LGA Executive
9 February 2012

Item 3

Local Government Finance

Purpose of report

For discussion and direction.

Summary

This report provides an update and overview on key local government finance issues.

Recommendations

Members are asked to provide general direction on the LGA's work on the significant local government finance issues described in this report.

Action

Finance Task Group; Director of Finance and Resources.

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Local Government Association

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Background

1. The December meeting of the Executive received a report on the implications of the Chancellor's Autumn Statement. This report noted that further cuts were likely in local government funding in 2013-14 and 2014-15, because HM Treasury now proposed to remove 'savings' attributable to pay restraint. In addition, the Autumn Statement's outlook for the public finances beyond 2015 suggested that potential continuing cash cuts in local government funding in 2015-16 and 2016-17 were possible.

2. After the Executive had met, the Government made announcements just before Christmas on how it proposed to take forward the relocalisation of business rates, and the localisation of council tax benefit, in the light of the consultations on these changes that had taken place over the summer of 2011.

3. The Government has also set out its detailed proposals for local government formula funding for 2012-13. Over the last few weeks, individual local authorities and the LGA have been making representations to Ministers about the finance settlement numbers, and it is likely that final figures will be approved by Parliament either before or around the time of the Executive meeting.

4. This report therefore aims to summarise the implications of these developments, and set out a possible approach to LGA work on behalf of member authorities over the next 12 months or so. The detail of this work will be taken to the newly established Task Group on Local Government Finance.

The 2012-13 Local Government Finance Settlement

5. The provisional local government finance settlement for 2012-13 was published shortly after the 2010 Spending Review. The figures now under discussion are not materially different from the original ones. The funding for the 2011-12 council tax freeze has, though, now been consolidated into the figures.

6. The LGA submitted a response to the consultation on the settlement, and the Chairman and Group Leaders met with Bob Neill MP on 11 January. The key points we sought to make covered:

   6.1. the sheer scale of the budget cuts combined with mounting spending pressures - meaning that services for vulnerable people will inevitably face a funding squeeze;

6.2. the academies funding transfer – a separate report to the Executive deals with this issue;

6.3. the opportunity for the Government to help alleviate these pressures at modest additional cost is by raising the threshold at which the transitional grant is paid from an 8 per cent loss in total spending power to a 5 per cent loss;

6.4. the inappropriateness of making local government funding subject to adjustment in future years because of the pay cap; and

6.5. the need to ensure that all the proceeds of growth from business rates go back to local government, rather than the Treasury using some of the money to set against other funding cuts.

7. The finance settlement has very recently been published in its final form, for the approval of the House of Commons. It appears to be unchanged from the settlement published for consultation.

Council tax freeze

8. Most councils appear to be planning to freeze their council tax for 2012-13 and will therefore receive the Government's grant to support this. We are aware of around 15 authorities that have announced proposed increases in council tax. The Chairman has commented, in relation to the grant, that it is important to understand that it is a one-off grant, and that councils need to consider the long-term interests of their residents before deciding whether to take up the offer of the freeze grant.

The Business Rates localisation proposals

9. The Government published a detailed document on 19 December 2011 setting out how it proposed to implement the localisation of Business Rates following last summer's consultation. In the document we issued setting out our immediate response to these proposals, we noted that:

9.1. the proposals went some way to addressing local government's concerns about business rates relocalisation, but many detailed points remain unresolved;

9.2. the design of the new arrangements now incorporates more safeguards to help authorities that raise relatively low amounts of business rates, and is likely to deliver a more even level of incentive for growth across the full range of local authorities; and

9.3. the ‘set-aside’ arrangements remain in place, but now return a proportion of business rates income fully to local government.

10. The new proposals are therefore an improvement on the original ones, and the movement in the direction of a number of key changes we had sought is welcome; but more needs to be done.

11. The way that business rates localisation will now work is in summary as follows:

11.1. every authority will have a starting point position calculated reflecting the result of a Formula Grant calculation rolled forward to 2014-15 – that will be the **funding baseline**;

11.2. every authority will also have allocated to it a share (less than 100 per cent) of the business rates raised in its area – that will be the **business rates baseline**, and the percentage share will remain fixed until the system is reset;

11.3. going forward, if an authority’s business rates baseline is **more** than its funding baseline, then its future funding will be the fixed percentage share of actual business rates raised less a tariff equal to the RPI indexed difference between the two baselines, and possibly also less a levy designed to ensure that rewards for business rates growth are proportionate between different authorities;

11.4. if on the other hand an authority’s business rates baseline is **less** than its funding baseline, the authority’s future funding will be the fixed percentage share of its actual business rates raised, plus a top-up amount equal to the RPI indexed difference between the two baselines;

11.5. safety net arrangements will apply to protect any authority that sees its funding decrease by more than a set percentage below its baseline funding level, uprated in line with RPI.

12. A graphic will be available at the Executive’s meeting that may help to illustrate how this new system will work.

13. In two tier areas, the proposals now published are significantly different from the original ones, which found little support. The Government has now decided to split the business rates share on a roughly 80:20 basis between Shire Districts and Counties. This will provide districts with a high degree of incentive to grow their business rates (and higher risk if growth is not achieved), and give counties more stability in their funding, as they will be more likely to be ‘top-up’ than ‘tariff’ authorities.

14. Single service Fire and Rescue Authorities will come within the scope of the scheme, as will the GLA, the revenue elements of whose general grant will be funded from business rates. The Government response notes that further consultation will be needed with London authorities about how this is achieved.

15. Many detailed parts of the scheme remain to be determined, but on the important area of resets the Government has set out an 'aspiration' that the reset period should be ten years. A number of authorities have questioned whether this would allow authorities sufficient funding to cover increases in the need for services caused by changes in demand, particularly in relation to social care. The LGA proposal was that resets should be triggered by evidence that they were needed.

16. The Local Government Finance Bill legislates for the framework of the new scheme, but leaves all the detail to be covered in secondary legislation or by Ministerial decisions allowed under the legislative framework. The LGA is actively working to brief Parliamentarians and inform the debate, for example by suggesting possible amendments.

17. As noted above, the new proposals incorporate many of the changes the LGA had sought in our consultation response. Indexed tariffs and top-ups and the 'proportionate' option for the levy are key design features of the new scheme that we advocated. The Government's approach to transitional relief on revaluation makes a significant concession, in terms of sharing overall risk of loss, as compared with the original proposals. And, most importantly, the new approach on the percentage sharing of business rates income between local and central Government is a major change from the original proposals, where the predetermined 'set-aside' guaranteed reward for the Treasury while leaving the downside risk with local authorities.

18. Whilst the new approach on set-aside is an improvement, it only gives local government partial access to business rates growth rather than the full proceeds of growth that we sought. Furthermore, the new forecasts announced in the Autumn Statement imply that the Government will continue to take 'set-aside' money until at least 2016-17, through the retention of strong controls over local government spending. Maintaining controls over spending through what is, in effect, a Government tax on local growth, is not true localisation of the business rates funding stream.

19. These proposed arrangements will have significant implications for the design and operation of the scheme over the four years from 2013-14. The Government has yet to set out exactly how the new arrangements will work, but we believe that, in order to be able to operate spending controls, the Government will set the local authority share of business rates relatively low – some very tentative calculations suggest a figure of around 70 per cent would fit

with what the Autumn Statement appears to imply about spending control between 2013 and 2017. In the first few years of the scheme, the business rates share retained by Government would be used to provide additional core funding to local authorities, but the level of that funding would fall year by year as public spending was reduced.

20. An alternative approach would be to transfer fully within local control more of the services that are now delivered through local government, but funded centrally through specific grants. One specific grant which the Government might see a case for transferring into the rates-funded portion, for example, could be the subsidy for localised council tax benefit. There may also be potential for the devolution of new responsibilities through this route. Transport and skills funding lend themselves particularly to this kind of approach as they fits naturally with the wider economic development that business rates retention aims to incentivise. It could therefore be consistent with the LGA's policy on business rates localisation to explore this kind of change.

Council tax benefit localisation

21. Alongside its proposals for business rates relocalisation, the Government also published its response to the consultation on localisation of council tax benefit.

22. The Government's document does not much help to clarify the likely financial implications for councils, beyond confirming a headline subsidy cut of 10 per cent. Ministers still wish to provide absolute protection for pensioners, and for vulnerable groups, but have left it up to councils to decide which groups they will treat as vulnerable. Preserving the provisions of the current system for pensioners alongside new protection for locally-defined groups risks making council tax support more complicated and possibly more expensive to administer. The Government's consultation response makes minimal acknowledgement of the need for financial risk attributable to increased demand to be shared. The Government document says that funding will be provided in 2013-14 and 2014-15 in line with the Office for Budget Responsibility's forecasts of demand for council tax benefit (less the 10 per cent cut) but thereafter funding will be determined as part of Spending Review decisions. However, there has been helpful confirmation that the additional costs of setting up new localised support schemes will be funded, in accordance with the New Burdens Doctrine. How future funding will be distributed between authorities is still under discussion: there is a tension between mimicking current patters of spend on Council Tax Benefit and anticipating a future scheme whose cost may be principally driven by the number of pensioners. Discussions are also under way about the shape of any national "model" scheme.

23. All this means that, with barely a year to go until the introduction of the new scheme, councils and their IT suppliers still have very little of the detailed

information needed to plan for the effective introduction of this major change which is likely to have a significant impact on large numbers of relatively poor people, particularly those of working age. Some progress is being made through engagement with the reference group set up by the Department for Communities and Local Government, but councils feel that more rapid impetus is needed.

Overall financial outlook

24. The factors discussed in this report combine to paint a picture of an exceptionally challenging financial outlook for local authorities over the next few years. Officers believe that it is essential that the overall picture is fully understood, and its implications properly debated and communicated. This is of particular importance in relation to decisions that will be taken in the next Spending Review. Having regard to the need to progress Community Budgets, a programme of LGA work is therefore proposed that will:

    24.1. construct a projection of the likely sustainable level of local public service provision by councils over the medium term if their revenue base were to be constrained within the spending levels implied by the Autumn Statement; this projection would look at the likely evolution both of levels of service and the balance in priority between services, delivery models, and councils' use of non-tax sources of revenue to fund services; it will also consider the ways in which any different future service model might be negotiated between councillors and their local electorates, and between councils and Government departments with oversight responsibilities for local services;

    24.2. provide an account of the possible level of service provision and delivery models on the same funding assumption but on the hypothesis that local public service budgets were pooled and services were to be commissioned across organisations on the community budget model; and

    24.3. develop support for member authorities both in assessing levels of future financial stress and in taking action to reduce future financial risk.

25. Alongside this, a campaign on the theme of sustainable funding for local government is suggested, and proposals for this campaign have been put to the LGA Leadership Board.

Financial implications

26. This is core work for the LGA which is funded from existing budgets.