Executive

Local Government Finance update Item 5

Report by:	Paul Honeyben	**Job title:**	Strategy Director: Local Government Finance & Improvement
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Contact Officer:	Paul Honeyben		
Telephone:	0207 934 9748	**Email:**	paul.honeyben@londoncouncils.gov.uk

Summary This report provides the Executive with an update on issues relating to local government finance, including on the Government's planned funding reforms, current issues - such as inflation, high needs deficits, adult social care reform, and concerns regarding the 2021 Census. It also looks ahead to London Councils priorities for lobbying on local government finance and funding for the next 18 months which fall within two broad areas: ensuring fair levels of funding for all parts of London that reflect its unique needs and inequalities; and establishing an updated vision for greater financial autonomy in London local government.

Recommendations The Executive is asked to note and discuss the contents of the report.

Local Government Finance update

Introduction

1. Spending Review 2021 set out funding envelope for local government for the next three years, and the 2022-23 Local Government Finance Settlement set out details for the current financial year, delivering a cash increase in funding of 7.3% (£541m) for London boroughs.

2. Welcome as this was, London Councils flagged that nearly all of the increase would go towards addressing the ongoing impact of Covid-19 on rising service demand and income losses, and in particular rising inflation (forecast to reach just 5% at the time). It was estimated that boroughs would still be required to make around £300-£400m of savings in 2022-23.

3. In December, the Government also committed to reforming the way core funding is distributed by reviewing the assessment of relative needs and resources that underpins the core funding councils receive from Government in the settlement. As yet, no plans have been set out and the distribution of funding is therefore not known for 2023-24 and 2024-25.

4. London boroughs are now considering the impact of inflation and other pressures on budgets for 2022-23 and are updating medium-term financial plans for the next 4 years in an uncertain environment.

5. This report provides the Executive with an update on issues relating to local government finance, including the latest on the Government's planned funding reforms, current issues – including inflation, high needs deficits, adult social care reform, and concerns regarding the 2021 Census. It also looks ahead to London Councils' priorities for lobbying on local government finance and funding for the next 18 months which fall within two broad areas: ensuring fair levels of funding for all parts of London that reflect its unique needs and inequalities; and establishing an updated vision for greater financial autonomy in London local government.

Funding reforms

6. The Secretary of State for Levelling Up, Housing and Communities at the 2022-23 LGFS, committed to ensuring an up-to-date assessment of councils' needs and resources, emphasising that "the data used to assess this has not been updated in a number of years". He committed to "working closely with the sector and other stakeholders to update this and to look at the challenges and opportunities facing the sector before consulting on any potential changes over the coming months". This was restated in the Levelling up White Paper in March.

7. However, the kind of fundamental reforms proposed within the Fair Funding Review now look unlikely to be deliverable in time for April 2023, as consultation and engagement with the sector would have had to have begun earlier in the Spring.

8. Were the Government to proceed with the full reforms, building on previous policy positions, it is proposed that London Councils priorities would be to:
    - ensure measures of need are up-to-date in light of the pandemic
    - ensure deprivation measures used reflect the higher costs of living in London
    - ensure the different costs of delivering services in different parts of the country are accurately reflected in the Area Cost Adjustment, with any proposed changes needing to be based on robust evidence
    - ensure population figures used are accurate and adjust for hard-to-count groups more prevalent in urban areas and appropriately adjust for the temporary reductions in population that may have occurred during the pandemic
    - Seek a separate needs formula for homelessness – reflecting unique factors that drive this in London
    - Ensure weightings within the Adult Social Care formula reflect current spending (with around 55% of spending going on working age adults)
    - Ensure any updated assessment of resources does not include sales, fees and charges income, appropriately accounts for the impact of the pandemic

on council tax collection rates and accurately reflects lower collection rates in urban areas more generally

- Ensure any transitional arrangements are clear and transparent to provide funding certainty.

9. The overarching priority would be for **no council to be worse off as a result of the review.**

10. Another of the more fundamental changes to funding distribution would be if the business rates retention scheme were reset to redistribute the growth that has accumulated since 2013-14, worth almost £2bn nationally. While not impossible, this would be technically difficult to deliver by April 2023, and may not make sense to do in isolation from the resetting of needs assessment.

Other options for reform

11. As these fundamental reforms now look less likely, the Government may be considering which other levers within the LGF Settlement could be used to change the overall distribution of Core Spending Power (CSP) in 2023-24. The table below provides a reminder of the breakdown of CSP in the 2022-23.

Table 1 – Core Spending Power (£m) 2022-23 – England and London boroughs

	England	London Boroughs	% share
Council Tax Requirement	31,742	3,963	12%
Settlement Funding Assessment	14,882	2,778	19%
Baseline Funding	*12,478*	*2,211*	*18%*
Revenue Support Grant	*2,405*	*567*	*24%*
Compensation for under-indexing the business rates multiplier	1,275	226	18%
Improved Better Care Fund	2,140	346	16%
Social Care Grant	2,346	378	16%
Market Sustainability and Fair Cost of Care Fund	162	25	15%
New Homes Bonus	556	87	16%
Rural Services Delivery Grant	85	0	0%
Lower Tier Services Grant	111	26	23%
2022/23 Services Grant	822	152	19%
Core Spending Power	**54,122**	**7,981**	**15%**

12. Given the cost-of-living pressures on residents, it seems unlikely the Government will amend upwards the intended council tax referendum principles (of 2% main CT and 1% ASC precept) confirmed at SR21 for the next three years. SFA and the compensation for under-indexing business rates multiplier are derived by the underpinning needs and resources formulae and the business rates retention scheme. The new funding to support ASC reforms (£162m in 2022-23), increases to £600m nationally in 2023-24 and will have a separate distribution formula derived by DHSC. The above accounts for almost 90% of CSP.

13. The Government may, therefore, focus any changes on the remaining 11% (£6bn nationally). Of the remaining funding streams, the two social care grants (the Improved Better Care Fund and Social Care Grant) rely on the adult social care needs formula from 2013. An updated formula had been developed as part of the fair funding review; however, given the unlikeness of the core funding formula being updated (which includes an element for ASC), the Government may feel it would be inconsistent to use any updated formula within these two large specific grants (which account for £4.5bn nationally; £724m in London).

14. The remaining grants within CSP seem more likely candidates to redistribute funding. These include:
    - New Homes Bonus – worth £556m in 2022-23, on which the Government consulted in Spring 2021. All legacy NHB funding is set to end in 2023-24, and so even if the scheme continues under the current parameters, funding is likely to reduce by 40% to around £330m. London boroughs have historically received over 20% of this funding stream compared to an average of 15% for CSP overall. Any repurposing of this would be more likely to disbenefit London as a whole.
    - Lower Tier Services Grant – worth £111m in 2022-23 and created in 2020-21 to support councils delivering lower tier services. London boroughs receive 23% of this funding stream nationally, and so any repurposing of this would be more likely to disbenefit London as a whole.

- Rural Services Delivery Grant – worth £85m nationally (of which London boroughs receive nothing) and has grown steadily since it was introduced in 2014-15.
- Services Grant – worth £822m in 2022-23 nationally, as a one-off grant. The spending totals set out at the Spending Review suggest this funding is still included in the system for 2023-24 and 2024-25 and may be used to support any transition to new funding baselines if the more fundamental reforms go ahead. This funding could be used to top up other funding streams or repurposed to create new ones. London boroughs received around 18% of the grant in 2022-23.

15. Given the lack of information, there remains much uncertainty. However, London Councils will respond to any consultation on planned changes to the distribution of funding were it to be published over the summer.

Current issues and challenges

16. This section sets out some of the current and future financial challenges facing London boroughs for the remainder of the year.

<u>Uncertainty</u>

17. While the Spending Review set a three-year envelope for local government funding, boroughs continue to have very little certainty over funding for the next two years. There have effectively now been 4 single-year settlements in a row, which hinders any strategic long-term planning, impacts on delivering best value for money and will explain why some authorities will have felt it necessary to add to reserves in recent years to manage growing risks relating to this uncertainty. The need for funding certainty will continue to be a core priority for London Councils' finance lobbying.

<u>Inflation</u>

18. Rising energy prices, global supply chain issues and the economic consequences of the war in Ukraine have driven inflation levels to a 40-year high. The changes to GDP inflation alone (from under 3% at the time of the Spending Review to over

4% in March) mean the increase funding London boroughs received in 2022-23 is now worth around £100m less in real terms than when it was agreed.

19. The Government's standard measure of inflation – the GDP deflator – will not reflect the true costs of inflation within council contracts and other running costs, some of which may be closer to CPI inflation (currently at 9% and forecast by the Bank of England to peak at 10% later this year). The high inflation environment will also put upward pressure on pay inflation, which is likely exceed the 2% boroughs have budgeted for on average. Modelling suggests inflation may lead to additional budget pressures of at least £400m in 2022-23, continuing at £200-300m next year.

20. DLUHC has been monitoring the financial impact of the pandemic since April 2020 through a regular survey of local authorities. The final survey return was completed in May, looking back at the financial year 2021-22. At the pan-London level, funding has covered the costs of the pandemic over the last 2 years across London, which totaled £2.1bn in 2020-21 and £1bn in 2021-22 in London. The final outturn survey shows, over the two years, boroughs collectively received around £100m (3%) more than they reported in spending pressures and income losses. However, the majority of the council tax and business rates losses only impact council budgets this year totaling up to £250m with a further £100m next year. Any surplus in funding received so far is being used by boroughs to mitigate budget pressures caused by those tax losses and by ongoing heightened demand pressures, notably within adult and children's social care. This point will be made within any lobbying around rising costs of inflation, which is a new and separate issue.

High Needs

21. Dedicated Schools Grant (DSG) deficits resulting from high needs pressures, remain a growing concern for the vast majority of boroughs. The DfE has set out a series of measures to address this through the uplift in High Needs block funding this year (13%), the increased number of "Safety Valve" deals, and plans to share good practice through the Delivering Better Value programme, as well as other policy changes set out in the SEND Green paper, which it believes will make the

system financially sustainable. However, accumulated DSG deficits are forecast to reach £400m by the end of 2022-23, with nearly all boroughs now carrying them. A recent survey with London treasurers suggested that, for just under half, this is a risk to financial resilience.

Adult Social Care reform

22. Around £162m of funding was provided in 2022-23 for authorities to prepare markets for reform and move to a "fair cost of care". The Government is working with authorities to collect data to inform the distribution of a further £600m in 2023-24 and 2024-25 nationally, as well as distribution of £800m next year for the wider reforms. Concerns are emerging across the sector that the funding set aside to cover the reforms may not be enough. A recent report found the costs would exceed funding by £10bn over ten years nationally[1]. The impact will vary across London but could be significant for those with higher proportions of self-funders.

23. While there are concerns over the cost of the funding reforms, arguably the bigger concern is whether, over the longer term, the level of funding support for social care through the Health & Social Care Levy (not known beyond 2024-25) will be able to meet the growing demand pressures resulting from the pandemic, an ageing population and growing complexity of need within younger adults.

Census 2021

24. Finally, there is a growing concern that the 2021 Census may have undercounted some parts of London's population, which was taken during the third national lockdown in March 2021. Younger residents may have temporarily moved back to live with parents, immigrants may have returned to their countries of birth, people with second homes in less densely populate areas may have preferred to stay there and because the census was undertaken almost entirely online, may have undercounted communities who are digitally excluded.

25. As a result, there is a risk that all funding formulae which rely on population characteristics from the census will misrepresent London's population.

[1] http://www.countycouncilsnetwork.org.uk/download/4278/

26. Lobbying priorities are therefore to ensuring there is an appropriate statistical adjustment before raw Census numbers are turned into projections/estimates (which are used in funding formulae) and to ensure thorough sense-checked with other administrative data sources (for example the 2021 schools census, which shows little impact from the pandemic).

<u>Lobbying priorities</u>

27. Given the above issues, a key focus for London Councils' finance policy work in 2022 and 2023 will be to lobby government to ensure fair levels of funding for all parts of London that reflect its unique needs and inequalities and ensure no borough is left worse off by any funding reforms. This is reflected within the Shared Ambitions under "London's Voice".

28. Some key outputs within this programme of work will include, but are not limited to:
    - Responding to any consultation on core funding distribution – summer 2022
    - Responding to SEND review with high needs funding concerns – summer 2022
    - Lobbying around use of accurate population data from Census 2021 – summer/autumn 2022
    - Lobbying campaign/submission ahead of the Budget – autumn 2022
    - Lobbying ahead of the 2023-24 LGF Settlement – autumn 2022
    - Lobbying to influence ASC reform funding – summer/autumn

Financial autonomy and fiscal devolution

29. London Councils has, for the last decade or so, consistently called for greater fiscal devolution and for London boroughs to have access to a broader range of revenue raising powers. This aligned closely with the recommendations of the London Finance Commissions in 2013 and 2017. The London business rates pilot and pools from 2018-19 to 2020-21 were seen as showing progress towards London Government having greater financial autonomy.

30. In the short term, the rebounding of London's economy may mean business rates pooling will be profitable again in 2023-24. Analysis will be undertaken over the summer, and Leaders' Committee will be asked to take a decision on whether to reconstitute the pan-London pool, in the autumn.

31. However, the pandemic has demonstrated some of the weaknesses of overreliance on business rates as a source of income, and the complexity of the retention scheme, evidenced by the fact that the government will be providing over £1bn of grant funding this year to compensate for historical decisions. The Government has now paused any consideration of further business rates retention beyond the existing 50% scheme. Future direction of London Councils' policy positions on business rates will form part of a wider renewing of policy positions on fiscal devolution in the autumn.

32. The levelling up context also provides an impetus to consider alternative funding streams and ways of accessing additional sources of revenue and capital in big cities like London. The Levelling Up White Paper provided a helpful set of long-term public policy ambitions, with the 12 Levelling up missions setting objectives to 2030, alongside a framework for devolution. While there is no commitment to fiscal devolution, one of the aims within the 12th mission is "for every area of the country to have a simplified long-term funding settlement" by 2030. This provides an opportunity to work to a more autonomous funding settlement for London over a gradual but arguably more realistic timeframe, given the current economic uncertainty and historic reluctance of government to devolve funding to local government.

33. The successful delivery of services and support to communities and businesses during the pandemic provides a strong evidence base to underpin arguments for greater local control over funding. London boroughs showed what could be delivered when they were given sufficient funding and responsibilities to support local communities.

34. More detailed work will be undertaken with the Elected Officers, the Executive and Leaders' Committee in the autumn. However, it is proposed that, as part of the

Shared Ambitions, the other core finance priority will be to set out an updated vision for greater financial autonomy in London local government, enabling London local government to retain more of the income it generates and take steps towards becoming more financially autonomous.

35. Key milestones/outputs will include but not be limited to:
    - Leaders Committee to reconsider business rates pooling – autumn 2022
    - Leaders Committee to agree a priority suite of taxes/flexibilities on which to focus - autumn 2022
    - Lobbying campaign – aligning with other cities if possible - to seek devolution over taxes and revenue raising powers - remainder of 2022 and 2023

Recommendations

36. The Executive is asked to note and discuss the contents of the report.

Financial Implications for London Councils

None

Legal Implications for London Councils

None

Equalities Implications for London Councils

None