National Audit Office

Departmental Overview, December 2018

HM Treasury

HM Treasury

This overview summarises the work of HM Treasury including what it does, how much it costs, recent and planned changes, and what to look out for across its main business areas and services.

Overview

About HM Treasury	How HM Treasury is structured	Where HM Treasury spends its money
Major programmes and developments	Exiting the European Union	Managing public money

PART ONE

An efficient and effective exit from the EU

PART TWO

Managing the government balance sheet

PART THREE

Securing sustainable public finances

PART FOUR

What to look out for

If you would like to know more about the National Audit Office's (NAO's) work on HM Treasury, please contact:

Elaine Lewis, Director,
Financial Audit, HM Treasury
elaine.lewis@nao.org.uk
020 7798 7906

If you are interested in the NAO's work and support for Parliament more widely, please contact:

parliament@nao.org.uk
020 7798 7665

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Sir Amyas Morse KCB, is an Officer of the House of Commons and leads the NAO. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund, nationally and locally, have used their resources efficiently, effectively, and with economy. The C&AG does this through a range of outputs including value-for-money reports on matters of public interest; investigations to establish the underlying facts in circumstances where concerns have been raised by others or observed through our wider work; landscape reviews to aid transparency; and good-practice guides. Our work ensures that those responsible for the use of public money are held to account and helps government to improve public services, leading to audited savings of £741 million in 2017.

Design & Production by NAO External Relations
DP Ref: 11795-001

CONTENTS
NEXT
PREVIOUS
LAST PAGE VIEWED

About HM Treasury

HM Treasury (the Treasury) is the government's economic and finance ministry, with overall responsibility for public spending. The Chancellor set the department 3 objectives for 2017-18:

1. Place the public finances on a sustainable footing.

2. Ensure the stability of the macro economic environment and financial system, enabling strong, sustainable and balanced growth.

3. Increase employment and productivity, and ensure strong growth and competitiveness across all regions of the UK through a comprehensive package of structural reforms.

These objectives are underpinned by cross-cutting work to ensure a smooth and orderly exit from the European Union (EU).

For 2018-19, these objectives have been updated and expanded. There are now explicit objectives for the delivery of the UK's exit from the EU. In addition, the objective of placing the public finances on a sustainable footing must now be carried out in the context of ensuring value for money and improved outcomes in public services.

The Treasury's Remit

Public spending	Maintaining control over departmental spending, public sector pay and pensions and capital investment.
Financial services policy	Responsible for the overall financial services regulatory framework for banking and financial services regulation, financial stability, and ensuring competitiveness in the financial sector.
Strategic oversight of the UK tax system	Oversight of direct, indirect, business, property, personal tax and corporation tax.
Infrastructure projects	The delivery of infrastructure projects across the public sector and facilitating private sector investment into UK infrastructure.
Ensuring the economy is growing sustainably	Ensuring the stability of the macro-economic environment and financial systems, enabling strong and sustainable growth.
Preparation of Whole of Government Accounts	Consolidation of over 7,000 audited accounts of organisations across the UK public sector.

CONTENTS
NEXT
PREVIOUS
LAST PAGE VIEWED

How HM Treasury is structured

HM Treasury

The Treasury is the sponsoring department for the executive agencies within the departmental group.

Debt Management Office (DMO)

The DMO is responsible for the government's debt and cash management. The Treasury sets the annual financing remit, which specifies how much money needs to be borrowed from the markets.

National Infrastructure Commission (NIC)

The NIC provides expert, impartial advice to the government on infrastructure to shape and develop the national infrastructure assessment.

UK Financial Investments Ltd (UKFI)

On 31 March 2018 UKFI ceased trading and transferred its activities to its parent UK Government Investments (UKGI), which has assumed responsibility for continuing UKFI's mandate of managing the government's shareholdings in the Royal Bank of Scotland (RBS) and UK Asset Resolution (UKAR).

Money Advice Service (MAS)

MAS was set up by government in 2010 to promote public awareness and understanding of financial services and enhancing consumers' ability to manage their financial affairs. In 2018-19 MAS is to be merged into the Single Financial Guidance Body (SFGB).

Financial Services Compensation Scheme (FSCS)

The FSCS provides compensation in the event that financial services, such as banks, are unable to meet claims against it. The FSCS provided support to Bradford and Bingley (B&B) during the financial crisis. The Treasury provided a £15.6 billion loan to the FSCS to fund this support. On 24 May 2018, this loan was fully repaid.

Group Structure of the Treasury

Parent

Core Department	HM Treasury		
Executive Agency	UK Debt Management Office	Government Internal Audit Agency	National Infrastructure Commission

Group

Non-departmental public bodies	Royal Mint Advisory Committee	Office for Budget Responsibility
Levy funded bodies	Money Advice Service	Financial Services Compensation Scheme
Managed by the Royal Household	Sovereign Grant	
Treasury-owned companies	UK Asset Resolution Ltd	UK Government Investments Ltd
	Infrastructure Finance Unit Ltd	UK Financial Investments Ltd
	UK Sovereign Sukuk Plc	IUK Investment Holdings Ltd
	IUK Investments Ltd	

CONTENTS
NEXT
PREVIOUS
LAST PAGE VIEWED

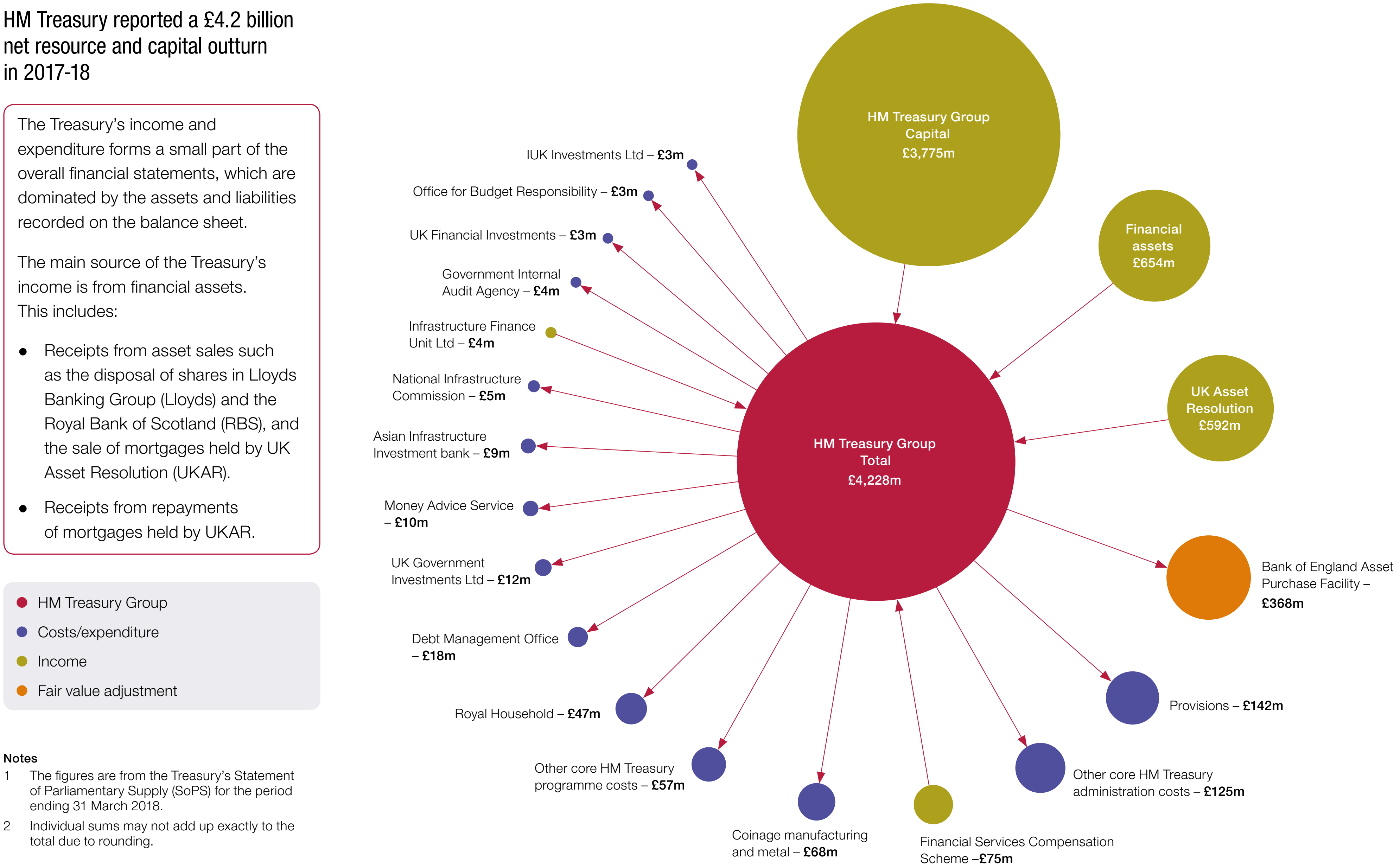
Where HM Treasury spends its money

HM Treasury reported a £4.2 billion net resource and capital outturn in 2017-18

The Treasury's income and expenditure forms a small part of the overall financial statements, which are dominated by the assets and liabilities recorded on the balance sheet.

The main source of the Treasury's income is from financial assets. This includes:

- Receipts from asset sales such as the disposal of shares in Lloyds Banking Group (Lloyds) and the Royal Bank of Scotland (RBS), and the sale of mortgages held by UK Asset Resolution (UKAR).
- Receipts from repayments of mortgages held by UKAR.



Notes

1. The figures are from the Treasury's Statement of Parliamentary Supply (SoPS) for the period ending 31 March 2018.
2. Individual sums may not add up exactly to the total due to rounding.

Source: National Audit Office analysis of HM Treasury *Annual Report and Accounts 2017-18*

Where HM Treasury spends its money

Assets and liabilities

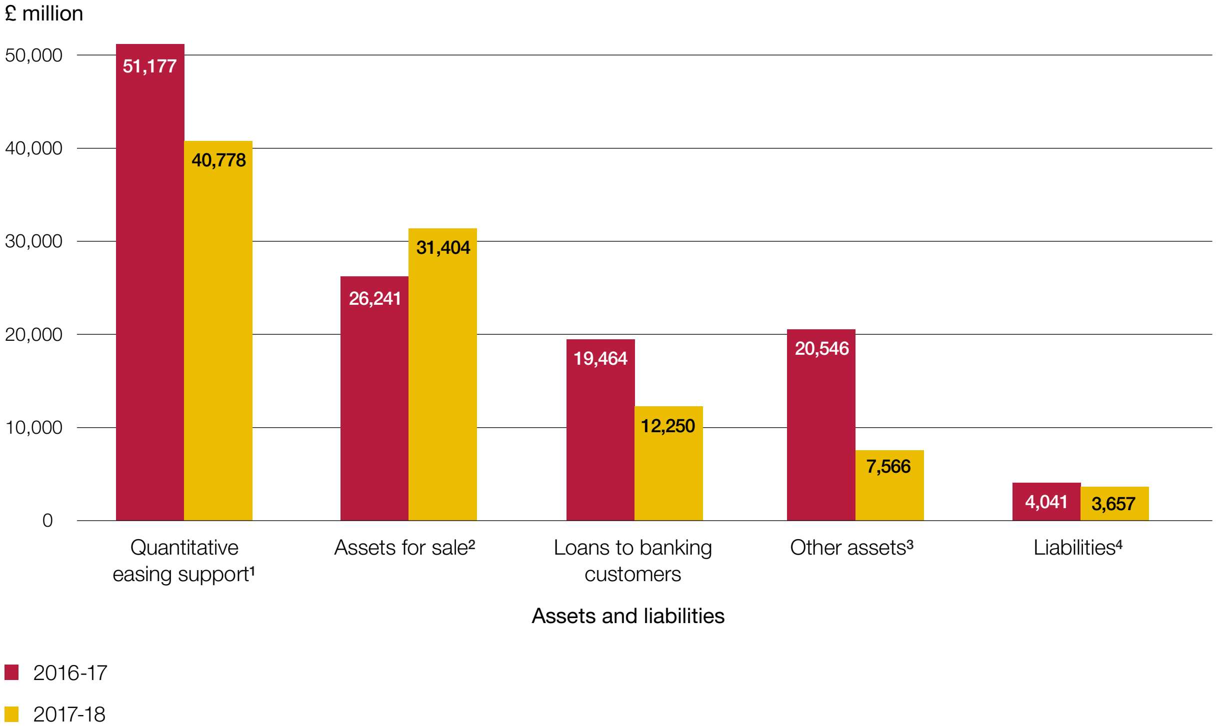
In 2017-18 the Treasury Group held a total of £92.0 billion of assets, a decrease of £25.4 billion compared with 2016-17. This decrease is largely due to changes in the value of some assets that are susceptible to changes in market conditions. The decrease can also be partly explained by the receipt of proceeds from the £11.8 billion sale of Bradford and Bingley (B&B) mortgages, which was completed in April 2017.

The £92.0 billion figure is predominantly made up of legacy assets following the government's financial interventions to support the stability of the UK banking system between 2007 and 2010:

- £40.8 billion of assets representing the Treasury's support to the Bank of England for any losses or profits from the quantitative easing programme. The value of this support fluctuates depending on prevailing market conditions.
- £31.4 billion of assets that the government intends to sell, largely reflecting the government's holding in the Royal Bank of Scotland (RBS) as well as a portfolio of B&B mortgages.
- £12.3 billion of loans to banking customers covering mortgages and loans as part of the government's nationalisation of B&B and Northern Rock.

The Treasury Group had liabilities of £3.7 billion in 2017-18 compared to £4.0 billion the previous year.

The Treasury held a total of £92 billion of assets and £3.7 billion of liabilities as at March 2018



Notes

1 Quantitative easing is the Bank of England's programme of asset purchases (also referred to as the Asset Purchase Facility Fund) to stimulate demand by boosting the money supply and supporting asset prices.

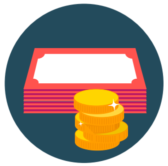
2 Assets for sale includes shares in the Royal Bank of Scotland (RBS) and a portfolio of Bradford and Bingley (B&B) mortgage assets.

3 Other assets include property, plant and equipment, intangible assets, trade and other receivables, loans and advances, loan hedging assets, cash and inventory. More details can be seen in the Consolidated Statement of Financial Position in HM Treasury's *Annual Report and Accounts 2017-18*.

4 Liabilities include trade and other payables, provisions, financial securities, derivative financial liabilities and debt securities in issues. More details can be seen in the Consolidated Statement of Financial Position in HM Treasury's *Annual Report and Accounts 2017-18*.

Source: National Audit Office analysis of HM Treasury, *Annual Report and Accounts 2017-18*

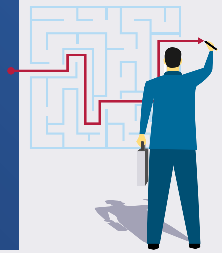
Major programmes and developments

Major programmes and developments	Description
UKFI ceased to exist in March 2018 	On 31 March 2018 UK Financial Investments (UKFI) ceased trading and transferred its activities to its parent company UK Government Investments (UKGI), which has assumed responsibility for continuing UKFI's mandate of managing the government's shareholdings in the Royal Bank of Scotland (RBS) and UK Asset Resolution Ltd (UKAR).
Increased staff to deliver EU exit 	The core department has grown to more than 1,300 staff in the past year to meet the challenge of leaving the EU. The Treasury has continued to experience high staff turnover and will review its workforce strategy to ensure it maintains sufficient skills and experience across the department.
New programmes to encourage long-term investment 	**National Productivity Investment Fund (NPIF):** the NPIF was established in 2016 to provide investment to areas critical for boosting productivity and promoting economic growth such as transport, digital communications, housing, and research and development. In Budget 2018 the NPIF was expanded from £31 billion to £37 billion and extended to 2023-24. At the end of June 2018, more than £24 billion had been allocated, including £11.5 billion for unlocking new homes close to areas with job opportunities and £740 million to help deliver 5G mobile and full fibre broadband in the UK. **Digital Infrastructure Investment Fund (DIIF):** in July 2017 the Treasury launched the DIIF, committing £400 million to invest in new fibre networks in the period to 2020. At the end of March 2018, £395 million remains undrawn. **British Patient Capital:** in November 2017 the Treasury announced a new investment fund with the purpose of ensuring UK high-growth innovative companies can access the finance they need to reach their full growth potential. The intention is to float or sell the fund once it has established a sufficient track record.
Key personnel changes 	**Head of Government Finance:** in June 2017, Mike Driver, Chief Financial Officer for the Ministry of Justice, was appointed to the Treasury Board and Treasury Board Sub-Committee as head of the government finance function. **Chief Economic Advisor:** in January 2018 Clare Lombardelli was appointed as Chief Economic Advisor following Dave Ramsden's appointment as Deputy Governor at the Bank of England. **Directors General:** in May 2017, James Bowler was appointed as Director General Public Spending and Beth Russell was appointed as Director General Tax and Welfare.

OVERVIEW

Exiting the European Union

In March 2019 the UK is set to leave the EU. The UK Government has instructed departments to make the necessary arrangements for the exit.



The Treasury's Role

As the government's economics and finance ministry, the Treasury is responsible for a number of EU-exit priorities such as ensuring fiscal stability, promoting stable and well-functioning financial services and delivering a robust customs regime.

The Treasury aims to achieve this by developing policy as well as providing support to other government developments. The Treasury will also coordinate and lead on key aspects of the EU exit negotiations, such as on separation issues, including the financial settlement.

Funding

At Autumn Budget 2017, the Chancellor committed £3 billion over the next two financial years to help departments and the devolved administrations prepare for leaving the EU. An additional £24.8 million has been allocated to the Treasury for 2018-19. Budget 2018 announced a further £500 million of funding will be available to departments and devolved administrations in 2019-20.

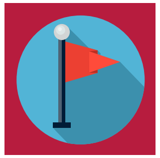
The Financial Settlement: under the terms of the Withdrawal Agreement published in November 2018, the UK will continue to contribute to the EU's annual budgets until December 2020 as if it had remained a member state. The UK will also bear a share of the EU's outstanding commitments and liabilities at that date, and receive a share of certain assets. It will not be required to pay these off until they fall due. During the implementation period, the UK will continue to participate in EU programmes and will also receive a share of payments relating to programmes it currently participates in after 2020 from the EU's balance of outstanding commitments.

Workstreams

In April 2018, the Department for Exiting the European Union provided a summary of the workstreams underway to implement the UK's exit from the EU. This stated that the Treasury has nine active workstreams relating to policies affected by the UK's exit from the EU. These include:

- financial services;
- sanctions and anti-money laundering; and
- the UK's future relationship with the European Investment Bank (EIB).

The other workstreams can be categorised as cross-cutting public spending issues, including the Treasury's public finance responsibilities, funding for future participation in EU programmes and the financial settlement with the EU. The Treasury faces a number of challenges in estimating the size of the financial settlement payment.



EU Exit Challenges

The Treasury faces a number of EU exit challenges, particularly around the delivery of what the UK will pay as part of the financial settlement.

Issues identified as part of the NAO's work on the EU financial settlement:

- The Treasury will need to ensure any payments to the EU are accurate. The UK's payments after 2020 will be calculated by the European Commission. Some of these complex payments will require the Treasury to implement new systems to keep track of the UK's liability in order prevent any overpayment.
- The government has some flexibility over when it can pay off certain outstanding commitments. There is an option for the government to pay off the UK's share of the pension liability early. This can represent a risk as the lump sum will be an estimate of the total future liability which could result in the UK overpaying if the assumptions do not hold in practice.

Other EU exit challenges identified by the Treasury in their financial statements:

- As a result of leaving the EU the Treasury may be required to settle any liabilities arising from changes in legislation, regulation and funding arrangements where these are not covered by other government departments.

Managing public money

Sale of Bradford & Bingley and Northern Rock mortgages

In April 2018 Bradford and Bingley (B&B), part of UK Asset Resolution (UKAR), completed a programme of mortgage sales designed to generate sufficient funds to repay the £15.6 billion loan extended by the Financial Services Compensation Scheme (FSCS) to B&B when it was nationalised in 2008.

The repayment of the loan was completed in two phases:

- Phase 1: in March 2017 an agreement was reached to sell £11.8 billion of mortgages. This resulted in a £10.9 billion repayment to the FSCS.
- Phase 2: in April 2018 a portfolio of mortgages was sold for £5.3 billion. The remaining £4.7 billion was paid to the FSCS.

The FSCS borrowed £15.6 billion from the Treasury to fund its loan to B&B which has now been repaid in full.

In September 2018, UKAR completed the sale of £860 million of equity release mortgages.

Financial relationship with the Bank of England

On 21 June 2018 a new financial relationship between the Treasury and the Bank of England (the Bank) was agreed. The key changes include:

- Transparency will be improved through enhanced information sharing.
- Since the financial crisis, the Bank's role has expanded, while its ability to absorb losses, via holding capital, has not changed. To address this, the amount of capital that the bank holds will increase to £3.5 billion. This will require a £1.2 billion capital injection from the Treasury.
- The £127 billion Term Funding Scheme (TFS) will be transferred from the Bank of England Asset Purchase Facility Fund (BEAPFF) to the Bank's balance sheet. This reduces the Treasury's exposure to the BEAPFF – the Treasury provides support to the Bank for any losses or profits from operating the BEAPFF.

Resource spending

In 2017-18 the Treasury reported a £24.9 billion underspend in resource expenditure.

This was mainly due to movements in the value of the BEAPFF which is highly dependent on prevailing market factors which can be volatile.

The Treasury decided it would be prudent to request enough resource budget to cover a potential £25 billion loss. This loss did not materialise due to more favourable market conditions.

Changes in underlying market conditions can have a significant impact on the Treasury's financial position.

Bank of England Asset Purchase Facility Fund (BEAPFF): in early 2009, the Bank initiated a programme of asset purchases (often referred to as quantitative easing) to stimulate demand by boosting the money supply and supporting asset prices. The programme is run through the BEAPFF, a wholly-owned subsidiary of the Bank.

Term Funding Scheme (TFS): this scheme provides funding to banks and building societies at rates close to the Bank of England base rate.

Resource spending: relates to day-to-day operations, including administration costs such as salaries.

Capital spending: relates to money spent on infrastructure such as roads and buildings.

CONTENTS
NEXT
PREVIOUS
LAST PAGE VIEWED

An efficient and effective exit from the EU – the costs of leaving the EU

Agreeing the terms of the UK's exit

The UK is scheduled to leave the EU on 29 March 2019. Prior to this, Parliament will be required to vote on two key documents setting out the terms of the UK's exit:

- **Withdrawal Agreement:** this sets out the arrangements for the UK's withdrawal from the EU including the financial settlement.
- **Political declaration:** a statement of intent about the future partnership and institutional arrangements between the UK and the EU.

The government has committed to Parliament having a 'meaningful vote' on the outcome of its negotiations with the EU and has expressed an intention to place the maximum amount of analysis in the public domain to help to support Parliament's decision-making.

EU financial settlement analysis

In January 2018, the Chancellor set out a 'reasonable central estimate' of the financial settlement's value of between £35 billion and £39 billion.

In our April 2018 report, *Exiting the EU: The financial settlement*, we noted that the Treasury's estimate was reasonable, given the parameters of the analysis. However, these parameters have an impact on the estimate:

- The Treasury's estimate reflects the net cost to the UK as a whole, including EU receipts that go directly to the private sector and not the government. We estimated these receipts to be around £7 billion.
- The settlement does not include the UK's commitments to the European Development Fund (EDF), which the Treasury expects to cost £2.9 billion after the UK leaves the EU.

The Financial Settlement: under the terms of the Withdrawal Agreement published in November 2018, the UK will continue to contribute to the EU's annual budgets until December 2020 as if it had remained a member state. The UK will also bear a share of the EU's outstanding commitments and liabilities at that date, and receive a share of certain assets. It will not be required to pay these off until they fall due. During the implementation period, the UK will continue to participate in EU programmes and will also receive a share of payments relating to programmes it currently participates in after 2020 from the EU's balance of outstanding commitments.

There are a number of factors that could result in the financial settlement payment being different to the Treasury's estimate:

1. Approval of the Withdrawal Agreement: payments under this settlement will only take place once the government and the EU approve the withdrawal agreement, which is yet to happen.

2. Sensitivity to assumptions: estimating the potential consequences of leaving the EU, which has no precedent, is inherently difficult and requires the use of assumptions. The Treasury has made a number of assumptions:

- The settlement value is exposed to exchange rate movements because payments will be made in euros. The exchange rate used in the Treasury's estimate may not match the prevailing rate when the payment is made.
- The UK will continue to make contributions to the EU budget in 2019 and 2020. The value of these contributions depends on the UK's economic performance relative to the EU's member states. Future economic growth is difficult to estimate accurately.

Relatively small changes in these assumptions would cause the central estimate to be outside the £35 billion to £39 billion range.

CONTENTS
NEXT
PREVIOUS
LAST PAGE VIEWED

An efficient and effective exit from the EU – the costs of leaving the EU

CONTENTS
NEXT
PREVIOUS
LAST PAGE VIEWED

Communicating uncertainty

Any analysis that uses assumptions will be inherently uncertain. It is important that this uncertainty is communicated clearly.

Our 2017 review *HM Treasury's economic analysis in the lead-up to the referendum on European Union membership* noted that the uncertainties surrounding the Treasury's modelling were not referred to prominently enough. The Chancellor's foreword refers to the results of the analysis as "economic facts", without mentioning the inherent uncertainties.

In its EU settlement estimate, the Treasury followed some of the good practices for communicating uncertainty such as producing a range of possible outcomes rather than a single estimate.

However, in our April 2018 report, *Exiting the EU: The financial settlement*, we found that where the Treasury adjusted assumptions, it did so using basic variances, such as adding 0.5% or €0.5 billion either side of its central estimate. The Treasury also did not include some of the uncertainties that it was aware of. As a result, the cost range of £35 billion to £39 billion is narrow given the level of uncertainty.

Wider costs of leaving the EU

The costs associated with the financial settlement do not represent the full cost of leaving the EU. Some of the wider costs will need to be agreed as part of the future relationship between the UK and the EU. The political declaration is a statement of intent about the future partnership and institutional arrangements between the UK and the EU that will endure beyond an agreed transition period ending in December 2020. It is likely that the UK will require new arrangements with the EU, such as how the UK's financial services will be regulated.

Our November 2018 report, *Exiting the EU: The financial settlement – follow-up* report highlighted a number of other costs that are not included in the financial settlement figure:

- Costs incurred in preparation for withdrawal.
- Establishing the replacement of EU funding/agencies in the UK.
- Fiscal costs/benefits of the UK exiting the EU.
- Retaining access to EU agencies and funds.

Challenges

Our November 2018 report, *Exiting the EU: The financial settlement – follow-up*, highlighted that the future relationship between the UK and the EU, as set out in the political declaration, cannot be translated into a binding legal agreement until after the UK's exit from the EU in March 2019. This is because the EU is not legally able to conclude new treaties with the UK relating to the future relationship while the UK is still a member state. Therefore, if the UK and EU ratify the Withdrawal Agreement, the UK will be committed to the financial settlement before the future relationship has been finalised.

Future analysis

Parliament has called for more quantification of the fiscal consequences of leaving the EU.

Since the Treasury's initial estimate of the financial settlement, new documents have been published allowing the Treasury to revise their estimates. The revised estimates remain within the initial range of £35 billion and £39 billion.

As more information is published, the NAO will continue to aid Parliament's scrutiny by providing independent assurance.

Managing the government balance sheet – impact on decision-making

In response to recommendations from the NAO and others, the Treasury has begun to strengthen its approach to analysing the government's balance sheet and evaluating fiscal risks such as higher interest rates and inflation, weak productivity growth and demographic change increasing demand on public services. At Budget 2017, it launched a Balance Sheet Review that aims to make more effective use of assets, improve the return of investments and reduce the cost of liabilities. Budget 2018 provided a progress update on this review.

UK's debt position

For the last 15 years, the government's annual spending has exceeded its income. This budget deficit is funded through borrowing. Over time, the UK has accumulated a significant amount of debt as a result of financing these past deficits.

Measuring debt

Public Sector Net Debt (PSND) is a long-established metric, constructed in line with internationally agreed accounting methodology, and has formed the basis of the government's debt targets since 1997. Our 2017 report *Evaluating the government balance sheet: borrowing* highlighted that other measures of debt besides PSND provide a more comprehensive view of the government balance sheet.

It recommended that the government should adopt other measures of debt, such as Public Sector Net Financial Liabilities (PSNFL) that provides a more nuanced view of the UK's indebtedness. Following this, the OBR has now published its first detailed forecast for PSNFL and the government has committed to further balance sheet reporting, including compliance with the IMF's Government Financial Statistics Manual.

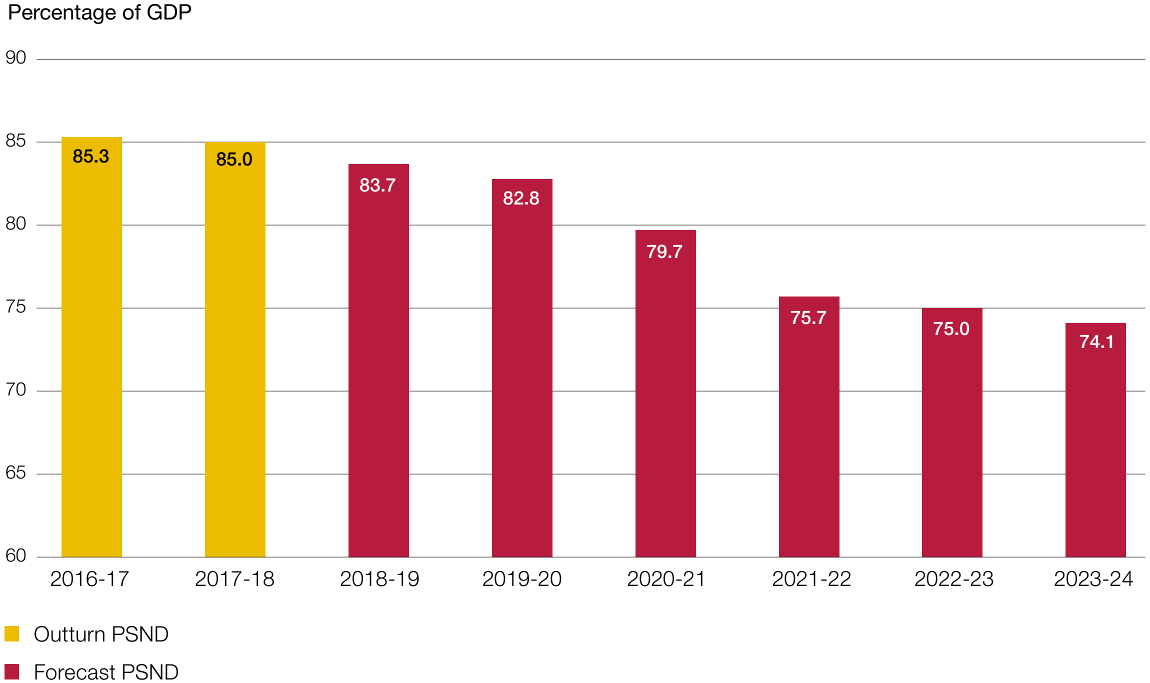
Debt reduction

The government is committed to ensuring the UK's public debt, as a portion of Gross Domestic Product (GDP), is falling by 2020.

The government can reduce debt in a number of ways, including asset sales. The government's policy is to sell assets where there is no policy reason for continued public ownership. In 2017-18, there were two assets sales with the specific objective of decreasing debt:

- Sale of student loans.
- Green Investment Bank (GIB).

Changes in Public Sector Net Debt (PSND) as a percentage of Gross Domestic Product (GDP)



Source: HM Treasury, Budget 2018, October 2018 and Office for Budget Responsibility (OBR), Economic and Fiscal Outlook, March 2018

The government's preferred measure of debt. It is calculated as total liabilities minus total liquid financial assets, ie cash.

Includes all the public sector's financial assets and liabilities recorded in the National Accounts.

Managing the government balance sheet – impact on decision-making

Potential impact on asset sales

When an objective of an asset sale is to reduce public debt, how this is measured can alter the associated fiscal impacts.

Our 2018 report, *The sale of student loans*, found that the government successfully achieved its objective of reducing national debt, despite selling £3.5 billion worth of assets for £1.7 billion. When the sale was assessed using Public Sector Net Financial Liabilities (PSNFL) – a wider measure of debt as it includes the loss of future student loan repayments – the sale resulted in an increase in debt of £1.8 billion.

If the government had used this wider measure of debt, the decision to sell the student loans would have been less clear cut.

This alternative measure is not without limitations. For example PSNFL does not take into account that when student loans are issued, government does not expect them to be fully repaid.

In 2017, our report *The Green Investment Bank,* stated that the sale of the Green Investment Bank (GIB) reduced Public Sector Net Debt (PSND) by £1.6 billion. Public debt only decreased by £201 million when the PSNFL measure of debt is used.

The International Monetary Fund describes such situations as a ‘fiscal illusion’. The Office for Budget Responsibility (OBR) has also highlighted that PSND is susceptible to fiscal illusion.

To increase transparency, after each material asset sale, Departments will now be required to publish the impact of that sale on a range of measures including PSND and PSNFL, subject to any commercial sensitivities, whether the sale price was above, below, or within the valuation range of not selling.

Fiscal illusion: accounting treatments that do not adequately reflect reality. For example, the sale of an asset will immediately reduce government debt, but may also mean forgoing a future stream of income that is not reflected in the accounts. The true nature of the transaction is not reported, especially if the size of the forgone income is greater than the income from selling the asset.

Impact on infrastructure financing

The government’s balance sheet, and subsequently the level of debt, are affected differently depending on the choice of financing used to deliver public infrastructure. As such, there are incentives to use specific types of financing, such as the Private Finance Initiative (PFI), for reasons other than value for money.

In our 2018 report, *PFI and PF2*, we explained that:

- Most PFI projects, unlike conventional government borrowing, are recorded as off-balance sheet in the National Accounts. This means the government can increase investment spending via PFI without adding to PSND.
- Under PFI the upfront costs of building an asset, such as a school, do not count against departmental capital budgets. Instead, the PFI costs are spread out over time and are classified as revenue expenditure. If departments require investment and have limited capital budgets, PFI is often the only option, even if it does not represent the best value for money.

These issues remained largely unaddressed in the reformed PFI model, known as PF2.

In Budget 2018, the government announced that PF2 will no longer be used for new projects. While PF2 has only been used in six projects since its launch in 2012, its predecessor PFI, was used extensively over the preceding 20 years. Without PF2 the government has one less option for delivering privately financed projects. It is important that choices around financing models are not distorted by balance sheet and budgetary incentives as we noted could happen with PFI and PF2.

Private Finance Initiative (PFI): a 25-year contract whereby the government makes annual payments to a private company who designs, finances, builds and maintains the asset, such as a school or hospital, over the life of the contract.

Securing sustainable public finances – returning assets to the private sector

Financial interventions

In 2008-09, the UK government provided significant support to the banking sector in order to maintain financial stability. However, it is not the role of the Treasury to be a permanent investor in UK financial institutions.

Policy to sell

UK Financial Investments (UKFI) was therefore set an overarching objective, by the Treasury, to implement a strategy for selling these assets in an orderly and active way.

The Treasury has stated that the original cost of the support is not considered relevant when selling the assets. Any potential loss is seen as a cost of ensuring financial stability and protecting the wider economy.

Since 2011 UKFI has been carrying out a programme of sales designed to fully return these assets to the private sector. On 31 March 2018 UKFI ceased trading and transferred its activities to its parent UK Government Investments (UKGI), which has assumed responsibility for continuing UKFI's mandate of managing the government's shareholdings in the Royal Bank of Scotland (RBS) and UK Asset Resolution (UKAR).

Future sales

A significant number of assets remain on the public sector balance sheet and are expected to be sold over the next five years:

- Bradford and Bingley (B&B) and Northern Rock assets will be fully sold by March 2020.
- The government intends to undertake a full disposal of its RBS shareholding by 2023-24 – around £15 billion worth of shares.

The government fully exited its shareholding in Lloyds Banking Group (Lloyds) on 16 May 2017.

Institution	Size of financial support	Initial public sector holding	Current public sector holding
Lloyds	£20.3 billion	41%	0%
RBS	£45.5 billion	84%	62.4%

Institution	Period of sale	Proceeds
Lloyds	September 2013	£3.2 billion
	March 2014	£4.2 billion
	December 2014 to July 2016	£9.2 billion
	October 2016 to May 2017	£4.2 billion
RBS	August 2015	£2.1 billion
	June 2018	£2.5 billion

Securing sustainable public finances – returning assets to the private sector

Challenges

UK Government Investments (UKGI) faces many challenges when trying to achieve value for money from an asset sale:

- Lloyds Banking Group (Lloyds) and Royal Bank of Scotland (RBS) shares are traded on the London Stock Exchange. Share prices constantly fluctuate with movements in the market.
- Government ownership of shares and the risk of insider trading limits the number of available sale opportunities.
- Government must strike a balance between maximising the sales price against a policy of returning the assets to the private sector.
- Assessing whether the current market price of shares accurately reflects the fair value of the business is difficult.

Results of sales

Since 2013 we have reviewed multiple asset sales:

- The £13 billion sale of former Northern Rock assets.
- The first sale of shares in Lloyds.
- The first sale of shares in RBS.
- The return of Lloyds Banking Group to private ownership.

In each case, we reported that the transactions were executed as skilfully as could reasonably be expected, and on the basis of the preparation, process and proceeds of the transaction, value for money was achieved.

Table 1: Net proceeds from sale of Lloyds shares

Excluding financing costs	£0.9 billion gain
Including financing costs	£3.2 billion deficit

Source: Comptroller and Auditor General, *The first sale of shares in Lloyds Banking Group*, Session 2013-14, HC 883, National Audit Office, December 2013

Lessons learned for future sales

While these transactions represented value for money within the context of a policy to sell, we have identified potential improvements that can be applied to future sales:

- When assessing the fair value of shares, adjustments were made to reflect the cost of RBS's financial misconduct continuing indefinitely. As the regulatory environment clears, UKGI should review whether these perpetual adjustments are still required.
- Irrespective of poor market conditions, or whether insider information prevents a sale, UKGI should conduct regular fair value assessments of all its investments.
- Consideration should be given to how the size and type of assets can be used to maximise competition between buyers and thereby the price.
- The Treasury should communicate the full costs of any financial interventions. By not including the cost of borrowing the money to buy the shares, the reported proceeds can appear higher (see table 1).
- The trade-off between simple and complex transaction structures should also be carefully considered.

What to look out for

	Issues	Future developments, risks and challenges
01	Exiting the EU	The Treasury's role as the UK's economic and finance ministry means that it is exposed to a number of risks as the UK leaves the EU. Beyond the monitoring, communicating and delivery of the UK's financial settlement payments, the Treasury also has to consider other important areas such as: • The UK's future relationship with the European Investment Bank (EIB), which provided the UK with €1.8 billion of financing in 2017. • The need to ensure there is a robust regulatory regime for the UK's financial services. • The UK's customs regime following EU exit, which the Treasury will need to assess together with HMRC. • The government is forecast to sell £40 billion worth of financial assets, such as shares in Royal Bank of Scotland (RBS), over the next five years. There is a risk that investor demand, and subsequently the potential sales price, is negatively affected by the UK leaving the EU. This may have consequences for the sale programme. • Provide support to other government departments to ensure they are prepared for the outcome of the EU exit.
02	Sale of student loans	The government is expected to raise around £15 billion by 2022-23 through the sale of student loans. One of the objectives of selling these loans is to reduce the UK's level of public debt. How student loans are accounted for in UK borrowing and debt statistics is currently being reviewed by the UK and EU statistical offices. This may affect the fiscal impact of the future sales programme if the new accounting treatment deems any sale of the loans to have a different impact on debt. In our 2018 report, *The sale of student loans*, we concluded that the sale achieved value for money but the way government assesses value for money and measures for the costs of student loans over time showed limitations.
03	Privately financed infrastructure	In Budget 2018, the government announced the end of the Private Finance Initiative (PFI), also known as PF2. PFI has been used extensively over the last 20 years to deliver around £60 billion of privately financed public projects. PFI was criticised for being more expensive and less flexible than conventional government borrowing. Its successor, PF2, has only been used to finance six projects since 2012. During this time, other forms of Public Private Partnerships (PPPs), have delivered more investment than PF2. The government has said it will continue to use private approaches for financing future infrastructure projects, supporting this through tools such as the Regulated Asset Base (RAB), Contracts for Difference (CfDs) and PPPs. While RAB and CfDs have been used as private finance tools across a range of national infrastructure projects, they have not been used to deliver the type of projects that typically adopted PFI i.e. schools and hospitals. In our report, *PFI and PF2*, we stated that there is less transparency about the costs of PPP deals. Furthermore, unlike PF2, the expected and actual equity investor returns received under PPPs are not publicly disclosed.
04	Delivering 2019 Spending Review	In March 2018, the Chancellor announced that the Treasury would carry out a spending review in 2019. Our 2018 report, *Improving government's planning and spending framework*, concluded that, while there have been improvements, a more integrated planning and spending framework would minimise the occasions where value for money is compromised by short-termism, over-optimism and silo decision-making. The 2019 Spending Review will be an important test of the improvements the Cabinet Office and the Treasury have made.

CONTENTS
NEXT
PREVIOUS
LAST PAGE VIEWED