Briefing

September 2020

What the £13bn debt write-off means for the NHS

In April 2020, the health and social care secretary announced that over £13bn of debt held by NHS trusts would be written off. All of the debts to be written-off are internal between NHS trusts and the Department of Health and Social Care, so the process does not include borrowing from external sources. The government plans to change the debt to a form of equity (public dividend capital), which will help trusts over the long term. It also potentially removes a barrier to capital investment in highly indebted trusts.

But while the policy will help many trusts with struggling finances, it only resets previous years' deficits and borrowings. For trusts that face an ongoing gap between revenue and expenditure, the loan write-off will make little difference in the short term and action will still be needed to address the underlying and ongoing problems of financial balance. Going forward, there needs to be additional support and planning for trusts in financial distress to enable a proper reset of NHS financial management.

This briefing, which was developed in partnership with the Health Foundation, explores the detail behind the numbers and what the write-off means in practice – both now and in the long term.

Key points

- The debt write-off forms part of a wide range of financial measures the government has brought in for health and social care during the current pandemic. However, this measure had been considered for some time. The National Audit Office had previously noted a solution was required to address NHS trusts' debt, as there were many loans that had no prospect of being repaid.
- All of the loans that are being written off are internal debts between NHS trusts and the Department of Health and Social Care (DHSC). This means it is a transaction within the DHSC and does not change overall public borrowing – it is not a cash injection. Additional funding for COVID-19 will be provided to trusts through emergency and other funding rather than this write-off.

- Interest charges for these loans ceased as of 1 April 2020.
- The debt will be converted into equity, known as public dividend capital (PDC). While PDC does not need to be repaid, it incurs an annual cost as a return on the investment. This is currently set at 3.5 per cent of the relevant net assets of the trust and this money goes from trusts to the DHSC.
- Recently, the DHSC and NHS England and NHS Improvement announced the PDC charge will be reviewed later in the year.
- This policy should help increase the amount of longer-term capital investments and other improvements in vital services. Without this debt, trusts can make stronger business cases for investment in their estates, along with possibly stronger finances to self-finance investment.
- While this is a positive step, concerns remain about the financial situation of many trusts. As noted by government, this provides a financial reset for these trusts. However, even without the current pandemic, further plans will be needed to address the problems that caused these debts.

Introduction

As part of the government response to COVID-19, there have been significant changes to NHS funding and substantial funding increases, including £6.6bn for health services from the COVID-19 emergency response fund,[1] along with additional spending on Test and Trace, personal protective equipment and capital. The method in which funding is allocated to trusts has also changed, with the temporary suspension of the NHS tariff (payment by results) in favour of block payments,[2] to ensure trusts have enough funding during the pandemic. As of 1 August, the NHS is now its in third phase[3] of the response to the pandemic. This includes returning services to near-normal levels, preparing for winter pressures and using lessons learned from the first peak of the pandemic.

As part of the financial measures announced on 2 April 2020, the Secretary of State for Health and Social Care set out that over £13bn in debt would be written off as 'a major financial reset for NHS providers.'[4] He acknowledged that this will allow trusts to plan for the future and invest in vital services. In broad terms, the debt reflects the borrowing that occurred by trusts while they were struggling to meet rising costs over recent years. Most of this debt was held by acute trusts, which will be the major beneficiaries of this policy.

At the time of the announcement, the complete details of the policy were not confirmed. Since then, the Department of Health and Social Care and NHS England and NHS Improvement have released updated guidance on the new cash regime for the NHS, which includes further details of the debt write-off. The key points from both documents are as follows:

- The value of the debt to be written off will be as at 31 March 2020, with no more interest as of 1 April 2020.
- The write-off will involve converting the debt into PDC, which is akin to equity investment by the DHSC in trusts.
- PDC will be issued to the trusts on 30 September 2020, alongside a memorandum of understanding (MoU) to repay the loans from this PDC. This does not involve any cash and reflects the change from a liability to an equity investment.
- As these loans are from the DHSC to trusts, there is no change to borrowings by the government as this transaction occurs solely within the DHSC.
- PDC generally incurs a charge of 3.5 per cent on the value of average relevant net assets[*] (assets minus liabilities) of trusts.
- The PDC is expected to incur a charge as normal, though the DHSC and NHSEI have stated that the PDC charge is going to be reviewed in the current financial year.

To explain the debt and the consequences of the write-off, it is helpful to understand how the debt came about and reached its current value of over £13bn.

NHS finances and debt explained

Since 2009/10, growth in real terms in NHS spending has been the lowest of any period since its inception. From 2009/10 to 2014/15, it averaged 1.1 per cent a year, and 1.6 per cent from 2014/15 to 2018/19. This compares to a historic average of about 3.6 per cent a year. From 2019/20, growth in spending is increasing at a higher rate. Currently, the NHS in England has a long-term funding settlement, with funding growing at 3.3 per cent per year in real terms. However, this will have changed as a result of the ongoing pandemic.

As a result of low funding growth and sustained cost pressures, including from an ageing population, from 2013/14, the NHS provider sector went into deficit and has been since. Deficits occurred as trust income, including the NHS tariff (payment by results), did not rise in line with increases in demand for health services.

In 2015/16, some 67 per cent of trusts were in deficit. Since then, the deficit has reduced and only 47 per cent of trusts were in deficit in 2018/19.[5] However, apart from efficiency savings by trusts, a lot of the reduction has come from the Provider Sustainability Fund (PSF), previously the Sustainability and Transformation Fund. This funding gives incentives for trusts to meet agreed in-year performance targets, and the cash is provided on the condition that it cannot be spent in the current year. As this funding is often provided late or after the year ends, it may still leave cash flow problems within trusts. Receipt of PSF is also based on achieving financial and operational objectives and is available to all trusts, including those in surplus. This is one reason why despite a decline in the total deficit across all trusts, debts continued to rise by significant amounts.[**]

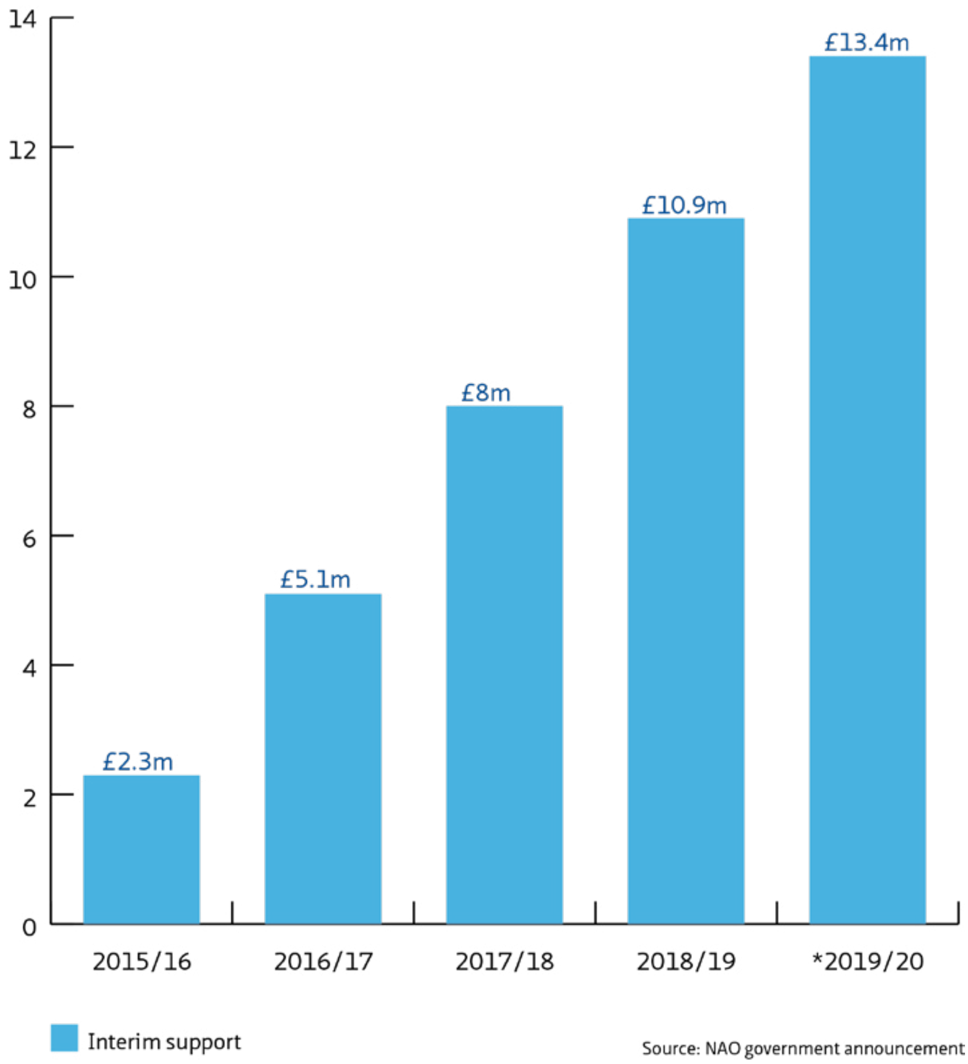
These deficits meant significant cash flow problems for trusts, as income was not covering costs. To ensure they had sufficient cash to pay staff and suppliers, trusts borrowed from the DHSC. The loans grew from £2.2bn in 2015/16 to over £13bn[***] in 2019/20,[6] and incurred interest charges in each year. Figure 1 shows the consistent growth in each year. This balance relates to interim support loans, which are the only loans being written off. In previous years, the provider sector had an additional balance of about £3bn each year for loans considered normal course of business.[7] These do not form part of the write-off.

* The PDC charge is calculated on relevant net assets of trusts. This is assets minus liabilities, and excluding some other balances, including donated and grant funded assets. For a full definition, refer to Note 1.16 in www.england.nhs.uk/wp-content/uploads/2019/09/Consolidated_NHS_Provider_Accounts_Web_Accessible.pdf

** The total surplus/deficit of trusts reflects the in-year performance of the sector. In simple terms, if all trusts in surplus end up with a combined £100m surplus, and all trusts in deficit a combined £200m deficit, then the total is a £100m deficit. However, debt may rise by up to £200m from those in deficit. This is because the providers borrow from the DHSC to fund their deficit.

*** The £14bn figure is higher than the £13.4bn being written off as loans considered 'normal course of business' are not included in the write-off.

Figure 1. NHS provider interim support loans: 2015/16 to 2019/20 prices



At times, if the interest could not be paid, it was added to the value of the debt. These loans were recognised as liabilities by trusts, and as assets by the DHSC, reflecting something that the DHSC expected to be repaid.

Of the value of these loans, 90 per cent were revenue loans, while 10 per cent were capital loans. This reflects that these loans were mostly used to finance ongoing revenue issues rather than long-term capital projects.

Before the current pandemic, negotiations had been ongoing about how to deal with this issue. In recent years, the NAO noted that a long-term solution needed to be reached on loans that had no prospect of being repaid, and also that the DHSC should stop issuing loans in this case. It was noted that that 'is not an acceptable approach to the financial management of major public bodies.'[8]

Debt write-off and public dividend capital

The write-off of these loans involves converting the loans from debt to a form of investment in the trusts by the DHSC: public dividend capital (PDC). This form of equity recognises an investment made by the DHSC into trusts. This changes the balance sheets of the trusts, as liabilities are reduced by the debt amount, with a corresponding increase in equity from the PDC. Any additional cash support needed by trusts will also be in the form of PDC, so that loans do not begin to rise again.

The government has listed the current value of the loans at £13.4bn, with the final value to be confirmed by the audited accounts for 2019/20. The debt is not split evenly across regions, with London and the Midlands having £6.6bn (49 per cent) of the total debt. The loans are held by 110 (almost half of all) trusts and the amount also ranges widely, from a low of £700,000 to a high of £735m, reflecting the wide variation in financial situations.

PDC charges

While PDC does not have to be repaid, it currently incurs an annual cost of 3.5 per cent on the average relevant net assets of the trust. This is similar to dividends from private companies, reflecting a return on the cost of capital provided to the trusts. However, unlike a private company, it is payable on relevant net assets, not profit. This means it is payable whether a trust is in surplus or deficit. This does contribute to the in-year surplus/deficits of trusts, but then is offset in the DHSC's accounts as income.

A key difference between PDC and loans is that PDC is not automatically repayable. Since the charge is calculated on average relevant net assets (assets minus liabilities*), these may decline over time through depreciation and impairments, as well as movements in cash balances. However, the write-off also increases the net relevant assets balance. As a result, those with a larger write-off (all else equal) will likely have a higher PDC charge. The DHSC and NHSEI recently announced they will carry out a review of the PDC dividend rate in the current financial year. Additionally, capital funding received during the pandemic directly related to COVID-19 expenditure will not incur any PDC charges.

* For a full definition of the calculation, refer to page 65 of the consolidated NHS provider accounts 2018/19 https://www.england.nhs.uk/publication/consolidated-nhs-provider-accounts-2018-19/

Will the debts start to grow again?

A concern this policy has not addressed is the causes of the debts. Many trusts still have annual deficits, and PDC charges will contribute to this. The long-term funding settlement for NHS England, along with other financial changes, are hoped to return the sector to balance. However, just because the sector is in balance does not mean debts will not rise, as there could still be large deficits and cash shortfalls in certain trusts. Hence the overall position of the provider sector may hide the significant financial difficulties in many trusts.

The new guidance from the DHSC and NHSEI says loans will no longer be issued, with revenue support offered in the form of PDC. While this may improve the balance sheet of trusts, uncertainty remains over how this will operate in practice if trusts continue to face significant or growing deficits. Going forward, if the DHSC begins to issue PDC for revenue support to trusts in financial strife, rather than loans, in reality this is an accounting change, and not a sensible or sustainable long-term solution to NHS financial management.

NHS Confederation viewpoint

Overall, this is a positive and necessary reform in funding. This measure will assist trusts in the long term and is one less concern to deal with during the pandemic. However, in the short term, trusts will need direct increases in funding to meet higher day-to-day running costs. The bigger impacts of this measure, as the NHS England chief executive noted, are that it will assist trusts to deliver on the ambitions set out in the NHS Long Term Plan.

Once the NHS returns to more normal service, there needs to be a more specific and detailed plan to address the underlying financial issues that led to the buildup of so much debt, particularly in the provider sector. Part of the problem is that the overall level of funding across the system has not kept pace with demand, and efficiency targets have often been unrealistic. However, some of the financial challenges also relate to longer-term structural issues, in particular health economies. Many trusts are still seeing significant deficits. Once this pandemic is over, a detailed assessment of the NHS funding environment is required to ensure that the situation does not repeat itself.

The government has committed to increased capital spending in the NHS and writing off the debt will assist with this. It will help trusts create stronger business cases for capital investment, as they no longer have to be measured against the significant debt that had been accumulated However, whether they can build sufficient cash reserves remains uncertain, and there is the possibility that trusts will need to use more PDC for future capital investment.

While it is welcome news that new debt will not be issued, there is a need to create a funding environment that does not require PDC for revenue loans either. Sound financial management should not involve equity investment by the DHSC to cover trusts that are unable to meet costs.

Questions remain on many trusts' financial positions each year, along with abilities to pay PDC. A future review of the PDC rate by the DHSC and NHSEI is anticipated and should be considered as part of a broader review into NHS funding and financial management.

Acknowledgments

This briefing was produced in partnership with the Health Foundation. Special thanks to Joshua Kraindler, economist at the Health Foundation's REAL Centre, for drafting this briefing on behalf of the NHS Confederation.

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We represent hospitals, community and mental health providers, ambulance trusts, primary care networks, clinical commissioning groups and integrated care systems.

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