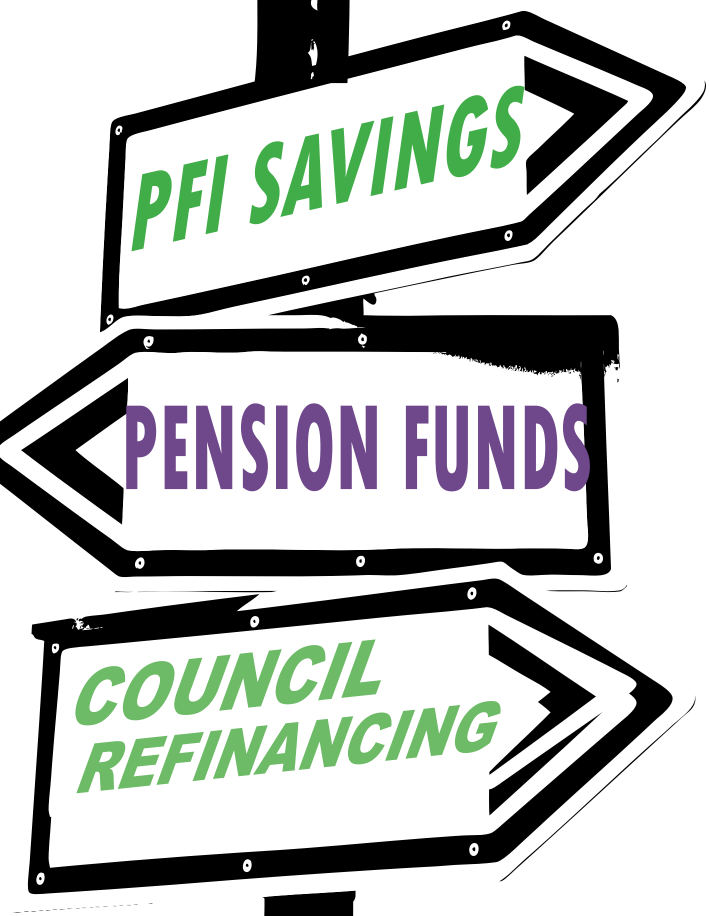
UNISON Scotland



COMBATING AUSTERITY

Signposting the ways Scotland could limit some of the damage

Contents

Join us in combating austerity by campaigning and by limiting the damage

Key Messages

The Conservative Government's austerity programme will result in around a further £2 billion of cuts to Scotland's public services.

There is a broad consensus across Scotland that austerity is damaging to public services and the economy. UNISON Scotland is part of the campaign against austerity.

As part of combating austerity we should also look at practical ways in which the Scottish Government, councils, health boards and other public bodies can mitigate against the worst of the cuts to come. Every sensible mitigation measure government and public authorities can take reduces the number of job losses and damage to vital public services and the economy.

This paper offers signposts to measures that would help combat austerity including:

- Contract buyouts and/or refinancing of expensive PPP/PFI projects;
- Refinancing of council and other public bodies debt;
- Imaginative use of council prudential borrowing and bonds;
- More efficient and effective use of local authority pension funds;

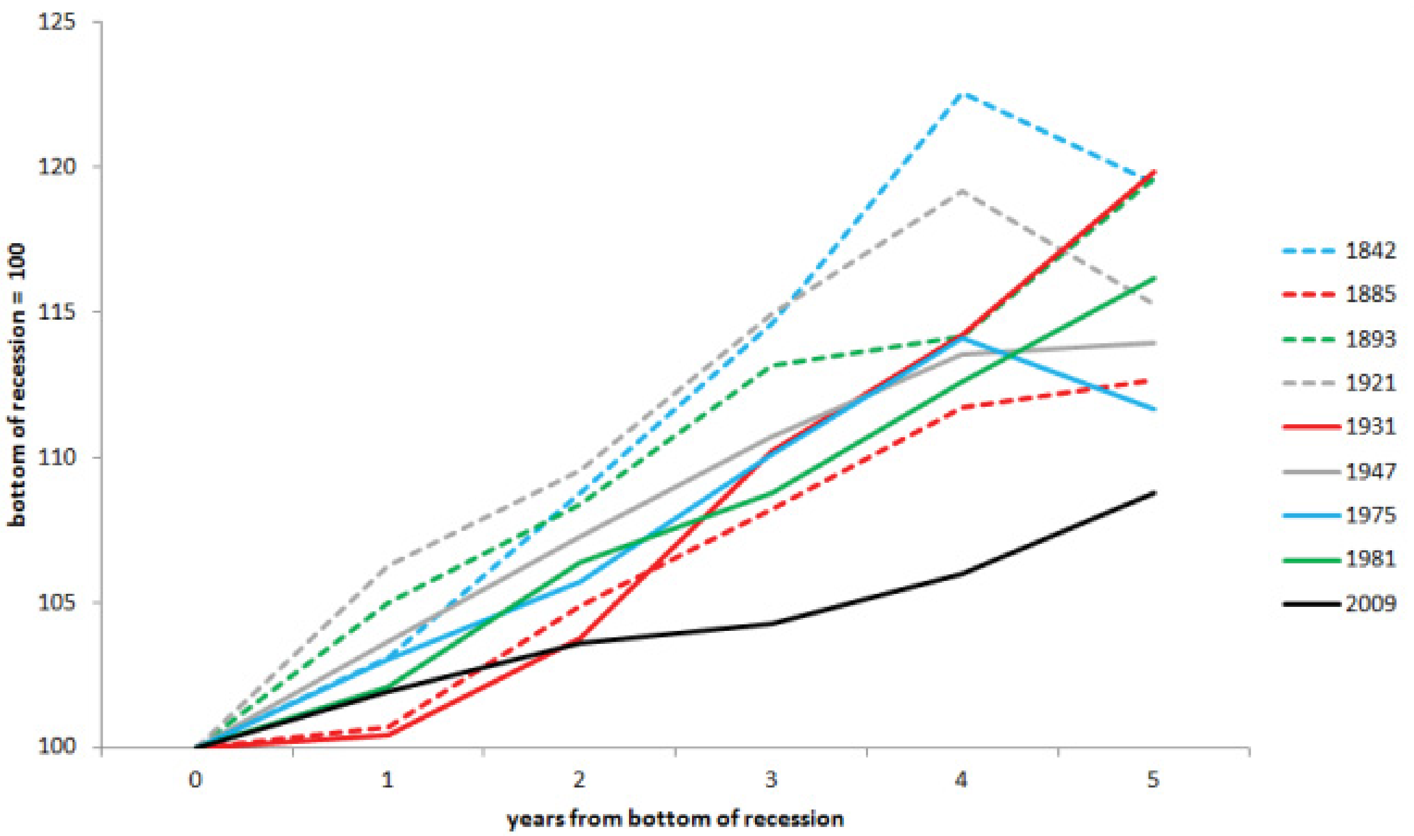
"Every sensible mitigation measure government and public authorities can take reduces the number of job losses and damage to vital public services."

Mike Kirby, Scottish Secretary

Introduction

The election of a majority Conservative government at UK level means a further ideological assault on public services. The emergency summer budget gives an indication of their spending plans and confirms a further period of austerity that has already caused untold damage to public services in Scotland and the wider economy. The slowest recovery from recession on record is evidence of this.

The UK Autumn Statement will give us a clearer indication of the scale of the impact on Scotland and the negative Barnett consequentials of cuts in England. The Scottish Government will then have to make difficult choices in their own Spending Review that has wisely been deferred until November.



Our primary campaign aim is to bring an end to austerity, by highlighting the impact on public services, the economy, jobs and wages - and making the case for our alternative strategy. We have covered these issues in our report 'Austerity Economics Don't Add Up' and our monthly damage series of reports that look at the impact of austerity on specific services.

While this remains our primary focus, we also need to explore practical ways to mitigate against these cuts. Every sensible mitigation measure government and public authorities can take reduces the number of job losses and damage to vital public services. In the Thatcher era we devised strategies to limit the damage of that government's policies. We need to be just as imaginative now when faced with an equally ruthless government.

This paper examines a number of possible initiatives to achieve this aim. It is very much work in progress and aims to signpost areas for consideration. Devolution gives Scotland some additional options using the powers we have and those we will gain through further devolution.

We will also want to work closely with colleagues across the UK who are working for similar outcomes.

As during the Thatcher era, this activity is most effective when public bodies and wider civil society work collaboratively. We would therefore welcome views on this paper from those who share our objectives.

We welcome views on this paper. Please contact:

- **Dave Watson, Head of Bargaining and Campaigns, UNISON Scotland**
- **d.watson@unison.co.uk**
- **UNISON Scotland's Bargaining and Campaigns team on 0141 342 2811**

Austerity

The austerity measures imposed by the last Con Dem Coalition and now the new Tory Government have caused untold damage across the UK - damage to the economy and in the full blown ideological assault on public services that is the real reason for austerity, shrinking the state.

The human cost can be seen in the effects on jobs and wages, with increasingly insecure employment and with pay for ordinary families down dramatically through pay cuts and freezes, and set to fall further, while the rich keep on getting richer.

It is illustrated most starkly in the cruelty of benefits for the most vulnerable being slashed and the scandal of punitive and controversial work capability assessments, with figures recently released showing many ill and disabled people died soon after being found fit for work.

And it is seen in the disgrace that in modern Britain thousands and thousands of people are forced to turn to food banks to eat.

The Trussel Trust has reported a 19% year on year UK rise, saying that their 445 food banks distributed enough to feed nearly one million people for three days in 2014-15, including a total of 116,789 in Scotland, up from 71,428, which itself was up 400% in three years.

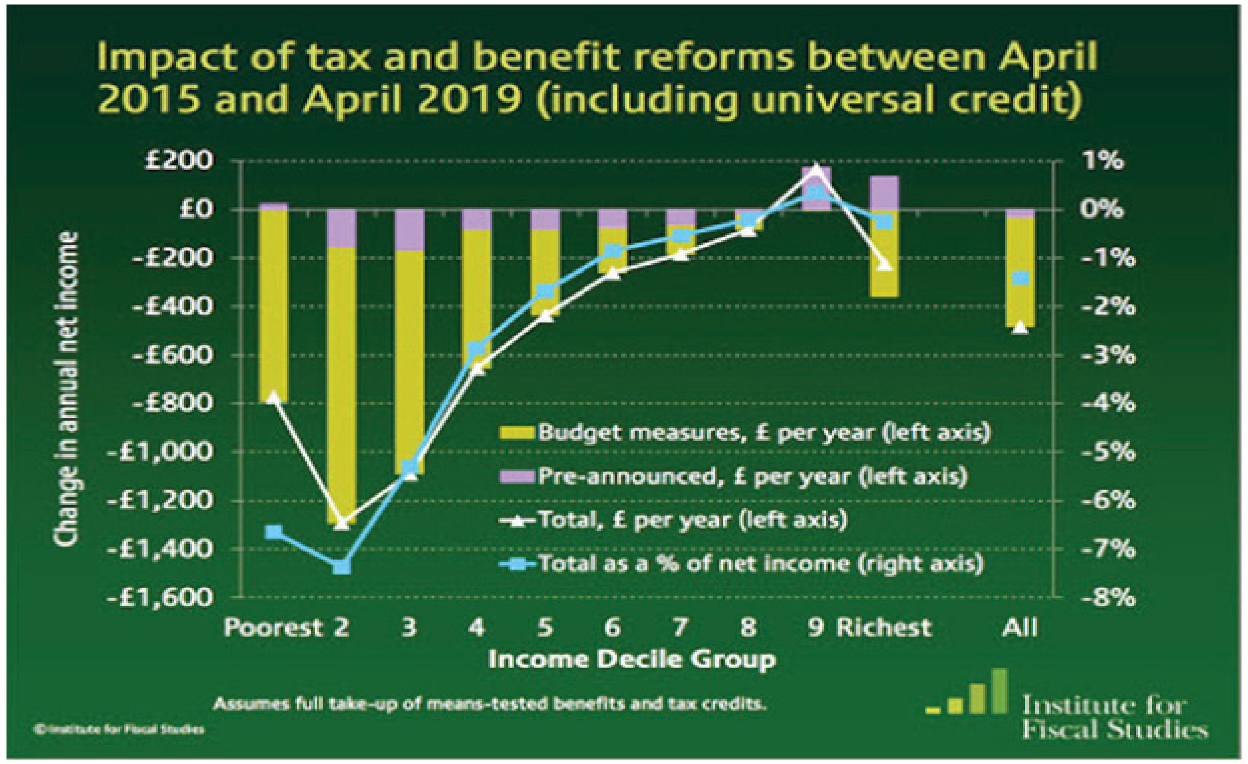
Meanwhile, the sleight of hand con trick of Chancellor George Osborne's so-called 'national living wage' will not counter the effects of the major benefit cuts he is making to slash £12 billion from the welfare budget.

A new Joseph Rowntree Foundation analysis of the impact of the July budget, found that single parents on low incomes will see their living standards going down sharply over the next five years, even if they work full-time, because of the changing relationship between pay, benefits and work incentives.

The Guardian reported: "The new research confirms that for many low-paid workers, the pay rise will leave them no better off...Even families in which both parents are in a minimum wage job will find it harder to afford a decent standard of living by 2020...unless both work full-time – a pattern which only applies to 6% of low-income families."

Those who benefit most from the budget overall will be the richest 10% of households, according to TUC research. They will be £780 a year better off by 2020, from changes including inheritance tax cuts.

The average public sector worker is currently around £2,000 a year worse off than in 2010.



This chart from the Institute for Fiscal Studies shows their damning assessment of the impact of the budget.

Instead of this rising inequality, which is damaging to the economy and to society as a whole, we should be ensuring that everyone shares in a growing, healthy, green economy.

UNISON's proposals include an active economic and industrial policy aimed at creating full employment, with investment in housing and infrastructure and green energy production, quality jobs, fair taxation and a crackdown on tax avoidance. We need a real Living Wage[1] paid by all employers, public, private and voluntary/charity sector.

In Scotland more than 50,000 public service jobs have been axed since 2009 and it is truly frightening to think of the impact of a further £2 billion of cuts to public services here. That could mean another 30,000 jobs will be lost along with untold damage to services we all rely on, but which are particularly important for those on lower incomes.

Last year's UNISON report Austerity Economics Don't Add Up[2] showed that the massive cuts weren't even doing what Osborne claimed they were for, and that the debt was rising, with the Coalition borrowing more in five years than the last Labour government did in thirteen.

We reported on Oxfam's warning that with inequality and poverty on the rise,

1 http://www.livingwage.org.uk/what-living-wage
2 http://www.unison-scotland.org.uk/publicworks/AusterityEconomics_Oct2014.pdf

Europe can expect “a lost decade” with an additional 15 to 25 million people across Europe facing the prospect of living in poverty if austerity programmes continue.

The election of Jeremy Corbyn as Labour leader with an overwhelming mandate to oppose austerity, as well as the Scottish general election result which saw an SNP pitching itself as anti-austerity wiping the other parties almost off the map, shows there is public support.

We believe that the public wants to see a fairer society for everyone, including welcoming refugees fleeing war zones, not slamming the door on them and on the most vulnerable people here, victims of the war on the poor.

There is also strong support from economists. A letter in the Guardian in August signed by more than forty leading figures, including David Blanchflower, a former member of the Bank of England’s monetary policy committee, said they didn’t all back Jeremy Corbyn but that “his opposition to austerity is actually mainstream.”

Former SNP leader Alex Salmond made a similar point on BBC Question Time on 16 September.

The economists’ letter said: “Despite the barrage of media coverage to the contrary, it is the current government’s policy and its objectives which are extreme.

“The attempt to produce a balanced public sector budget primarily through cuts to spending failed in the previous parliament. Increasing child poverty and cutting support for the most vulnerable is unjustifiable.

“Cutting government investment in the name of prudence is wrong because it prevents growth, innovation and productivity increases, which are all much needed by our economy, and so over time increases the debt due to lower tax receipts.”

We need decent work, and dignity for those who can’t work. There is a better way.

Savings from PPP/PFI projects

- **PPP is an expensive form of borrowing. With interest rates at historic lows, refinancing or contract buy-outs could save up to £12 billion**
- **There should be rigorous monitoring of contracts to ensure the public sector is getting what it is paying for**
- **Health and Care Partnerships are an opportunity to use council borrowing powers in health projects like the Hub Initiative**

With interest rates at historic lows, now is an ideal time to review the cost of Scottish Public Private Partnership and Private Finance Initiative schemes, deals that were signed when interest rates were much higher.

It is widely accepted and understood that PPP/PFI projects have been extremely expensive ways of funding new hospitals and schools.

Estimates of how much the public sector could save now through buying out PPP, PFI and so-called Non Profit Distributing PPP contracts range as high as £12 billion in Scotland.

Table 1: Overall unitary charge payments – PFI and NPD

	Number of projects	Payments made by 2012-13 (£m)	Estimated future payments (£m)	Total (£m)
PFI	83	6,388.4	24,547.8	30,936.1
NPD	12	173.3	4,193.1	4,366.4
Total	**95**	**6,509.3**	**28,793.2**	**35,302.6**

There have been ongoing, and very recent, calls for PFI NHS debt in particular to be bought out in England[1] and we would obviously support proposals from the new Labour leader Jeremy Corbyn for quantitative easing to support investment. While Scotland doesn’t have the powers to do this, if the UK government did, it would provide another way of using cheaper conventional financing to buy out PFI debt, with a massive saving to the public purse. UNISON Scotland has argued repeatedly for contract buyouts where this results in savings, and did so again in June.[2] We have also said that health boards should be given prudential borrowing powers, like councils have, which could help them in refinancing expensive deals.

1 http://leftfootforward.org/2015/09/pfi-is-still-crippling-our-public-services/
2 http://m.heraldscotland.com/news/13414284.Calls_to_renegotiate___500million_a_year_PFI_contracts_crippling_Scots_councils/

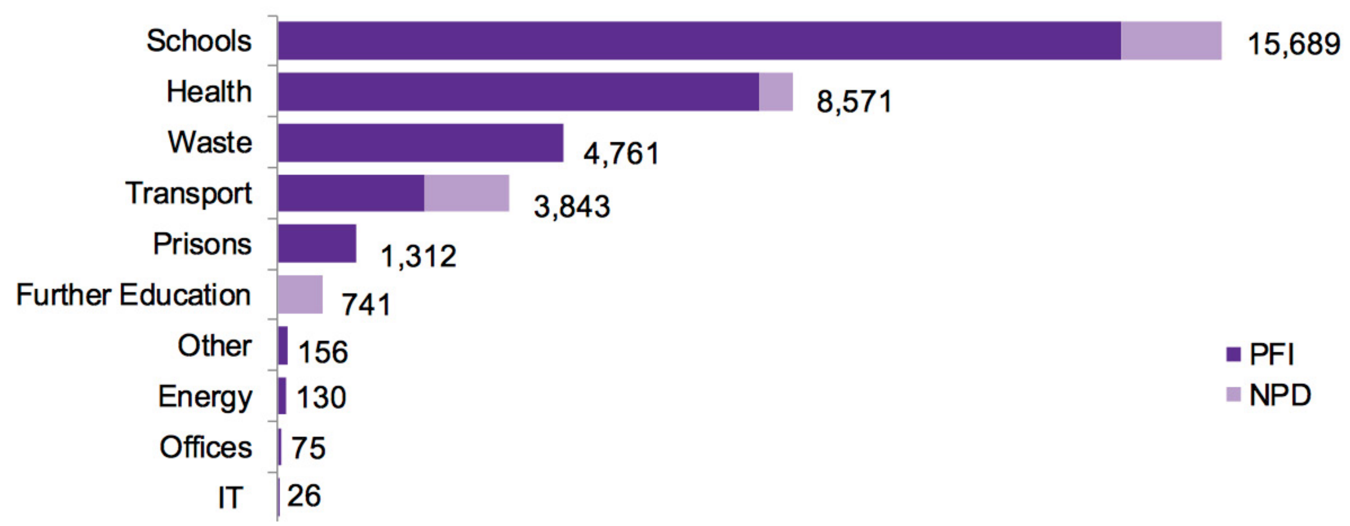
In 2011 a Scottish Futures Trust report on operational PPP/PFI and NPD projects did not calculate savings that it acknowledged were possible, arguing that "termination would bring assets back into the public sector for accounting purposes and the capital budget required for this is not currently affordable."

The report's conclusion that there was a poor case for refinancing in terms of margins in the financial markets and Public Works Loan Board rates is now completely outdated.

The position must be reviewed, with lessons to be learned from the buyout last year by Northumbria Healthcare Foundation NHS Trust of its PFI contract at Hexham General Hospital, saving £67 million.[3] This was funded by a loan from Northumberland County Council, which borrowed from the PWLB.

We want to see the Scottish Futures Trust at a minimum working with health boards and councils to examine the costings for buying out contracts, or for refinancing them at cheaper rates, potentially providing income for councils if they provide the funding for health boards.

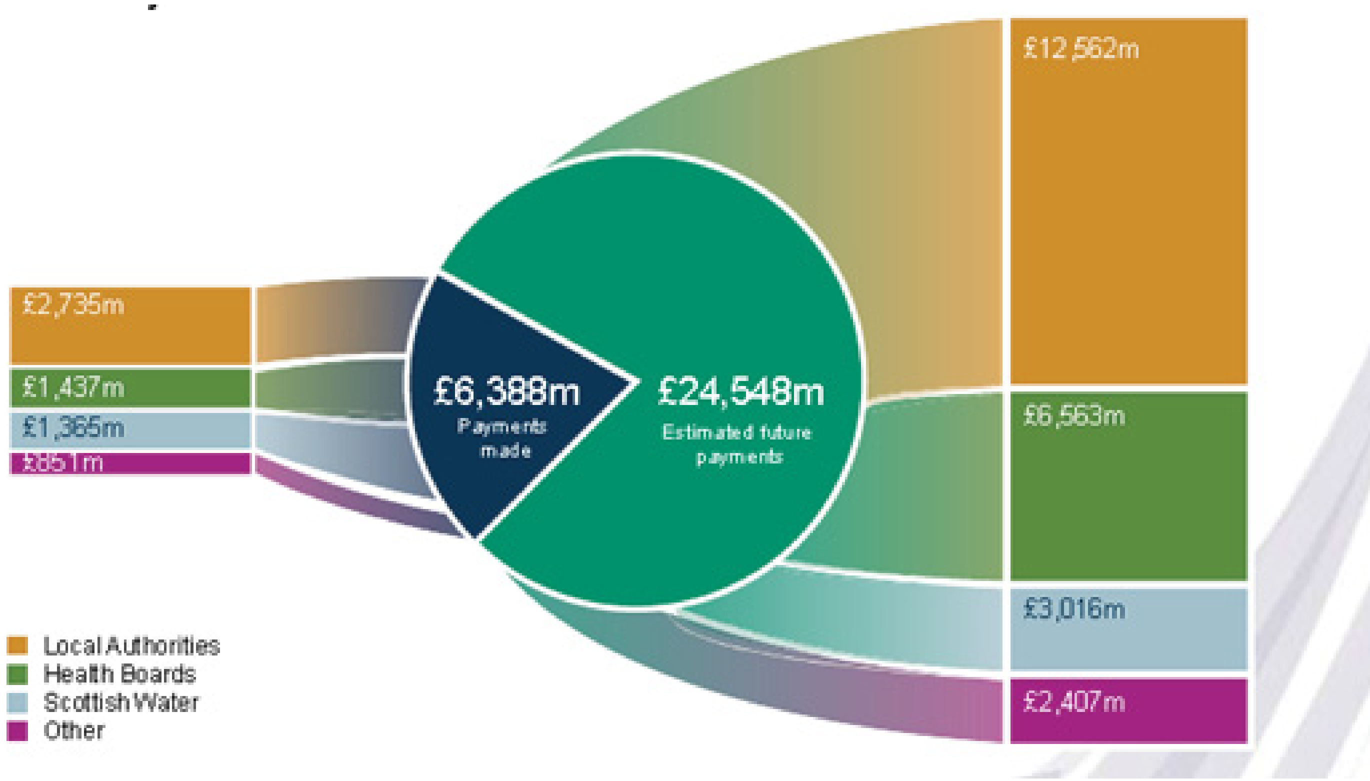
Figure 9: Overall unitary charge payments: sectoral split[2]



3 http://www.independent.co.uk/life-style/health-and-families/health-news/northumbria-nhs-trust-saves-67m-by-freeing-itself-from-pfi-deal-9517844.html

It would make sense though for the Scottish Government to take a more strategic approach and look, with the SFT, at a major programme of buying out contracts where this makes financial sense.

Labour's former shadow Scottish health secretary Neil Findlay proposed in December 2014, when standing to be Scottish Labour leader, that the Scottish Government should set up a debt disposal department dedicated to raising funds to buy out the total outstanding £28.8 billion PFI and NPD debt on operational contracts.[1]



From SPICE April 2014 briefing 14/29 Revenue-financed investment: the size of Scotland's PFI and NPD liability http://www.scottish.parliament.uk/ResearchBriefingsAndFactsheets/S4/SB_14-29.pdf Shows a total PFI debt of £24.5 billion in future payments. A further £4.2 billion remains in future NPD unitary charge payments, from a total PFI and NPD debt of £35 billion, of which £6.5 had been paid.

The Scottish Government should take this idea forward, making use of its new borrowing powers. Mr Findlay's campaign estimated up to £12 billion could be saved based on calculation methods from the 2011 House of Commons Treasury Select Committee PFI report [2] and on low interest rates.

1 http://www.scotsman.com/news/politics/top-stories/neil-findlay-proposes-pfi-debt-buy-back-1-3625928
2 http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/1146.pdf

His team based their figures on the government borrowing on international gilt markets at around 2.8% for 25-30 years, noting that the Select Committee report suggested most PFI contracts were financed at an interest rate of around 6 to 8%. Since November the 30 year government bonds have come down further, to 2.52%. (Financal Times Markets Data, accessed 15 Sept 2015.) However, they acknowledged the figures came from a uniform calculation, whereas contracts vary, with some including Facilities Management Services, and "tough negotiations" may be required.

Mr Findlay said at the time: ***"It would be financial madness to buy a house on a credit card yet that is exactly what we are doing with PFI and NPD. In some cases we are paying double digit interest rates on some existing PFI projects while at the same time interest rates on the money markets are at a record low.***

"It would be politically negligent and financially irresponsible if we didn't use these extremely low interest rates and pay off the current debt. We will be saving millions every year in interest repayments, money that will go into services, not offshore bank accounts of hedge funds that now own most of the PFI contracts".

If it takes some time for this to be implemented, there should in the meantime be rigorous ongoing monitoring of contracts to ensure the public sector is getting what it is paying for. Recent work by the SFT with councils and health boards on this has been delivering savings, but much more could be done.

(A recent example is one multiple schools contract where a council was offered £400,000 by the contractor, money that it was due as part of a sharing mechanism for reductions in insurance premiums. On examination it was discovered the council was in fact owed £800,000, not an inconsiderable error. Similar checks could potentially deliver hundreds of thousands of pounds for public bodies.)

The Scottish Government made the right decision on using conventional funding to build Glasgow's new, and newly renamed, Queen Elizabeth University Hospital.

Let's see it use that common sense in looking at the rest of Scotland's infrastructure projects. If even only a few are bought out as a result, the savings could be enormous. As The Herald said in June, with rising PFI costs and "fantastically low" interest rates, it's time "to play the market at its own game."[3]

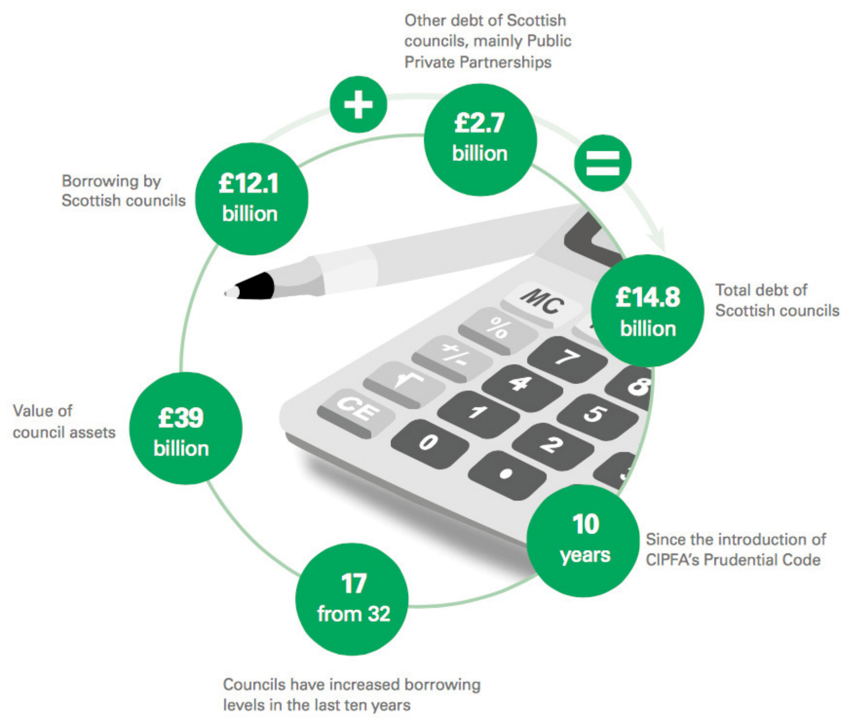
3 http://www.heraldscotland.com/opinion/13414335.Time_for_councils_to_play_the_market_at_its_own_game/

Councils refinancing savings

- **Councils in Scotland should collaborate in using bonds as a means of financing borrowing rather than routinely using the PWLB**
- **Councils should consider refinancing debt to take advantage of lower rates**
- **The repayment of funds regulations should be relaxed**
- **Councils should consider restructuring loans over a longer period**
- **LOBOs should usually be avoided as a form of borrowing contract**

Councils should review their existing debt and any investment plans to assess the potential for savings by looking at the use of bonds, and at refinancing and/or restructuring loans such as borrowing over a longer period.

Treasury Management and borrowing periods

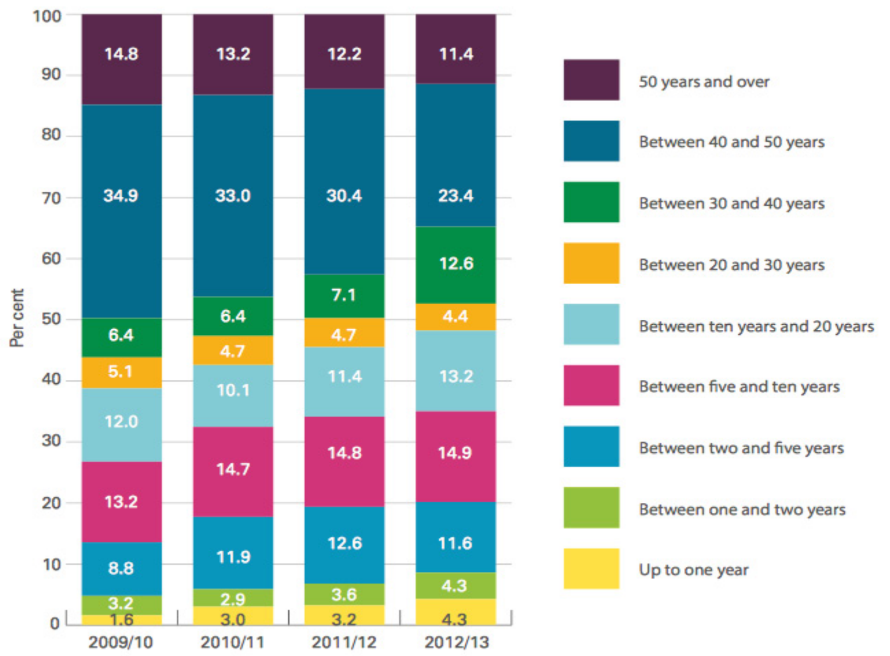


Councils have total debt of £14.8 billion of which £12.1 billion (82%) is from borrowing. Total council assets are £39 billion. Debt commits councils to charges over the long term and has been increasing, in real terms, in most councils over the last ten years.

While councils are following the general principles of the relevant codes of practice, Audit Scotland has recommended[1] that councils need to develop detailed analysis to support borrowing decisions and to demonstrate they represent best value for the council. This is a complex and technical subject not helped by job cuts and the loss of experienced staff. Audit Scotland has also recommended that the current governance structures in some councils could be improved to support more effective scrutiny.

The profile of borrowing is evening out and the percentage of loans maturing in over 20 years has fallen. At 2009/10, over 61 per cent of borrowing would mature in over 20 years; this decreased to 52 per cent by 2012/13. Around a third of councils' borrowing is due to be repaid in the next ten years (35 per cent), another third of borrowing will be due for repayment in over 40 years (34.8 per cent). While it is prudent for councils to have a mix of debt maturity, in difficult times such as these councils should consider increasing repayment periods to release revenue savings.

Exhibit 5
Scottish councils–maturity of total borrowing 2009/10 to 2012/13
Percentage of borrowing due to be repaid in the periods shown.



Source: *Capital Expenditure and Treasury Management*, CIPFA Statistics, June 2014

1 http://www.audit-scotland.gov.uk/docs/local/2015/nr_150319_borrowing_treasury_management.pdf

Loans funds rules consultation

The Scottish Government will shortly be consulting again on rules governing loans funds.

It seems likely the proposed rules for borrowing periods for repayment of loans fund advances will follow those from an earlier consultation, in 2011, the results of which have been under consideration by a working group including the Scottish Government, COSLA, CIPFA and Audit Scotland.

Those proposals[2] were for maximum periods reflecting the useful life of the asset, up to a maximum of 100 years for property, plant and equipment including council dwellings and other land and buildings, for community and heritage assets; 60 years for infrastructure; 50 years for vehicles and plant; and 20 years for furniture and equipment. This would extend the maximum periods for some types of loans from those set out in Finance Circular 29/1975,[3] currently in place.

The forthcoming consultation and expected subsequent changes should offer even more options/flexibility and we urge the Scottish Government to move quickly, especially given the inexplicable delays to date.

LOBO

One particularly controversial borrowing practice has been 'Lender Option Borrower Option' loans known as LOBO.[4] This is typically a very long-term loan, for example 40 to 70 years, where the rate is initially fixed, but the lender has the "option" to propose or impose, on pre-determined future dates, such as every 5 years, a new fixed rate.

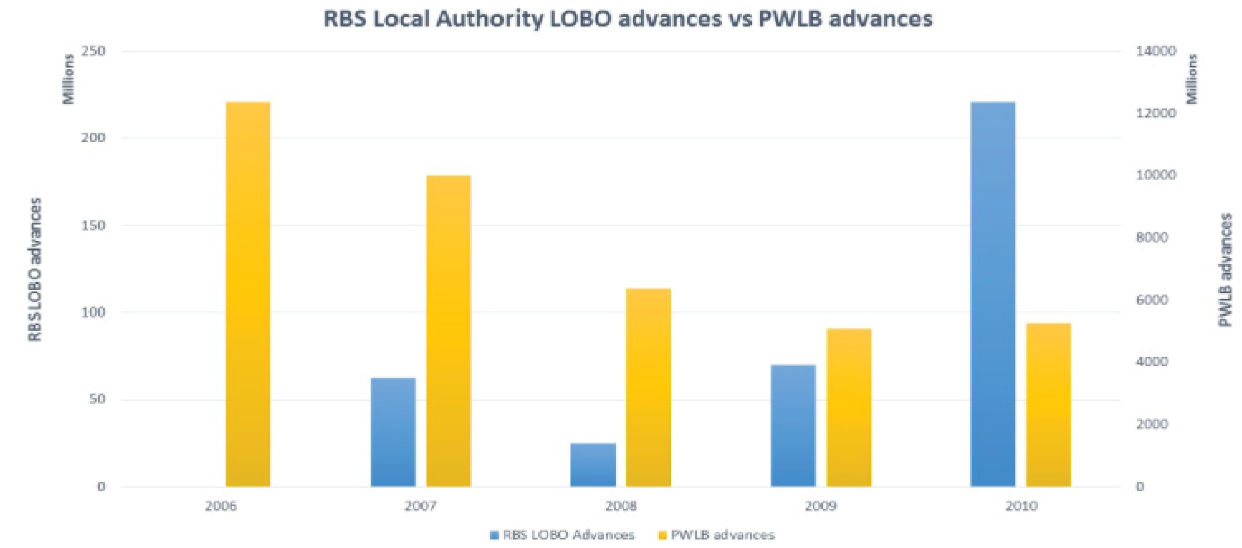
The borrower has the "option" to either accept the new rate or repay the entire loan. If the local authority chooses to repay the loan early (for example to access a cheaper rate loan elsewhere) it would need to pay a "break penalty" to exit the loan, which given the pricing of derivatives in the contracts can cost multiples of the original loan principal. Councils are teased into these loans at low starting rates designed to undercut PWLB rates. However, because of the complexity of the contracts they are difficult to price over the long term.

As ex Barclays Capital employee Rob Carver put it: "You just need a Bermudan swaption pricer to know the relevant volatility surface, some kind of interest rate model calibrated to the appropriate processes and the full forward and spot curve."

2 http://www.gov.scot/Resource/Doc/1070/0119811.pdf
3 http://www.gov.scot/Topics/Government/local-government/17999/FinCirc29-75
4 http://www.ianfraser.org/how-city-banks-and-brokers-stitched-up-local-authorities-with-lobo-loans/

These skills are not immediately available in most council finance departments! An analysis of LOBO loan contracts shows that some councils are facing 7-9 % interest rates, which is more than twice the current rate of lending at the PWLB. With LOBO loans, Local Authorities are replacing safe fixed rate 50-year loans from Central Government with new variable rate loans that could end in 5 years time and need to be repaid in full. This creates a significant refinancing risk for councils.

Refinancing



Sources: Analysis of 455 LOBO contracts obtained from Local Authorities by DRUK Freedom of Information requests, PWLB Annual Reports

Borrowing through the Public Works Loan Board (with rates set by the Treasury) has traditionally been the cheapest way for councils and other public bodies to finance various projects. However, with interest rates at very low levels, some organisations have managed to raise funds at comparable or even below relevant PWLB rates.

In January 2015 Wheatley Group, Scotland's biggest social housing landlord, raised the last £50m of a £300m bond at 3.5 %.[5] Councils should be able to do better.

Current PWLB 30 year fixed rates are 3.56% (maturity)[6], 3.36% (Annuity) and 3.26% (Equal Instalment of Principal) as at 21 Sept 2015[2]. Although councils may qualify for a discount. Local authorities will choose different repayment methods depending on their capital financing strategies. A new bond scheme

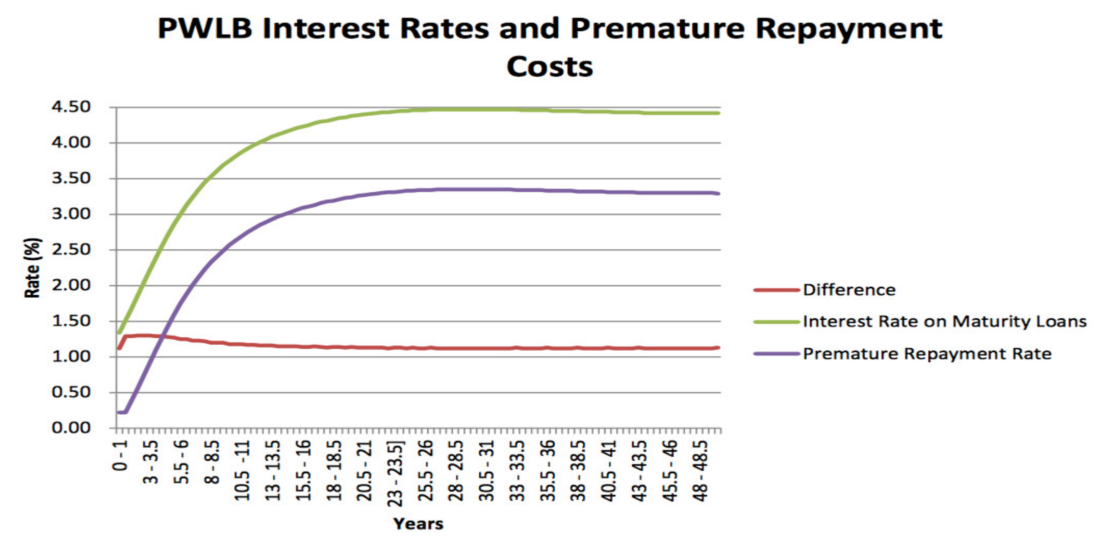
5 http://www.socialhousing.co.uk/news/wheatley-sells-50m-retained-bonds-at-record-low-rate-of-3542/7007962.article
6 http://www.dmo.gov.uk/reportView.aspx?rptCode=D7A.2&rptName=5dcc2ae9-2ee7-4ba9-9737-da782148db3b||PWLB%20(2)&reportpage=Current_PWLB_Fixed

about to launch for local authorities south of the border expects to offer interest rates 0.2 to 0.25 percentage points cheaper than PWLB rates.

Around 60 local authorities in England and Wales have joined together in the Municipal Bonds Agency, which has set up the Local Capital Finance Company. It has the express aim of reducing council's capital costs by arranging loans at cheaper rates than the PWLB or if councils were to issue their own bonds. They plan to use the loans not just for economic development, housing and similar projects but also to refinance existing borrowing.*

The Local Government Association, which worked to set up the agency, estimates council savings on financing costs over 30 years could be as high as £1.45 billion. A March 2014 report to the LGA Executive, reviewing the outline business case and making next steps' recommendations,[7] said that with a joint and several guarantee they should be able to reduce costs versus the PWLB by 20 to 25 basis points. The report calculated that on a £100m loan, this equates to annual savings of £200,000 to £250,000 or £6 to £7.5 million over a 30 year loan.

Scottish local authorities should consider a similar initiative, whether by working together with one council taking the lead, or by, if necessary, pursuing powers to borrow from an agency founded on a joint and several guarantee. While there may be legal and financial issues with some debt agreements, making them unsuitable for refinancing, if half of the outstanding £9 billion of debt of Scottish councils currently with the PWLB was transferred on the above basis, the savings could potentially be between £270m and £337.5m over 30 years.



7 http://www.local.gov.uk/documents/10180/11531/MBA+Report+Final.pdf/037bbcf0-e7f5-4f06-946e-98e7e824ce49

The PWLB does have punitive repayment costs and this needs to be addressed. However, it is still often cheaper to adopt a repayment strategy.

There is also scope for councils issuing their own bonds, and for refinancing existing debt on the open market, where interest rates are historically extremely low.

Health and social care partnerships

New health and social care partnerships could also access funds through local authority prudential borrowing powers. This could be used to finance shared infrastructure, currently being done very expensively through the five hubcos.

Using council powers for wider purposes was at one stage an early proposal for the Scottish Futures Trust. And with both councils and health boards being forced to make austerity cuts, all potential options for new financing should be explored thoroughly, particularly as this could generate income for councils.

Income Generation

- **Building a consensus on reform of local taxation should be priority for all political parties in Scotland**
- **This should lead to consideration of new forms of local taxation**
- **Charges are generally a regressive way of plugging financial gaps caused by the Council Tax freeze**
- **Councils should consider new forms of municipal enterprise like energy generation**

Charges

Councils generate income from a range of sources. The main increase in recent years has been charges.

UNISON Scotland research[1] has highlighted increased charges for local services since the council tax freeze was introduced. An Audit Scotland[2] report confirmed that the income that councils raise from charges has risen over the last decade and is estimated at some £1.3 billion, or approximately 7% of a council's overall expenditure. That's equivalent to over 50% of the amount councils raise through council tax.

Many charges are regressive in that they hit those least able to pay, while the Council Tax freeze benefits wealthy householders the most. However, not all charges have this effect and councils should review their charging regimes to establish sources of income that are progressive.

For example, as part of the review of local taxation a number of organisations have recommended new initiatives such as tourist and hotel bed taxes.

City energy generation

Another initiative UNISON has been encouraging councils to look at is energy generation.[3] Cities, in particular, should be engaging in the energy supply market where this can support efforts to tackle energy affordability/fuel poverty and to promote local renewables generation.

1 http://www.unison-scotland.org.uk/briefings/e-briefing_CouncilTaxFreeze_May2013.pdf
2 http://www.audit-scotland.gov.uk/docs/local/2013/nr_131031_hcw_charging_services.pdf
3 http://unisondave.blogspot.co.uk/2014/11/diversifing-energy-ownership-needs-more.html http://publicworksscotland.blogspot.co.uk/2015/09/power-to-people.html

Financing could come from options described in this paper such as council pension funds, prudential borrowing or local authority 'municipal bonds' or potentially from the Green Investment Bank. Another option may be for councils to team up with Scottish Water, which has a range of 'Hydro Nation' inspired energy generation projects and is actively pursuing more.[4] It aims to facilitate more energy generation than it consumes by 2018.[5]

Inspiring examples of city energy generation include Nottingham's not-for-profit Robin Hood Energy, which made it into the Which Top 5 Cheapest Energy Deals in September 2015.[6] The Western Isles Council has just announced a similar plan.

The newly published IPPR report City Energy: A New Powerhouse for Britain[7] gives examples like Aberdeen's plan to become a "global pioneer" in the use of hydrogen produced using excess power from nearby offshore wind farms. The report states: "City engagement in energy supply would unlock the potential of local generation and generate a new source of income for cities."

Reform of Local Taxation

The council tax freeze was supposed to be a temporary measure until a new tax was introduced. We have now been through an economic recession and 8 years of budget cuts but are no nearer a fair tax for local government.

The Commission on Local Taxation must lead to action. We cannot afford to see another report end up like "A Fairer Way: Report by the Local Government Finance Committee 2007" sitting on shelves gathering dust. We need to develop a new consensus that provides a long-term solution, providing adequate funding for the essential services that local government provides.

It is vital that services are properly funded and that everyone pays a fair share towards those costs. Businesses benefit too, that's why they too must bear a share of the costs. Taxation is the fairest way to fund local services.

Local government needs to be able to call on a range of funding sources to ensure that vital services that communities vote for can provide no matter what central governments impose. Scotland needs a fair progressive tax to replace the council tax. Business rate need to be returned to local authority control. This will not only give authorities more flexibility in setting its tax rates it also gives the opportunity to link rates to other community development plans: targeting cuts/increases in rates in line with measures which will save authorities money in other budgets. For example higher taxes for those businesses that create most refuse.

4 http://www.scottishwater.co.uk/investment-and-communities/investment-programme/energy
5 http://www.gov.scot/Resource/0045/00458322.pdf
6 http://www.which.co.uk/news/2015/09/top-five-cheapest-energy-deals-for-september-2015-409503/ http://www.theguardian.com/environment/2015/sep/07/robin-hood-energy-nottingham-council-launches-not-for-profit-energy-company
7 http://www.ippr.org/publications/city-energy-a-new-powerhouse-for-britain

Local Authority Pension Funds

- **Pension funds should be a source of funding for infrastructure.**
- **The investment regulations should be relaxed to give funds greater flexibility**
- **Fiduciary duty is not the constraint some claim it is, but if it is, government should consider legislation**
- **Pension funds should demand greater transparency over investment management fees and move to less active fund management**
- **Pooling or merging funds could result in significant cost savings and better returns on investment**

Access to funding for infrastructure investment has led to successive Scottish governments using expensive and inflexible private finance. The revenue cost of this is now beginning to be better understood and alternative sources of finance are being considered.

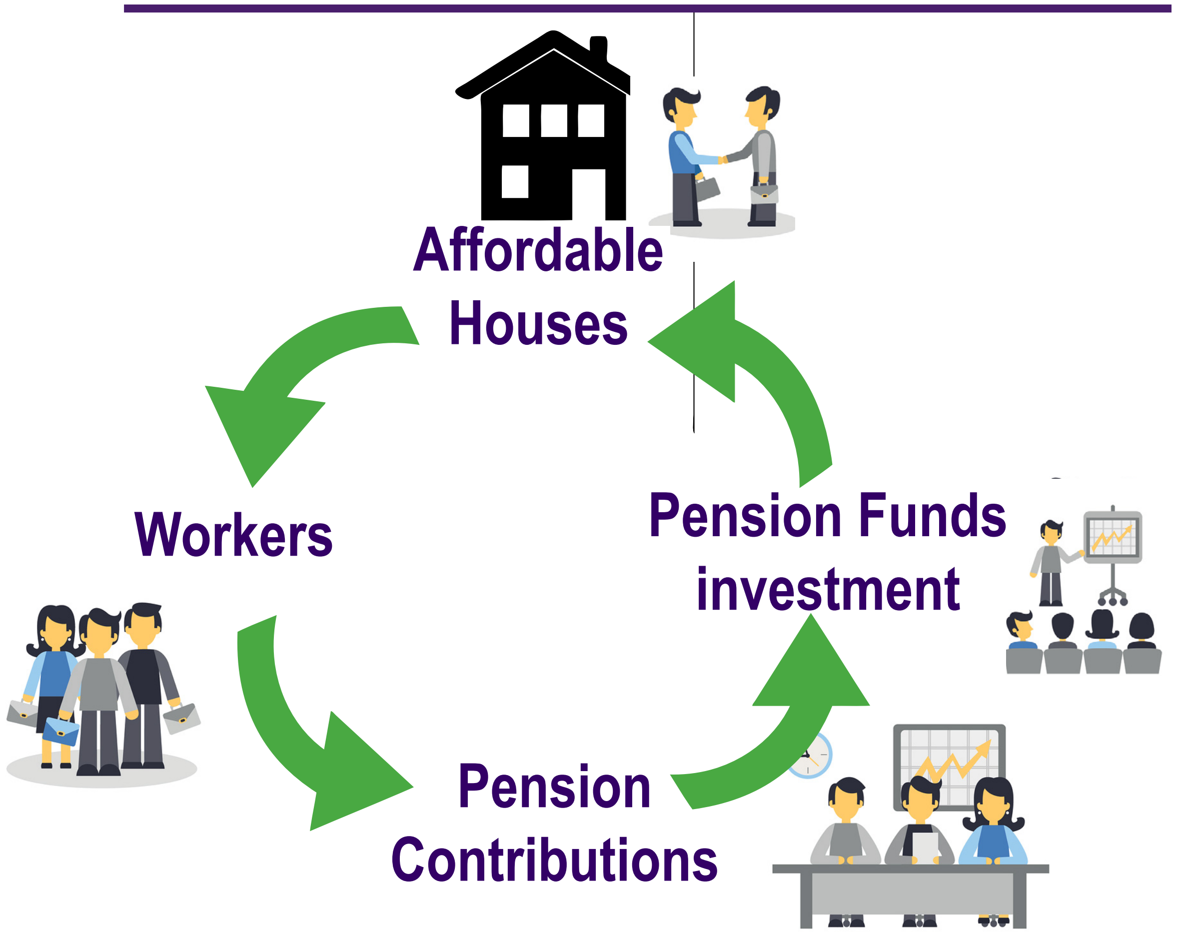
One huge source of funds that has largely been ignored is local authority pension funds.

The Scottish Local Government Pension Fund (LGPS) is a funded scheme administered by 11 funds with regulations devolved to the Scottish Government. The funds are currently valued at just under £30bn. The funds are currently invested in a range of areas including: 26% in UK equities, 45% in overseas equities and the balance mostly in gilts (7%), bonds (6%) and property (7%).

UNISON Scotland has previously suggested that the funds might be invested in infrastructure including housing. UNISON's report,[1] prepared with assistance from the Scottish Federation of Housing Associations, shows how this could be done.

1 http://www.unison-scotland.org.uk/housing/FundingAndBuildingTheHomesScotlandNeeds_Mar2013.pdf

Based on these ideas, Falkirk Council's Pension Fund Committee has agreed a £30 million commitment to Social and Affordable Housing in the Edinburgh area. They have also agreed a further £30 million commitment to investment in UK social and affordable housing, after reaching an agreement with Lothian Pension Fund to consider UK investment opportunities, identified as likely to afford further opportunities for collaboration.



Strathclyde Pension Fund has agreed 12 separate infrastructure and related investments with a total commitment value of c £275m (total value including other investors of over £1 billion). These range across a wide spectrum of projects throughout the UK and beyond but with a significant allocation to Scotland.

This is not unique to Scotland. In England the local government minister has announced plans to double the amount pension funds can invest in infrastructure projects. According to a survey by Greenwich Associates, many funds are reviewing their position and some have begun to change the balance of their portfolios to close mounting funding shortfalls while reducing volatility. The Greater Manchester Pension Fund has used their fund to invest in local housing projects with an initial 240 homes being built.

A report published by the Smith Institute, Centre for Local Economic Strategies, Pensions Investment Research Consultants and the Local Authority Pension Fund Forum has also highlighted the issue. The research showed that while fund managers said they wouldn't accept lower returns in exchange for delivering local benefits, it did detect a growing interest in finding new ways to invest generally and in maximising the social, environmental and economic impact of pension funds. Paul Hackett, Director of the Smith Institute said,

Funding and building the homes Scotland needs

A proposal by the union UNISON to develop a new stream of finance to provide much needed social and affordable housing in Scotland

March 2012

Introduction

This paper outlines a proposal from UNISON Scotland, developed with assistance from the Scottish Federation of Housing Associations, to finance social housing in Scotland. It recognises Scotland's current housing crisis and the cost of finance to build new houses for rent. In particular it looks at the potential for utilising local authority pension funds as a source of finance.

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"This group of people are very careful, they don't want to be in the spotlight but do "get it" and want to invest in projects with social and economic value. This is the right decision for the fund managers, who need to achieve higher returns than they are getting in the equity or bond markets, while the councils themselves win because it provides more affordable housing."

Richard Murphy of Tax Research puts it rather more forcefully, "At a time when conventional pension fund investment policy is simply guaranteed to lose people money in the UK because of inept management, market corruption and excessive charges why aren't pension funds being invested in things that we really need, like housing, where the payback over a period of, say, 25 years is exactly the sort of return a pension fund needs?"

In 2011 the UK Government established the Pensions Infrastructure Platform (PiP) to encourage and facilitate UK pension scheme investment in infrastructure. The PiP was developed as a result of discussions between the National Association of Pension Funds (NAPF), Pension Protection Fund (PPF) and HM Treasury. Subsequently developed for pension funds, by pension funds; the PiP is fully independent of government and offers future opportunities for investment in infrastructure and housing projects. A 'Memorandum of Understanding' signed in November 2011 noted that there is the potential for mutual benefit for the Government and pension funds from increased levels of investment in infrastructure. Strathclyde Pension Fund is one of the founding members of this venture.

The Scottish Parliament's Local Government Committee has taken a special interest in this issue as part of their budget strategy considerations.[2] They held a useful evidence session on this issue in April 2015 . The limitations include; rate of return, risk, internal expertise and the investment regulations. However, Barry White from the Scottish Futures Trust said: "I think that Scottish infrastructure and the Scottish economy could benefit from a more active investment style on the part of pension funds ". We agree.

There are limits on the amount a pension fund can invest in this category. Strathclyde Pension Fund officials have said that the limits in the regulations are no longer fit for purpose. Their view is that the 15% limit is arbitrary and, whilst they have not yet reached this limit, they are fast approaching it. The new Scottish Local Government Pension Scheme Advisory Board has the issue in its work plan and is likely to recommend relaxing this regulation. UNISON Scotland believes that the regulations are outdated and should be replaced by a broader duty and a code of practice. This does not mean we are in favour of using pension funds to invest in expensive private finance schemes.

Another quoted constraint is the legal concept of fiduciary duty, particularly when the investment is within the fund's geographical boundary. UNISON Scotland's view is that this is all too often interpreted narrowly. We have set out how pension funds should be interpreting this duty in a recent briefing.[3]

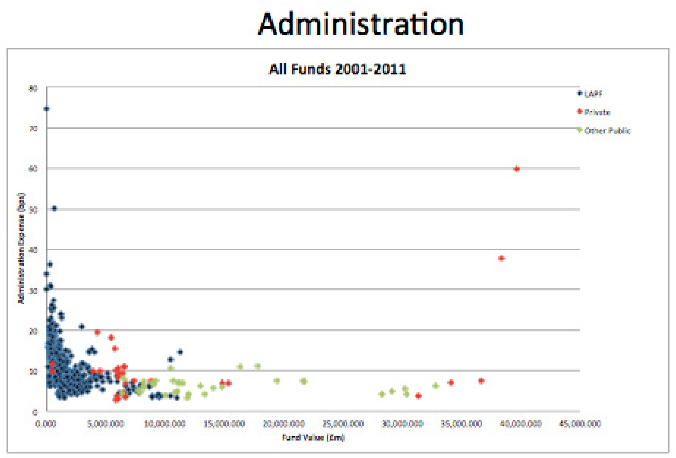
The primary duty of a pension fund is to pay member's benefits. However, within that primary purpose it is possible, and we would argue desirable, to make better use of Scotland's local authority pension funds. In some cases it may require the Scottish Government to underpin investments and relax the regulations. In others, the Scottish Futures Trust could assist in creating suitable investment opportunities outwith their PPP programme. It also requires pension funds themselves to think outside their current rather narrow approach.

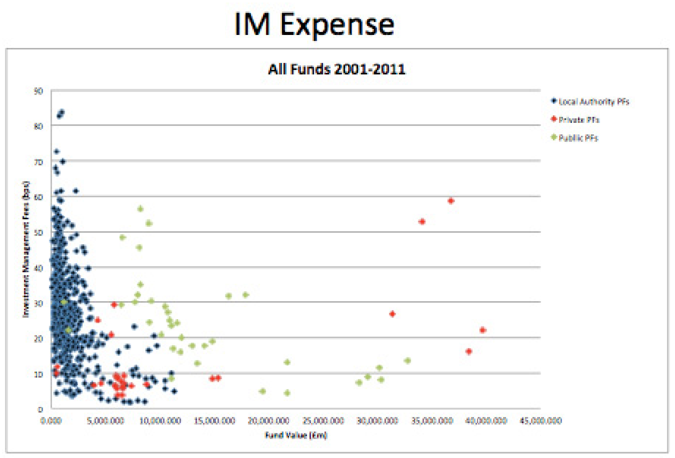
2 http://www.scottish.parliament.uk/parliamentarybusiness/report.aspx?r=9931
3 http://www.pensionsscotland.org/uploads/3/9/5/5/39556225/fiduciary_duty_briefing.pdf

In addition to a new approach to investment, significant savings could be achieved if local authority pensions funds were managed differently. At present huge transaction charges go unreported through the use of external fund managers. There is little evidence that active fund management is any more effective than passive fund management that generates much lower charges. Greater use of in-house staff would also obviate the need for these expensive services.

There are eleven funds in Scotland. This means there is significant duplication and charges to external advisors are being paid several times for the same or similar services. There is significant evidence that larger funds are more effective and the UK Treasury is currently preparing a consultation proposal for England that would create common investment vehicles (CIV) no smaller than £30 billion. If we applied the same approach in Scotland that would mean one Scottish pooled fund. A report commissioned by UNISON into Scottish funds showed that very significant savings and better investment returns could have been achieved in Scotland using a similar approach.

The charts below show how larger funds perform better, particularly when it comes to investment management.





The Cabinet Secretary for Finance has rightly asked the Scottish Local Government Scheme Advisory Board to give consideration to this issue.

Future Powers

This paper has focused on actions that could be taken in Scotland under existing devolved powers.

The Scotland Bill 2015/16 is progressing through Westminster at present and the Calman Commission powers come into force in April 2016.

These powers may create opportunities to consider further ways that Scotland can use these powers to combat austerity. Examples include using new borrowing powers, albeit constrained unnecessarily by Treasury rules.

There also needs to be a debate about how Scotland uses increased fiscal powers. The Scottish Government has taken action over the replacement for stamp duty, land fill tax and created Revenue Scotland. It also briefly used new forms of taxation including the public health supplement on large retailers. We should consider other forms of taxation that raise revenue, but also support public policy goals such as tackling inequality and climate change.

The next big debate will need to be over income tax. There will be a reluctance to use the Calman powers because of their constraints on rates between bands. However, most of those constraints are likely to be lifted under the Scotland Bill 2015/16, if agreement can be reached on the important fiscal framework.

While this paper is aimed at immediate practical measures, we should not avoid a longer term debate over fiscal strategy.

Conclusion

UNISON Scotland is opposed to austerity and continues to fight, with other trade unions and with civil society organisations to make the case for investment in quality public services and proper funding for the necessary Just Transition to a low carbon economy.

However, given the scale of cuts being imposed by the UK Government, it makes sense to also do everything within our powers in Scotland to mitigate against the worst of the cuts as they will hit public services very, very hard in the next few years.

All public bodies should be examining the options discussed here, as part of their budgetary processes. The Scottish Government, should fully support a wide range of mitigation measures, by making any relevant policy and legislative changes; for example, in allocating financial support if needed for buying out PPP/PFI contracts and in making any necessary regulatory changes as identified above.

We would encourage everyone interested in mitigating the effects of austerity to come together to work on developing these and similar proposals in the coming months. We hope we provided some signposts and that this will be the start of a national conversation.

We welcome views on this paper. Please contact:

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