Published in Property Management Select Magazine 2010

Property & FM Winners and Losers in the Public Sector Spending Review

By Martin Pickard

In some ways Chancellor George Osborne's spending review came as a bit of an anti-climax as so much of the detail was leaked to the press well in advance of the formal announcement. Nevertheless there was plenty of substance in the actual speech and a great deal of small print still has to be revealed. It will be some time before we fully understand the implication of the largest cuts to public spending since World War Two.

For the property and facilities management markets, proposals designed to reduce public spending by £81billion over the next four years seem to promise mixed fortunes. Those businesses that are providing services to government departments will be directly affected and existing contracts are certain to come under heavy scrutiny. However the diminution of big government also throws up opportunities for the private sector.

One of Osborne's self-declared principles was growth and the promotion of a private sector recovery. "By restoring macroeconomic stability we have brought certainty to businesses," he said. "By cutting business taxes we are giving business the freedom to compete. Today's review builds on these steps – because even when money is short, we should prioritise those areas of public spending which are most likely to support economic growth."

Another key message from Osborne's speech was the devolving of power from central to local government with more local services provided by the private sector. He was clear about this point: "We should understand that all the services paid for by government do not have to be delivered by government." In the "Big Society" the private sector, communities and charities will be expected to take on more responsibility for public service delivery.

There will, of course, be challenges for the FM sector in a tough public procurement climate with pressure to renegotiate existing contracts. On the other hand, this review may offer opportunities for private business to work with the public sector in a different way and provides the FM and property sector with a chance to demonstrate how effective outsourcing can be used to deliver both efficiency and effective service.

At the same time, average budget cuts of 19 per cent across Government departments, massive cutbacks in capital spending and a raft of punitive tax and welfare initiatives will create significant problems for property and facilities management businesses. There is also a serious risk that the property market will be flooded as local and central government seek to offload surplus property at the same time.

Property experts fear that a sharp rise in the of number of assets up for sale could trigger another fall in UK commercial real estate values which are already struggling to recover from a steep downturn. There is real concern that government property downsizing could spark a new wave of pricing slumps in secondary office markets with surplus stock hitting a struggling sector at a time when there is already very poor occupational demand.

Chancellor Osborne said the new Government Property Unit established under former Ernst & Young senior partner John McCready would make "substantial gains" by co-ordinating the management of property assets across government departments. This new unit is to create property vehicles in London and Bristol to own and manage government offices, before rolling out additional vehicles covering other regions and cities if the model proves effective.

This renewed focus on making more efficient use of property will be welcomed by many in the sector but the government will need to be realistic about the speed at which disposals and savings can be achieved. Some property experts have suggested that the government may consider packaging assets into portfolios before floating them as tax-efficient real estate investment trusts but there is doubt about the attractiveness of such investments.

Surprisingly, infrastructure and other major capital projects were not hit as hard as expected. Infrastructure spending will marginally increase in the next four years which will partly offset the cuts to health capital expenditure and the likely impact on new-build housing from the reduced local government budget. Private Finance Initiative (PFI) schemes and the Building Schools for the Future programme (BSF) have already seen major surgery.

Despite considerable reductions in capital spending and the cancellation of major projects like the Severn barrage scheme and the long awaited work on the A1 and A14; £30bn is still to be spent on new transport projects and £15.8bn on refurbishing or rebuilding schools. Big projects such as Crossrail, the M25 widening and the Mersey Gateway bridge have survived along with Network Rail spending worth £14bn and £6bn on the London Underground.

It may seem that those who feared a bloodbath in infrastructure projects have won a reprieve, however it remains to be seen whether projects of such scale will be repeated in the years to come. Despite Osborne’s apparent commitment to infrastructure projects as part of the recovery process, it is significant that the surviving schemes are those where the cost of extricating the government from contracts already signed was highest.

One peculiarity about how the comprehensive spending review has been reported is that government spending will actually grow in the coming four years, with the “protected” health budget being a major contributor to this. But to allow for this ring fencing and the fact that the cost of delivering public services generally outpaces prices, huge cuts are required in other departments.

Those most affected were Business, Transport, Justice, Environment and the Home Office with budget cuts of between 21% and 29%. Central government was hit even harder with 34% cuts in Whitehall and local government grants were slashed by 26%. The government is predicting 490,000 job losses in the public sector in the next four years and market analysts estimate a similar impact on the private sector because of the reduced spending.

Sir Philip Green’s efficiency review called for more centralised procurement of services, Cabinet Secretary Francis Maude has already begun renegotiating contracts with central government suppliers and the Efficiency and Reform Group expects to save another £800m this year. All of these will create significant opportunities for suppliers of property and facilities management products and services to government.

The biggest FM players are likely to benefit most from this approach as efficiency-hungry civil servants will be attracted by those who can offer the widest range of building support and business process services across a wide estate. Shared service arrangements, like that already announced by three London Councils are likely to increase in popularity as bigger bundles and collaborative procurement strategies are used to drive down cost.

Although the big players are well placed to take advantage of such initiatives, there will be losers as well. Operating efficiencies alone will not be able to avoid major impact on public services. The comprehensive spending review has delivered a hefty dose of economic reality which hints at several years of grim austerity. But the true cost, and opportunity, will only become clear in the months and years to come.