Leaders' Committee

Local Government Finance update Item 5

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Summary

This report updates Leaders' Committee on the latest issues relating to local government finance, including the Government's planned funding reforms, the rising costs of inflation, high needs deficits, adult social care reform, concerns regarding the 2021 Census, and reforms to Homelessness funding.

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

Leaders' Committee 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. While the 2022-23 Local Government Finance Settlement confirmed funding allocations for the current financial year, delivering a cash increase in funding of 7.3% (£541m) for London boroughs and £3.7bn (£7.4%) across England, funding allocations were not set out for the remaining 2 years.

2. Welcome as the funding increase was, London Councils flagged that nearly all of the uplift 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).

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. London boroughs have, therefore, been considering the impact of inflation and other pressures on budgets for 2022-23 updating medium-term financial plans for the next 4 years in a very uncertain environment.

4. As well as the planned reforms, this report provides Leaders' Committee with a broader update on issues relating to local government finance including the rising costs of inflation, DSG deficits, adult social care reform, issues with the 2021 Census, and the latest proposals to reform the Homelessness Prevention Grant.

5. 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. At the 2022-23 LGFS in December 2021, the Government committed to provide an up-to-date assessment of councils' needs and resources and to consult with the sector on any changes in the coming months. However, the kind of fundamental reforms previously proposed as part of the Fair Funding Review – between 2016 and 2019 – 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.

7. The previous Secretary of State for Levelling Up, Housing & Communities, Michael Gove, confirmed to the LGA conference on 28 June the Government's intention to provide a 2-year local government finance settlement for 2023-24 and 2024-25, on which it would consult shortly. He also suggested that the "fair funding" reforms would be complete this calendar year. However, given the complexity and fundamental nature of the previously proposed reforms, it is likely that this was either a reference to the planned consultation on a 2-year settlement, or to restarting the process (including working groups with DLUHC and the sector) to deliver the more fundamental reforms over a longer time period in time for 2025-26.

8. Another fundamental change to the funding distribution that had been previously suggested would be delivered alongside the fair funding reforms would be the reset of the business rates retention scheme – which would redistribute around £2bn of accumulated growth that has been retained by local authorities since 2013-14. While not impossible, like the fundamental reforms to the needs and resources assessment, this would be technically very difficult to deliver by April 2023, and discussions with civil servants suggest this is unlikely to be delivered in isolation of the fair funding reforms.

9. At the time of drafting, the position of the new Secretary of State, Greg Clark, regarding the reforms remains unclear, although it is worth noting that the original fair funding reforms were set in train when he was the SoS for Housing, Communities and local Government in 2016.

10. Were any fundamental reforms to go ahead, London Councils' top priority would be for **no London borough to be worse off as a result of the review.**

Other options for reform

11. As the fundamental reforms now look less likely, the Government may be considering which other levers within the local government finance settlement (LGFS) could be used to update 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 across England and London boroughs.

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) set out 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, which - as suggested above – are unlikely to be reformed for 2023-24.

13. The funding to support ASC reform (£162m in 2022-23), increases to £600m nationally in 2023-24 and will have a separate distribution formula derived by

DHSC, which is planned to be subject to consultation shortly. The remaining social care funding streams (the Improved Better Care Fund and Social Care Grant) use the adult social care relative needs formula from 2013. An updated formula had been developed as part of the fair funding review; however, given the unlikeness of the overall core funding formula being updated, 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), but not the main formula. While these grants may be subject reforms, they are unlikely to be significant or fundamental.

14. The remaining grants within CSP (which represent about £1.6bn in 2022-23 – or 3% of CSP) seem more likely candidates to be reformed 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. Any additional funding for this grant would – in relative terms – disbenefit London boroughs and other urban authorities.
    - *Services Grant* – worth £822m in 2022-23 nationally, as a one-off grant. The spending totals set out at the Spending Review suggest £700-800m of this funding is still included in the system for 2023-24 and 2024-25. It had been planned to be used to support the transition to new funding baselines, had the more fundamental reforms gone ahead. This funding could

therefore 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. London Councils will respond to any consultation on planned changes to the distribution of funding, emphasising the need for funding certainty and additional funding to address ongoing inflationary pressures (see paragraphs 18 to 22 below).

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>Inflation</u>

17. 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.

18. 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 10% and forecast by the Bank of England to peak at 11% 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.

19. The previous secretary of state for LU&HC suggested it was unlikely the government would provide additional funding support to cover growing inflationary pressures, stating: "I wouldn't want to hold out any false hope that there's going to

be a significant additional injection of cash, we have to operate within the constraints that the Spending Review gave us"[1].

20. It has been suggested that the funding local government received to deal with pressures during the pandemic, and the uplift in funding for 2022-23, provides enough to address the ongoing impact of inflation. The figures for London boroughs suggest the covid-19 related funding received in 2020-21 and 2021-22 exceeded the additional spending and lost income in those years; however, around £300m of lost tax income is due to hit budgets in 2022-23 and 2023-24. Any increase in reserves that may have resulted from underspending of covid-19 related funding, 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.

22. London Councils' response to the consultation on the SEND Green Paper raises concerns about these ongoing pressures and whether the reforms proposed will be enough to make the system financially sustainable. It also calls for the short-term extension of the hardened ringfence on the DSG to be extended beyond 2022-23, to protect authorities with the highest deficits.

[1] https://www.lgcplus.com/finance/gove-dont-have-false-hope-of-extra-funding-28-06-2022/

Adult Social Care reform

23. 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[2]. The impact will vary across London but could be significant for those with higher proportions of self-funders.

24. Partly in response to these concerns, the Government confirmed, on 7 July via Written Ministerial Statement, that implementation of section 18(3) of the Care Act 2014 (which extends the right for self-funding individuals to have their eligible care needs met by their local authority) will be phased in rather than implemented from October 2023, meaning current self-funding individuals will not be able to ask local authorities for support until April 2025. Given the concerns raised across the sector about its ability to deliver the reforms by October 2023, this staged approach is largely welcome.

25. It is believed the Government will consult shortly on the distribution of around £700-800m of funding to support the capping element of the reforms next year. London Councils will respond to any such consultation and seek to ensure a fair distribution method which reflects London boroughs priorities and population characteristics.

Census 2021

26. The first results from the 2021 Census were published on 28 June. London's population was estimated to be 8.8 million on 21 March 2021 when the census was taken. London Councils raised concerns that the census is likely to have undercounted some parts of London's population, as it was taken during the third national lockdown in response to the coronavirus pandemic. The overall figure is almost 300,000 lower than the previous 2021 ONS population projection for London of 9.1 million, and around 200,000 lower than the mid-year estimate for 2020.

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

27. There is evidence to suggest that younger residents temporarily moved back to live with parents, some immigrants may have temporarily returned to their countries of birth, and people with second homes in less densely populated areas may have preferred to stay there during the pandemic rather than risk living in more densely populated areas. It is likely that the population in March 2021 was lower than prior to the pandemic and lower than it is now.

28. As a result, there is a risk that funding formulae which rely on population characteristics from the census could misrepresent London's "true" business-as-usual population. London Councils press release in response to this first release of census figures urged caution over their wider use without additional sense-checking. A briefing was also sent to London MPs to raise awareness of the issue. Further lobbying will be undertaken – in partnership with the GLA and sub-regional partnerships - to urge the ONS to ensure there is an appropriate statistical adjustment to the census numbers when they deliver 2021 and 2022 population estimates, which will ultimately be used in future funding formulae.

Homelessness Prevention Grant

29. On 1 July the Government published a technical consultation on the future of the Homelessness Prevention Grant from 2023-24 onwards. This is one of the larger grants boroughs receive outside of the core finance settlement, worth £310m nationally in 2022-23, of which London boroughs received £149m (48%). The overall funding will remain the same for the next two years 2023-24 and 2024-25, but the consultation proposes two options to reform the distribution of the grant, based on a simplified formula and putting greater reliance on past expenditure data rather than modelling. The options result in London boroughs losing £6m and £15m respectively, and London Councils is working with London Housing Directors and London Treasurers to provide a well-evidenced and robust response to the consultation by 26 August.

Lobbying priorities

30. 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”.

31. 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 to influence ASC reform funding – summer/autumn
    - Responding to the current consultation on the Homelessness Prevention Grant – (deadline 26 August 2022) – further campaigning summer/autumn 2022
    - Lobbying campaign/submission ahead of the Budget – autumn 2022
    - Lobbying ahead of the 2023-24 LGF Settlement – autumn 2022

Financial autonomy and fiscal devolution

32. 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.

33. 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.

34. 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.

35. 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 12^{th} 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.

36. 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.

37. 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.

38. 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

39. Leaders’ Committee 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