



# **TOUGHER TIMES, SMARTER WAYS**

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## **AN ASSESSMENT OF LOCAL AUTHORITY FINANCES**

**NOVEMBER 2009**

**△ CREDO RESEARCH PAPER**





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# FOREWORD

This paper sets out to analyse the impact of the economic downturn on Local Authority finances, and how this impact might be mitigated through innovative approaches to service delivery.

The study brings together information on a cross section of 150 Local Authorities across the UK. We evaluate their financial resilience and financial prospects going forward.

We then consider the merits of outsourcing as a tool to manage shrinking budgets whilst maintaining and improving excellent service levels.

The Government's reluctance to commit to any concrete spending plans means that it is more important than ever to be prepared for tougher times.

# EXECUTIVE SUMMARY

## PART 1 - LOCAL AUTHORITY FINANCES

The global economic crisis has left many Local Authorities in a tough financial position. 90% of Local Authorities ran a deficit in 2007/8, up from 75% in 2006/07.

Our analysis indicates the future economic climate remains difficult for Local Authorities, with income set to fall and unavoidable expenditure to rise further.

Based on our Financial Resilience Rating, only 23% of Local Authorities have robust finances and are well-placed to weather the storm.

## PART 2 - OUTSOURCING

Economic woes mean councils need to look for innovative solutions to ensure their future solvency, without cutting back on what really counts: maintaining high-quality front-line services.

Outsourcing helps drive significant cost savings and improved performance across a range of government sectors.

Traditional outsourcing can typically achieve cost savings of at least 10-15% on self-delivery models.

Collaborative and transformational models of outsourcing provide scope for further reductions in cost (up to 35%), whilst maintaining or improving service performance.

Other benefits of these approaches are a greater transfer of risk, continuous process improvement and a partnership model of working.

## PART 3 - FINANCIAL IMPACT OF OUTSOURCING

Local Authorities are presently driving only 28% of their total potential cost savings from outsourcing.

If transformational outsourcing approaches were widely adopted, Local Authorities could potentially save a further £15bn annually – over 10% of total costs, and an average of £32m per Local Authority.

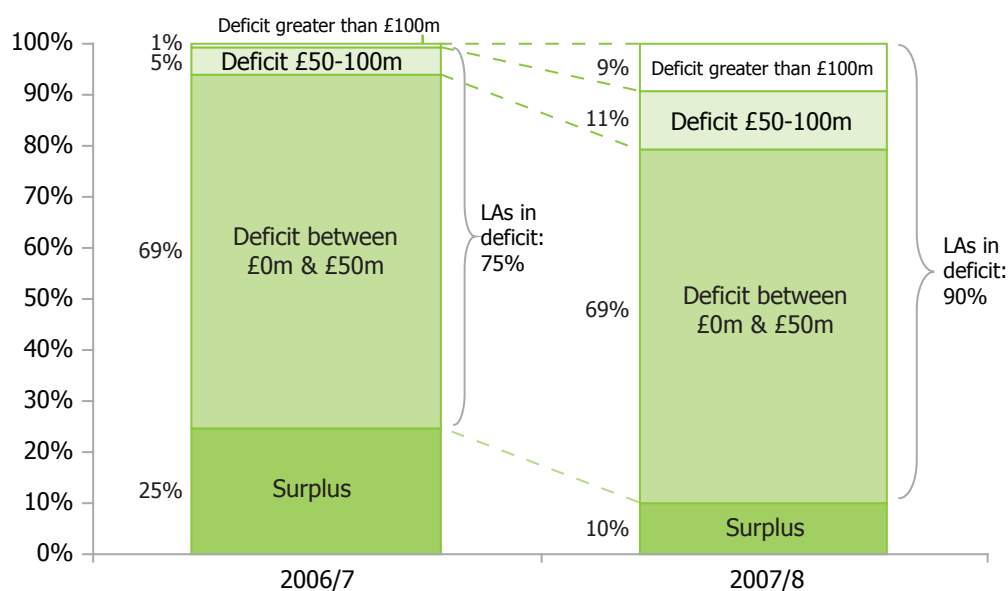
# PART 1

## LOCAL AUTHORITY FINANCES

### A CLOSER LOOK

Taking an initial snapshot, how are Local Authority finances faring through the crisis? We examined the change in surplus/ deficit of a sample of 150 councils between 2006/7 and 2007/8, the last year for which data is fully available.

**FIGURE 1 SURPLUS/ DEFICIT IN 2006/7 AND 2007/8**



SOURCE: LOCAL AUTHORITY ANNUAL REPORTS 2006/7 AND 2007/8

The picture is telling. Over the space of a year we have seen an increase of 23% in the number of Local Authorities running a net deficit. Only one council had a deficit of over £100m in 2006/7 – this rose to fourteen in 2007/8.

**INCREASING  
DEFICIT**

We have taken this further and created a Financial Resilience Rating by combining three readily available measures of Local Authority financial performance:

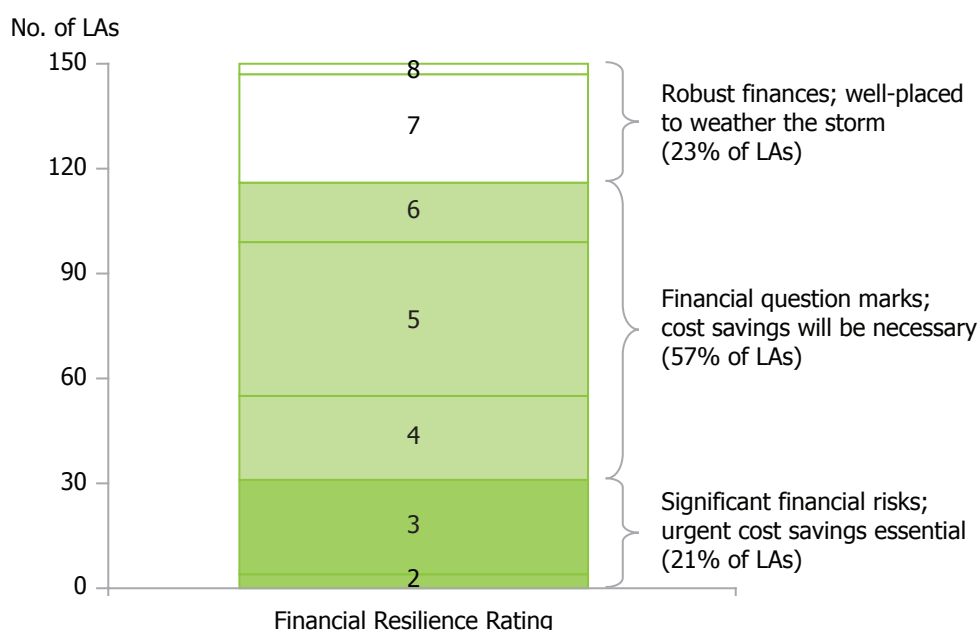
- Net debt
- Change in surplus / deficit
- Reserves

Local Authorities are scored out of eight on this measure. The higher the score, the more financially resilient the Local Authority.



Totting up the scores, we see that 78% of Local Authorities will be under significant pressure to cut costs going forward.

**FIGURE 2 FINANCIAL RESILIENCE RATING**



SOURCE: CREDO ANALYSIS; LOCAL AUTHORITY ANNUAL REPORTS

**TOUGHER YET**

The outlook for the next five years isn't great either. Local Authorities face a squeeze at both ends – huge pressure on funding sources and increased demand for services.

Reduced economic activity and tax receipts will severely constrain government income going forward.

“In the current economic situation, we’ve seen income drop from building control and planning applications, parking receipts, and leisure centres. We’re also getting less interest income on our reserves.”



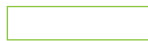







Finance Officer, District Council




**NO ROSY FUTURE**

**INCOME IS FALLING**

But where will the axe fall for Local Authorities? The figure below breaks out Local Authority spend and shows areas most at risk of cuts.

**FIGURE 3 LOCAL AUTHORITY OPEX 2007/8, BY LA EXPENSE CATEGORY**

TOTAL £137BN	OPEX	% OF TOTAL	DETAIL
	 £52bn	39%	Primary, secondary & special schools
	 £27bn	20%	Adult & older care; children & families
	 £14bn	10%	Core costs; tax collection
	 £11bn	8%	Repairs; supervision & management
	 £10bn	7%	Public transport; traffic management; parking
	 £7bn	5%	Waste management; environmental protection
	 £5bn	4%	Sport & recreation; open spaces; libraries
	 £5bn	3%	Community development, housing development
	 £4bn	3%	Buildings; community; economic growth
	 £1bn	1%	

 **PROTECTED**    
  **CURRENTLY RINGFENCED**    
  **UNPROTECTED**

SOURCE: DCLG; STATS WALES; THE SCOTTISH GOVERNMENT; CREDO ANALYSIS

Education and social care budgets are generally well protected, as cuts here are politically hard to swallow.

“Schools and social care are emotive issues, making up about 50% of our expenditure: there’s no way of making savings here.”

Assistant Finance Director, Unitary Authority

Other areas of spend are more discretionary, and therefore more at risk in the downturn. Under the current system, social housing spend (through the HRA) is ringfenced, but Local Authorities contribute to the HRA subsidy based on their ability to generate rental income.



The DCLG's review of social housing proposes the termination of the HRA subsidy, but is likely to see £18bn of housing debt distributed between all stock-retaining Local Authorities, regardless of their current financial position.



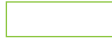







Financial autonomy is a good move, but also implies greater risk in managing the debt - a strong incentive to make every penny count.




**AN INCENTIVE  
TO SAVE**

### DEMAND FOR SERVICES - ON THE UP

Population growth, among other factors, will continue to drive service demand across the board, putting additional pressure on budgets.

**FIGURE 4 DEMAND TRENDS GOING FORWARD, BY LOCAL AUTHORITY BUDGET AREA**

SECTOR	OPEX 2007/8	PROSPECTS FOR DEMAND	DETAIL
EDUCATION	 £52bn	↑	More state school students as fewer choose independent schooling
SOCIAL CARE	 £27bn	↑↑	More benefits/ support due to mortgage defaults, unemployment, homelessness
CENTRAL	 £14bn	(↑)	Costs incurred as suppliers go bankrupt
SOCIAL HOUSING (HRA)	 £11bn	↑↑	Increased mortgage defaults
HIGHWAYS	 £10bn	↓	Non-essential work put on hold; reduced car usage
ENVIRONMENTAL	 £7bn	↑	Legislative compliance
CULTURAL	 £5bn	(↑)	Demand for cheap leisure activities & escapism
HOUSING (WELFARE ETC.)	 £5bn	↑↑	More benefits due to mortgage defaults, homelessness; less new affordable housing
PLANNING	 £4bn	(↑)	Less new affordable housing
OTHER	 £1bn	(↑)	

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SOURCE: CREDO ANALYSIS; LOCAL AUTHORITY ANNUAL REPORTS

So there's further financial pain brewing. But what can Local Authorities do to manage down costs whilst maintaining service levels?

## PART 2

# OUTSOURCING - THE WAY FORWARD

### OUTSOURCING REDUCES COST AND CAN IMPROVE PERFORMANCE

Numerous research studies across a range of government services and sectors show that outsourcing delivers significant cost savings.

**A STRONG  
EVIDENCE  
BASE FOR COST  
REDUCTION**

“The [UK] prison sector has experienced cost savings [through outsourcing] of over 20 per cent and internationally, across sectors, savings are found to be between 10-30 per cent. Recent UK experience in contracting alternative providers of medical services found similar results.”

Public Services Industry Review, BERR, 2008

But it's not all about money – what happens to service quality when services are outsourced?

“The evidence on quality change is weaker and more limited than that on cost savings. However, the few rigorous studies available point to similar or improved service quality from contracting out. This is particularly the case when increased attention has been paid to quality issues during the contracting process with an explicit focus on output and outcomes.”

Public Services Industry Review, BERR, 2008

### OUTSOURCING TODAY

So, traditional outsourcing approaches deliver material savings. But are there further benefits to be had?

In both public and private sectors, innovative approaches to outsourcing are reaping larger rewards. Some outsourcers are developing partnership models of working that drive greater efficiencies than the traditional outsourcing model alone, creating additional cost savings and service benefits.

In our view outsourcing contracts fall into one of three broad types – traditional, collaborative or transformational.

**FIGURE 5 A COMPARISON OF DIFFERENT OUTSOURCING APPROACHES**

	TYPE OF OUTSOURCING		
	TRADITIONAL	COLLABORATIVE	TRANSFORMATIONAL
<b>OVERVIEW</b>	<ul style="list-style-type: none"> <li>Activity based arrangement</li> </ul>	<ul style="list-style-type: none"> <li>End-to-end management and process improvement</li> </ul>	<ul style="list-style-type: none"> <li>End-to-end management and process improvement</li> <li>Whole asset transfer / collaborative asset management</li> </ul>
<b>ROLES</b>	<ul style="list-style-type: none"> <li>Provider undertakes activities prescribed by the Client</li> <li>Client manages demand and end-users</li> </ul>	<ul style="list-style-type: none"> <li>Client / Provider agree inputs, activities and outputs</li> <li>Joint management of demand and end-users</li> </ul>	<ul style="list-style-type: none"> <li>Client / Provider agree outputs</li> <li>Provider decides inputs and activities</li> <li>Provider manages demand and end-users</li> </ul>
<b>PERFORMANCE MANAGEMENT</b>	<ul style="list-style-type: none"> <li>Extensive set of performance indicators (PIs), mostly input-based</li> </ul>	<ul style="list-style-type: none"> <li>Broad set of performance indicators (PIs), some output-based</li> </ul>	<ul style="list-style-type: none"> <li>Smaller set of key performance indicators (KPIs), mostly output-based</li> </ul>
<b>TYPICAL CONTRACT LENGTH</b>	3-5 years	5-10 years	10 years +
<b>CONTRACTUAL FLEXIBILITY</b>	Low	Medium	High
<b>RELATIONSHIP</b>	Often adversarial	More collaborative	Partnership
<b>COST OF CONTRACT MGMT</b>	Medium	Medium/ Low	Low
<b>COSTING</b>	<ul style="list-style-type: none"> <li>Cost per activity</li> </ul>	<ul style="list-style-type: none"> <li>Cost per activity</li> <li>Some additional contractual sophistication to minimise perverse incentives – e.g. pain/ gainshare</li> </ul>	<ul style="list-style-type: none"> <li>Agreed upfront cost for an agreed set of outputs over contract length</li> <li>Sophisticated approach to incentives</li> </ul>
<b>DRIVER(S) OF VALUE</b>	<ul style="list-style-type: none"> <li>Competitive aspect of RFP</li> <li>Increased productivity of existing set of processes and activities</li> </ul>	<ul style="list-style-type: none"> <li>Competitive aspect of RFP</li> <li>Increased productivity through end-to-end process improvement and innovation</li> <li>Collaborative relationship</li> </ul>	<ul style="list-style-type: none"> <li>Competitive aspect of RFP</li> <li>Increased productivity through end-to-end process improvement and innovation</li> <li>Significant supplier investment in early years</li> <li>Asset management with contractual incentives to improve asset value</li> <li>Partnership approach; aligned vision and objectives</li> </ul>
<b>RISK TRANSFER TO PROVIDER</b>	Low/ Medium	Medium	High
<b>COST SAVING (CONSERVATIVE)</b>	<b>10-15%</b>	<b>15-25%</b>	<b>20-35%</b>

SOURCE: CREDO ANALYSIS

Overleaf is a case study of collaborative outsourcing in practice.

### **COLLABORATIVE OUTSOURCING CASE STUDY: UK SOCIAL HOUSING REPAIRS & MAINTENANCE**

Morrison Facilities Services piloted an innovative gas and electricity repairs and maintenance contract in partnership with registered social landlord Midland Heart.

Analysis of a typical repairs and maintenance workflow process revealed that only five of eighteen steps added value for the client and the tenant. And that was just the core process: over 99% of repairs required extra steps before completion.

Morrison's approach was therefore to cut out the non-essential processes, and create a more flexible system, where minor problems could be incorporated into the core process if necessary.

The steps that Morrison took were as follows:

- Introduced a shared call centre to improve initial reporting and diagnosis; this minimises appointment rescheduling and increases understanding of the problem to avoid later conflict
- Empowered field operatives to carry out any necessary repairs on the first site visit
- Improved information management, thereby enabling batch repairs and resource delivery to operatives on site if needed

The results of these small steps were impressive in terms of time, customer satisfaction and client cost savings:

- These improvements have enabled Midland Heart to reduce related expenditure by 21%
- The first time fix rate now stands at 92%, a great improvement on the previous 77%
- This has in turn led to a 37.5% drop in the number of jobs raised per repair from 1.6 to just 1
- The average end-to-end-time per repair has dropped from 88 days to an incredible 2.1 days

## PART 3











# FINANCIAL IMPACT OF OUTSOURCING


So, how much money are Local Authorities presently saving through outsourcing? And what further savings could they make if they increased outsourcing and adopted a more partnership-based approach?

### CURRENT AND POTENTIAL LEVELS OF OUTSOURCING

Present outsourcing levels vary by sector and by type.

**FIGURE 6 LOCAL AUTHORITY OUTSOURCING BY SECTOR 2007/8**

TOTAL £137bn	OPEX	CURRENT OUTSOURCING LEVELS	TYPE OF OUTSOURCING		
			TRADITIONAL	COLLABORATIVE	TRANS-FORMATIONAL
EDUCATION	 £52bn	Low	✓	(✓)	(✓)
SOCIAL CARE	 £27bn	High	✓✓	×	×
CENTRAL	 £14bn	Low	✓	(✓)	×
SOCIAL HOUSING (HRA)	 £11bn	Medium	✓✓	(✓)	×
HIGHWAYS	 £10bn	High	✓✓	(✓)	×
ENVIRONMENTAL	 £7bn	Medium	✓	✓	×
CULTURAL	 £5bn	Low	(✓)	✓	×
HOUSING (WELFARE ETC.)	 £5bn	Medium	✓	(✓)	×
PLANNING	 £4bn	Medium	✓	×	×
OTHER	 £1bn	Medium	(✓)	(✓)	×















SOURCE: DCLG; STATS WALES; THE SCOTTISH GOVERNMENT; BERR; CREDO ANALYSIS

Outsourcing today provides a total estimated saving for Local Authorities of £7.3bn annually, of which £0.7bn relates to social housing.

We have also analysed the potential for growth in outsourcing by sector. This indicates Local Authorities could outsource to a much greater degree, significantly increasing cost savings whilst maintaining or improving service quality.

FIGURE 7 POTENTIAL GROWTH IN OUTSOURCING BY SECTOR AND BY TYPE

TOTAL £121bn	POTENTIAL OPEX	POTENTIAL FOR GROWTH IN OUTSOURCING	TYPE OF OUTSOURCING		
			TRADITIONAL	COLLABORATIVE	TRANS-FORMATIONAL
EDUCATION	 £47bn	High	(✓)	✓	✓
SOCIAL CARE	 £23bn	Medium	(✓)	✓	✓✓
CENTRAL	 £13bn	Medium	✓	✓	(✓)
SOCIAL HOUSING (HRA)	 £9bn	High	x	(✓)	✓✓✓
HIGHWAYS	 £9bn	Medium	✓	✓✓	(✓)
ENVIRONMENTAL	 £7bn	High	(✓)	✓	✓✓
CULTURAL	 £5bn	High	✓	✓	x
HOUSING (WELFARE ETC.)	 £5bn	High	(✓)	✓	✓✓
PLANNING	 £4bn	Medium	✓	✓	x
OTHER	 £1bn	High	(✓)	✓	✓

 OUTSOURCED   
  IN-HOUSE

SOURCE: DCLG; STATS WALES; THE SCOTTISH GOVERNMENT; BERR; CREDO ANALYSIS

### £15bn OF SAVINGS THROUGH OUTSOURCING

If outsourcing were scaled up to its full potential, we estimate Local Authorities could drive a further **£15bn reduction on their current operating expenditure** – a saving of 10%.

This equates to an average £32m saving per Local Authority.

Solely within the social housing sector, additional savings of £2bn could be made. That would mean on average **an extra £14m for each stock-retaining Local Authority to save or reinvest.**

**£2bn SAVINGS IN SOCIAL HOUSING**

By any measure, outsourcing has enormous potential to help Local Authorities through these tough economic times.



This white paper is a collaboration between Morrison and Credo.

### **MORRISON**

Morrison is one of the country's largest providers of social housing services. It looks after over 400,000 homes in the UK, providing repair and maintenance services for councils, housing associations and arms length management organisations (ALMOs).

**[www.morrisonplc.com](http://www.morrisonplc.com)**

### **CREDO**

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