Andrew Jepp

Through a lens, safely

Financial innovation offers councils some creative solutions – but it is essential to view these through a long-term lens to ensure stability

WITH MUCH RECENT publicity over households increasingly looking to payday lenders during difficult economic times, councils appear to be developing innovative finance solutions of their own. With less central government funding, authorities are diversifying their financial base and exploring new approaches to raising capital. But as I have previously noted, innovation comes with risks – so it is important for councils to view decisions through a long-term lens.

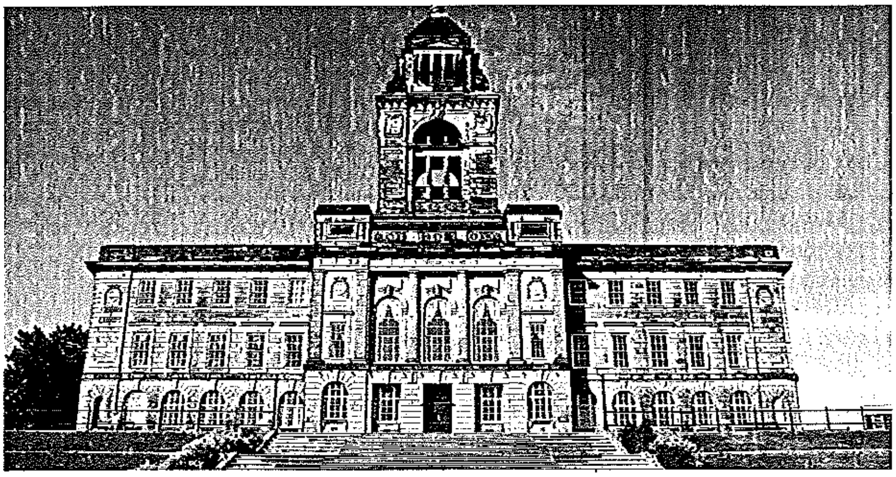
Wirral Borough Council, for example, currently loans out more than £30m of residents' taxes to other authorities in a series of low-interest loans. Interest rates typically lie at the 1% mark, which reflects the low-risk investment for the council, yet still allows for considerable returns.

Unsurprisingly, there is no shortage of demand for the service. The minimal interest rates offer considerable value for money in comparison to borrowing from other sources, and local authorities are keen to capitalise on the favourable conditions.

Municipal bonds also offer scope for financial innovation. While there is no collective municipal bonds agency in the UK, there are increasing calls to create an independent body to raise bonds for local authorities from the commercial market to reduce reliance on central funding.

But the borrowing market is just one tool local authorities are considering in view of declining budgets. Lord Heseltine's review argued for a rebalancing of responsibilities for economic development between central and local government, and offers good opportunities for increased innovation among authorities, which will allow for additional funding flexibility.

For instance, local enterprise partnerships empower local authorities through collaborative working. The European Structural and Investment Fund for England (2014–2020) will soon be available, and will enable councils to work with LEPs to win a share of the £5bn resource to invest into communities.



The long view: Wirral Borough Council's low-risk approach involves loaning out residents' taxes at 1% interest

The latest round of central government initiatives has created another lever of financial control. The partial localisation of business rates was introduced in April 2013 to motivate councils to promote local business growth. Not only will authorities be better able to respond to the needs of the local economy, but they will also keep a share of increased business rate income.

But while such proposals represent financial opportunities for local authorities, they are not a one-size-fits-all model, and can be costly if not fully aligned to individual communities' appetite for risk. Innovation inevitably brings new risks, and the key for financial stability in the long term is retaining buffers of resilience now. For example, councils can profit from greater control over business rates, but they will also find themselves at greater exposure should incomes fall.

Local authorities that do not experience economic growth might see a reduction in their business rates and a rise in council tax benefit claimants, compounding an already adverse financial situation. The dilemma for local government therefore is to manage both short- and long-term financial risks, and to balance their interdependencies. On the one hand, they must immediately maintain a resilient financial position, and on the other, they must mitigate costly future social issues.

Risk-weighted reserving for liabilities and uncertainties is absolutely critical to sustainable financial management. Robust scenario planning is important to understanding 'financial risks' if authorities are to be prepared for a range of incidents – from natural events like fire or floods to continued delivery of children's day care.

Embracing new financial opportunities while remaining mindful of the economic resilience and risk appetite of the community is difficult. However, local authorities have demonstrated clear proficiency of their management capabilities in the past few years, and appear well placed to realise the benefits from financial innovation.

As councils respond to the pressure to deliver public services for far less, they must think creatively to maximise resources. Coupled with planning, future-proofing and risk management, financial innovation offers the opportunity not only to gain a healthier balance sheet, but also to deliver local services with a maximum impact for residents.

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