Introduction

Research for Action has investigated local government finance and debt, especially borrowing from private banks in the form of LOBO loans. In October 2018, we published a report detailing the LOBO debt in London Borough of Newham, following a May 2018 report on the impact of cuts in services on Newham residents. Both reports are available to download on our website and form the basis of this submission:

"Debt and Democracy in Newham: A citizen audit of LOBO loans"

"Cuts and Contempt: Experiences of austerity and council democracy in Newham"

Through our research, we have encountered a sector in crisis, failing to meet the needs of residents. For the purposes of this submission, we have identified the following areas of concern:

- Lack of accurate and transparent information
- A severe funding crisis that is affecting residents in the form of cuts and council tax hikes
- Unsustainable borrowing that drains funds to the private sector
- Lack of oversight

1. Lack of information

1.1. The 2014 Local Audit and Accountability Act and the 2000 Freedom of Information Act guarantee the public's right to access information from public bodies. However, in practice this is often very limited. Our problems to access information from Newham councils have been documented in our report. We have also appealed Royal Borough of Kensington and Chelsea's refusals to provide information to the ICO. Also other groups, such as Lambeth People's Audit in South London, have encountered problems trying to use their rights to acquire information.

1.2 Problems include authorities not responding to Freedom of Information requests on time and rejecting access to information that should be in the public interest, not informing
residents of their right to inspect accounts under the Local Audit and Accountability Act and having a very narrow interpretation of what information the public is entitled to under that Act.

1.3 Problems with access to data are not only limited to members of public. Since the 2011 Localism Act centralised decision-making power in councils, also backbench councillors have cited difficulty accessing information.

1.4 When available, data is inaccurate. Problems range from simple errors such as lack of 0's to changes in the way accounts are presented that makes year-on-year comparison of spending impossible.

2. Local government funding in crisis

2.1 According to the National Audit Office (NAO), from 2010 to 2018, funding from central government to local authorities has been cut by 49.1%. This figure is expected to rise to 56.3% by 2020, leaving many councils struggling to meet their legal obligations to deliver services to residents. In February 2018, Northamptonshire County Council declared it was effectively bankrupt, suspending all new expenditure decisions.

2.2 There is significant uncertainty as to how local government will be financed post 2020. A 2018 survey among council officials suggested that 80% of councils fear for their financial sustainability and that Northamptonshire CC is just the tip of the iceberg.

2.3 Local authorities have, with varying success, tried to protect spending on areas such as adult and children’s social care, where they have statutory responsibilities. For these services they receive specific support grants from central government and have been allowed to introduce a social care levy to raise more funds locally. Cuts have hit hardest in spending areas that are more discretionary. According to the NAO, spending on housing services in England has fallen by 45.6% since 2010, while spending on planning and development and highways and transport have fallen respectively by 52.8% and 37.1%. Spending on cultural and related services also fell by 34.9%. Unfortunately, a lack of consistent categorisation and data documenting changes in these areas makes it difficult to assess the impacts of spending reductions.

2.4 According to our findings in Newham, frontline services seem disproportionately affected. Between 2010/11 and 2017/18, Newham’s service budget has been reduced by £71m. Children and young people’s services alone appear to have been reduced by nearly £10m, from £94.3m in 2010/11 to £83.9m in 2017/18. Business efficiency savings in the area of children and young people’s services show worrying reductions to support for the most vulnerable, such as the £300,000 cut in leaving care services or £200,000 in special
educational needs’ home to school transport in 2016/17 only. Housing and community infrastructure has been reduced from £14.4m in 2013/14 (only appears in the budget from this year onwards) to £8.3m in 2017/18.11

2.5 A combination of reduced funding and higher demand has meant that a growing number of local authorities have not managed to remain within their budgets and have relied on reserves to balance their books. These trends are not financially sustainable. The NAO estimates that 10.6% of local authorities with social care responsibilities have the equivalent of less than three years’ worth of reserves left if they continue to use them at the rate they did in 2016/17. The government has used multiple short-term funding initiatives in recent years to address some of the funding gaps, especially with regards to social care. However, this is not a sustainable alternative to a long-term funding plan.

2.6 It appears that the policy intentions of central government are to reduce the role of local government to a provider of a narrow core of social care services, that in many cases will be then outsourced to private companies. This model is known as commissioning councils, and is already been experimented with in local authorities such as the London borough of Barnet.

3. Impacts of austerity on residents

3.1 We interviewed 51 randomly selected residents in Newham in 2017-18. Nearly all described council services as important, and the rest chose "don't know" – not a single person described council services as not important.

3.2 All were aware that cuts were happening, and half had been personally affected.

3.3 The most common ways in which people described the cuts were: lack of staff and increased bureaucracy; closures of community centres, venues and libraries; charges on services that had previously been free; changes to benefits; increased need to justify eligibility for services and benefits; increased travel time to services that had previously been near.

3.4 The effects respondents described this had had on them varied from not much effect to "nuisance" to "feeling ditched", "rejected" and suffering increased stress as well as financial and mental health problems.
3.5 In addition to the poverty and inequality already affecting residents’ everyday life, deprivation and lack of services are also taking their toll on the community. Newham Council’s youth budget has been cut by 81% since 2010, and many residents link the disappearance of youth services to the increases in violent crime: in 2017, Newham recorded the highest number of murder investigations of all London boroughs and an increase in violent crime by 7% compared to the previous year. A quarter of the capital’s acid attacks between 2010 and 2017 took place in Newham.

3.6 As a consequence of the cuts to central government funding, over 90% of councils in England plan to raise council tax and increase charging for services in 2018. This will have significant impacts on residents, especially those on low incomes, who will end up paying more for less services.

3.7 In 2013, council tax benefit was replaced by local council tax support, which does not cover 100% of council tax for the poorest residents, something the previous system did.

3.8 In Newham as in many other councils, the maximum reduction in council tax a working age person can receive is 80%, meaning that many people already on low incomes are now hit by extra living costs. Cuts to services, reductions in housing benefits and the removal of council tax benefit have increased financial hardship especially for the poorest residents.

3.9 After the 2013 reforms, council tax became the most common problem debt for which people approached Citizens Advice Bureau. It is also one of the only debts people can be imprisoned for not paying.

3.10 Due to its regressive nature, council tax is not an adequate basis to finance local government in the UK.

4. LOBO loans and unsustainable borrowing

4.1 Local authorities spend a significant amount of income on interest payments on their debt. Loan repayments and interest payments are ring-fenced, which means that reducing them is not an option when cuts are imposed. Essential services are impoverished instead with significant impact on residents, especially the most vulnerable.

4.2 Debt owed to banks by local authorities comes mainly in the form of Lender Option Borrower Option loans. They are typically very long-term loans up to 70 years and start
with a given interest rate that can be fixed or variable. The main feature is an embedded option: As part of the contract the lender (bank) has the option to propose, on predetermined future dates, such as every 6 months or every 5 years, a new rate. The borrower (the council) then has the option to either accept the new rate or repay the entire loan in full, without penalty. If the bank does not exercise its option to change the interest rate, the council can only exit the loan by paying a very high exit fee (breakage fee) which is entirely at the discretion of the bank.

4.3 240 councils across the UK have taken out loans from financial institutions in the form of LOBO loans.

4.4 Prior to 2003 council borrowing was very much controlled by central government. The Prudential Code introduced by the 2003 Local Government Act gave local authorities powers to set their own borrowing limits and to borrow from ‘any willing lender’ (as long as in GBP sterling) without consulting central government, provided the borrowing was ‘socially sustainable’. However, the code did not clarify how in practice individual councils should determine and measure the social sustainability of borrowing. The introduction of the Prudential Code resulted in a substantial increase in borrowing post 2004, which appears to be neither prudent, nor sustainable.

4.5 Local government finance is unregulated by the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) which has considered local authorities to be ‘sophisticated’ borrowers. The term suggests that councils are expected to hold the necessary experience and knowledge to fully understand risks when borrowing and investing, as if they were equals with investment banks.

4.6 Historically, after a ruling known as Hammersmith and Fulham v. Hazell (High Court 1989, upheld in the House of Lords 1991), councils were banned from taking out derivatives and gamble with taxpayer money.

4.7 Many of the banks that sold councils LOBO loans are now allowing them to exit the loans early due to public pressure. However, this does not address the underlying problems with local authority funding that leads councils to rely on short-term funding fixes and behave like profit-seeking private companies. Local authorities need to be guaranteed stable funding from the government to meet residents’ needs.

5. Lack of oversight

5.1 There is no one authority that would oversee local government finance. Local authorities are supposed to be accountable to central government through the Ministry for Housing, Communities and Local Government (MHCLG) and HM Treasury, but also
through other departments for specific grants and related services, for example the Department of Education for education and children’s services, and the Department of Health for adult social care and public health. The MHCLG also publishes statutory guidance for councils on investments and minimum revenues provision.

5.2 Concerns regarding the effectiveness of scrutiny of local government by the MHCLG were raised in June 2018 by the Public Accounts Committee inquiry on the “Financial sustainability of local authorities”: “The Department does not have a consistent and transparent method to assess financial risk in local authorities. [...] There is therefore no shared definition of what financial sustainability means in practice in the local authority sector. In particular, the Department is not able to say at what specific point it would have a concern either about individual local authorities or the sector as a whole. This lack of information on the Department’s understanding of financial risk amongst local authorities complicates both assessing risk in the local authority sector and holding the Department to account. It also raises a concern that the Department lacks a clear methodology for assessing risk on a consistent basis. Similarly, the Department does not make public any of the work underlying its bid as part of the government’s 2015 Spending Review, which determined how much money the Department will have over the following four years, and how much government funding local authorities will receive.”

5.3. With the 2014 Local Audit and Accountability Act, the responsibility for audit of local government was handed over to private audit firms, such as the big four.

5.4 The big four accountancy firms undertake audit and consultancy work for both councils and corporations councils have contracts with. Concerns have been raised regarding the auditors’ conflicts of interest and their reluctance to flag corruption that could affect fee-paying clients. Following the collapse of Carillion in January 2018, calls for regulators to break up the big four accountancy firms have intensified.

6. Conclusion

6.1 The current funding regime is not fit for purpose. When councils try to make ends meet by increasing business rates and council tax locally, this has a significant impact on residents. Local authorities are at a breaking point where they are failing residents, especially the most vulnerable and those who most need local services. To guarantee the functioning of local government in the UK, urgent changes are needed, such as the return to increased central government funding, better oversight of financial decision-making and steps to ensure that services for the poorest, most marginalised and vulnerable are protected.

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