For example, an authority might invest in an area to support local regeneration, due to market failure.

Responsibilities within the prudential framework

The Ministry of Housing, Communities & Local Government (the Department)

1.12 The Department's responsibilities include:

- ensuring that the prudential framework is functioning as intended, and making effective changes where necessary; and
- understanding the risks to local government finance from changes in local authorities' borrowing and investment activities.

1.13 The Department has policy responsibility within government for the prudential framework including accompanying legislation. The Department produces two of the four key codes or guidance within the framework (Figure 1), to which local authorities must have regard: the statutory guidance on investments and on MRP. The Department has chosen not to produce the other two key codes or guidance itself, but remains responsible for the requirement for authorities to have regard to them.[5]

1.14 The Department is also responsible for overseeing the wider local accountability system that provides assurance about how local authorities use their resources. This system consists of various checks and balances including external audit and the roles of statutory officers. The prudential framework sits within this broader accountability system.

The Chartered Institute of Public Finance and Accountancy

1.15 CIPFA is the author of the other two key codes or guidance: the prudential and treasury management codes. These are designed to ensure that local authority capital spending and financing are affordable, prudent and sustainable, and treasury management follows good professional practice. The then Secretary of State chose to specify these codes in regulations and therefore the Local Government Act 2003 requires authorities to have regard to them.

4 The prudential legislation covers all forms of 'credit arrangement' that incur long-term liabilities to achieve the same effects as borrowing; the cost of all such arrangements must be included under an authority's affordable borrowing limit.

5 Comptroller and Auditor General, *Financial sustainability of local authorities: capital expenditure and resourcing,* Session 2016-17, HC 234, National Audit Office, June 2016.

HM Treasury

1.16 HMT is in practice accountable for funds loaned by PWLB and decides the cost of these loans, which are currently set at a margin above government borrowing costs. HMT also has an interest in the functioning of the wider economy and the government's fiscal framework. HMT is not formally a participant in the prudential framework but the framework is central to the context in which PWLB operates.

1.17 HMT relies on the Department's accountability system for assurance on the value for money of PWLB loans to local authorities, agreeing that value for money is best achieved by allowing spending decisions to be taken locally. Officials told us that HMT takes a view on the value for money of loans provided to local authorities as a whole rather than appraising each one.

1.18 HMT needs to ensure that the total stock of PWLB debt remains within the statutory limit on PWLB's ability to lend, while avoiding the impacts on local authority financial management that would occur if PWLB stopped lending. If the statutory limit is approached, HMT can choose between making changes to the terms of PWLB lending (subject to statutory constraints) and recommending to ministers that secondary or primary legislation be used to increase the limit.

Part Two

Local authority commercial property acquisition

2.1 This section sets out recent pressures faced by the sector and examines commercial property acquisition alongside other local authority responses.

Pressures on the sector

2.2 Local authorities have faced financial and service demand challenges in recent years:

- Over the period 2010-11 to 2019-20 the sector experienced a 28.7% real-terms reduction in spending power (government funding plus council tax) (**Figure 2** on page 22).[6]
- Demand in key service areas has increased, including a 14.3% increase in the estimated population of older adults in need of care between 2010-11 and 2016-17, a 33.9% increase over the same period in the number of households accepted as unintentionally homeless and in priority need, and a 15.1% increase in the number of looked-after children from 2010-11 to 2017-18.[7]

Local authority responses to these pressures

2.3 In response to these challenges, authorities have made significant savings.[8] Increasingly, authorities have also sought to generate income. Strategies, which may also serve other policy agendas, include:

- **Providing traded services through trading accounts.**

  From 2010-11 to 2018-19 the surplus from these activities increased by 9.5% in real terms to £195.7 million.[9]
- **Establishing wholly or partly owned trading companies.**

  These provide services or develop housing/property commercially.

6 This figure excludes funding received by local authorities through the Better Care Fund. The methodology is available with our report Comptroller and Auditor General, *Financial sustainability of local authorities 2018,* Session 2017–2019, HC 834, National Audit Office, March 2018.

7 Comptroller and Auditor General, *Local authority governance*, Session 2017–2019, HC 1865, National Audit Office, January 2019, paragraph 1.15 and Figure 4; Comptroller and Auditor General, *Financial sustainability of local authorities 2018*, Session 2017–2019, HC 834, National Audit Office, March 2018.

8 Comptroller and Auditor General, *Local authority governance,* Session 2017–2019, HC 1865, National Audit Office, January 2019.

9 This excludes the surplus from trading accounts linked to authorities' investment properties.

- **Providing loans to developers and public bodies at a commercial rate.**

  This is generally using existing cash balances, but there are examples of authorities borrowing to on-lend, such as Warrington Borough Council.

- **Investment in financial opportunities.**

  For example, solar bonds and renewable energy schemes, which can support environmental objectives while also delivering a financial return. Thurrock Council (Thurrock) has established a £784 million renewable energy investment portfolio.

- **Joint ventures with private developers.**

  These often feature the authority providing development land, to support regeneration and housing objectives while also delivering a financial return.

2.4 In addition to these strategies (which are not within the direct scope of this report), investing in property that can be operated on a commercial basis has emerged as an important strand of activity for some authorities. As with all income-generation strategies, elected members will make choices as to whether the acquisition of commercial property is an appropriate strategy for their authority in the context of their financial position (see further discussion starting paragraph 2.18).

Commercial property investment

Scale and type of acquisition

2.5 We estimate that local authorities spent £6.6 billion on acquiring commercial property between 2016-17 and 2018-19 (**Figure 3** on page 23).[10] This is 14.4 times more spend than in the preceding three years. We estimate that authorities spent £1.0 billion on commercial property in the first two quarters of 2019-20. This is comparable with the first two quarters of 2017-18 (£1.1 billion) and 2018-19 (£1.1 billion).

2.6 Owning investment properties is not new. In 2015-16, the sector had a stock of £10.9 billion in investment properties.

2.7 Spend on the acquisition of office and retail property accounts for the bulk of local authorities' recent investment (£3.1 billion and £2.3 billion, respectively) (**Figure 4** on page 24).[11] Retail acquisitions by local authorities fell noticeably by value in 2018-19. At the national level (in England), market acquisitions of retail properties have been in steady decline from an estimated peak of £12.4 billion in 2014-15 to £7.8 billion in 2018-19.[12]

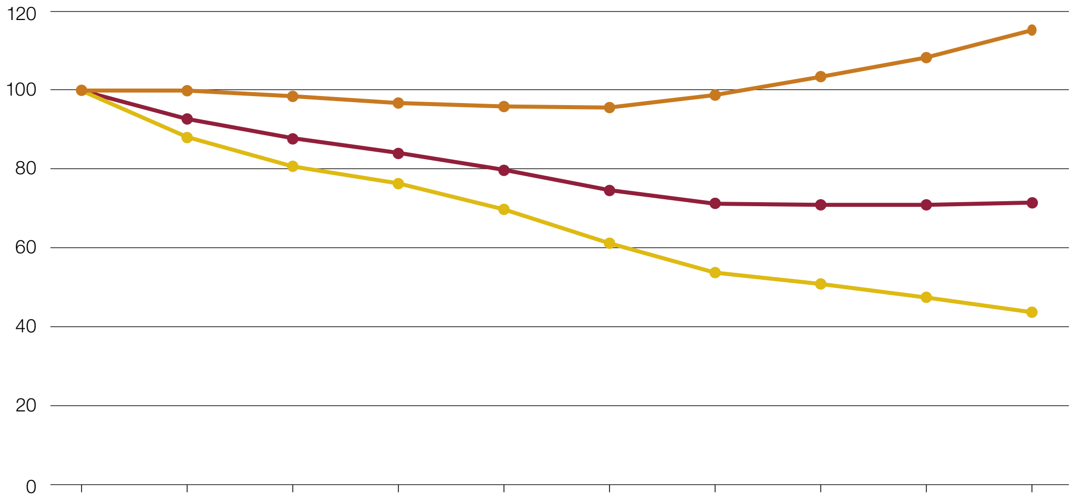
10 See Appendix Two (Quantitative analysis – Proprietary commercial property data) for estimation methodology.
11 This covers 2016-17 to 2018-19. Spend on industrial property totalled £956.5 million during this period, with spend on 'other' property totalling £257.7 million (see Figure 4).
12 National totals from CoStar data. See Appendix Two.

Figure 2

Change in spending power for English local authorities 2010-11 to 2019-20

Reductions in spending power have levelled off in recent years as growth in council tax income has offset reductions in government funding

Spending power and its components (indexed: 2010-11=100) (real terms in 2018-19 prices)



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Spending power	100.0	92.6	87.7	84.2	79.8	74.5	71.2	71.0	70.8	71.3
Government-funded spending power	100.0	88.1	80.8	76.2	69.6	61.1	53.7	50.5	47.2	43.6
Council tax	100.0	99.8	98.6	96.9	95.9	95.5	98.8	103.3	108.3	115.3

Notes

1 Spending power is an indicator that captures the main streams of government funding to local authorities alongside council tax. There have been significant changes in the duties placed on local authorities and the way financial data were reported in this period. To allow for a like-for-like comparison over time we adjust the data to account for these changes using a chain-linked index approach. This means that the results from our time series analysis show percentage change in a weighted index. This provides a good estimate of change over the period that is not skewed by changes in duties and reporting approaches. However, because the data is weighted it will not match spending power and council tax data published by the Department precisely. We use data published with the 2019-20 final local government settlement. Our full methodology is available with our report *Financial sustainability of local authorities 2018*.

2 The values of the three data series are indexed against their 2010-11 values to enable comparison from a common starting point.

3 Funding received by local authorities through the Better Care Fund is excluded from this analysis.

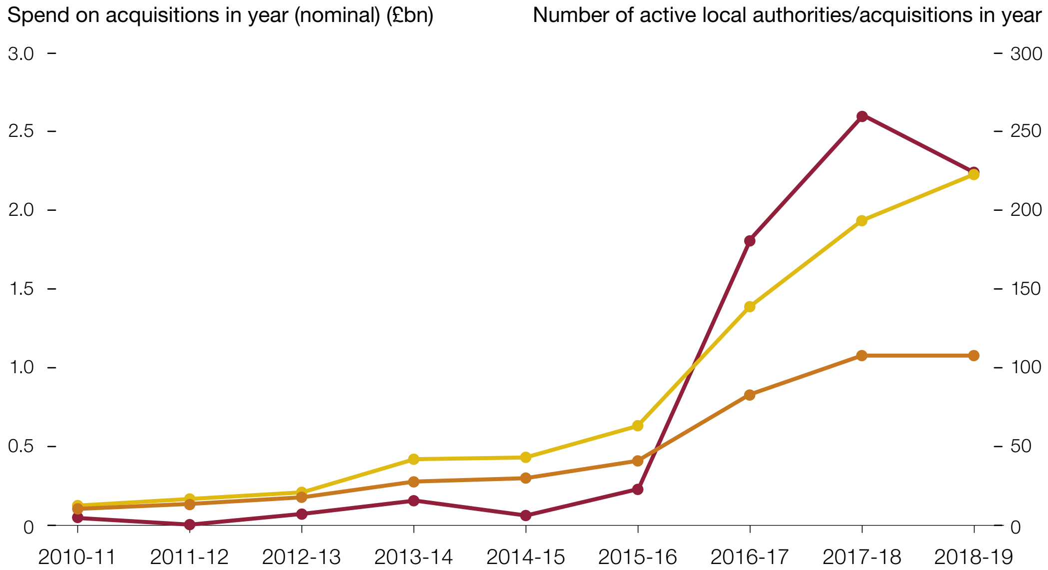
4 Comptroller and Auditor General, *Financial sustainability of local authorities 2018*, Session 2017–2019, HC 834, National Audit Office, March 2018.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 3

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

Spend on acquisitions has increased significantly in the period 2016-17 to 2018-19



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Spend on acquisitions (£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
Acquisitions in year (count)	13	17	21	42	43	63	138	192	221

Notes

1 These figures include acquisitions by companies owned by authorities.

2 Acquisitions may be a portfolio of properties. The analysis classes a portfolio as one acquisition.

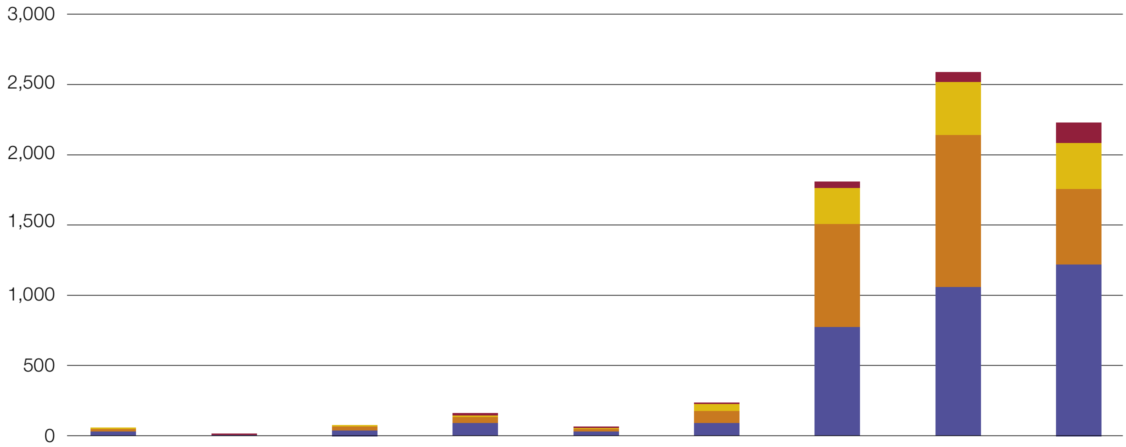
3 Authorities that are 'active in year' are those that purchased commercial property in that year.

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

Figure 4

Spending on commercial property purchases by property type by English local authorities, 2010-11 to 2018-19

Offices have been the main property type by value acquired by local authorities



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Other (£m)	0	0	0	21	4	5	42	70	146
Industrial (£m)	6	1	9	8	12	54	254	380	323
Retail (£m)	13	4	25	38	18	87	733	1,078	537
Office (£m)	34	4	43	94	30	90	776	1,058	1,218

Note

1 'Other' comprises leisure, speciality, sports and healthcare properties.

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

Alternative forms of investment in commercial property

Income strips

2.8 In general, local authority investment in commercial property consists of the acquisition of a property's freehold or long leasehold. However, there are examples of authorities that have used alternative investment approaches such as income strips, whereby an authority effectively takes a lease on a property. The authority then rents the property out to tenants to secure an income. At the end of the lease, the authority can buy the freehold for a nominal sum. Until then, the authority pays a fixed, index-linked annual rent to the freeholder.

2.9 Watford Council, for instance, acquired a 40-year lease for a local business park in early 2019-20. The authority will pay an annual rent of £9.2 million (linked to the Retail Price Index), and expects to utilise an annual net income of £1.5 million for the first 10 years, then £1 million until year 35. The public report informing the decision by full council to pursue the transaction stated that a 'right of use' asset would be entered on the council's balance sheet alongside a finance lease liability with a net present value estimated at £241.7 million.[13] The report added that this liability will be counted as borrowing for the purposes of the prudential framework.[14]

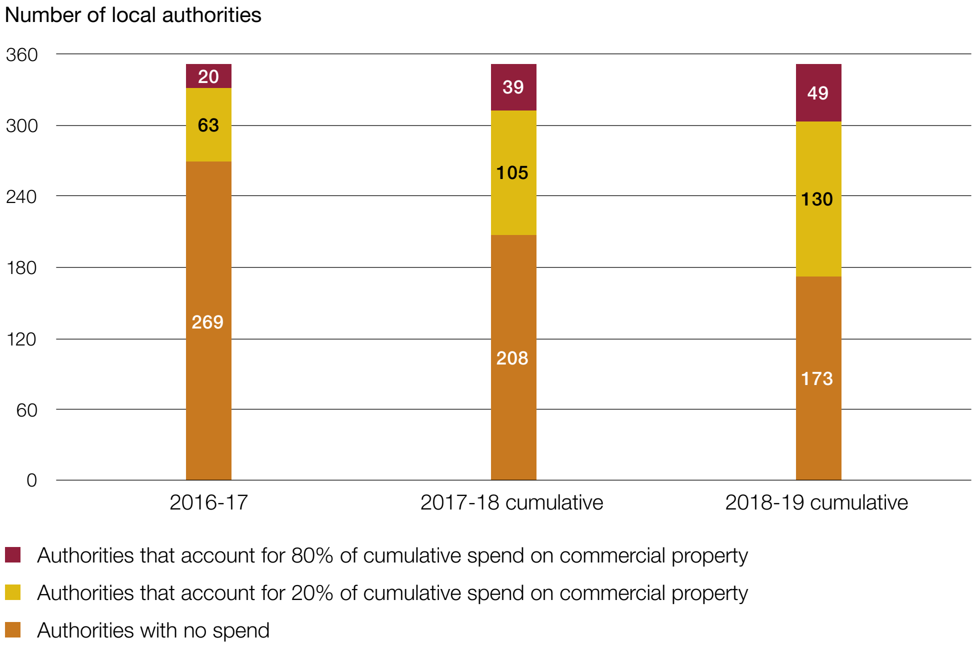
Distribution of activity

2.10 Just over half (179) of local authorities purchased commercial property in the period 2016-17 to 2018-19. However, 80% of the spend in the sector during this period was by only 49 authorities (13.9%) (**Figure 5**).

Figure 5

Share of cumulative spend on commercial property by English local authorities 2016-17 to 2018-19

In 2018-19, 49 authorities (13.9%) accounted for 80% of cumulative spend on commercial property



Notes

1 Total cumulative spend is £6.6 billion. Of this, nearly £5.3 billion (79.7%) was accounted for by 49 authorities and £1.3 billion by 130 authorities.

2 In each year we have rounded the underlying data to the 20% and 80% categories for presentation purposes.

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

13 This data is not recorded by CoStar as a sale price and therefore is not included in our estimate of spend for the first two quarters of 2019-20 (see paragraph 2.5).

14 The increase in borrowing would be partially offset by an £88 million initial reserve fund, which will be invested. This £88 million is a cash payment to the authority from the freeholder to fund maintenance costs and projected shortfalls in rent, to help mitigate the risks within the transaction.

2.11 The number of authorities that have acquired commercial property has grown steadily since 2016-17. Some 32 local authorities (9.1%) spent £10 million or more on commercial property in 2016-17. By 2018-19 a cumulative total of 105 authorities (29.8%) had spent at least £10 million on commercial property since 2016-17 (**Figure 6**). This compares with the preceding three-year period in which 13 authorities (3.7%) spent £10 million or more on commercial property.

Characteristics of active local authorities

2.12 District councils are disproportionately active in the acquisition of commercial property. From 2016-17 to 2018-19, they accounted for 51.2% of total spend on commercial property (**Figure 7**), but only 6.0% of spending power (government funding plus council tax) nationally. This is followed by unitary authorities, who accounted for 24.8% of spend and 22.5% of spending power nationally.

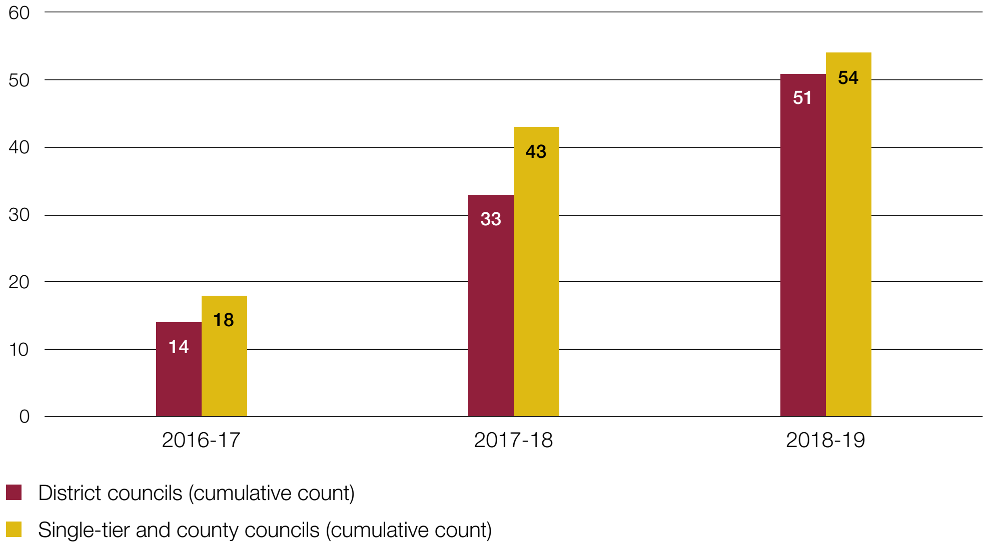
2.13 There is also a strong geographical skew. Authorities located in the South East accounted for 52.9% of acquisitions by value from 2016-17 to 2018-19 (**Figure 8** on page 28).

Figure 6

English local authorities with cumulative spend on commercial property of more than £10 million – 2016-17 to 2018-19

The number of authorities that have spent at least £10 million on commercial property has grown since 2016-17

Local authorities with cumulative spend on commercial property of more than £10 million from 2016-17 to 2018-19



Note

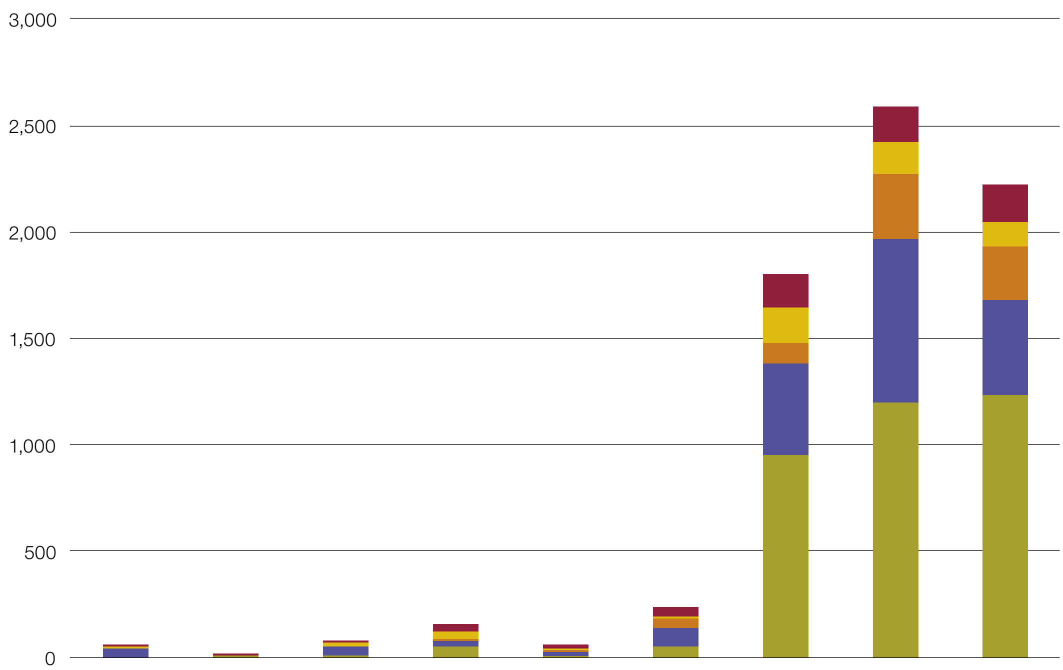
1 Between 2016-17 and 2018-19 there were 201 district councils, and 151 single-tier and county councils. We exclude City of London.

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

Figure 7

Acquisition of commercial property by type of English local authority, 2010-11 to 2018-19

District councils have accounted for the largest proportion of commercial property spend from 2016-17 to 2018-19



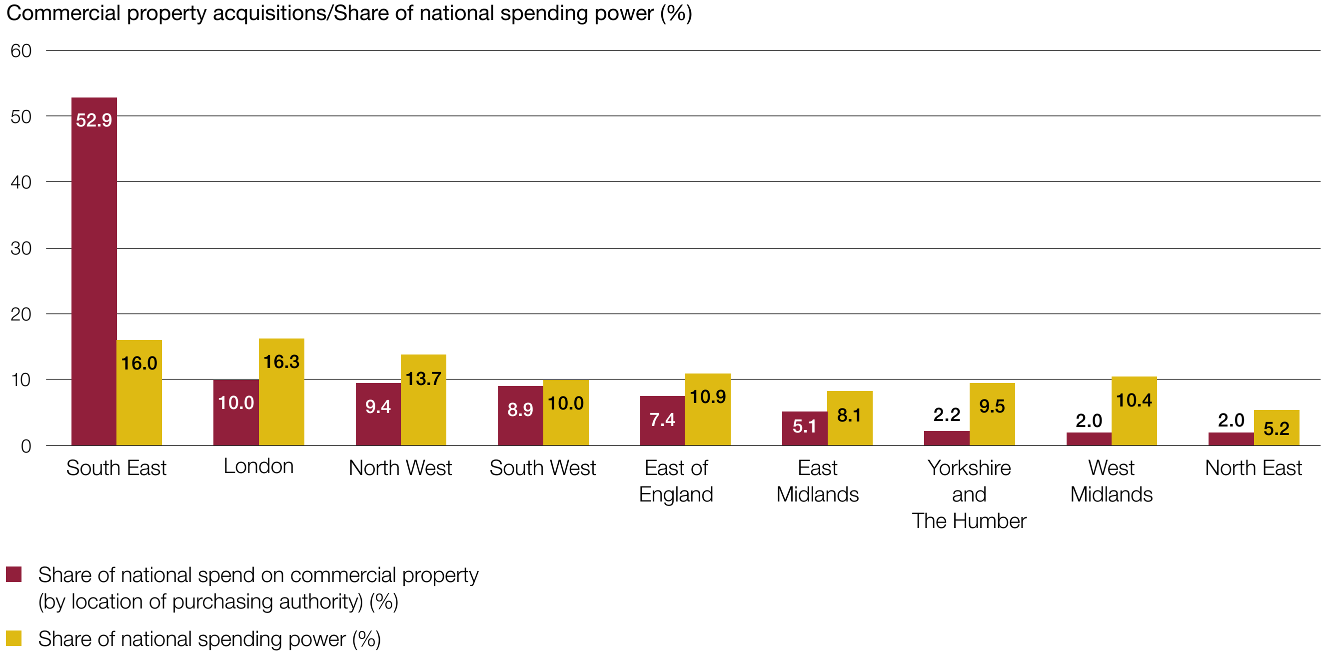
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
County councils (£m)	1	1	3	33	19	38	164	168	175
Metropolitan district councils (£m)	5	1	22	34	6	8	162	144	114
London borough councils (£m)	0	0	0	17	10	50	101	309	253
Unitary authorities (£m)	43	0	37	22	17	82	427	768	445
District councils (£m)	4	8	15	54	13	58	952	1,197	1,236

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

Figure 8

Regional share of commercial property acquisitions by English local authorities 2016-17 to 2018-19 (cumulative)

Local authorities in the South East accounted for more than half of spending on commercial property between 2016-17 and 2018-19, despite accounting for less than a fifth of national spending power



Notes

1 Share of national spend on commercial property shows the regional share of total spend from 2016-17 to 2018-19.

2 Share of national spending power shows regional share of spending power from 2016-17 to 2018-19. This figure is included to give a sense of the financial scale of authorities in each region.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government and CoStar data. See Appendix Two for more information

Reasons for commercial property acquisition

Varied objectives

2.14 Local authorities can acquire commercial property for yield, to support regeneration or otherwise benefit the local area, or for a mix of these factors. In our case study and workshop conversations, securing income was cited as a predominant but by no means the only reason. For instance:

- Portsmouth City Council, Torbay Council (Torbay) and Essex County Council established commercial property acquisition funds with the sole objective of generating yield.[15] The bulk of acquisitions are outside their boundaries to mitigate risk through portfolio diversification.

15 Where authorities have established specific commercial investment funds they may also have separate specific regeneration funds. Torbay, for instance, has a separate regeneration fund to support the council's place-shaping and job creation objectives.

- Spelthorne Borough Council (Spelthorne) and Runnymede Borough Council (Runnymede) both told us they have acquired property both within and outside their areas primarily for yield. This income is used both to support their general funds and to fund new regeneration or housing projects.
- Elmbridge Borough Council has pursued an acquisition programme aimed at generating income for its general fund, to lessen reliance on reducing government funding. It has combined this objective with local place-shaping objectives by buying property wholly within its area. Leeds City Council has also acquired properties within its area to both generate income for the general fund and support local economic regeneration and place-shaping.
- Canterbury City Council (Canterbury) bought its local shopping centre to ensure that the authority can deliver its place-shaping agenda. This acquisition makes only a minimal contribution to the general fund in the medium term.

2.15 In the 45 capital strategies we reviewed, 42 cited generating income as an aim of their property spending.[16] There were examples where it was the primary or even sole aim. However, in three instances (including Canterbury), income generation was not an immediate objective.

2.16 The importance of yield is perhaps reflected in the nature of local authorities' acquisitions. In general, local authorities have acquired property that can be let at near or above average market rents (**Figure 9** overleaf). Acquisition of property that attracts the lowest market rents is relatively limited.

2.17 The importance of yield is also reflected in the Whole of Government Accounts (WGA) data on the acquisition of investment properties by local authorities. These show that authorities spent £4.1 billion on investment properties across 2016-17 and 2017-18.[17] WGA data submitted by local authorities is based on principles and definitions from CIPFA's code of practice on local authority accounting, which itself is based on international financial reporting standards. CIPFA's code defines investment properties as property held to earn rental income or for capital appreciation or both. They exclude properties used to support the delivery of a service. CIPFA's local authority accounting code states that, "If earning rentals were an outcome of a regeneration policy, for example, the properties concerned would be accounted for as property, plant and equipment rather than investment property."[18]

16 We focused on authorities that either had been, or were planning on undertaking commercial property acquisitions. See Appendix Two.

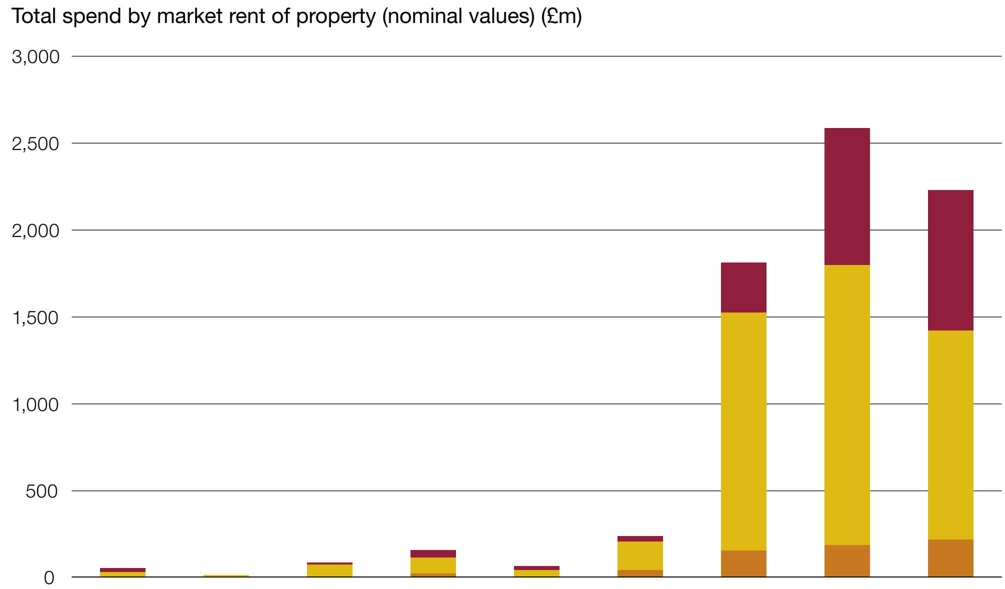
17 Over these two years our data from CoStar demonstrates that authorities spent £4.4 billion on acquiring commercial property. The difference between the CoStar and WGA data is likely to reflect the inclusion of spend by authorities' trading companies in the CoStar data, whereas they are absent from the WGA data (see Appendix Two).

18 Chartered Institute of Public Finance and Accountancy/Local Authority (Scotland) Accounts Advisory Committee, *Code of practice on local authority accounting in the UK 2017-18,* March 2017.

Figure 9

Market rents of commercial properties acquired by English local authorities, 2010-11 to 2018-19

Most authorities' acquisitions are of properties able to generate average, near to average or above average market rents



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Rents above market average	25	0	7	42	17	25	287	791	803
Average or near average market rents	23	9	66	96	42	168	1,365	1,605	1,206
Lowest rents in market	5	1	4	22	6	43	153	189	214

Note

1 Rent categories are based on CoStar's building ratings classification. Properties rated as 1- or 2-star have the lowest rents in the market. Three-star properties attract average or near average market rents. Four- and 5-star properties attract above average market rents. The classification uses locally relevant comparators in determining the rating of the building.

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

Reasons for pursuing yield

2.18 A consistent theme among our case study authorities and in our finance director workshops was that where authorities were acquiring commercial property in order to secure yield, either as a sole objective or alongside other objectives, this was driven by a desire to respond to grant funding lost since 2010-11. Offsetting funding reductions was also a common theme in the capital strategies we reviewed. All local authorities had seen a real-terms reduction in their spending power from 2010-11 to 2018-19.[19] Some single-tier and county councils we spoke to also mentioned service pressures as a reason for pursuing yield.

19 Between 2010-11 and 2018-19 the minimum real-terms reduction in spending power experienced by a local authority was 8.5%. However, 347 authorities (out of 352) saw reductions in excess of 15%, and 327 saw reductions greater than 20%.

2.19 However, funding reductions or service pressures in themselves are not necessarily enough for an authority to invest in commercial property, where yield is an objective. A common theme in our case study and workshop conversations was the importance of the views of elected members. Where authorities told us, primarily in workshops, that they were not pursuing property investments where yield was an objective, there were two relevant aspects: risk aversion among members and/or a view among members that property investment for yield was not the role of a local authority. In addition, there were examples of authorities referring to other specific local factors that they felt restricted their ability to pursue these strategies such as a perceived lack of local investment opportunities.

2.20 Consequently, funding reductions and spending pressures provide the context in which members take decisions about how to respond based on their risk appetite and other local factors. In some cases, they will select commercial property investment as a response to budget pressures; in other instances, they will select different strategies. For instance, elected members in one of our case studies, Thurrock, have to date rejected investment in commercial property as a solution to their funding reductions and low reserve levels on the grounds that members do not consider that it is the role of the council to engage in this type of investment. Instead the authority has pursued a different strategy to address its financial pressures and has engaged in a substantial programme of investment in renewable energy schemes.

2.21 A consequence of the fact that members are selecting from a range of responses to funding reductions and service pressures is that there is no clear statistical relationship between the scale of funding reductions faced by an authority and the extent of their commercial property activity. At the median the most active authorities in acquiring commercial property received similar funding reductions to those that are less active or inactive.[20] Equally, at the median, authorities that were most active in acquiring commercial property made service spending reductions at broadly the same level as less active or inactive authorities.

2.22 In general, authorities we spoke to were aiming to make a contribution to their budget gap through commercial property investment rather than seeing it as the sole solution. However, two of our case study authorities, Runnymede and Spelthorne councils, said that an initial stage of their property investments had allowed them to address their initial objective of offsetting their funding reductions and stabilising their finances. Subsequent investment in commercial property has been to generate yield to fund additional local priorities, such as housing or regeneration, and grow their service provision. This model was unusual among authorities we spoke to, and may reflect the fact that these two authorities have relatively large commercial property portfolios compared with other authorities.

20 We define the 'most active' authorities as the top 20% in terms of level of spending on commercial property relative to their spending power in the period 2016-17 to 2018-19. 'Less active' authorities are the remaining 80% of authorities that incurred spend on commercial property acquisition. We group single-tier and county councils and lower-tier councils separately.

Location of investment

2.23 In general, investments within an authority's boundaries can support local policy objectives as well as generating yield. In contrast, out-of-area acquisitions are more likely to be solely or predominantly for yield. The share by value of out-of-area acquisitions has grown, reaching 47.9% in 2018-19 (**Figure 10**). Over the period from 2016-17 to 2018-19, 38.0% of acquisitions by value have been outside authorities' boundaries.

2.24 Yield may also have been an objective in the 62.0% of spend from 2016-17 to 2018-19 that was within authorities' areas. Many of the case study authorities we spoke to were clear that while their in-area investments were often intended to contribute to policy objectives such as place-shaping, they were also designed to generate income for their general funds. The strategies we reviewed from non-case study authorities also contained examples where yield was clearly one of the objectives for in-area investments.

2.25 From 2016-17 to 2018-19, 47.0% of industrial property acquisitions, and 44.2% of offices were bought out of authorities' areas. In contrast, only 28.1% of retail acquisitions were out of area. The in-area concentration of retail acquisitions is partly due to local authority purchases of retail properties in shopping centres. From 2016-17 to 2018-19, authorities spent £759.4 million on these, with 95.0% of spend in-area.[21] In our case studies and workshops, all authorities that had acquired shopping centres told us that they were primarily pursuing place-shaping objectives, not yield.

2.26 Some 20.8% of local authorities' property acquisitions in the period 2016-17 to 2018-19 are outside of their region (**Figure 11** on pages 34 and 35).

Portfolio structure

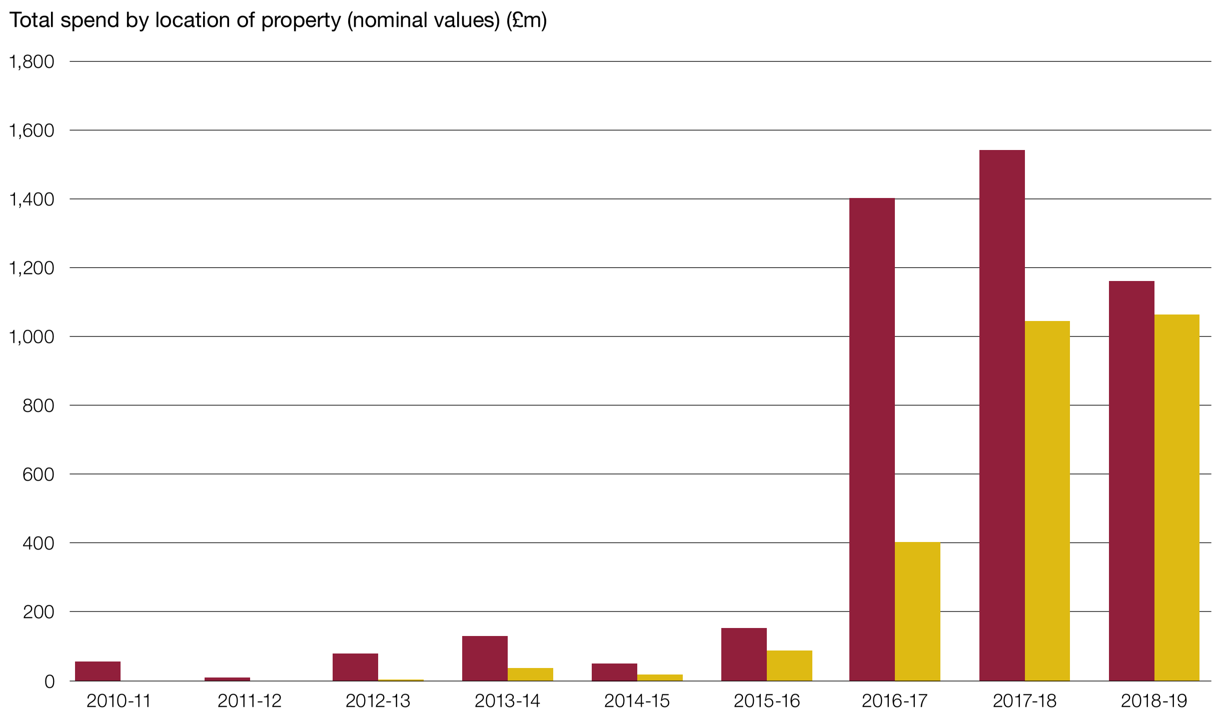
2.27 Of the 179 authorities that acquired properties from 2016-17 to 2018-19, 35.8% (64 authorities) acquired properties out of their area. On average, these authorities tended to have spent more on property acquisition compared with those that invested solely in-area. These authorities also demonstrated a wider sectoral diversification in their acquisitions relative to those buying solely in-area.[22] In our case study and workshop discussions, out-of-area acquisitions were generally seen as important in mitigating risk, such as the possibility of a downturn in the local economy or general decline in a locally dominant sector.

21 Our estimate is a combination of £727 million investment in acquiring whole or partial shopping centres, plus an additional £32 million investment in individual retail units within shopping centres. This calculation excludes investment in retail parks, which we estimate at £523 million between 2016-17 and 2018-19.

22 See Appendix Two (Quantitative analysis – Proprietary commercial property data) for estimation methodology.

Figure 10
The location of commercial properties acquired by English local authorities, 2010-11 to 2018-19

In 2018-19 local authorities spent nearly as much on acquiring properties out of their areas as they did on in-area properties



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
In authority area (£m)	**53**	**9**	**77**	**128**	**48**	**153**	**1,401**	**1,541**	**1,159**
Out of authority's area of which:	**0**	**0**	**1**	**32**	**17**	**83**	**404**	**1,044**	**1,064**
Out of LEP and region (£m)	0	0	0	8	6	61	327	680	365
Out of region, but in LEP (£m)	0	0	0	2	0	2	0	0	6
In LEP and region (£m)	0	0	1	14	10	7	30	107	145
Out of LEP, but in region (£m)	0	0	0	9	0	13	47	257	548

Notes

1 Local Enterprise Partnership (LEP) areas are as defined in 2017.

2 See Appendix Two for estimation methodology.

3 Columns in the chart show in-area and out-of-area spend. The data table breaks down out-of-area spend into its four component parts.

4 We include LEP areas as some authorities we spoke to stated that investments within these areas had the potential to support their local economies in addition to providing yield.

5 Totals may not sum due to rounding.

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

Figure 11

Location of commercial property acquisitions by English local authorities – cumulative spend from 2016-17 to 2018-19

Local authorities spent £1.4 billion (20.8% of their total spend on commercial property) acquiring property outside of their region in the period 2016-17 to 2018-19

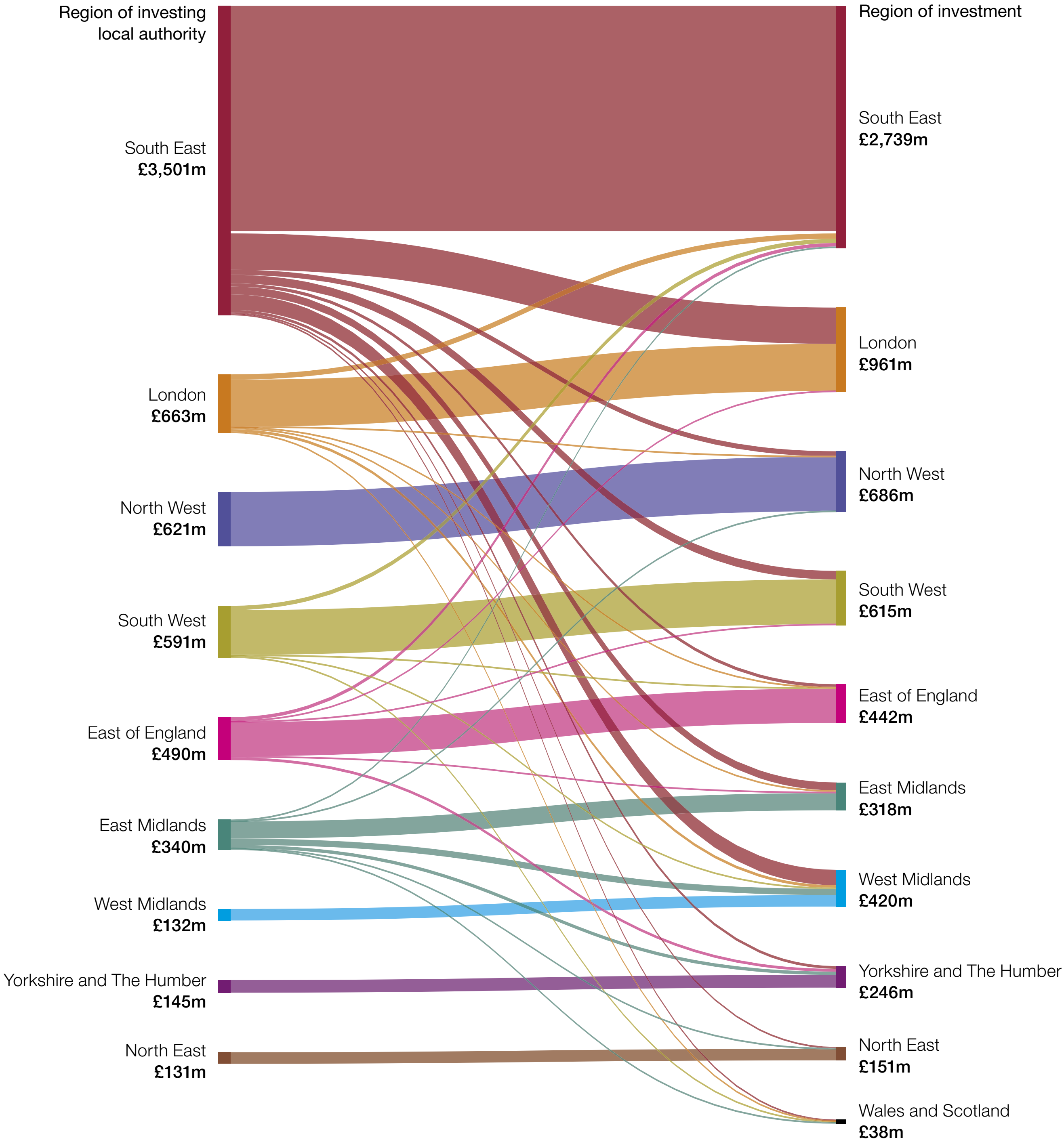


Figure 11 *continued*

Location of commercial property acquisitions by English local authorities – cumulative spend from 2016-17 to 2018-19

	Location of investment									
Location of investing local authority	South East	London	North West	South West	East of England	East Midlands	Yorkshire and The Humber	West Midlands	North East	Wales and Scotland
South East	**2,571**	414	58	97	37	90	31	176	15	11
London	61	**537**	5	–	5	19	–	32	–	5
North West	–	–	**621**	–	–	–	–	–	–	–
South West	49	–	–	**511**	10	–	–	8	–	13
East of England	40	10	–	6	**391**	12	32	–	–	–
East Midlands	18	–	2	–	–	**197**	38	72	4	9
Yorkshire and The Humber	–	–	–	–	–	–	**145**	–	–	–
West Midlands	–	–	–	–	–	–	–	**132**	–	–
North East	–	–	–	–	–	–	–	–	**131**	–

Notes

1 Figure shows investment made by English local authorities in the English regions, Wales and Scotland. It does not show investments made by Scottish or Welsh authorities.

2 Data may not sum to totals due to rounding.

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

Part Three

Risks and risk management

3.1 This section examines the risks generated by local authorities' investments in commercial property and the steps they have taken to manage these risks.

Borrowing to invest in commercial property

Prudential borrowing

3.2 Some authorities we spoke to said that the bulk of their investment had been financed by external borrowing. Some case study authorities have internally borrowed from their cash balances. Only one case study authority had been able to spend on commercial property without any borrowing support to date, by using historical capital receipts from the transfer of its housing stock. Essex County Council has also used capital receipts; however, it has primarily repurposed existing capital receipts and then used borrowing to finance the projects that the capital receipts could have been applied to. When we reviewed a sample of strategies of authorities that have been, or are planning to be, particularly active these gave a similar picture. All had used, or were planning to use, prudential borrowing to at least partly finance their commercial property acquisitions.

3.3 The Ministry of Housing, Communities & Local Government (the Department) publishes data on the value of all capital spending supported by prudential borrowing. It is not possible to isolate the value of this spend supporting investment in commercial property. However, we estimate that of the £6.6 billion spent by authorities on the acquisition of commercial property from 2016-17 to 2018-19 a minimum of £2.5 billion (38.5%) of this was financed by prudential borrowing (**Figure 12**).[23] Our analysis produces a maximum estimate of £6.0 billion (91.2%) of spending on commercial property financed by prudential borrowing in the period 2016-17 to 2018-19.[24] Over the same period a total of £21.7 billion in capital spending on all activities was financed by prudential borrowing.[25]

23 See Appendix Two for data definitions and estimation methodology.

24 We have no preferred option from our three estimates of prudential borrowing to support spending on either commercial property or trading services more broadly, although we think it technically unlikely that the actual figure is below our mid-range estimate in Figure 12. We also note that the Department uses a single estimate in their analysis of borrowing for commercial purposes, and this uses the same methodology as we use to calculate our 'high' estimate. Our high and low estimates for spend on commercial properties financed by prudential borrowing are 90.3% and 18.8% for 2016-17, 93.6% and 43.9% for 2017-18, and 89.2% and 48.0% for 2018-19.

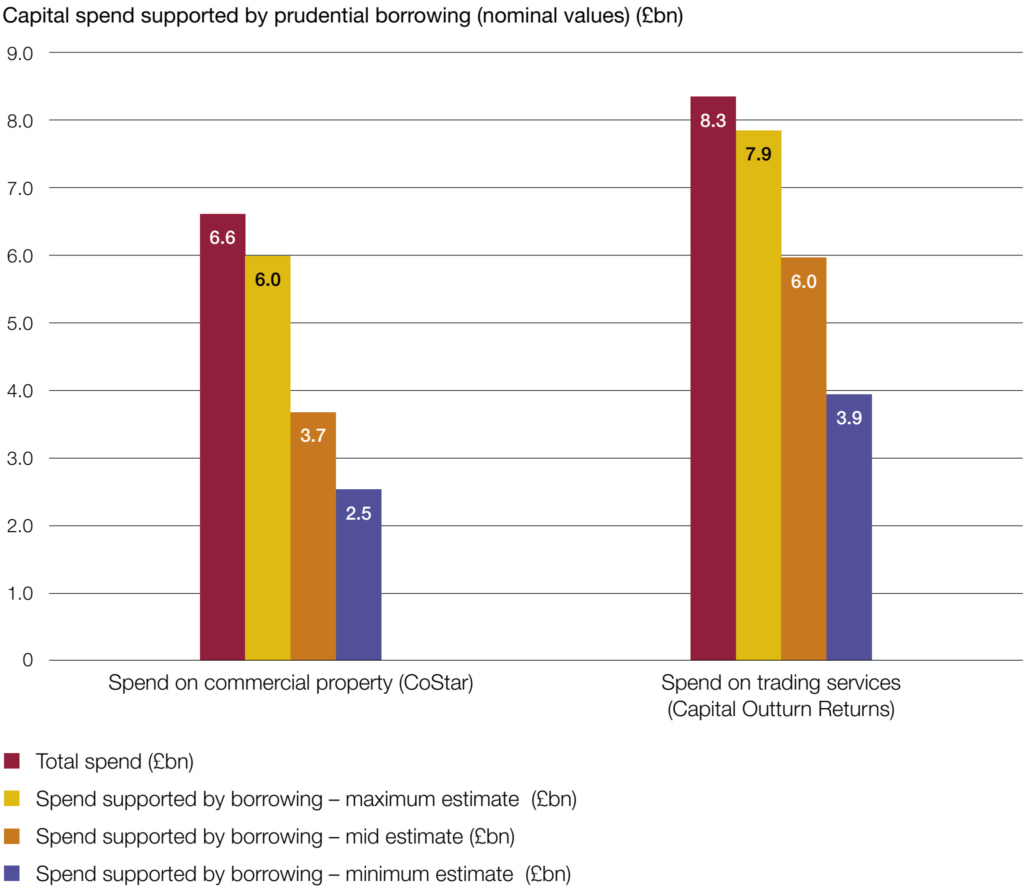
25 This excludes Housing Revenue Account spending supported by prudential borrowing.

3.4 We have also estimated the share of spending on trading services supported by prudential borrowing. This is a wider measure of local authority activity with the potential to generate yield. It includes the acquisition of commercial property alongside other activities such as spending on residential property for sale or rent at market rates, or investments in renewable energy. It does present a similar pattern, however.

Figure 12

Estimated amount of commercial investment financed by prudential borrowing 2016-17 to 2018-19

We estimate that there was a minimum spend of £2.5 billion on commercial property financed by prudential borrowing in the period 2016-17 to 2018-19



Notes

1 See Appendix Two for data definitions and estimation methodology.

2 Prudential borrowing includes external borrowing and internal borrowing. Internal borrowing is a practice whereby an authority temporarily uses cash it is holding for other purposes until the original expenditure planned for the 'borrowed' cash arises.

3 Between 2013-14 and 2015-16, we estimate there was a minimum spend of £32 million on commercial property supported by prudential borrowing, and a maximum of £331 million. Our mid-estimate is £77 million for this period.

4 Spend on trading services reported in departmental data prior to 2018-19 may include a degree of under-reporting. See Appendix Two.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government and CoStar data

External borrowing

3.5 Local authorities' capital programmes, which include the acquisition of commercial property, are funded as a whole. Consequently, it is not possible from national data to link changes in authorities' external borrowing directly to their acquisition of commercial property. However, local authorities that have been most active in property acquisitions since 2015-16 are most likely to have seen an increase in their stock of external borrowing (**Figure 13**).

Sources of borrowing

3.6 Case study and other discussions highlighted recent low interest rates as important in supporting commercial property investment. The Public Works Loan Board (PWLB) is a key source of finance. The interest rate for 50-year maturity loans fell from 4.48% in September 2013 to 1.87% in September 2019 (monthly averages).

3.7 Levels of PWLB in-year lending have increased, growing from £400 million in 2013-14 to £6.8 billion in 2018-19.[26] This has contributed to the stock of external borrowing across the sector growing by £14.3 billion since 2015-16 (**Figure 14**). PWLB in-year lending during the first two quarters of 2019-20 was £4.8 billion.

Figure 13

Change in stock of external borrowing in English local authorities by level of commercial property investment activity, from 2015-16 to 2018-19

Authorities that have been most active in acquiring commercial property have seen the largest changes in their stocks of external borrowing

		Most commercially active group	Less commercially active group	Not active group
District councils	Proportion with increased external borrowing (%)	100.0	47.1	23.3
	Median change in stock of external borrowing (£m)	88.8	0.0	0.0
Single-tier and county councils	Proportion with increased external borrowing (%)	100.0	68.0	57.9
	Median change in stock of external borrowing (£m)	121.0	46.5	10.7

Note

1 We define the 'most active' authorities as the top 20% in terms of level of spending on commercial property relative to their spending power in the period 2016-17 to 2018-19. 'Less active' authorities are the remaining 80% of authorities that incurred spend on commercial property acquisition. We group single-tier and county councils and lower-tier authorities separately. See Appendix Two.

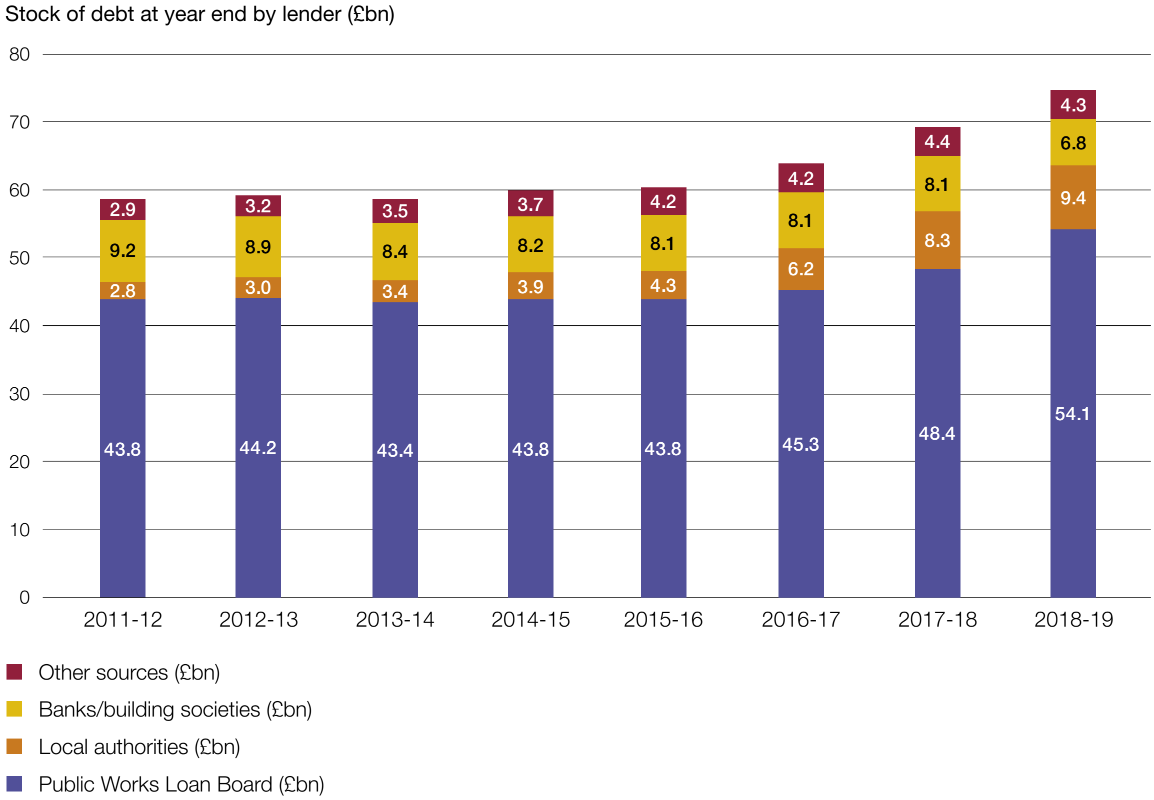
Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government and CoStar data

26 This relates to in-year borrowing by the 352 English local authorities in the scope of this study. The data are from PWLB.

Figure 14

External borrowing by source by English local authorities, 2011-12 to 2018-19

The total stock of local authority external borrowing has increased each year since end 2015-16 to £74.6 billion at end 2018-19, driven in the main by borrowing from Public Works Loan Board (PWLB)



Notes

1 Data are as reported by local authorities themselves.

2 Data include Housing Revenue Account borrowing.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government and CoStar data

Stock of borrowing and commercial property acquisition

3.8 While external borrowing has supported commercial property investment, these acquisitions alone do not account for all the increase in the sector's debt since 2015-16. We estimate that the sector spent £6.6 billion on commercial property from 2016-17 to 2018-19, not all of which will have been funded by borrowing, compared with an increase in the stock of outstanding borrowing of £14.3 billion.

3.9 There is a clear difference between district councils and other councils in this regard. We estimate that district councils spent £3.4 billion on commercial property from 2016-17 to 2018-19. These councils saw their stock of borrowing increase by £4.1 billion over the same period. In contrast, we estimate that single-tier and county councils spent £3.2 billion on commercial property, but saw their stock of borrowing increase by £10.1 billion. This compares with an increase in their borrowing of only £959 million in the previous three-year period. It is not clear what is driving this additional borrowing. Both the Department and HM Treasury (HMT) are currently assessing the underlying reasons, however.

Fiscal risks

National borrowing

3.10 The government's overall exposure to PWLB loans to English local authorities is relatively limited. As of March 2019, the loans outstanding represented 3.6% of the government's stock of gilts. The Office for Budget Responsibility (OBR) sets out long-term projections and assesses whether they imply a sustainable path for public sector debt. This has included consideration of the effect on public sector debt of local authority borrowing to support commercial property investment. HMT told us that it actively monitors the scale of such borrowing and its implication for the fiscal path.

3.11 In October 2019 HMT announced a one percentage point increase in the cost of new PWLB loans, due to substantially increased use of PWLB in the preceding months. HMT wanted to ensure that there was sufficient headroom within PWLB's statutory limit for authorities to continue to borrow over the medium term. HMT told us that this was not connected specifically to local authorities' borrowing for commercial property investment. However, in our view, some authorities planning to use PWLB lending to support future commercial property acquisition may now reconsider their plans.

Local fiscal risk – financial and service sustainability

3.12 Individual local authorities face potential risks from commercial property investment. These include ‘specific risk’ associated with each individual property such as the financial strength of the tenant. Local authorities also face ‘systematic risk’, which reflects movements in markets. For instance, in the last recession UK commercial property values and market rental values both fell.[27] More recently, systematic risk is perhaps apparent in the performance of the retail sector with the shift to online sales, among other factors, leading to growth in vacancy and void rates.[28]

Gross borrowing and net debt exposure

3.13 The stock of external borrowing has increased across the sector recently. Local authorities, particularly district councils, that have been highly active in acquiring commercial property are more likely to have seen substantial increases in their stock of gross borrowing relative to spending power (government funding plus council tax) (**Figure 15** overleaf). Single-tier and county councils that have been highly active have also seen a noticeable increase in their gross external debt at the median, but not of the same scale as the most active district councils.

3.14 A similar pattern is present in relation to net debt (**Figure 16** on page 43). While the trajectory of the most active district councils is most marked, there has also been an increase for the most active single-tier and county councils. As a measure, the stock of net debt is often lower where a local authority has high reserves. Reserves will often be held as financial investments, in which case they are subtracted from gross borrowing to arrive at net debt. Alternatively, reserves may have enabled internal borrowing leading to external borrowing being lower than it otherwise would have been.

3.15 The Department has stated that it is important for authorities to have realistic plans to manage any failure of debt-financed commercial investment strategies, as otherwise there is no realistic prospect of any local authority being able to pay back debt many times larger than their spending power without a long-term impact on service delivery.

Debt servicing costs

3.16 There are two major components to local authority debt costs: interest and Minimum Revenue Provision (MRP) (**Figure 17** on page 44). Despite the recent overall growth in the stock of borrowing, both have fallen. The current low interest rate environment has allowed authorities to borrow at markedly lower levels than historically. Authorities have also revisited their approaches to calculating MRP.

3.17 Local authorities that have been more active in relation to commercial property acquisition have seen the greatest increase in their debt servicing costs relative to their spending power. This is particularly so for highly active district councils, although less active district councils have also seen an increase at the median (**Figure 18** on page 45).

27 Royal Institution of Chartered Surveyors, *UK economy and property market chart book – January 2014*, December 2013; Cluttons IM, *The next UK recession – not if but when?*, August 2019. Market rental value is the estimated rental income for a newly leased property, assuming a normal market lease contract.

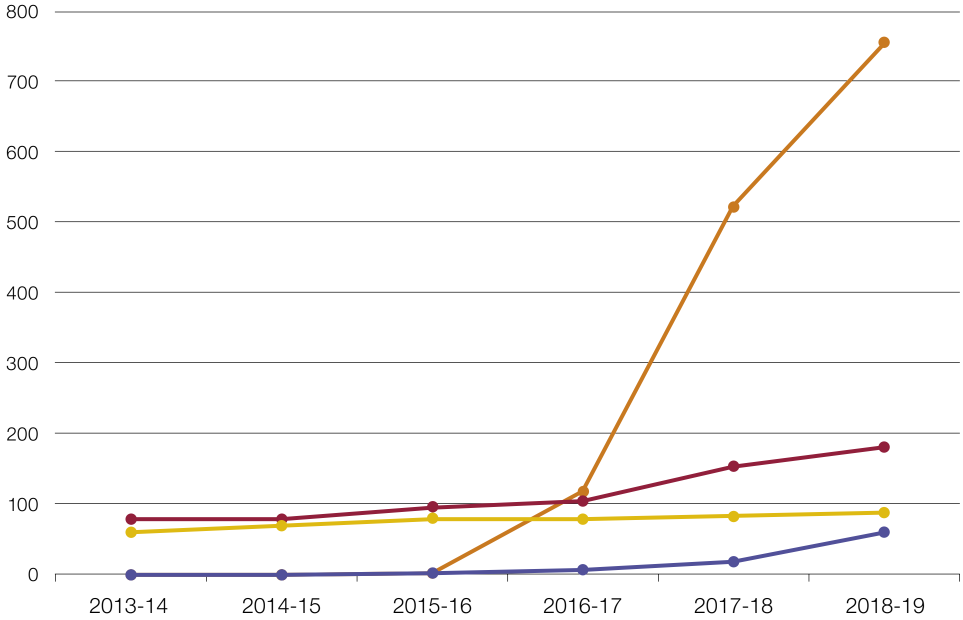
28 Local Data Company, *GB retail and leisure market analysis – H1 2019 update,* September 2019.

Figure 15

Gross external borrowing as a share of spending power in English local authorities 2013-14 to 2018-19

The group of district councils that have been most active in investing in commercial property have seen their gross external borrowing increase the most at the median

Gross external borrowing as a share of spending power (%) (group medians)



	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Single-tier and county councils						
Most active (%)	77.5	79.1	94.6	104.6	153.8	180.7
Less active (%)	60.5	68.3	78.8	78.6	82.8	88.3
Not active (%)	71.9	77.8	83.7	87.9	85.1	92.1
District councils						
Most active (%)	0.0	0.0	2.6	118.6	523.3	756.1
Less active (%)	0.4	0.4	0.9	7.2	17.1	59.5
Not active (%)	10.4	10.4	11.3	12.0	12.9	12.4

Notes

1 For presentational purposes, we have excluded councils that are not active at all in property acquisition from the chart.

2 Estimated Housing Revenue Account debt has been removed from the analysis.

3 We define the 'most active' authorities as the top 20% in terms of level of spending on commercial property in the period 2016-17 to 2018-19. 'Less active' authorities are the remaining 80% of authorities that incurred spend on commercial property acquisition. 'Not active' authorities did not incur spend during this period. We group single-tier and county councils (151 authorities), and lower-tier councils (201 authorities) separately. See Appendix Two.

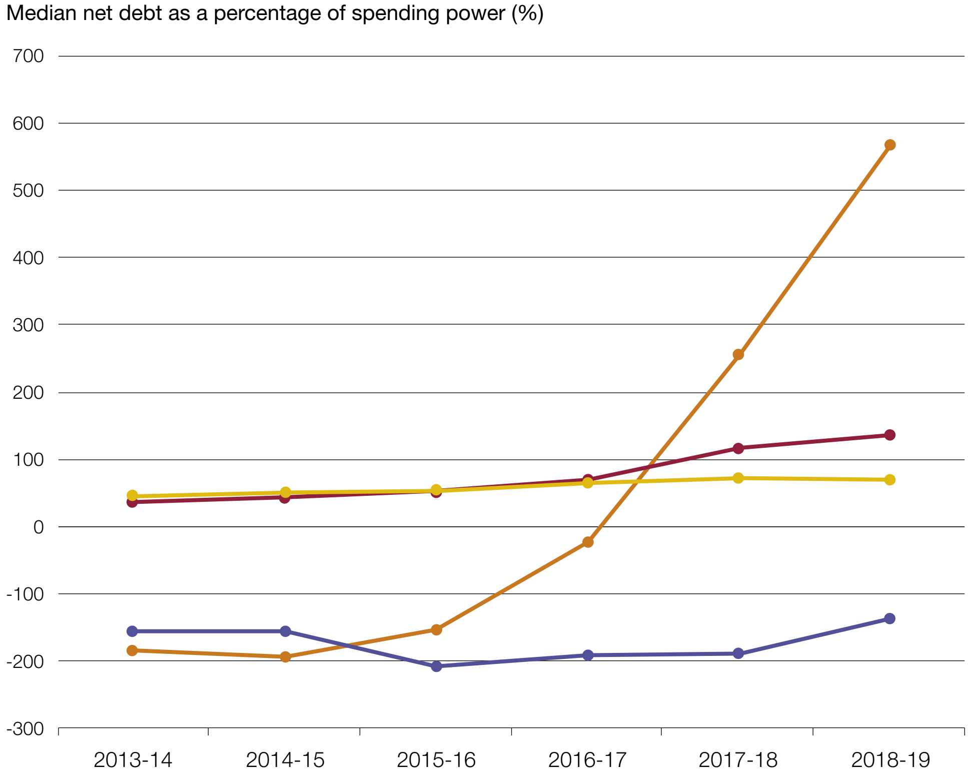
4 See Appendix Three for further descriptive statistics.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 16

Net debt as a share of spending power in English local authorities 2013-14 to 2018-19

The group of district councils that have been most active in investing in commercial property have seen their net debt increase the most at the median



	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Single-tier and county councils						
Most active (%)	37.3	43.7	52.3	70.1	117.0	136.6
Less active (%)	45.7	50.9	52.4	65.5	71.9	70.4
Not active (%)	59.8	52.0	60.4	70.6	80.9	74.1
District councils						
Most active (%)	-183.9	-194.3	-153.2	-22.8	257.4	567.2
Less active (%)	-154.8	-155.2	-207.5	-190.9	-189.2	-136.0
Not active (%)	-68.9	-83.8	-119.0	-129.7	-152.9	-191.2

Notes

1 For presentational purposes, we have excluded councils that are not active at all in property acquisition from the chart.

2 Estimated Housing Revenue Account debt has been removed from the analysis.

3 We define the 'most active' authorities as the top 20% in terms of level of spending on commercial property in the period 2016-17 to 2018-19. 'Less active' authorities are the remaining 80% of authorities that incurred spend on commercial property acquisition. 'Not active' authorities did not incur spend during this period. We group single-tier and county councils (151 authorities), and lower-tier councils (201 authorities) separately. See Appendix Two.

4 Net debt subtracts the stock of an authority's financial investments from its stock of external borrowing and long-term liabilities. See Appendix Two.

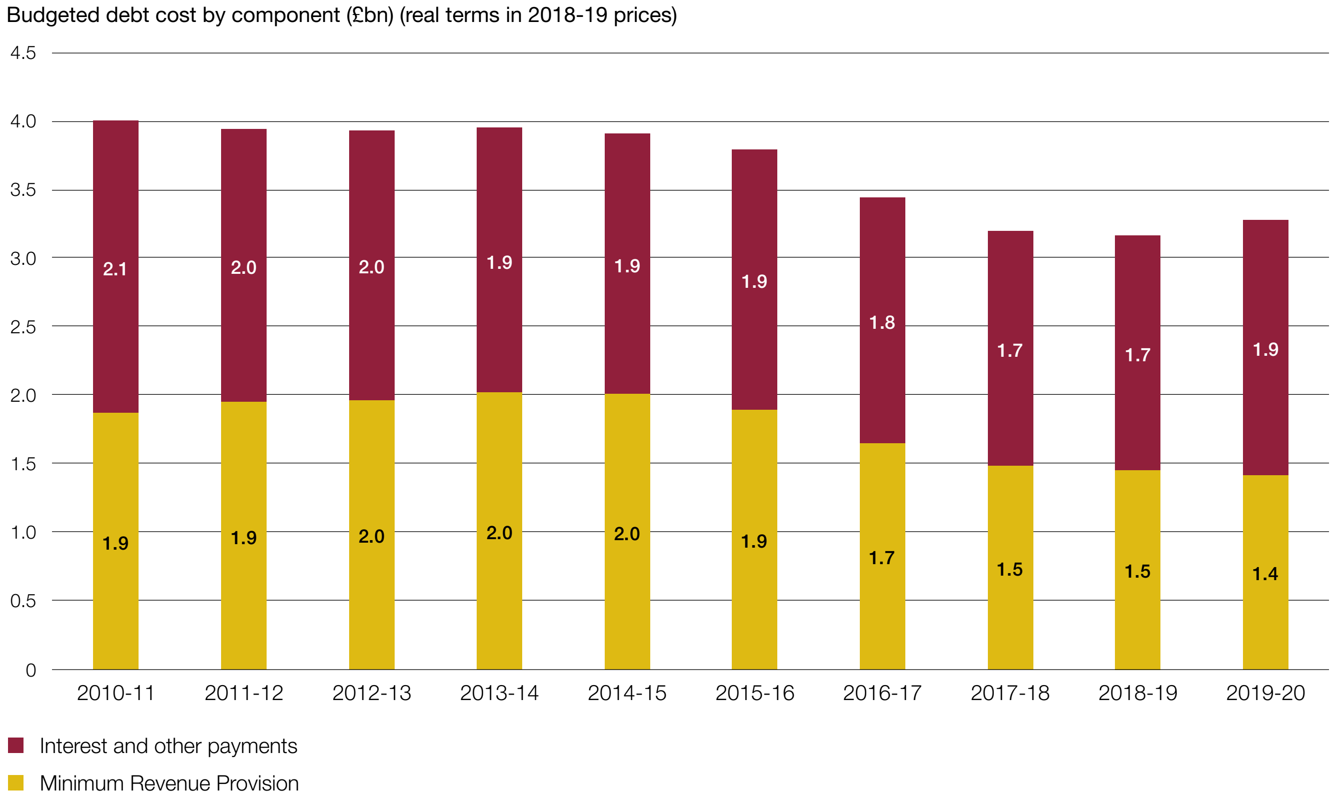
5 See Appendix Three for further descriptive statistics.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 17

Budgeted interest and Minimum Revenue Provision debt costs for English local authorities 2010-11 to 2019-20

Budgeted interest and Minimum Revenue Provision debt costs have both fallen in recent years



Note

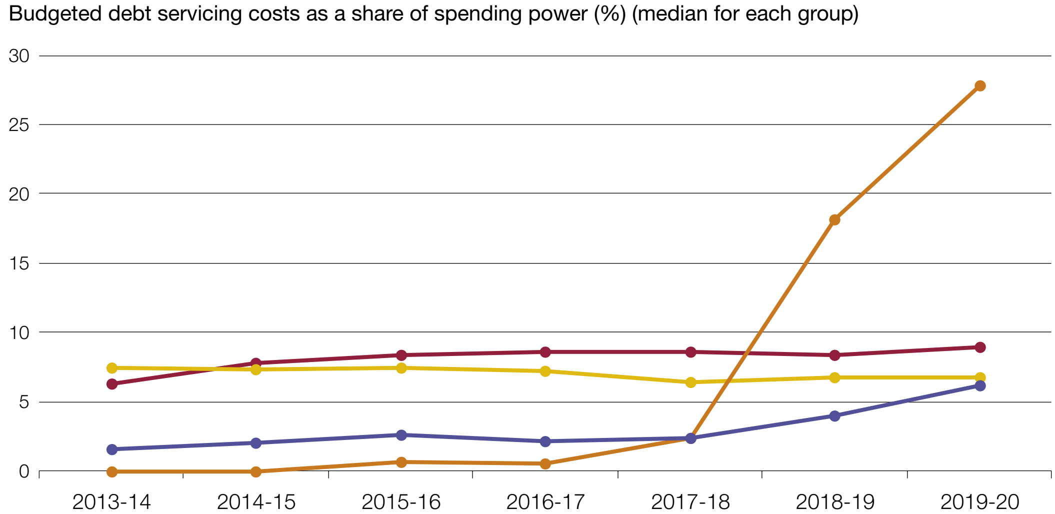
1 This analysis only includes authorities not subject to reorganisation in 2019-20.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 18

Debt servicing costs as a share of spending power in English local authorities 2011-12 to 2019-20

The group of district councils that have been most active in investing in commercial property have seen their debt servicing costs increase the most at the median



	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Single-tier and county councils							
Most active (%)	6.2	7.7	8.3	8.6	8.6	8.4	8.9
Less active (%)	7.5	7.3	7.5	7.2	6.4	6.8	6.7
Not active (%)	8.1	9.0	8.6	8.1	7.3	6.8	6.7
District councils							
Most active (%)	0.0	0.0	0.6	0.5	2.4	18.1	27.8
Less active (%)	1.6	2.0	2.5	2.1	2.4	4.0	6.1
Not active (%)	2.6	2.8	2.8	2.9	3.1	3.9	4.1

Notes

1 We define the 'most active' authorities as the top 20% in terms of level of spending on commercial property in the period 2016-17 to 2018-19. 'Less active' authorities are the remaining 80% of authorities that incurred spend on commercial property acquisition. 'Not active' authorities did not incur spend during this period. We group single-tier and county councils (151 authorities), and lower-tier councils (201 authorities) separately. See Appendix Two.

2 This analysis only includes authorities not subject to reorganisation in 2019-20.

3 See Appendix Three for further descriptive statistics.

4 We exclude both groups of 'not active' authorities from the chart for presentational purpose.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

3.18 In general, debt servicing costs for authorities' commercial property investment are expected to be met from rental income, rather than from other general fund income. However, were an authority's investment properties to underperform, and the authority to have failed to establish a sufficient contingency reserve, there are potential implications for the general fund.

Interest rate risk

3.19 The level of very short-term debt (less than 12 months) in the sector has increased from £2.6 billion in 2013-14 to £7.8 billion in 2018-19. This aggregate increase is overwhelmingly due to rising short-term borrowing from other authorities. On average, this debt has increased most rapidly among authorities that are most active in commercial property investment.

3.20 In absolute terms the stock of longer-term debt (more than 12 months) has increased by more than the stock of short-term debt, growing by £10.7 billion from £55.7 billion in 2013-14 to £66.4 billion in 2018-19. This has been driven by local authorities taking out PWLB loans over increasingly longer durations (**Figure 19**). Local authorities tend to take out PWLB loans at a fixed rate.

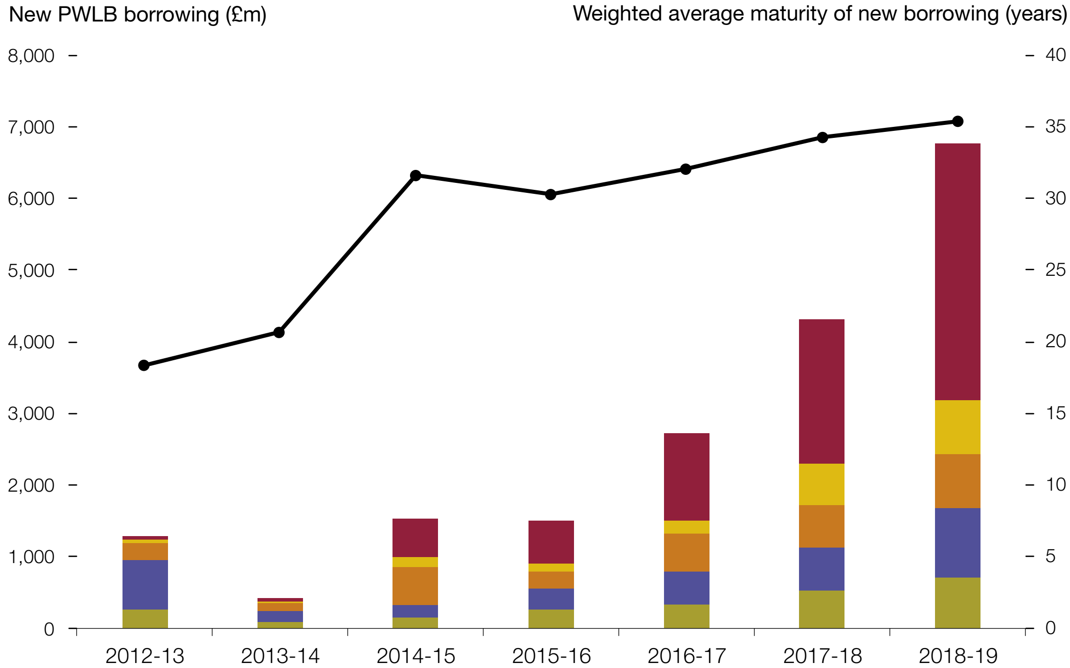
3.21 For individual authorities, different balances between short-term and long-term borrowing may represent different approaches to interest rate risk. There were examples among our case study authorities who had built their commercial property investment strategies around long-term fixed rate PWLB borrowing specifically to guard against the risk of interest rate rises.

3.22 Debt financing of commercial property acquisitions, particularly if long term, raises issues of inter-generational fairness. It is not possible to be certain about the effectiveness of many risk mitigation plans, such as selling the property without loss or finding an alternative use for the land, for the lifetime of 50-year loans. Authorities could potentially face capital losses or income shortfalls that have an impact decades after the purchase of the property, affecting some residents who were not born when the borrowing decision was taken. However, where an authority consistently makes MRP and the property's rental returns are as anticipated, these forms of investment will pass assets rather than costs on to future generations.

Figure 19

Change in duration of Public Works Loan Board (PWLB) loans taken out by English local authorities 2013-14 to 2018-19

Local authorities' total PWLB borrowing has increased in recent years and at increasingly longer terms



	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
41–50 years (£m)	54	45	521	596	1,221	2,003	3,581
31–40 years (£m)	47	16	133	113	164	582	758
21–30 years (£m)	241	108	531	232	529	585	762
11–20 years (£m)	681	148	175	291	472	610	971
1–10 years (£m)	265	91	158	262	324	524	698
Weighted average maturity of new borrowing	18	21	32	30	32	34	35

Source: National Audit Office analysis of Public Works Loan Board data

Reliance on commercial income to support service provision

3.23 In principle, where authorities derive a significant amount of income from their commercial properties, the failure or under performance of these investments has the potential to affect levels of local service provision. It is difficult, however, to assess the level of local authority reliance on these income streams:

- It is not possible to identify the net returns generated by commercial properties from the national data collected by the Department. A key issue is that authorities record their data inconsistently in their returns.
- The Whole of Government Accounts (WGA) contains data on rental income received by local authorities from investment properties alongside associated operating costs. However, it does not identify any associated borrowing costs. The publication of these data can also lag behind other national data sets. As a result, departmental analysis of WGA data shared with us in July 2019 only went up to 2016-17.

3.24 To overcome these data issues we reviewed a sample of 45 local authorities' capital strategies:

- We found 13 strategies where we could identify a net yield figure where it appeared that MRP was being made on their commercial property. Net returns ranged from 1.49% to 7.6%. However, returns were clustered towards the bottom of this range, with only two authorities recording net yields of more than 2.6%. The two authorities with higher yields appeared to have largely debt-free, historical portfolios.
- We found three strategies containing net yields where it appeared that MRP was not being made. In these cases, net yields ranged from 3.32% to 6.56%.[29]

3.25 The net contribution made by these returns to service budgets, as opposed to contingency reserves, and therefore the reliance of services on these income streams, is also difficult to establish. We were also not able to identify enough strategies in our sample with information on the contribution of net commercial income to service provision or contingency funds to make any meaningful assessment. Ultimately in the absence of information on net returns (planned and outturn) from commercial property, alongside the size of annual contributions to contingency funds and the overall size of contingency funds, it is hard to assess the risk to which authorities are exposed from these investments.

29 See Appendix Two (Stewardship of the Framework) for methodology.

3.26 The Department has undertaken work to estimate the debt costs associated with local authority borrowing for commercial purposes. The Department told us these figures can be combined with the WGA data on rental income from investment properties to estimate the net contribution made by commercial property to authorities' revenue income. The Department has not yet linked its estimates on commercial debt with WGA data on rental income from commercial properties, but it told us it has now begun this work and is looking at data for 2017-18. However, the Department's estimate of the costs of borrowing for commercial purposes, which includes all forms of commercial activity rather than solely commercial property, may not be directly comparable with the WGA data on rental income from commercial property. This analysis will also not account for any rental income set aside in contingency reserves.

Market distortion and value-for-money risks

Market distortion

3.27 Both the Department and HMT are alive to the possibility that local authority activity could distort the national market or crowd out private sector investors. Both told us they are satisfied that local authority activity represents a small share of the national market and therefore is unlikely to have had these effects.

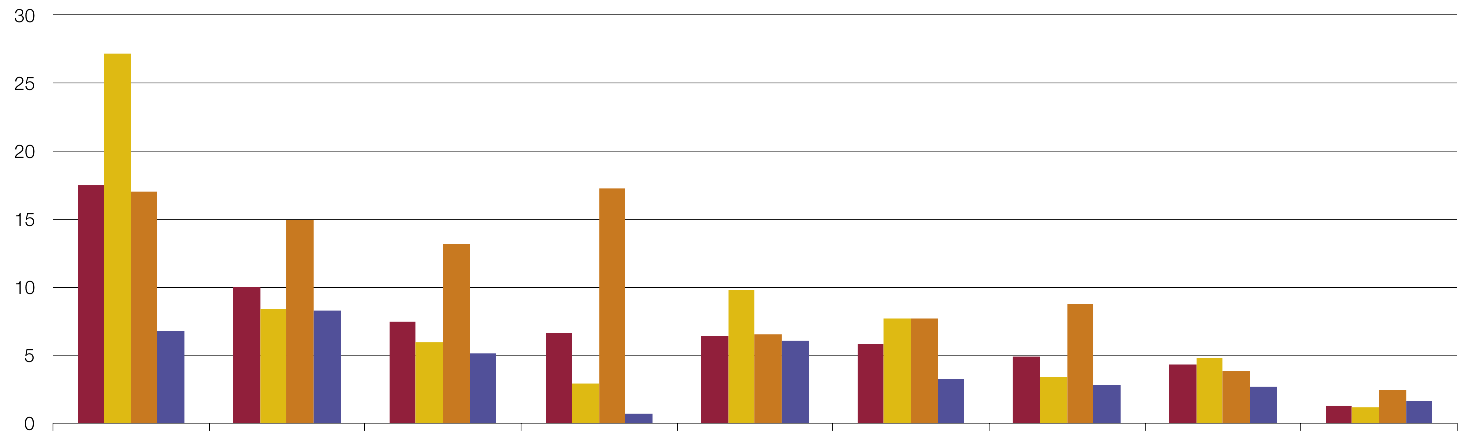
3.28 We estimate that local authorities accounted for 4.9% by value of commercial property acquisitions from 2016-17 to 2018-19 in England.[30] This includes 4.2% of office acquisitions, 4.3% of industrial acquisitions and 8.8% of retail acquisitions. There are marked regional differences in the significance of local authority activity, which have not been considered in the Department's or HMT's analysis (**Figure 20** overleaf). A key factor is that the London commercial property market accounted for more than half of all sales in England by value from 2016-17 to 2018-19, but local authorities have invested relatively little in this market. From 2016-17 to 2018-19 local authorities accounted for 9.4% by value of all commercial property acquisitions in England outside London. This includes 13.0% of office, 4.8% of industrial, and 11.8% of retail acquisitions.

30 National data from CoStar. See Appendix Two.

Figure 20

Local authority acquisitions as a share of total market activity by region and property types – 2016-17 to 2018-19 cumulative

The significance of local authority activity varies substantially across different regional and property type markets



	South East	South West	North West	North East	East Midlands	East of England	West Midlands	Yorkshire and The Humber	London
All property (%)	17.5	10.0	7.5	6.7	6.4	5.8	4.9	4.3	1.3
Office (%)	27.1	8.5	5.9	2.9	9.8	7.7	3.4	4.9	1.2
Retail (%)	17.1	15.0	13.1	17.2	6.5	7.7	8.8	3.9	2.5
Industrial (%)	6.8	8.3	5.2	0.7	6.1	3.3	2.8	2.7	1.6

Note

1 'All property' comprises office, industrial, retail and 'other' properties. Local authority acquisitions of 'other' properties formed 2% of the national market share during this period.

Source: National Audit Office analysis of CoStar data. See Appendix Two for more information

Value-for-money risks

3.29 The geographic concentration of local authorities' investments means there is a risk that authorities are competing against each other or are distorting market prices for other authorities. Given that local authorities bought investment properties at a rate roughly 12.4 times higher than they have been selling them in the period 2016-17 to 2017-18, the sector as a whole is unlikely to have benefited from any increased competitive tension arising from greater local authority activity.[31]

3.30 Among authorities we spoke to, primarily during case study visits, there were examples of authorities taking action to avoid competing with other authorities. But there were also examples of authorities reporting that inter-authority coordination was absent or limited.

3.31 Another potential value-for-money risk relates to local authorities' access to borrowing from PWLB that does not involve loans being priced in accordance with risk. There is a possibility that the relatively low rates available to authorities may have led to authorities being able to pay a premium above the market rate to acquire property.[32] Neither the Department nor HMT have assessed whether this has taken place.

Managing risk

3.32 In our previous study of local authority governance we said authorities need to ensure that they have robust risk management arrangements in place when making commercial investments.[33] Authorities we spoke to in our case studies and workshops were confident that they had taken appropriate steps to minimise and mitigate risks from property acquisitions:

- Accessing **appropriate skills and expertise**. Authorities with larger portfolios, such as Runnymede Borough Council, had often recruited individuals with specialist experience.
- Undertaking **appropriate due diligence** for each acquisition drawing on a wide range of information and external expertise.
- Managing property risks by **diversifying** portfolios, which could be in terms of property type, location, lease length or yield. Geographic diversity also reduces the risk that were an in-area tenant to fail, the authority would lose both rent and business rates.
- Establishing **contingency funds** to deal with falls in rental income, capital refurbishment at the end of leases or unexpected additional costs. Torbay Council (Torbay), for instance, put rental income equivalent to a minimum of 0.25% of its portfolio value into a reserve annually. Torbay calculate the necessary level of contingency based on the potential risks of each individual property within their portfolio.

31 See Appendix Two (Quantitative analysis – WGA data).
32 Relatively low compared with, for example, estimates of the cost of capital to major property companies.
33 Comptroller and Auditor General, *Local authority governance*, Session 2017–2019, HC 1865, National Audit Office, January 2019, paragraph 5.

3.33 We held a workshop with external auditors to discuss their views on authorities' governance for commercial property acquisition. The group did not express acute concern about these arrangements. While viewing some authorities as demonstrating good practice, some participants did express clear concerns about practices in others, including:

- insufficient transparency and reporting to elected members or to the public on commercial investments and their performance;
- limited internal challenge to decision-making, such as from internal audit or audit committees. Audit committee members did not always have the expertise to scrutinise commercial deals;
- in some authorities, one or more members with firm opinions driving commercial investment without sufficient regard to risk;
- over-reliance on external expertise or using a single adviser for all or multiple parts of the acquisition process;
- reduced governance, including extensive delegation, to enable faster decision-making;
- limited capacity and skills in some authorities, particularly smaller district councils but also larger authorities engaging in complex arrangements; and
- some authorities having the skills and capacity to make initial investment decisions but not for managing the investments over the long term.

3.34 Some auditors in the workshop said that risks are highest in the early or 'transitional' phase of building a portfolio. Accordingly, auditors were concerned where authorities moved straight to large deals in imitation of others.

3.35 In relation to 2016-17, the external auditor for Spelthorne Borough Council issued an 'adverse' qualified conclusion on value-for-money arrangements in respect of significant weaknesses identified in relation to the purchase of the BP campus for £385 million. In relation to 2017-18, the external auditor for Cherwell District Council issued an 'except for' qualified conclusion on value-for-money arrangements in respect of weaknesses in providing members with sufficient and appropriate information to support a decision on the £5.6 million acquisition of a company owning a commercial property that the council wished to redevelop.[34]

34 KPMG, *Spelthorne Borough Council: Annual Audit Letter 2016/17*, March 2019.
EY, *Cherwell District Council: Annual Audit Letter for the year ended 31 March 2018,* November 2018. Cherwell's auditor also reviewed a separate, much larger commercial property acquisition in that year and identified no matters to bring to the council's attention.

Part Four

The government's stewardship role

4.1 This section examines how the Ministry of Housing, Communities & Local Government (the Department) and HM Treasury (HMT) have discharged their responsibilities (as set out in Part One). Because of the Department's decisions to make codes created by the Chartered Institute of Public Finance and Accountancy (CIPFA) part of the prudential framework and their ongoing engagement with CIPFA, we also examine CIPFA's actions in relation to these codes.

Organisational objectives and approaches to oversight

4.2 The three main organisations involved in the prudential framework have different but overlapping responsibilities and objectives, and therefore different approaches to oversight and intervention.

- The Department's main aim is to support local decision-making while delivering its responsibilities in relation to risks of financial and service failure.[35] It seeks to monitor risks and influence behaviour (for example, through support or guidance) while overriding local decisions (through intervening or directing) as little as possible.
- CIPFA is concerned to uphold high standards of financial management, irrespective of financial pressures. In respect of the codes specified by the Department, CIPFA does not have formal powers relating to authorities but the codes are CIPFA statements of professional practice and so form part of the professional responsibilities of CIPFA members.
- HMT sees local decision-making as relatively far removed from its interests at the national level. It monitors national totals and otherwise relies on the local accountability system overseen by the Department.

35 These responsibilities are set out in Ministry of Housing, Communities & Local Government, *Accounting Officer System Statement*, July 2018, Annex A.

Oversight and assurance

4.3 Oversight of the prudential framework needs suitable data and intelligence. The Department also needs assurance that key elements of the framework operate as intended.

Knowledge of commercial activities and risks

Data on spending and income

4.4 The Department collects data on authorities' investment in trading services, which in principle includes local authority spending on commercial property. Historically the reporting of spend in this category has been inconsistent, undermining comparisons over time. The Department addressed this in 2017-18, contributing to a marked jump in spending recorded. In the same year the Department also introduced new sub-categories but these have not added much clarity.

4.5 Departmental data do not give information on the scale, type and location of individual acquisitions. This means it is hard to assess the purpose of authorities' spending, or to understand its implications for regional or sectoral property markets. The Department has accessed some additional proprietary data on commercial property. However, the data appear to understate the overall scale of the acquisition of commercial property by local authorities, particularly property acquired out of area. The data and associated analysis are also now outdated.

4.6 Departmental data do not demonstrate whether commercial property investments are delivering planned returns or how significant these returns are to local service provision. Data on income from commercial investments and any associated debt costs are impossible to isolate in the departmental returns, meaning that costs cannot be compared to benefits. The Department told us it is able to estimate this income using estimates it has produced on the costs of borrowing for commercial purposes alongside data from the Whole of Government Accounts (WGA) on rental income from investment properties. The Department is currently undertaking this estimation.

Data on borrowing

4.7 The Department has better data on borrowing. This includes quarterly data on the total stock of local authority debt, alongside monthly data on new Public Works Loan Board (PWLB) borrowing.

4.8 Under the prudential framework, the capital programme is resourced as a whole. As a result, it is not possible to identify from national data whether borrowing is for commercial investment or not. The Department has recently developed a method to estimate this. The estimate contributes to the Department's financial risk assessment models. We applied this method (to different data) to produce our 'maximum estimates' in Figure 12.

Other intelligence

4.9 The Department draws on information such as discussions with stakeholders, visits to local authorities, roundtables with senior finance officers as part of Spending Review preparation, and national and local media reports.

4.10 The Department told us that where data or information suggest either unusual activity or higher risk it draws on published strategies to carry out focused desk-based investigations of individual authorities.

Analysis and use of data and information

4.11 The Department has focused primarily on risks to authorities' financial sustainability from borrowing. Its conclusions are that currently most authorities' debt-funded property acquisitions are not of the scale where their failure would risk the authorities' financial sustainability. To date the focus of this work has been on authorities' debt levels and debt costs associated with commercial investments rather than authorities' dependence on income (planned and outturn) from these investments, or the scale of authorities' contingency arrangements to manage risk.[36] The outputs from the Department's work feed into its broader work on assessing local authority financial sustainability.

4.12 The Department's oversight work has not addressed enough:

- the potential market-distorting effects of local authority commercial property acquisition, particularly in relation to regional and sectoral sub-markets;
- the potential risks to value for money from inter-authority competition or access to finance through PWLB that does not involve individual risk-assessment or risk pricing; or
- the drivers of, and potential risks from, the growth in the stock of debt across the wider sector not connected to commercial property acquisition, although the Department has recently begun work on this.

The Department and HMT should work together to identify the relevant expertise within government to address these questions.

36 The Department has analysed rental income from investment properties from the WGA, but the Department's analysis currently goes no further than 2016-17.

Assurance about the framework's operation

4.13 The Department's assurance over the operation of the commercial investment framework relies on checks and balances within the local accountability system. However, there are issues with the system:

- Our report *Local authority governance* raised concerns about some elements of local governance. We concluded the Department does not have a system-wide evidence base that would allow it to test these.[37]
- Participants in our external auditor workshop highlighted that given audit work focuses on significant risks and the level of discretion authorities have within the statutory codes and guidance, auditors would comment on commercial decisions only in relation to very clear problems. For example, given the way that capital programmes are financed, establishing conclusively whether an authority is borrowing in advance of need is challenging. Similarly, where an authority can demonstrate to its auditor that it has received comprehensive and properly instructed legal advice supportive of its approach, auditors are unlikely to consider there is a clear legal problem to investigate in the absence of other information suggesting cause for concern.
- In one workshop with council finance directors, concerns were raised that section 151 officers are potentially put in a difficult position if an authority's legal advice about its powers differs from CIPFA's interpretation of the codes. CIPFA told us that the Prudential and Treasury Management Codes are CIPFA statements of professional practice and as such CIPFA members are required to follow these codes as part of their professional responsibilities. CIPFA's view is that section 151 officers must "have the confidence to give impartial and objective advice even if it may be unwelcome".[38]

4.14 It is also not clear how the Department assures itself at the sector level on the extent to which authorities' activities are within the spirit of the guidance as understood by the Department. The Department has produced an estimate of borrowing for commercial investment and stated that borrowing solely for yield is not compliant with the investment guidance. However, it has not made an assessment of whether or to what extent any authorities are borrowing solely for yield. The Department lacks the necessary data on acquisitions by location and type to support an assessment at the sector level. Any assessment would of course be indicative, but even this would be an important contribution to the Department's assurance on the framework's effectiveness at the sector level.

37 Comptroller and Auditor General, *Local authority governance*, Session 2017–2019, HC 1865, National Audit Office, January 2019, paragraphs 3.9 to 3.11.

38 Chartered Institute of Public Finance and Accountancy, *Statement on the role of the chief financial officer in local government,* February 2016.

Recent changes to the prudential framework

4.15 The Department and CIPFA changed aspects of the codes and guidance shortly before the start of 2018-19. This resulted from wider reviews but they were both concerned about increased borrowing to buy property. CIPFA was particularly concerned about borrowing to buy properties with substantial commercial income, and the Department about borrowing disproportionate to the size of an authority. The Department told us a Committee of Public Accounts report in November 2016 initiated the work that ultimately led to its guidance changes and was important context for the Department's input into CIPFA's changes.[39] CIPFA's review sought to address commercialisation more broadly than solely property investment.

4.16 HMT was initially concerned about the value of spending and borrowing, and that these activities could affect wider macro-economic and fiscal objectives. Following discussion with the Department, HMT was not convinced that local authority behaviour was distorting market prices or creating a system-threatening risk. HMT has continued to engage with the Department as the Department considers risks to the financial sustainability of local authorities from commercial spending and borrowing. HMT, with the Department, has continued to monitor the impact of commercial spending and borrowing on its macro-economic and fiscal objectives. HMT told us the October 2019 change in PWLB loan costs was in response to an overall rise in borrowing.

4.17 The Department has introduced a new principle to the framework: the principle of contribution, whereby an authority must disclose the contribution that an investment makes toward its service delivery objectives and/or place-making role. In general, the Department has sought to ensure that authorities act within the spirit of the approach set out in the framework. In relation to Minimum Revenue Provision (MRP), the Department has been willing to state its belief that a particular practice (unconnected to commercial activity) is not prudent or within the spirit of the approach in the framework. However, the Department has not made public any specific descriptions or examples of commercial property investment practices it believes are outside the spirit of the framework, whether by providing thresholds or benchmarks, naming authorities, or giving examples of particular activity for particular purposes.

39 HC Committee of Public Accounts, *Financial sustainability of local authorities,* Twenty-sixth report of Session 2016-17, HC 708, November 2016.

Objectives of the changes

4.18 Both the Department and CIPFA wanted to ensure that authorities remembered their prime duty or function: to deliver services to local people. The Department was keen not to discourage local authorities from investing to deliver local economic regeneration. Each wanted to ensure decision-making about commercial investment took account of risks to financial sustainability.

4.19 Both bodies sought to reinforce in the statutory guidance or codes (**Figure 21**) the existing position that "Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed".[40] This implies that authorities should not borrow to invest solely for yield. An authority can choose not to accept this position, but it must still assure itself that it has appropriate legal powers to support its actions and it must now explain the rationale for the approach in its capital strategy.

Impacts of the changes

The Department's and CIPFA's conclusions to date

4.20 CIPFA concluded relatively swiftly that the changes to their codes had not yet met their objectives. In October 2018, CIPFA issued a statement raising concerns about "the recent continuation and (in a small number of cases) acceleration of the practice of borrowing to invest in commercial property", and saying that CIPFA would issue more guidance to "make it clear that these investment approaches are not consistent with the requirements of fiscal sustainability, prudence and affordability". CIPFA published this non-statutory guidance in November 2019. The objective of the guidance is stated as "to explain the provisions in the updated Prudential Code and Framework that relate to the acquisition of properties intended to make investment returns and confirm their implications in the light of the growing activity and the changes to statutory guidance".

4.21 The Department is reviewing the changes to its statutory guidance, which is a positive step. It told us the direct aim of the changes was to encourage desired behaviours, not to achieve measurable outcomes. They expected to see gradual movement in the "right direction" rather than sector-wide change from the outset, emphasising that the key change to the MRP guidance did not take effect until 2019-20. In our view, while a positive step, the Department's review does not go as far as it could have done as it took a purely qualitative approach. The Department did not have clear measures to test the impact of the changes on risk from commercial property investment and did not carry out new quantitative analysis of commercial investment activity in the sector. The Department has told us it has subsequently decided this work will form a first phase of its review and that this work was scoped to provide an initial review of early progress. The Department will review trends in the sector in later phases of its review work.

40 Chartered Institute of Public Finance and Accountancy, *The prudential code for capital finance in local authorities*, CIPFA, November 2011.

Figure 21

Selected changes in the most recent versions of the statutory codes and guidance within the prudential framework for local authority capital finance

Codes or guidance owners	Ministry of Housing, Communities & Local Government	Chartered Institute of Public Finance and Accountancy
Codes or guidance changed.	Statutory guidance on local authority investments.	Prudential code.
	Statutory guidance on Minimum Revenue Provision.	Treasury Management Code.
Revised versions issued.	February 2018.	December 2017.
Key changes		
Effective 2018-19	Non-financial investments now in the scope of the investment guidance.	Extended the scope of the Treasury Management Code to cover non-financial investments; mentioned commercial activity in the Prudential Code.
	Stated that borrowing to invest solely for yield is against the guidance.	Retained the prohibition on borrowing in advance of need in this wider context.
		Full council to approve a capital strategy that covers the authority's commercial investments.
Effective 2018-19, but strategies put in place earlier did not need to be revised during this year	Full council to approve an investment strategy setting out the: • contribution commercial investments make; • proportionality of commercial activity; and • steps taken to ensure members and statutory officers have suitable capacity, skills and information.	
Effective 2019-20	Stated that it is not prudent to use an approach that could lead to making no provision to repay borrowing to fund investment properties.	

Note

1 Because of primary and secondary legislation, local authorities must "have regard to" the codes and guidance within the prudential framework when fulfilling duties or exercising powers relating to borrowing or investment.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government and Chartered Institute of Public Finance and Accountancy published documents

National Audit Office review of the codes and guidance changes

4.22 Drawing on our own quantitative work and contact with local authorities we examined what has happened following the changes to the statutory codes and guidance that were made in late 2017-18. We have not examined what has happened in the short period following the publication of non-statutory guidance by CIPFA in November 2019.

Behaviour changes

Borrowing to invest for yield

4.23 Both the Department and CIPFA's immediate changes stressed that investment solely for yield should not be supported by external borrowing. Our case study and workshop discussions and our review of a sample of capital strategies identified a range of responses including:

- explicitly acting against or not in full accordance with the codes or guidance, after giving them consideration;
- changing behaviour with the effect of bringing it into accordance with the Department or CIPFA's interpretation of the codes or guidance; and
- stating or implying they are acting in accordance with the codes or guidance, while it is not clear in our view that they always interpret the codes or guidance in the way that the Department or CIPFA intend.[41]

Some case study authorities and workshop participants mentioned their own legal advice that they felt supported their interpretation of permissible behaviour in the context of the new guidance.

4.24 How the whole sector is reacting is unclear, but our quantitative analysis shows that levels of commercial property acquisition remained largely unchanged up to September 2019, 18 months after the first elements of the new guidance came into force and six months after the last elements came into force. However, our analysis does suggest that the distribution of acquisitions was different in 2018-19. The scale of out-of-area acquisitions has stayed roughly stable compared with 2017-18, but these acquisitions are now more likely to be in-region rather than out of region.

41 This does not imply a judgement about the legality or appropriateness of any of the approaches taken in these responses, as the Department or CIPFA's intentions are not definitive of either point.

4.25 Investments out of area are more difficult to justify as providing benefits to the authority beyond yield. Some authorities we spoke to said that the changes effectively restricted property investment to within their boundaries, or economic area, unless it can be funded without borrowing. This interpretation has influenced some authorities: Essex County Council has paused its investment programme, which was based solely on out-of-area investments, and Torbay Council has restricted its investments to within its functional economic area.

4.26 Frequently, our case study and workshop participants argued that out-of-area investments were important to manage risk to their portfolios. There is a possibility that the changes have the unintended consequence of authorities responding by continuing to invest at the same rate but in a more concentrated geographical area. The Department disputes that growing geographic concentration is a risk. It told us that guidance is in place to help authorities manage risk; geographic concentration in a property portfolio can be offset by non-property investments and authorities may be prepared to accept a higher risk threshold and concentrate their activity if it serves other objectives such as local growth.

Minimum Revenue Provision

4.27 The new MRP guidance states that authorities should make full provision for debt taken on to fund acquisition of investment properties, and that it is not prudent to adopt an approach in which no MRP is made unless the value of the property is impaired. Our case study visits, other discussions and review of new capital strategies for 2019-20 show that some authorities had already been making MRP for commercial investments funded by borrowing. In addition, some that were not doing so previously have changed their approach. But some are still not paying MRP in relation to borrowing associated with acquisition of commercial property.[42]

Transparency in capital strategies

4.28 To improve transparency, the Department encourages authorities to publish information on key aspects of their commercial investment activity and supporting arrangements in their capital strategies. In our review of 45 strategies for 2019-20, from authorities that had already been or were planning to be highly active, we found examples of strategies that did not include various items of information. Data on risk indicators, net income from authorities' investments, the contribution of commercial income to service spending and the scale of contingency arrangements were often missing.

42 We make no judgement about the prudence or appropriateness of the various approaches taken by authorities and anticipate that they will have undertaken a variety of steps locally to justify the prudence of their MRP strategy. Portsmouth City Council, for instance, told us they have discussed their decision not to pay MRP in relation to borrowing associated with their commercial property portfolio with their auditor.

Implications for the prudential framework

4.29 Strong support for the prudential framework was expressed during our fieldwork, including among stakeholders, and in the Department, CIPFA and HMT. However, in our view, recent developments in commercial property investments raise fundamental questions about aspects of the framework and its fitness for purpose in the current legal and financial context:

- When the framework was created, borrowing was intended primarily to be used to support service provision directly rather than to generate income. The capacity of an authority to borrow was restricted by the affordability of the resulting debt costs given their income from local tax and government grants. Now, where borrowing (non-Housing Revenue Account) is frequently for property purchases that generate a return that meets the debt costs, the duty to set an affordable limit for borrowing, which lies at the heart of the framework, is no longer a constraint in the same way.
- Recent years have shown that in the context of significant and sustained financial pressure, some authorities, perhaps inadvertently, will test the limits of the framework. Permissive guidance where local authorities' powers are potentially open to a range of interpretations creates a risk of non-compliance. The Department has not improved its oversight in relation to compliance sufficiently given this risk, particularly in relation to borrowing solely for yield.
- New behaviours have emerged quickly and within a specific group of authorities, but the framework has proved to be complex and slow to change, and the reforms have been sector-wide rather than targeted. While commercial behaviour changes emerged in 2016-17, it took until 2018-19 before the guidance changes came into effect, with no immediate change in behaviour expected that year. Plus, changes apply across the sector, whereas behaviour concerning to the Department is not sector-wide.

Appendix One

Our audit approach

1 This study examined whether the framework governing local authority capital expenditure and resourcing allows for the management of risks relating to local authority investment in commercial property. We reviewed:

- the level and nature of local authority commercial property acquisitions, including how they have been financed;
- available evidence on the risks that local authorities may be exposed to because of this activity; and
- the way in which the government is exercising its stewardship responsibilities for the system governing local authority capital investment.

2 For the first and second of these, we:

- purchased and analysed data on commercial property acquisitions;
- analysed government data on local authority borrowing and capital spending;
- analysed a sample of local authority capital and investment strategies;
- held workshops with council finance directors (three workshops) and external auditors (one workshop); and
- carried out case study visits to active local authorities.

We drew on property industry accounts of property investment risks.

3 For the third of these, we:

- interviewed a range of government officials;
- carried out workshops and stakeholder interviews; and
- analysed government documents.

We applied an analytical framework based on government accounts of its objectives and responsibilities.

4 To support our quality assurance work the draft report was reviewed by three external experts:

- Martin Easton – Head of Capital and Treasury, Birmingham City Council; Member of Chartered Institute of Public Finance and Accountancy's (CIPFA's) Treasury and Capital Management Panel.
- Sean Nolan – former Chief Financial Officer for two county councils and a police and crime commissioner. Former Director of Local Government at CIPFA. Former President of the Society of County Treasurers and the Association of Local Authority Treasurers Societies.
- Julie Parker – former Section 151 officer and Director of Resources at a number of London councils; Assistant Inspector to Max Caller (Lead Inspector) in the Northamptonshire County Council Best Value Inspection.

The experts provided independent views on the report's methods, findings and conclusions, focusing in particular on the technical aspects of the report. The National Audit Office considered these views but remains solely and fully responsible for the content of the report.

5 Our audit approach is summarised in **Figure 22**. Our evidence base is summarised in Appendix Two.

Figure 22
Our audit approach

The objective of government

Enable local authority capital spending while managing the risks to value for money and to the achievement of government objectives arising from or relating to local authority investment in commercial property.

How this will be achieved

Through oversight of the devolved capital framework and wider accountability system, along with control of lending by the Public Work Loans Board.

Our evaluative criteria

Local authority commercial property acquisitions

The level, nature and funding of recent commercial property acquisitions is important context for assessing the government's stewardship of the framework.

Risks of commercial property acquisitions

The risks that local authorities are creating through their commercial property acquisitions and the extent to which they are being mitigated is important context for assessing the government's stewardship of the framework.

Stewardship of the framework

The government has clear objectives for what it wants to achieve through the framework.

The government has a good understanding of commercial property acquisition activity and the related risks.

The government understands how well the framework is working and tests the safeguards within the framework.

Where necessary, the government makes effective changes to ensure delivery of its objectives.

Our evidence
(see Appendix Two for details)

As part of our evidence collection we:

- analysed central government data on authorities and proprietary data on commercial property acquisitions;
- interviewed or conducted workshops with external auditors, council finance directors and other key stakeholders;
- analysed key central government documents and a sample of local authority capital strategies; and
- conducted 16 case studies with Aylesbury Vale, Barking & Dagenham, Breckland, Canterbury, Cherwell, Elmbridge, Essex, Leeds, Portsmouth, Runnymede, Sevenoaks, Spelthorne, Thurrock, Torbay, Warrington and Watford local authorities.

Our conclusions

The acquisition of commercial property can enable authorities to generate income in the context of financial pressure, while also supporting regeneration. However, the scale of investment of public funds in this activity in the last three years, the concentration of this activity in a relatively small group of authorities, and the use of borrowing to finance such investments is striking. The benefits from this investment therefore must be considered against the potential financial sustainability and value-for-money risks that have emerged.

The Ministry of Housing, Communities & Local Government (the Department) as steward of the prudential framework, alongside CIPFA, has sought to address the implications for the framework of emerging risks from these activities. It has been alive to the financial sustainability risks for a small number of authorities and has made system changes in response. However, the Department is only expecting gradual change in those authorities' behaviour despite the Committee of Public Accounts first highlighting concerns in November 2016.

The position set out in this report raises questions about the extent to which the Department and HM Treasury can rely on the prudential framework in its present form to support value-for-money decision-making in the current legal and financial context. The permissive nature of the prudential framework has been tested by new behaviours in the sector, and the Department has not yet responded in a timely way that also reflects the marked variations in activity across the sector. To protect against risks to value for money, the Department must take steps to ensure that authorities' actions are in line with the principles underlying the framework. To support this, it should strengthen framework oversight and develop methods for more timely, flexible and targeted intervention when required.

Appendix Two

Our evidence base

1 Our independent conclusions on whether the devolved framework overseen by the Ministry of Housing, Communities & Local Government (the Department) allows for the management of risks to the financial sustainability of local authorities from investment in commercial property were reached following our analysis of evidence collected primarily between June and November 2019.

2 We applied an analytical framework with evaluative criteria that set out how the government's overall objective can be achieved. Our analytical approach is set out in Appendix One.

3 We define 'local authorities' as principal councils. These include metropolitan borough councils, unitary authorities, London borough councils, county councils and district councils. We include the Isles of Scilly but we exclude the City of London. The City of London acquires commercial property through a number of separate funds, not all of which relate to its activities as a local authority. We are not able to separate relevant and non-relevant spend by the City of London from all of the data. As a result, we remove the City of London from all the data in this report.

4 We group metropolitan borough councils, unitary authorities, London borough councils and county councils together as 'single-tier and county councils' throughout the report.

5 We exclude combined authorities, police and crime commissioners, stand-alone fire and rescue authorities, national park authorities and the Greater London Authority.

Local authority investment in commercial property

6 **We examined levels and patterns of local authority investment in commercial property.** When we talk about spending on acquiring commercial property as 'investing', we are using the term to describe capital expenditure. We recognise that this spending can represent either a formal investment to secure yield, or expenditure to support policy objectives directly. Our usage is not intended to imply that this spending meets any specific legal or regulatory definition of an investment.

Quantitative analysis

Deflation

- In general, data in this report are in cash terms. However, in some instances we have put figures in real terms at 2018-19 prices. In these cases we used the gross domestic product (GDP) deflators published by HM Treasury on 1 October 2019.
- There are a small number of instances where we have used data from other publications that are already in real terms. We have left the deflation unchanged in these cases.

Departmental data

- **We drew on and updated evidence from previous work on the financial sustainability of local authorities.** This includes an update of our analysis of changes in spending power. All references to spending power in this report relate to our chain-linked time series developed in our study *Financial sustainability of local authorities 2018*.[43] The methodology for our time series is available with that report.
- **Our analysis drew on the Department's Revenue Outturn (RO) dataset to assess change in service spending levels and surpluses from trading services (which is shown as gross and excludes investment properties).**

Proprietary commercial property data

- **We purchased a commercial property investment dataset (CoStar) to analyse local authorities' acquisitions.** This dataset allowed us to explore in detail the scale, location and characteristics of acquisitions made by authorities. This is not possible with data collected by the Department or in the Whole of Government Accounts (WGA) as they provide data on total spend only.
- CoStar is an international commercial property data provider. It sources data from property agents, surveyors, the Land Registry, company press releases, news reports, FTSE filings and their own field agents. It validates its data through contact with agents, vendors and purchasers and looks to interview at least one party to each transaction.
- As the CoStar data are proprietary data, rather than having been produced by the National Audit Office or the Department, and because it is live and potentially subject to revision, **all analysis in this report that draws on this data should be treated as an estimate.** Furthermore, because we view CoStar data as an estimate we do not name or identify any individual authority based on data from this source.
- We identified local authority purchases ourselves from within CoStar's overall sales database. We used the buyer name to identify acquisitions made by councils. We recorded completed sales only.

43 Comptroller and Auditor General, *Financial sustainability of local authorities 2018*, Session 2017–2019, HC 834, National Audit Office, March 2018.

- In some cases CoStar data ascribes acquisitions made by an authority's trading companies to the authority itself. As it is not possible to identify each case where this might have occurred, and because trading company activity is still relevant to our work, we leave acquisitions made by trading companies in our data for each authority. For consistency we also add the spend of the trading companies that have been identified separately by CoStar to those of their parent local authority. Acquisitions that were clearly identifiable as being made by trading companies totalled £659 million in the period 2016-17 to 2018-19. We cannot guarantee, however, that we have been able to capture the activity of every relevant trading company.
- We used sale date and price information as provided by CoStar. In general, we have used the confirmed sale price. In a small number of cases we have used asking price where the sale price was absent. CoStar does not include stamp duty or legal fees in its price information.
- In general, we report details on individual properties as this provides data on property type and location. However, where we refer to the number of acquisitions this relates to a combination of portfolios and individually acquired properties. We have not included any data on the acquisition of residential property.
- We used individual property postcode details provided by CoStar to identify the location of each property and then used this to classify properties in relation to local authority, Local Enterprise Partnership (LEP) and regional boundaries. We used the 2017 LEP boundaries. We recognise that these have changed over time, but adjusting for these changes would have been excessively complex.
- In preparing the data we:
  - validated our CoStar extracts by matching the purchaser and sale details for a randomly selected 10% sample of local authority acquisitions from CoStar against Land Registry: Commercial and Corporate Ownership Data, and local authority papers where necessary;
  - performed a second round of validation focusing on acquisitions we identified as being out of an authority's area. We compared a sample of 10% of out-of-area purchases in 2016-17 to 2018-19 from CoStar against Land Registry: Commercial and Corporate Ownership Data and local authority papers to ensure that purchaser name and sale details matched;
  - cross-checked pension fund authority properties, where possible, to ensure the acquisition in our CoStar data was made by the local authority and not its pension fund;
  - excluded properties classified as land purchases, as these could potentially be used for residential development; and
  - examined available CoStar tenancy data and excluded properties that were tenanted by authorities themselves. This includes all healthcare properties purchased in-area, which we assume are used by the authority for service delivery.

- To validate the CoStar data further we triangulated it against data in the WGA on local authority acquisition of investment properties, and data held by the Department on local authority acquisition of land and existing buildings (within trading services expenditure). All three datasets are on a different basis and we would not expect a precise match between the CoStar data and either of the other two datasets. For instance, unlike the departmental and WGA data, the data we extracted from CoStar includes spend by trading companies and excludes the acquisition of land and residential property (for sale or rent at market rates).

- To adjust for these differences we have produced a revised measure of spend based on the CoStar data as well as our main measure (**Figure 23** overleaf). This revised measure is used solely for the purpose of triangulation and is not used elsewhere in the report. The revised measure excludes identifiable spend from trading companies and the purchase of off-shore unit trusts, and adds back in spend on the acquisition of land. We have also adjusted the departmental data for 2017-18 and 2018-19 by removing spend on the acquisition of land and existing buildings in relation to commercial residential property from total trading services as this spend is not included in the CoStar data.

- There is a close fit between our main measure of spend from the CoStar data with both the WGA and the departmental data despite the underlying differences in the data (Figure 23). Our revised measure from the CoStar data also shows a close fit with the WGA data up to 2017-18 and the departmental data for 2018-19. The departmental data are slightly lower in 2016-17 and 2017-18, but this is likely to reflect under-reporting of this type of spending by authorities. This has been acknowledged by the Department. WGA 2018-19 data were not available at the time of publication.

- Despite the close fit between the CoStar data and the other datasets and the steps we have taken to validate and clean the data **we cannot guarantee that it is complete and does not contain errors.** This reinforces the need for these data to be treated as estimates and for individual authorities identified in the data to remain anonymous.

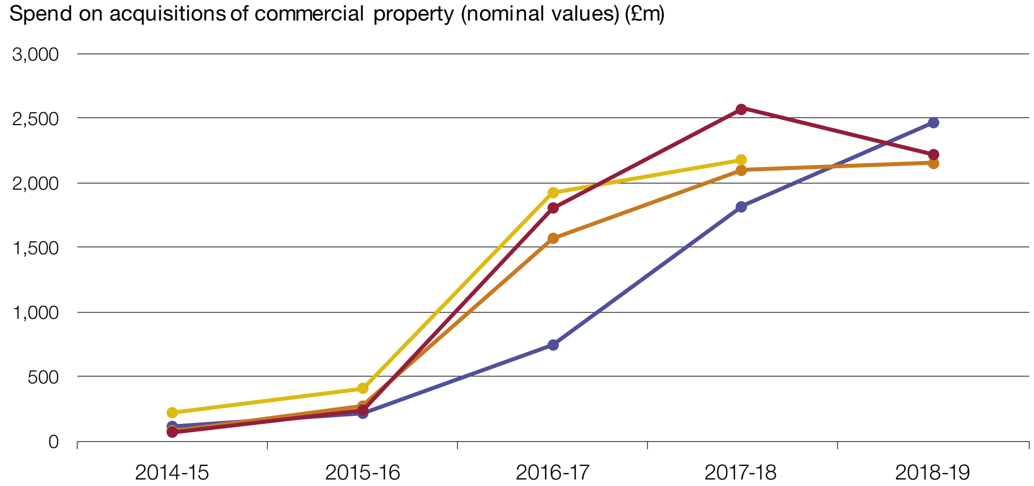
- Using data from CoStar we created three authority groups based on the estimated investment activity of each authority between 2016-17 and 2018-19. Single-tier and county councils (**Figure 24** on page 71), and district councils were treated separately in this calculation:

  - **Most active** authorities are defined as the top fifth of authorities that invested in commercial property, relative to their core spending power; that is, the top fifth when ranked by estimated spend on commercial property in this period as a share of spending power. There were 17 authorities in the most active group of district councils. The figure for single-tier and county councils was 19. The most active district councils accounted for 73.7% of acquisitions by value in this period for their tier. The equivalent figure for the most active single-tier and county councils was 64.9%.

Figure 23

Comparison of three different datasets on the acquisition of commercial property by English local authorities, 2014-15 to 2018-19

Our estimates for total investment by local authorities in commercial property closely match other government datasets



	2014-15	2015-16	2016-17	2017-18	2018-19
● CoStar – total spend on acquisitions (£m)	65	236	1,806	2,586	2,223
● CoStar – adjusted total spend on acquisitions (£m)	78	270	1,568	2,098	2,153
● Whole of Government Accounts (WGA) – local authority investment property purchases (£m)	219	403	1,925	2,184	
● Capital Outturn Return (COR) – total trading services, acquisition of land and existing buildings (£m)	110	211	743	1,827	2,471

Notes

1 WGA 2018-19 data were not available at the time of publication.

2 The adjusted CoStar line contains our main CoStar data but with identifiable spend by trading companies and by local authorities on offshore unit trusts excluded. We have also added in spend on land as this is included in both the WGA and the COR.

3 COR data are adjusted to remove 'commercial housing' from 2017-18 and 2018-19 to make it more consistent with the CoStar data. It is not possible to make this adjustment to the COR data in previous years. We have excluded one authority from this adjustment as there is a potential reporting anomaly in its data.

4 COR data in 2016-17 and 2017-18 may contain a degree of under-reporting.

Source: National Audit Office analysis of CoStar data, Ministry of Housing, Communities & Local Government's Capital Outturn Return (COR), and Whole of Government Accounts

- **Less active** authorities are defined as the remaining authorities that purchased commercial property in this period. This included 68 district councils, and 75 single-tier and county councils.
- **Not active** authorities are those authorities that did not invest during this period according to the data held by CoStar. This included 116 district councils, and 57 single-tier and county councils.
- We use these groups in a number of pieces of analysis throughout the report. These groups are based on estimates from CoStar data. We therefore do not identify any of the member authorities in each group.
- We used CoStar data to analyse the sectoral diversification for each authority's acquisitions. This was estimated using a Herfindahl Hirschman Index for property type by value. The index was calculated using the share of each authority's acquisitions by property type.

Whole of Government Accounts

- We used the WGA data to calculate the stock of investment properties held by local authorities in 2015-16; and the value of authorities' acquisitions in 2016-17 and 2017-18; and the difference in the value of authorities' acquisitions in 2016-17 and 2017-18. If an authority had missing data at any point across these time periods they were excluded from our analysis. WGA 2018-19 data were also not available at the time of publication.

Figure 24

Breakdown of single-tier and county council activity groups by type of English local authority

Local authority type	Most active	Less active	Not active
Unitary authorities	13	28	15
London boroughs	2	19	11
Metropolitan districts	2	18	16
County councils	2	10	15

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government and CoStar data

Case studies

- **We visited case study authorities.** We spoke to officers and, where possible, an elected member, at 16 local authorities: Aylesbury Vale District Council, London Borough of Barking and Dagenham, Breckland District Council, Canterbury City Council, Cherwell District Council, Elmbridge Borough Council, Essex County Council, Leeds City Council, Portsmouth City Council, Runnymede Borough Council, Sevenoaks District Council, Spelthorne Borough Council, Thurrock Council, Torbay Council, Warrington Borough Council and Watford Council. We used these visits to explore the range of investment strategies, the governance arrangements around investments, and funding used to finance acquisitions.

  - At case study authorities, we always spoke to the section 151 officer (chief finance officer) or head of finance. In addition, we often spoke to the chief executive or other members of the leadership team. We also spoke to officers working closely with property acquisitions, such as commercial directors, property managers or a director at a council-owned company.

  - We spoke to 14 elected members at 10 case study authorities. These were generally members of the cabinet or executive (such as the leader, deputy leader or a portfolio holder); in one instance we spoke to the chair of a member working group that considers potential property purchases.

- We selected these authorities with a clear purpose: to speak to a range of highly active local authorities of different types and pursuing different approaches. We used other methods, particularly workshops, to capture the perspective of less active or inactive authorities.

  - Eight of the case studies (four shire district councils, one London borough, one metropolitan district council, one unitary authority and one county council) were selected randomly from authorities that spent more than the average for active authorities of their type in the available data.

  - Eight of the case studies were selected purposively to ensure that we covered a wide range of investment approaches among authorities, including relatively unusual ones.

- We excluded a small number of authorities from the possibility of selection because of concerns about:
  - the risk of over-burdening the authority or key contacts (for example, if the authority was in intervention); or
  - the possibility of a perceived conflict of interest.

Assessing the risks of commercial property acquisitions

7 We examined the risks and risk management arrangements relating to commercial property purchases and the way they are resourced.

Estimating levels of borrowing used to support commercial property spending

- **We used the COR data alongside our estimate of spend on commercial property from CoStar to estimate the level of spending on commercial property supported by prudential borrowing.** We looked at spending supported by prudential borrowing in each year from 2016-17 to 2018-19 for each authority. We summed our results to create estimates for the three-year period. We first removed the value of spending supported by prudential borrowing used to support Housing Revenue Account (HRA) spending in each year from our prudential borrowing data. We recognise that prudential borrowing includes both internal and external borrowing.
  - For our **minimum estimate** we assumed that prudential borrowing was applied first to all forms of capital spend other than commercial property spending (as measured by our CoStar data). Any balance was then assumed to have been used to support spending on commercial property.
  - For our **mid-range estimate** we applied the same approach as with our minimum estimate. However, we first subtracted the value of spending supported by capital grants, the major repairs reserve and revenue expenditure from the HRA from the value of all capital spending other than on commercial property (on the basis that these funding sources are unlikely to have been used to support spending on commercial property). We then applied the value of spending supported by prudential borrowing to the adjusted figure for all capital spending other than commercial property. Any balance from prudential borrowing was then assumed to have been used to support spending on commercial property.
  - For our **maximum estimate** we assumed that prudential borrowing was applied first to spending on commercial property, with any balance then being allocated to spending on all other forms of capital spending.

- The CoStar data includes spending on commercial property by authorities' trading companies. In general, this spending is funded by loans made by the local authority or the purchase of equity in the company by the local authority. This spending by local authorities is in the data on spending supported by prudential borrowing reported by the Department. However, it is possible that trading companies have secured funding from elsewhere, or have not yet invested funding secured from local authorities or have done so in a different financial year.

- We applied an identical methodology for our estimates of spending on trading services supported by prudential borrowing, but substituting the CoStar data for total trading services spend from the Department's data. We include total capital expenditure (on fixed assets and financial expenditure). We also include spend treated as capital by virtue of a Section 16 direction. We repeated this analysis for 2013-14 to 2015-16.

- In principle, trading services incorporates local authority spend on commercial property. It does include other forms of commercial investment, including commercial housing, hospitality and catering, and energy generation and supply; however, these represent the minority of spend.

- We made one adjustment to the trading services data in 2017-18 as an authority with significant spend had changed the service line in which it reported this spend in 2018-19. In this case we moved data into the trading services line in 2017-18.

- In both the commercial property and trading services calculations we removed five authorities from the calculations as they had missing data for at least one year. We recognise that because capital programmes are funded as a whole it is not possible to associate individual funding lines with particular capital programmes or acquisitions. However, our minimum and maximum estimates are based on calculating residuals rather than linking funding lines and spending lines. As such they show the absolute limits for the amount of spend on commercial property supported by prudential borrowing rather than an assessment of what we think they might have spent. Our mid-range estimate does include some linking, however. We have assumed that authorities are unlikely to have used capital grants, their major repairs reserve or revenue funding from the HRA to acquire commercial property.

External borrowing, net debt and debt servicing costs

- **We used the Department's COR to look at the change on the stock of external debt held by authorities** as of 31 March in each year. Where an authority failed to provide a return in a particular year they are excluded from the relevant analysis across the whole time period. Five authorities were excluded on this basis. We examined patterns of change within our local authority activity groups.
- **We used the Department's Quarterly Borrowing and Investment tables to explore changes in the sector's overall stock of external borrowing by source** as of 31 March in each year. We also used these data to look at change in stocks of short-term (less than 12 months) and long-term borrowing.
- **We used the Department's COR data to look at the median levels of gross external borrowing and net debt (as of 31 March in each year) in our activity groups.** Net debt subtracts the stock of an authority's financial investments from its stock of external borrowing and long-term liabilities. Where an authority failed to provide a return in a particular year they are excluded from the relevant analysis across the whole time period.
- **We used the Department's Revenue Account (RA) dataset to examine debt servicing costs.** This is budget data, rather than outturn as used elsewhere. We choose budget data as we are specifically interested in whether Minimum Revenue Provision (MRP) levels are likely to have changed in 2019-20 following the guidance change that came into effect in that year.
- This analysis is based on local authorities that have existed for the whole of 2010-11 to 2019-20. This analysis only includes authorities not subject to reorganisation in 2019-20. In addition, where an authority failed to provide a return in a particular year they are excluded from the relevant analysis across the whole time period. Five authorities were excluded on this basis.
- Figure 17 shows the main components of debt servicing costs; MRP and interest rate payments (adjusted for HRA item 8). Our analysis in Figure 18 also includes leasing payment costs.

- **In order to address HRA debt within our borrowing and debt figures we make the following adjustments:**
  - For our calculations of gross borrowing and net debt in Figures 15 and 16 we subtract the value of each authority's HRA capital financing requirement (CFR) from its respective stocks of borrowing and debt in order to adjust for HRA borrowing. We use the HRA CFR in the absence of a precise figure on HRA external debt. We recognise that this may overstate the adjustment as it removes both external and internal HRA borrowing. Nonetheless, we think the adjusted data provide a more accurate estimate for our purposes than leaving these figures unadjusted as this would have a material effect on the level of borrowing and debt in each year for our groups.
  - For our debt servicing cost analysis in Figures 17 and 18 we include HRA item 8 figures which effectively strip out debt servicing costs associated with HRA borrowing.
- We have not adjusted the analysis in Figures 13 and 14 for HRA borrowing. The main purpose of Figures 13 and 14 is to show change in external debt, and because this is unlikely to have been driven significantly by HRA borrowing, and because our HRA debt adjustment is not perfect, we do not adjust this analysis. The unadjusted data provide exactly the same message as any adjusted data would, so our preference is to leave these unadjusted.
- We have not adjusted our analysis of the Public Works Loan Board (PWLB) loans in Figure 19. We have no method to identify loans taken for HRA purposes in this period. Because of the HRA borrowing cap for most of this period it is also likely that there was not significant change in HRA borrowing over this period.

Market distortion

- **We used CoStar data to estimate total market activity in England and at the regional level from 2016-17 to 2018-19.** We then estimated the share of this activity accounted for by local authority acquisitions. It is possible that the national and regional data exclude off-market sales or undisclosed sales, and as a result may be slightly understated. Consequently, the estimates we produce on local authority activity as a share of national and regional activity need to be seen as a maximum estimate.

Workshops

- **We held workshops with holders of key roles:**
  - External auditors – including 10 auditors from six firms that audit principal local authorities either in the current round of contracts, or that did so in the previous round that ran until the end of 2017-18.
  - Section 151 officers – including 30 section 151 officers in sessions organised by the Society of District Council Treasurers, the Society of Unitary Treasurers and the Society of County Treasurers.

  As local authority contexts, experiences and approaches differ, evidence drawn from these workshops was not necessarily unanimous across all participants.

Stakeholder interviews

- **We interviewed representatives of a range of stakeholders:**
  - Chartered Institute of Public Finance and Accountancy;
  - Association of Local Authority Treasurers' Societies;
  - Society of District Council Treasurers;
  - Society of County Treasurers;
  - Society of Municipal Treasurers;
  - Local Government Association;
  - Chief Economic Development Officers' Society;
  - Link Asset Services;
  - Arlingclose; and
  - CCLA Investment Management Limited.

Other methods

- **We made a 'call for evidence'.** We invited section 151 officers to respond to questions regarding their authority's commercial investment, the regulatory framework and guidance, and sector-wide activity. We received 16 responses.
- **We drew on evidence from our past work on** local authority governance, for example we reviewed survey results and workshop evidence relating to governance of commercial investments.

Stewardship of the framework

8 We assessed the government's stewardship of the financial framework for commercial property investment.

Literature analysis

- **We reviewed departmental documents.** This included the prudential framework statutory guidance and codes.
- **We reviewed a sample of 45 authorities' capital strategies.**[44] These strategies related to 2019-20 and were approved after the start of 2018-19. Where necessary, we drew on supporting documents. We focused on authorities that either had been, or were planning on, undertaking commercial property acquisitions.
  - We selected the 10 most active single-tier and county councils and the fifteen most active district councils between 2015-16 and 2018-19 based on CoStar data.
  - We selected 10 single-tier and county councils and 10 district councils from authorities in the Department's Capital Expenditure Return (CER) for 2019-20, which shows budget data. We selected authorities that were budgeting the largest amounts to acquire commercial property.
  - Seven of the strategies we reviewed were from authorities that were also case study authorities; 38 strategies were from other authorities (17 single-tier and county councils, 21 district councils).
- We gathered data on authorities' budgeted net yield for 2019-20 from their commercial property portfolios from their capital strategies. Where an authority did not report net yield but had presented net income and investment property asset value in their investment strategy, we calculated net yield as net income divided by asset value. Authorities that presented net yield were analysed separately if the strategy suggested that they calculated MRP in relation to borrowing supporting their commercial property portfolio differently to the Department's suggestions in the guidance, or if the calculation or components of the calculation were unclear. We have relied on authority-reported numbers for this analysis. It is possible that authorities differed in whether they took account of costs other than solely debt servicing costs, such as contributions to contingency reserves, in calculating their net income figures.
- We looked at further capital strategies, for example where significant activity appeared in our CoStar dataset but had not been included in our sample, or to cross-check pension fund properties; however, we did not formally review these strategies.

44 The strategies sometimes had different titles, such as treasury management strategy or investment strategy.

Departmental interviews

- **We interviewed officials from government departments.** We designed these interviews to focus on how the government:
  - informs itself of local authorities' commercial property investment and related risks;
  - assures itself that the framework is working; and
  - makes effective changes to ensure delivery of its objectives.
- As well as the Department, we spoke to officials at HM Treasury.

Appendix Three

Additional data on local authority borrowing

Figure 25

Descriptive statistics for Figure 15

Council type	Activity group	Quartile	2013-14 (%)	2014-15 (%)	2015-16 (%)	2016-17 (%)	2017-18 (%)	2018-19 (%)
District	Most active (17 authorities)	Minimum	-219	-195	-221	-9	139	291
		Lower quartile	0	0	0	17	308	559
		Median	0	0	3	119	523	756
		Upper quartile	88	124	159	1,082	1,118	1,657
		Maximum	1,851	2,137	2,296	3,578	6,070	9,900
	Less active (68 authorities)	Minimum	-103	-111	-141	-90	-77	-169
		Lower quartile	0	0	0	0	0	0
		Median	0	0	1	7	17	60
		Upper quartile	42	33	57	81	85	177
		Maximum	225	241	278	250	473	642
	Not active (113 authorities)	Minimum	-528	-446	-135	-155	-194	-222
		Lower quartile	0	0	0	0	0	0
		Median	11	10	11	12	13	12
		Upper quartile	70	73	78	76	85	90
		Maximum	334	268	288	314	472	353
Single-tier and county	Most active (18 authorities)	Minimum	0	0	0	21	4	76
		Lower quartile	43	58	51	71	109	115
		Median	77	79	95	105	154	181
		Upper quartile	106	117	130	167	218	253
		Maximum	152	201	200	299	527	626
	Less active (75 authorities)	Minimum	-97	-96	-105	-106	-96	-92
		Lower quartile	38	40	43	50	57	58
		Median	62	72	79	79	83	88
		Upper quartile	90	96	108	109	126	142
		Maximum	180	203	259	288	303	365
	Not active (56 authorities)	Minimum	-54	-54	-75	-61	-51	-67
		Lower quartile	57	57	59	59	62	64
		Median	72	78	84	88	85	92
		Upper quartile	93	105	113	123	127	136
		Maximum	192	224	199	223	533	822

Notes

1 We define the 'most active' authorities as the top 20 in terms of level of spending on commercial property in the period 2016-17 to 2018-19. 'Less active' authorities are the remaining 80 of authorities that incurred spend on commercial property acquisition. 'Not active' authorities did not incur spend during this period. We group single-tier and county councils (151 authorities), and district councils (201 authorities) separately. See Appendix Two.

2 Percentages have been rounded to the nearest percentage point for presentational purposes.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 26

Descriptive statistics for Figure 16

Council type	Activity group	Quartile	2013-14 (%)	2014-15 (%)	2015-16 (%)	2016-17 (%)	2017-18 (%)	2018-19 (%)
District	Most active (17 authorities)	Minimum	-516	-498	-465	-2,456	-278	-304
		Lower quartile	-287	-284	-265	-96	168	331
		Median	-184	-194	-153	-23	257	567
		Upper quartile	-95	3	55	163	987	1,376
		Maximum	1,795	2,022	2,329	3,493	6,288	9,617
	Less active (68 authorities)	Minimum	-876	-987	-988	-1012	-1,099	-1,118
		Lower quartile	-250	-257	-290	-313	-320	-359
		Median	-155	-155	-208	-191	-189	-136
		Upper quartile	-41	-50	-77	-73	-49	30
		Maximum	220	95	85	172	476	625
	Not active (113 authorities)	Minimum	-1125	-811	-791	-888	-1,050	-1,212
		Lower quartile	-145	-185	-191	-220	-263	-309
		Median	-69	-84	-119	-130	-153	-191
		Upper quartile	-7	-28	-35	-26	-32	-85
		Maximum	256	134	141	135	363	319
Single-tier and county	Most active (18 authorities)	Minimum	-56	-46	-30	1	-6	69
		Lower quartile	1	7	13	29	67	84
		Median	37	44	52	70	117	137
		Upper quartile	73	82	126	158	196	222
		Maximum	122	139	218	285	452	581
	Less active (75 authorities)	Minimum	-281	-333	-390	-443	-487	-413
		Lower quartile	11	4	12	15	26	29
		Median	46	51	52	66	72	70
		Upper quartile	81	92	100	108	124	130
		Maximum	214	242	279	311	329	348
	Not active (56 authorities)	Minimum	-150	-184	-204	-196	-195	-209
		Lower quartile	24	19	16	13	19	20
		Median	60	52	60	71	81	74
		Upper quartile	93	102	104	131	135	131
		Maximum	237	237	256	283	730	703

Notes

1 We define the 'most active' authorities as the top 20% in terms of level of spending on commercial property in the period 2016-17 to 2018-19. 'Less active' authorities are the remaining 80% of authorities that incurred spend on commercial property acquisition. 'Not active' authorities did not incur spend during this period. We group single-tier and county councils (151 authorities), and district councils (201 authorities) separately. See Appendix Two.

2 Percentages have been rounded to the nearest percentage point for presentational purposes.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 27

Descriptive statistics for Figure 18

Council type	Activity group	Quartile	2011-12 (%)	2012-13 (%)	2013-14 (%)	2014-15 (%)	2015-16 (%)	2016-17 (%)	2017-18 (%)	2018-19 (%)	2019-20 (%)
District	Most active (17 authorities)	Minimum	-3	-3	-10	-10	-9	-4	-8	-2	0
		Lower quartile	0	0	0	0	0	0	0	6	13
		Median	0	0	0	0	1	0	2	18	28
		Upper quartile	8	7	10	9	8	7	36	41	63
		Maximum	64	76	92	93	103	113	161	220	317
	Less active (65 authorities)	Minimum	0	-5	0	-1	-4	-5	-1	0	-6
		Lower quartile	0	0	0	0	1	1	1	2	2
		Median	2	2	2	2	3	2	2	4	6
		Upper quartile	4	5	6	6	6	6	7	9	13
		Maximum	18	15	11	14	14	19	17	22	33
	Not active (107 authorities)	Minimum	0	0	-3	-4	-4	-4	-3	-2	-2
		Lower quartile	0	0	0	0	0	0	0	0	0
		Median	3	3	3	3	3	3	3	4	4
		Upper quartile	6	6	7	8	9	8	9	9	9
		Maximum	17	18	19	28	31	31	33	36	37
Single-tier and county	Most active (18 authorities)	Minimum	1	1	2	2	2	2	2	2	3
		Lower quartile	5	5	5	5	6	5	5	5	7
		Median	6	7	6	8	8	9	9	8	9
		Upper quartile	9	9	9	10	11	11	12	12	12
		Maximum	10	16	17	18	19	19	19	21	22
	Less active (74 authorities)	Minimum	0	0	0	0	0	0	0	0	0
		Lower quartile	6	6	5	6	6	5	5	5	5
		Median	7	7	7	7	7	7	6	7	7
		Upper quartile	8	9	10	10	10	10	9	9	10
		Maximum	14	13	18	22	25	26	25	25	31
	Not active (56 authorities)	Minimum	0	1	1	1	1	1	0	-1	0
		Lower quartile	6	7	7	7	7	5	6	5	5
		Median	8	8	8	9	9	8	7	7	7
		Upper quartile	10	10	11	11	12	11	10	9	9
		Maximum	13	20	16	18	20	20	18	17	18

Note

1 We define the 'most active' authorities as the top 20 in terms of level of spending on commercial property in the period 2016-17 to 2018-19. 'Less active' authorities are the remaining 80 of authorities that incurred spend on commercial property acquisition. 'Not active' authorities did not incur spend during this period. We group single-tier and county councils (151 authorities), and district councils (201 authorities) separately. See Appendix Two.

2 Percentages have been rounded to the nearest percentage point for presentational purposes.

3 This analysis only includes authorities not subject to reorganisation in 2019-20.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

This report has been printed on Pro Digital Silk and contains material sourced from responsibly managed and sustainable forests certified in accordance with the FSC (Forest Stewardship Council).

The wood pulp is totally recyclable and acid-free. Our printers also have full ISO 14001 environmental accreditation, which ensures that they have effective procedures in place to manage waste and practices that may affect the environment.

National Audit Office

Design and Production by NAO External Relations
DP Ref: 006571-001

£10.00

ISBN 978-1-78604-302-3