Cutting costs not corners

Rationalising public sector property whilst protecting frontline service delivery

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Summary

The next decade will see significant change in the quantum and role of public sector property assets. Local public sector operational property (i.e. excluding central government property) could reduce by as much as 50% as a response to major financial cuts and the service delivery changes that will result from financial constraints.

The challenge will be to deliver change within constrained budgets while continuing to protect frontline services – services which themselves are facing greater demands from major economic, social, demographic and environmental changes. Public service providers will need to do more with less. Efficient use of property assets becomes an imperative in a much more significant and transparent way than ever before.

Public sector assets are generally not managed well and there is insufficient joined up thinking across the public sector. Major opportunities exist to create more efficient estates over the medium term, to reduce operational costs and carbon footprints. In the short term, well considered commercial strategies can generate sizeable cashable savings.

The challenge for public sector service leaders and property professionals is significant. Property needs to be at the centre of debate about service change and financial efficiencies. Given the relatively illiquid nature of property, ambitious strategies need to be put in place now if the unprecedented reform agenda for public sector property is to be met.

Radical change in public service delivery

The state of the UK's public finances has been well documented and extensively discussed. With a pending general election, rational debate is somewhat elusive. But there is an emerging consensus that financial cuts to public services will be severe. Discussion is focusing on the speed and exact level of cuts and where the axe will fall most heavily.

There is a further view that the previous decade has been a benign one for public sector finances. It is the speed of change faced by the pubic sector that presents perhaps the greatest challenge. This was illustrated by Institute the of Fiscal Studies (IFS) figures produced at the time of the 2009 Budget (Table 1). These show, in particular, the major reduction in net public sector investment. While revenue figures demonstrate a less sharp trend, with funding of additional debt repayment and increasing benefits payments, the impacts on public service revenue funding will remain severe.

In public sector investment terms, the shift from an annual real terms growth of 13.6% over a decade to a 17.5% annual reduction over the next three year period is unprecedented and will be impossible to manage as a smooth transition. The challenge is to make the change as painless as possible.

The scale of decline in public sector finances means that changes in public services will be radical. The "salami-slice" approach to services that may have been sustainable in periods of funding constraints during previous recessions will not suffice. Public sector organisations are starting to look at their objectives and their core obligations from first principles. Some non-statutory services will cease. More will be commissioned from private and third sector organisations as a route to reducing costs. More flexible working will be introduced – not just to save property costs – but as a route to efficiency and greater productivity. Home working will grow and hot desking will become mainstream. Outsourcing of service delivery, especially back office functions, will escalate. While none of these trends are new, the pace of change will accelerate dramatically and in combination they will have significant effects. Further, more innovative approaches are also likely to emerge to address the challenges being faced.

Table 1: Historical trends in public sector expenditure (source Institute of Fiscal Studies).

Period	Average annual real terms changes		
	Total managed expenditure	Current expenditure	Public sector net investment
Labour plans 2011-12 to 2013-14	0.0	0.7	-17.5
Labour spending reviews to date 1999 - 2000 to 2010 - 11	4.2	3.9	13.6
Labour, inherited conservative plans 1997 - 98 to 1998 - 99	0.0	-0.1	2
Conservatives 1979 - 80 to 1996 - 97	1.5	1.7	-5.0

(Following the Pre-Budget Report in December 2009, the IFS has adjusted the figures for 2011-12 to 2013-14 to an average annual real terms increase in current expenditure of 0.8% and to a decrease in public sector net investment of 19.2%.)

Major change in property requirements

Financial cutbacks combined with radical service transformation will have fundamental implications for public sector property. Central government is recognising this and has been pushing the agenda of efficient use of property assets for a number of years. The critical importance of property efficiency across the public sector has never been higher on the political agenda. (see Box 1)

At a local level, financial cuts will have an impact on staffing levels, with the majority of services being strongly labour intensive. This will reduce property needs. General efficiency measures will further reduce the number of people employed by the public sector for a given level of service output. Hot-desking and home-working will further reduce the quantum of space required to be provided. They will though create a demand for a different type of accommodation with an increased need for meeting spaces, "touch down" facilities and highly IT friendly environments.

Outsourcing of back office functions has been a feature of public sector service delivery for some years. But the pace and scope of outsourcing will quicken. Additional service areas will be subject to outsourcing, including functions such as HR, which have not traditionally been considered (witness the outsourcing contract won by Hays in 2009 to provide services to Buckinghamshire County Council).

Outsourcing will also be at the heart of the discussion about shared service delivery across the public sector. There are growing examples of local authorities sharing the same Chief Executive and Senior Management Teams and of local authorities and primary care trusts sharing senior managers. These trends will accelerate. Increasingly a local area will outsource to a single provider to deliver services

Box 1:

The challenge from central government

The government is driving change across the public sector through its Operational Efficiency Programme. A series of five reports published alongside the April 2009 Budget, included Lord Carter of Coles report on property. This identified potential running cost savings of £1.5 billion per annum and potential capital receipts (excluding council housing) of £20 billion over a 10 year period.

In a statement in October 2009, Prime Minister Gordon Brown talked about raising £16 billion over two years from asset disposals. There was an expectation that £11 billion of this sum would come from local government.

Regional Improvement and Efficiency Programmes have been established and in the West Midlands a pilot has looked at potential savings from improved asset management and other best practice. Extrapolating the West Midlands findings across England suggests potential savings of over £6 billion. Organisational structures are being put in place to deliver this efficiency agenda in the West Midlands and will be rolled out around the country.

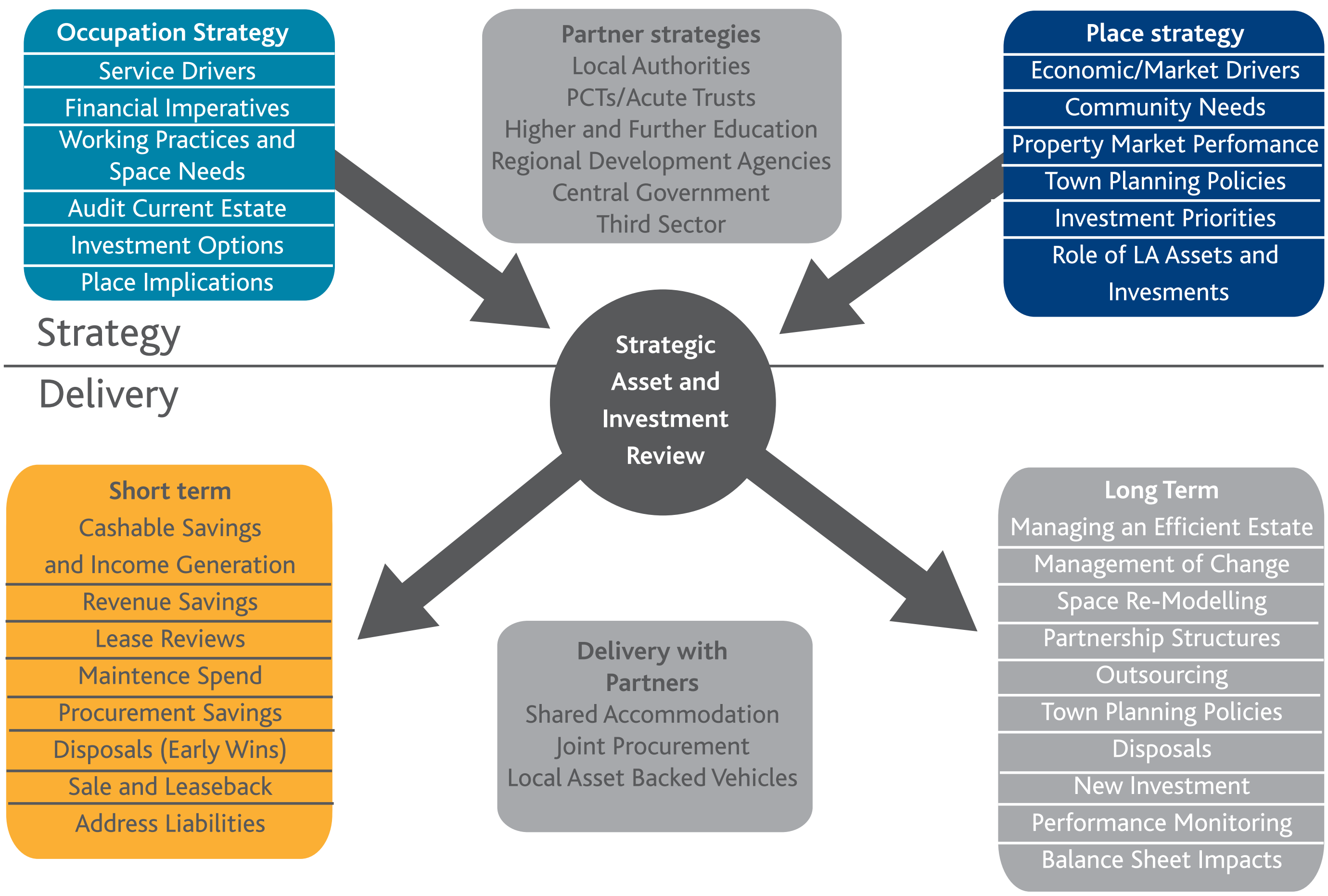
across all public sector agencies – local government, health, education, police and so on. Finance, IT, estates management, procurement and vehicle fleet management are likely to lead this trend.

Looking at the core office accommodation of local government, primary health, police, partners such as housing associations and central government local offices and quangos, it is quite easy to imagine that the total accommodation occupied will fall by at least 50% over the next two comprehensive spending review periods (say to 2017) as a result of the trends described.

There will be important consequences for local property markets as office stock is freed up. Significantly though, service changes will not be deliverable in the poor quality of existing space and so new space will need to be created on an "invest to save" model to enable service efficiencies to be achieved.

Organisations will increasingly share space - a relatively new current trend but one which will grow dramatically. The main public building in a locale (often the Town Hall) will become the "public sector HQ", the base for Chief Executives and Chief Officers from across the local public sector and partner bodies. This trend is a logical conclusion of "Total Place", local strategic partnerships and comprehensive area assessment and could help to overcome some of the hurdles to more joined up and co-ordinated approaches to service delivery.

Managing change for the Public Sector



Box 2:
Are property market conditions supportive?

The credit crunch and consequent recession has had a dramatic impact on property markets and property values. Britain is coming out of recession only slowly and the negative impacts for employment are expected to last for several more years.

Rental levels have fallen sharply in all sectors and in all regions and are only expected to return to positive growth in 2012. The picture for property yields has been more fluid. An increase in yields (meaning lowering of capital values) began in 2007, away from the historically low and unsustainable levels of 2006. This worsening position continued into 2009 but in the second half of 2009 there was an improving position. Some have suggested that this is an investment market "bubble", although it largely reflects strong interest in only the very best of primary property assets.

Some commentators predict that property values will fall again in 2010, a trend that would mirror those of previous recessions. Property values are only expected to grow weakly thereafter.

Despite these trends, there are a number of investors with cash to spend on property assets. They are attracted by the AAA covenant strength of the public sector, meaning that there is strong interest in buildings with public sector tenants on institutional terms with lengthy leases. It follows that there is strong interest from investors in sale and leaseback arrangements with the public sector.

Box 3:
Service change and property – the big cities

Birmingham

Birmingham City Council is the largest local authority in the country. It has been embarking on a major service transformation programme for a number of years. A major change driver is investment in IT and associated services for which the Council has contracted with a joint venture delivery partner. All residents and local businesses will be provided with "one stop shop" access to Council services on-line.

The Council is delivering major productivity gains and is now revising its property to reflect the new approach to service delivery. New ways of working will see total workstations reducing from some 10,500 in 2008 to 6,500 in 2014-15.

Integral to the strategy is the Council's investment in property to create modern working environments to meet the new service requirements. For example the Lancaster Circus building is being refurbished and new accommodation is being developed at Woodcock Street.

The Council's strategy is based on an "invest to save" premise with the overall transformation programme seeing investment of nearly £600 million but with expected savings of £2 billion over the longer term.

Manchester

Manchester City Council is similarly embarking on a major strategic transformation programme. This is aimed at greatly enhancing services to local people, especially the most vulnerable. Reducing the number of separate contacts with Council staff is a key objective.

The Town Hall complex plays a key role as a customer interface but at the same time the Council is faced with a major backlog maintenance liability for the historic civic buildings.

It is bringing these agendas together in a £140 million investment which will transform ways of working in civic buildings, greatly enhance customer experiences, increase worker productivity and address building issues.

The Council is soon to decant staff into modern office space so enabling a transformation in culture and working practice before moving staff back into the town hall complex which will have been transformed to accommodate new practice.

Box 4:

Service change and property – essential responses for small authorities

Torbay

Torbay Council in Devon is one of the smallest in the country. The local economy is weak and development activity has been slow even in good property market conditions.

The Council remains dedicated to its overall master plan and to support new economic activity. It is also committed to enhance public services and its interface with its customers. Across its estate it is faced with a £40 million backlog maintenance problem.

"The Hub" project will focus Council staff in a central location around the listed town hall and council library but with investment in new office space. Staff will be centralised from 17 separate locations. At the same time overall space occupied will reduce by 50%.

Public access to civic buildings will increase by 200%. Additional space will be made available for partner organisations to the Council. The wider "Hub" project will include a speculative office building with potential to create 1,000 jobs.

An insurmountable challenge?

The agenda for public sector property asset management is therefore huge. But there are further complexities. Firstly, property values have fallen dramatically over the last 18-24 months and are expected to rise only slowly. Raising significant capital receipts from property rationalisation will remain difficult (see Box 2). On the contrary, for those property investors with funds, public sector tenants are highly sought after and create additional value to that investor. This makes sale and leaseback arrangements very achievable in the current climate.

The second challenge comes from the expectations that the public sector – especially local government – places on property assets. Councils are increasingly looking at property assets as a means to underpin development and regeneration programmes which have stalled in the recession. Local asset backed vehicles (LABVs) have been heralded as a solution for many authorities but are clearly no panacea.

The third agenda will be sustainability and carbon reduction. This will bring further impetus for the rationalisation of property – excess property equates directly to excess carbon use – but will also require organisations to consider investment needed to reduce the carbon footprint of retained buildings.

There are key questions about how the public sector dovetails a property rationalisation agenda, a revised capital programme and local development and regeneration objectives. A number of authorities – large and small - have embarked along the path (see Boxes 3 and 4). Plans may need to be revised given changed strategic objectives and difficult property markets but lessons also need to be spread more widely.

Notwithstanding the challenges and the need for a longer term view, there are some actions that organisations can take now to achieve savings. All should be looking at their 2010 business rates liability and considering whether this can be reduced. For those in leased accommodation, there may be opportunities to restructure leases for financial benefit. Service charge arrangements should be reviewed. Some of these short term savings may provide a breathing space to do the necessary longer term thinking around property portfolios that is required.

Perhaps the greatest challenge faced is one of timescales. Pressures for savings are short term but property remains a relatively illiquid asset and changing property will take years to deliver. Securing capital receipts from surplus assets will be a medium term objective for many Councils.

The situation is compounded because many public bodies are starting from a low level in terms of how they analyse property assets and develop strategic approaches to property change. This was identified in the Audit Commission's "Room for Improvement" report on local authority asset management in June 2009.

Too many organisations do not have the right quality of property data to inform strategic planning. There remains too great a gap between senior managers designing service change and property professionals translating change into an evolving property portfolio.

The new agendas will require better data, more joined up thinking within organisations and with external partners. Business case tools to justify rationalisation and "invest to save" approaches will need to become more sophisticated.

The pressures of cuts are fast approaching and the best organisations are preparing for the change now. No organisation can afford to wait.

A well planned and thorough approach to property and asset management is needed. A "head in the sand" approach will only increase the pain when it comes and could result in "knee jerk" decision making which makes the objective of protecting frontline service delivery even more difficult to secure.

This paper has drawn on presentations made by the GVA Grimley team and a series of external speakers at a number of seminars around the country in October and November 2009.

For further information and helpful advice please contact us:

John Keyes
T: 0161 956 4136
E: john.keyes@gvagrimley.co.uk

Stephen Hollowood
T: 0121 609 8318
E: stephen.hollowood@gvagrimley.co.uk

Steve Smith
T: 020 7911 2217
E: steve.smith@gvagrimley.co.uk

London West End
10 Stratton Street
London
W1J 8JR

Belfast
Rose Building
Third Floor
16 Howard Street
Belfast
BT1 6PA

Bristol
St Catherine's Court
Berkeley Place
Bristol
BS8 1BQ

Edinburgh
Quayside House
127 Fountainbridge
Edinburgh
EH3 9QG

Leeds
First Floor, City Point
29 King Street
Leeds
LS1 2HL

Newcastle
Yorkshire Chambers
112/118 Pilgrim Street
Newcastle upon Tyne
NE1 6LL

London City
80 Cheapside
London
EC2V 6EE

Birmingham
3 Brindleyplace
Birmingham
B1 2JB

Cardiff
One Kingsway
Cardiff
CF10 3AN

Glasgow
206 St Vincent
Street
Glasgow
G2 5SG

Liverpool
Mercury Court
Tithebarn Street
Liverpool
L2 2QP

Manchester
81 Fountain Street
Manchester
M2 2EE

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