Future funding outlook for councils from 2010/11 to 2019/20

Local Government Association

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www.local.gov.uk

Foreword

This paper, setting out the impact of growth pressure and funding cuts on English local authorities, shows once again that the model we have for local government finance will not see us through for very much longer.

Councils were cut earlier and harder than the rest of the public sector as the Government began to implement its deficit reduction strategy. From the outset the Local Government Association (LGA), working with local authorities from across the country, has sought to model and explain the impact of these cuts. The 'Future funding outlook' for 2012 set out the results of the first published national model of local government spending to the end of the decade and was generally well received. As the scale of the cuts continues to bite in local authorities, we have updated and further refined the modelling for 2013, confirming our 2012 results.

The model shows a widening gap between what local authorities would need to spend to continue to respond to the pressures on local services and the funding likely to be available.

That gap widens by approximately £2.1 billion a year across England – about 4 per cent of what is currently spent on the services captured in the model.

Funding cuts are not the sole cause of this gap. Growing pressure on public services, much of it brought about by population change, makes a contribution too. It is evident that a system in which demand and costs are going up and funding is going down is unsustainable and unless something changes, by the end of the decade, councils will not be able to deliver existing services in the way they are delivered now.

Every local authority in the country will be grappling with spending pressures and less money to pay for them, but the impact of cuts varies across the country.

This is another reason why top-down central solutions do not work.

It should be up to local people, with their knowledge of local circumstances, to work out how to respond in detail to these challenges, unhindered by government. It is clear they cannot do so unless something changes.

To address these issues, however, the LGA has launched a new vision for the future of English public services. ‘Rewiring public services: Rejuvenating democracy’ contains a menu of ideas designed to:

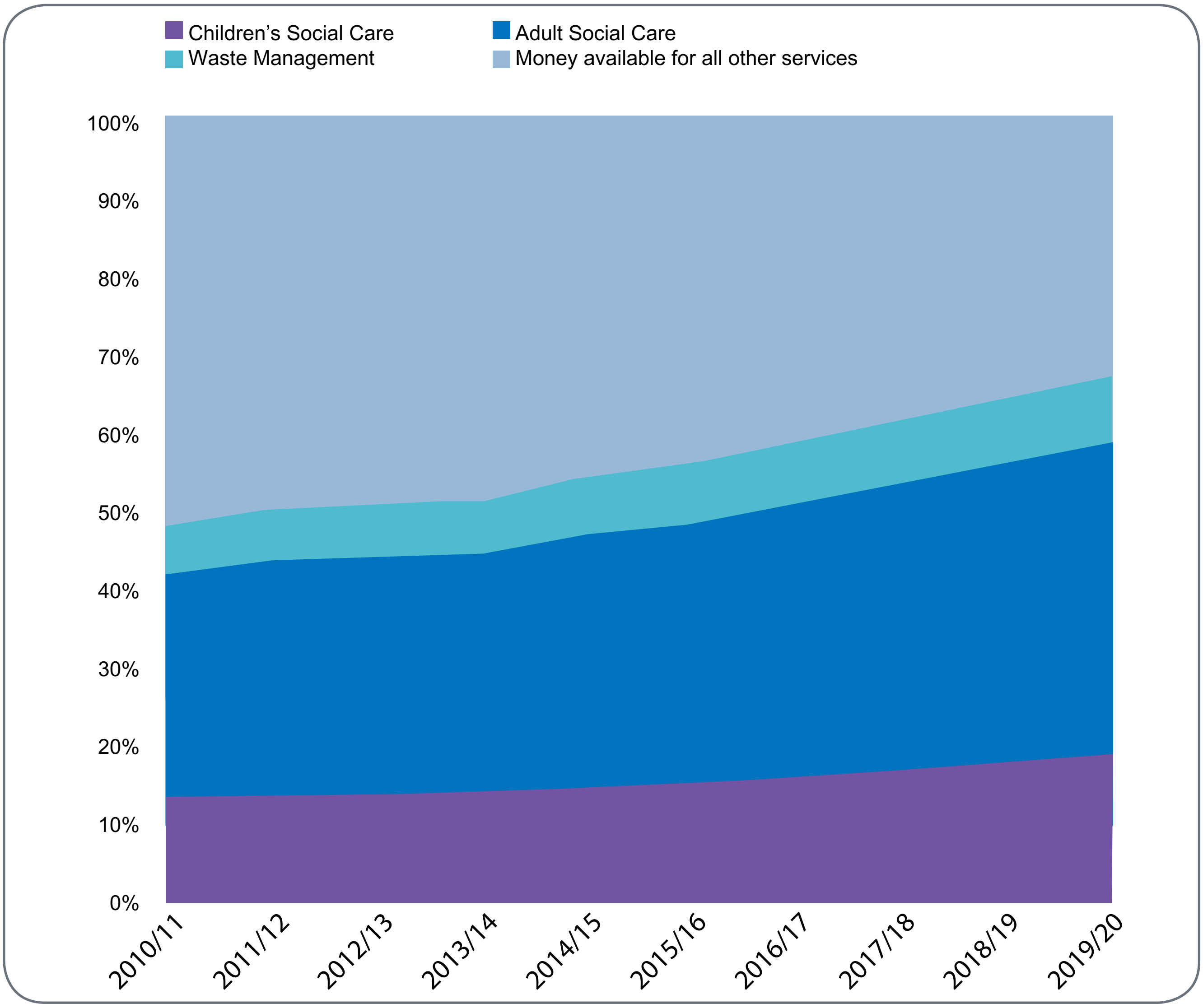
- rejuvenate democracy and give back to people real reasons to participate in civic life and their communities
- transform public services so they prevent problems instead of just picking up the pieces
- boost economic growth in a way that offers prosperity to every place.

We hope this modelling is once again of use to decision makers in government, opinion formers and not least local authorities themselves as together we take on the challenges.

Councillor Sir Merrick Cockell
Chairman of the LGA

Executive Summary

- The purpose of this paper is to set out the impact, on the available resources of English local government, of funding cuts and unavoidable growth pressure.
- The 'Future funding model' for 2013 largely confirms the findings of the 2012 modelling.
- The funding gap is growing at around £2.1 billion a year, adding up to £14.4 billion by the end of the decade. It is created by a combination of funding cuts and spending pressure.
- We don't yet have the full picture from government of what future funding cuts will mean in detail. However on the same trajectory of cuts that has been experienced to date, over the period from 2010/11 to 2019/20 income falls by 15 per cent in cash terms, or over 27 per cent in real terms. When we account for the introduction of public health funding, income falls by 21 per cent in cash terms and 32 per cent in real terms.



- Assuming authorities can keep making efficiencies at between 1 per cent and 2 per cent per year, the model shows a total predicted increase in expenditure in cash terms of some £7 billion, or 14 per cent, by 2019/20.
- With social care and waste spending absorbing a rising proportion of the resources available to councils, funding for other council services drops by 46 per cent in cash terms by the end of the decade, from £26.6 billion in 2010/11 to £14.3 billion in 2019/20. More funding from the NHS for social care does not fully fund the adult social care funding gap for the period.
- The model assumes that local authorities will use reserves to spread the impact of cuts where they can afford to. Authorities will have different strategies in relation to the use of reserves, but using up reserves more quickly increases the risk to services and does not reduce the gap to be closed by 2019/20.
- Aspects of the local government funding system, such as the use of ringfencing and the protection of certain budgets and the lack of flexibility in the generation of income, get in the way of delivering efficiencies to deal with the funding gap.
- A sustainable future for local government in the face of funding cuts and spending pressures is dependent upon changes in the way we think about funding local government, and how we manage the system. The LGA's publication 'Rewiring public services: Rejuvenating democracy' sets out our proposals.

Contents

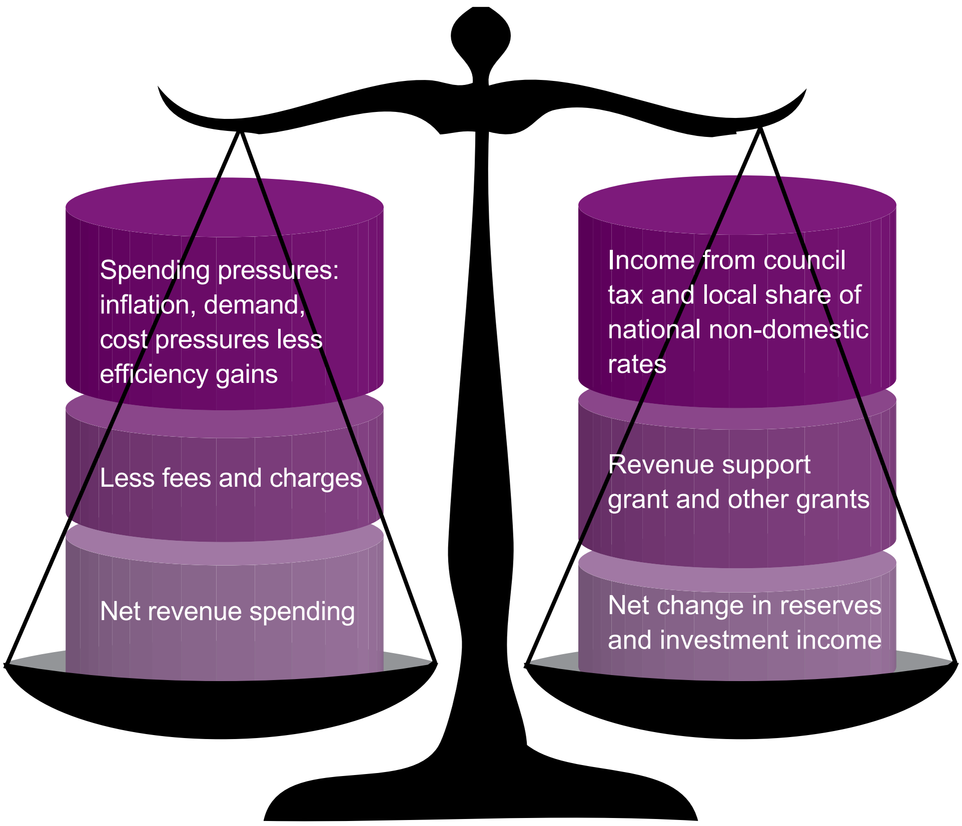
Introduction

In June 2012 the Local Government Association (LGA) published the preliminary model of future funding for councils. The aim of the paper was to present a credible analysis of the challenges facing local councils in the current and future spending review period.

This paper presents the results of the improved and updated funding model we have produced to illustrate the impact of change on local government in England. It will also be of interest to other parts of the UK facing similar pressures.

We have modelled all future sources of council revenue, including grants, local taxes, fees and charges, investment income and use of reserves to the end of this decade on assumptions that offset grant cuts against the potential for growth in other revenue sources.

Alongside this analysis we have projected likely expenditure pressures in all service areas, while recognising that councils are actively taking steps to mitigate cost pressures by reforming the way they deliver services.



Our analysis is built on:

- projections of council tax, business rates, grant and other income streams over the period 2010/11 to 2019/20
- projections of total annual net revenue spending in ten principal service blocks within council budgets over that same period.

To help readers understand how these figures work for an individual authority, we have also provided a narrative showing how three typical local authorities have responded to austerity so far, and how they see their future plans in the light of this analysis. These are available on the LGA's website under the titles 'AnySingleTier', 'AnyCounty' and 'AnyDistrict': www.local.gov.uk/finance

In addition, a technical annex is available to explain the technical analysis and assumptions built into the model.

Any projection of this sort must rely on some estimates and assumptions. There are inevitably areas are not covered by the model. We would like to draw the reader's attention in particular to the additional pressures created by welfare reform, and forthcoming local government pension revaluations. Because the impacts of these two high-risk areas are inherently uncertain, and very dependent on local circumstances, no account has yet been taken of any further change in the model.

We believe this model presents the most comprehensive picture available of the impact of cuts and spending pressure across the sector. It is not a pretty picture, but it should allow both central government and local authorities to better plan for the period ahead.

The path of council income

Over the course of the 2010 Spending Review, local government funding will have reduced by 33 per cent in real terms. A further real-terms cut of 10 per cent is confirmed for most local government services for 2015/16, and a similar trajectory is projected for the period beyond. In June, the Institute for Fiscal Studies expressed the view that government spending cuts will continue until 2020.

Our model projects the likely path of council revenue, based on a number of assumptions:

Council tax: We have assumed that council tax will increase by 1 per cent in 2014/15 and will thereafter grow by 1.5 per cent per year (below inflation projections). We have also assumed a modest growth in the tax base.

Business Rates: We have assumed future business rates will grow by retail price index (RPI) plus a local area growth estimate.

Grant funding: The position to 2013/14 is based on confirmed grant allocations, and the 2014/15 position is based on the provisional local government finance settlement. For 2015/16 we have applied a real-terms cut of 10 per cent, as confirmed in the Chancellor's Spending Round announcement of 26 June 2013, to the previous year's total Local Government Departmental Expenditure Limit. Additional funding from the NHS for adult social care is assumed to benefit social care authorities by up to £1.5 billion by 2020. We have calculated the grant funding trajectory after 2015/16 based on an estimate of the overall reduction in these grants. The central assumption is an 8 per cent cash cut in 2016/17 reducing to a 7 per cent cut in 2017/18 and onwards, modelling a similar trajectory of savings to that experienced in the period 2010-2014, as indicated by the Government[1].

Public health: We have used the public health funding allocation for 2013/14 and 2014/15 and for following years have assumed that the overall level of funding rises in line with CPI inflation.

Investment income: We assumed that yield will be responsive to the changes in the market gilt rate and be slightly affected by overall reserve levels.

Transfers to and from reserves: The model assumes that where a funding gap exists each authority will draw up to 5 per cent of its reserves each year to plug the gap, with the reserve level never going below 5 per cent of total annual expenditure. If the funding level is above predicted expenditure then all surplus will be added to reserves for that year. In practice individual authorities will make varying assumptions based on local analysis of risk and their local financial strategy.

A full description of the projections and all data sources are provided in the Technical Annex, available on the LGA's website: www.local.gov.uk/finance

1 Due to publication deadlines, further announcements made in relation to 'Investing in Britain's Future' on Thursday 27 June 2013 are not reflected in this paper.

Figure 1: Total council funding income 2010/11 to 2019/20

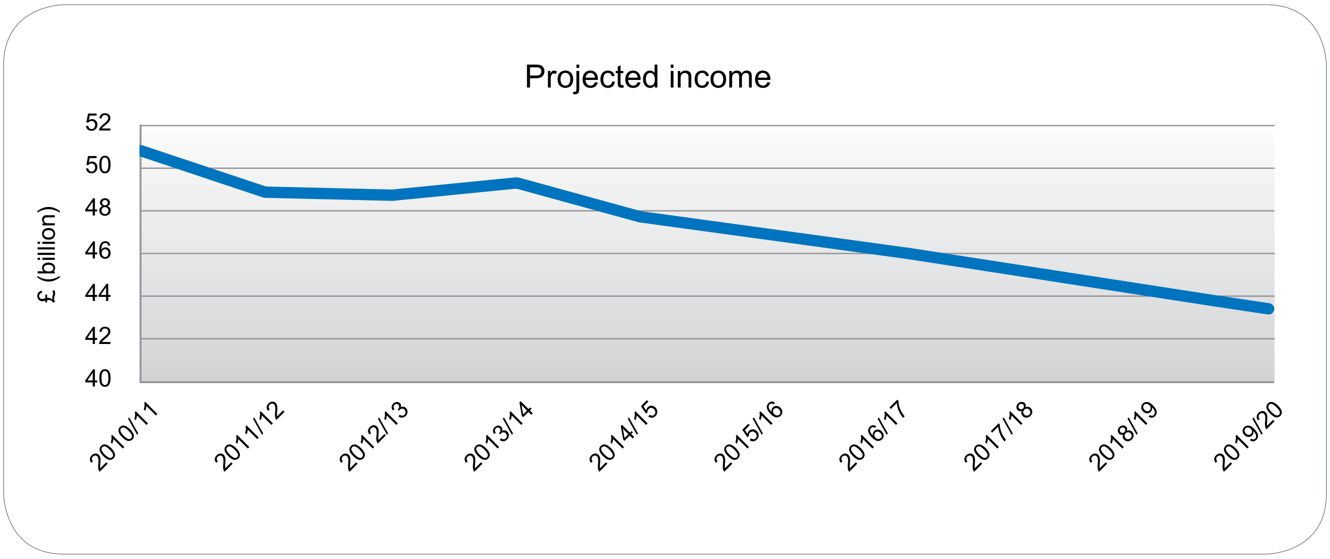


Figure 1 shows that total council income falls by £7.4 billion between 2010/11 and 2019/20. However, this total includes the introduction of ring-fenced funding for transferred public health responsibilities in 2013/14 and beyond, and when this is excluded the overall fall in income rises to £10.5 billion.

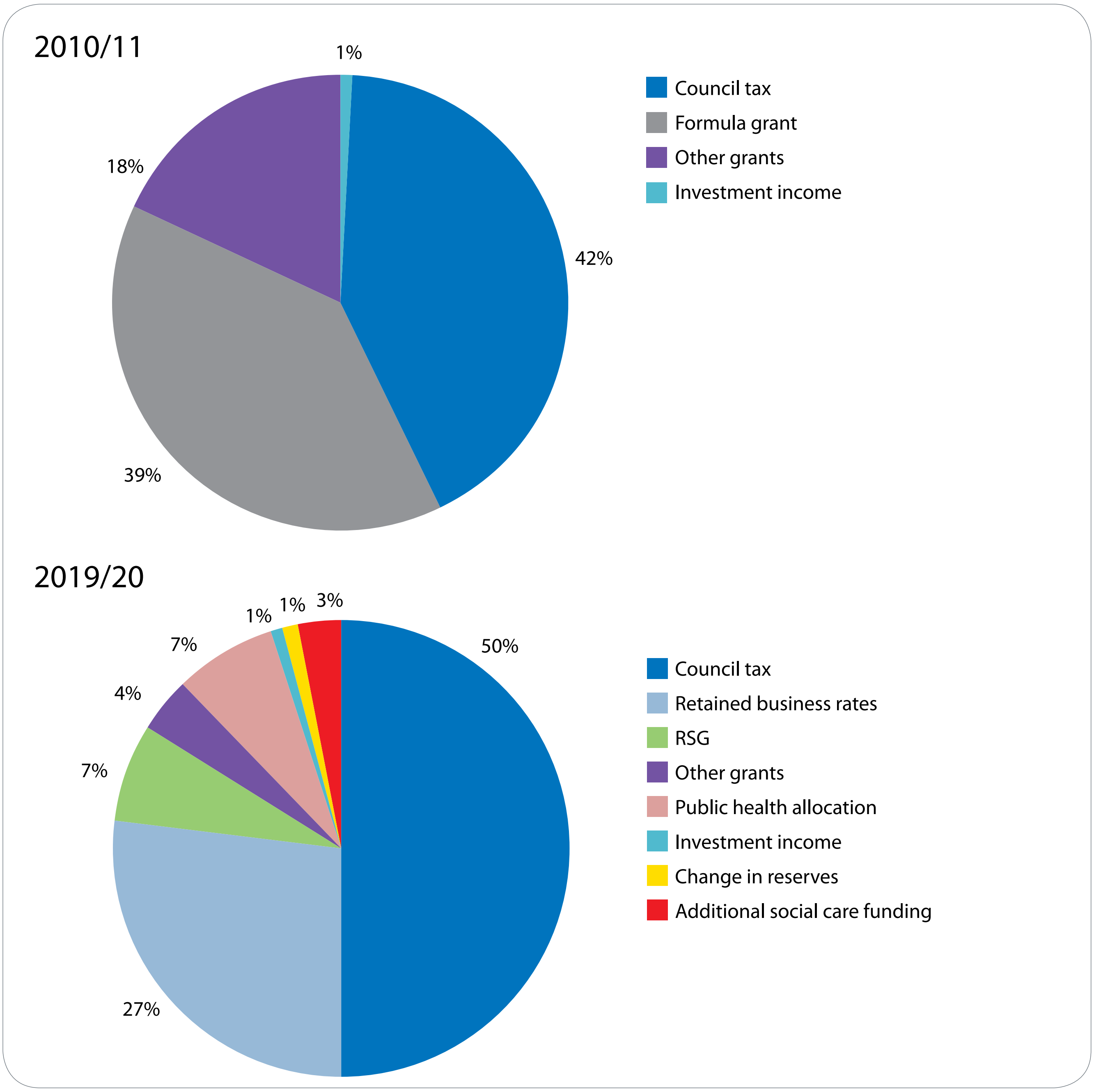
Over the period, income falls by 15 per cent in cash terms, or over 27 per cent in real terms[2]. When we account for the introduction of public health funding income falls by over 20 per cent in cash terms and 32 per cent in real terms.

The figures include an assumption that NHS funding to adult social care announced in the Spending Round for 2015/16 will be ongoing and will reduce pressure on such spending.

The changes in the way local government is funded can clearly be seen by comparing the sources of overall funding in 2010/11 and 2019/20. Council tax provides 50 per cent of the total funding income by the end of the decade, with the proportion of income coming from centralised grants falling over the decade as illustrated in Figure 2.

2 Real terms is calculated using the GDP deflator series: http://www.hm-treasury.gov.uk/data_gdp_fig.htm

Figure 2: Composition of total local government funding 2010/11 and 2019/20

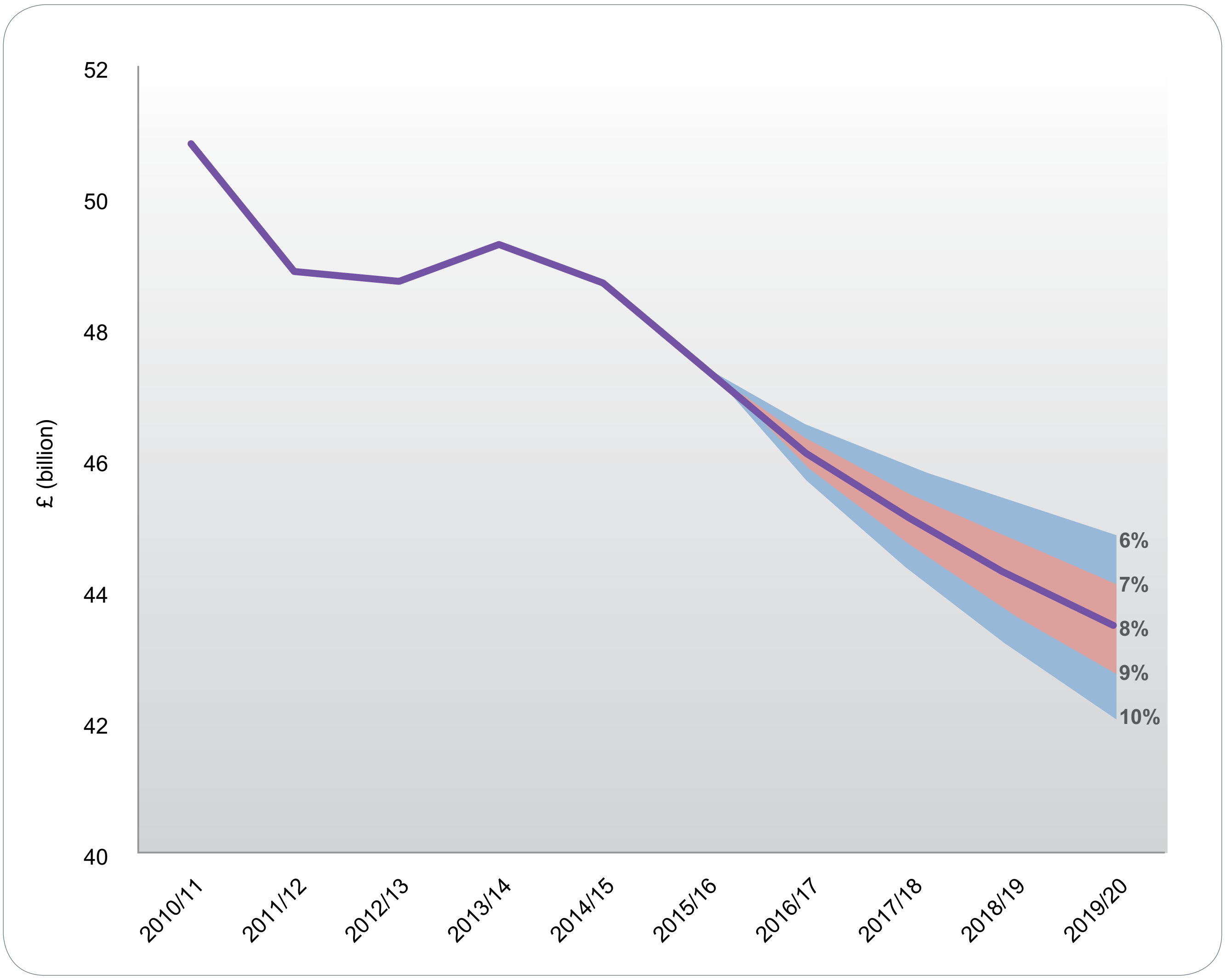


Although the central assumption we are working from is an 8 per cent grant reduction in 2016/17 reducing to 7 per cent in 2017/18 and beyond, we have also modelled other possible scenarios.

A 10 per cent tapered grant reduction would result in a further reduction in 2019/20 funding of £1.3 billion over and above the core assumptions, equating to a 17 per cent cash reduction since 2010/11.

A 6 per cent tapered reduction would lead to additional funding of £1.5 billion over and above the core assumptions, equating to a 12 per cent cash reduction.

Figure 3: Total income reductions fan of possible tapered reductions from 2016/17 onwards



The path of council spending

The funding model then projects the path of council spending between 2010/11 and 2019/20 in ten major service blocks:

- culture, recreation and sport
- education (excluding schools funding via the Dedicated Schools Grant)
- environment including waste
- highways, roads and transport
- housing (not including housing revenue account (HRA) or housing benefit)
- planning and development
- public health
- regulatory
- social care
- other services.

The model excludes separate Fire and Police authorities.

Spending includes additional public health expenditure which starts in 2013/14, although this is currently assumed to be funded in full by the ringfenced Public Health Grant.

Future expenditure trends (including 2013/14 because full data on local authority budgets has yet to be published) have been modelled by identifying factors that influence costs, known as ‘cost drivers’. Full details of all cost drivers are available in the Technical Annex to this document but they have only been included where credible, quantifiable data has been available or where possible methods have been borrowed from other reputable sources. For example, much of the analysis for adult social care uses the same analysis as has been used for the Dilnot report[3].

Efficiencies

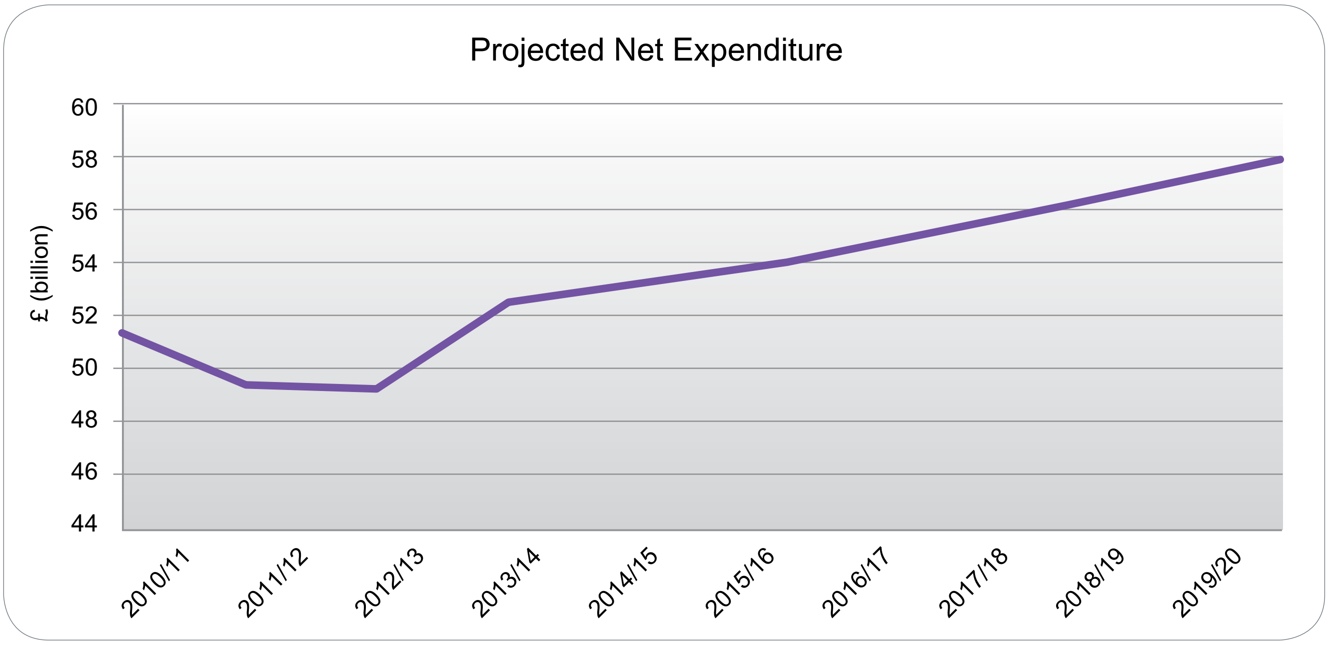
The model also builds in efficiency assumptions. The assumption for most services is that councils start by achieving 2 per cent annual efficiency savings which tapers to 1 per cent by the end of the period. It is sensible to assume diminishing returns from efficiency: nearly two-thirds of councils are already engaging in shared service arrangements and over 200,000 jobs have been shed since 2010.

Projected expenditure

The overall result for council spending pressures is shown in the graph below. The model shows a rise in expenditure demand throughout the period, with total predicted expenditure demand up by some £7 billion, or 14 per cent, by 2019/20. This would be higher but for assumptions about fees and charges and sustained efficiency savings.

3 The Dilnot Commission Report on social care, 2011.

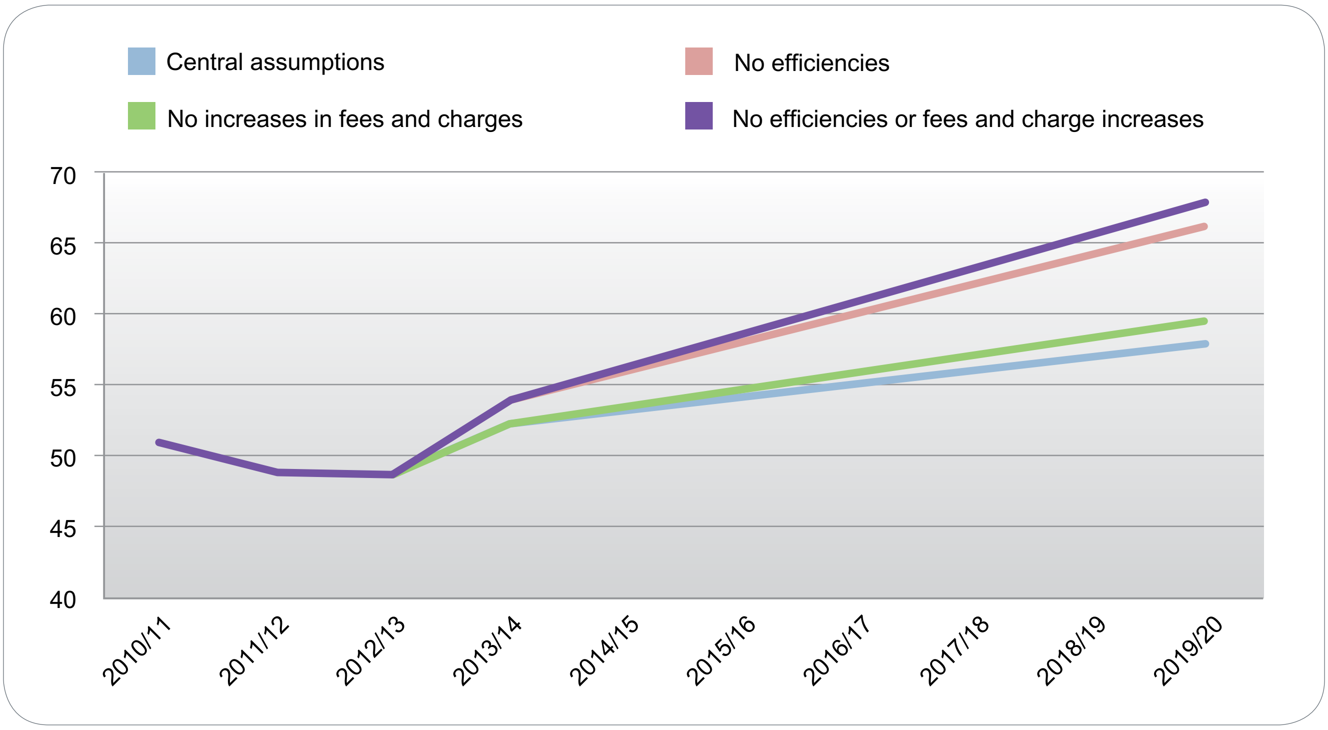
Figure 4: Total council service expenditure 2010/11 to 2019/20



We can see the effect that the inclusion of efficiency assumptions and sales, fees and charges increases have on the overall level of expenditure in Figure 5. If we assumed no increase in fees and charges this would increase expenditure in 2019/20 by £1.6 billion. Assuming no efficiency savings expenditure would increase by £8.4 billion.

This means the assumptions on sales, fees and charges and efficiencies have reduced overall expenditure in 2019/20 by £10 billion, or 15 per cent. Figure 5 makes it clear that the scenario shown in the model is not a pessimistic one and any variance that emerges as a result of 'real world' factors is likely to widen the gap rather than help close it.

Figure 5: Total council service expenditure 2010/11 to 2019/20 with different assumptions about efficiencies, fees and charges

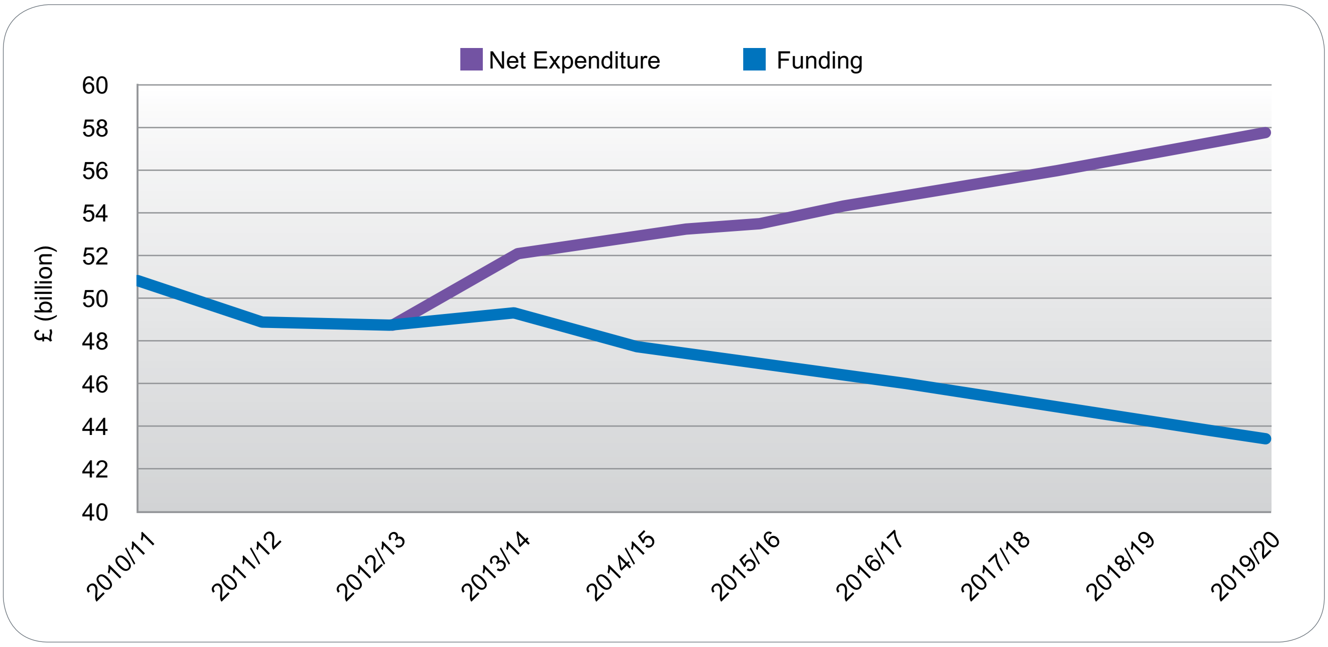


Mapping income against spending

We can now bring together the analysis of projected income and expenditure trends to form a picture of local authority funding overall. This shows that the overall funding gap starts at about £2.8 billion in 2013/14 and reaches over £14.4 billion by 2019/20, increasing on average by £2.1 billion per year.

This is equivalent to a figure of £16.5 billion if we were to extend this model over the same eight-year period as last year's preliminary modelling.

Figure 6: Income against expenditure 2010/11 to 2019/20



In former times, such an analysis would have begun a conversation with central government about an increase in grant income. The Government has, however, already made clear its broad intentions for public expenditure. The question, therefore, is what those intentions mean for services.

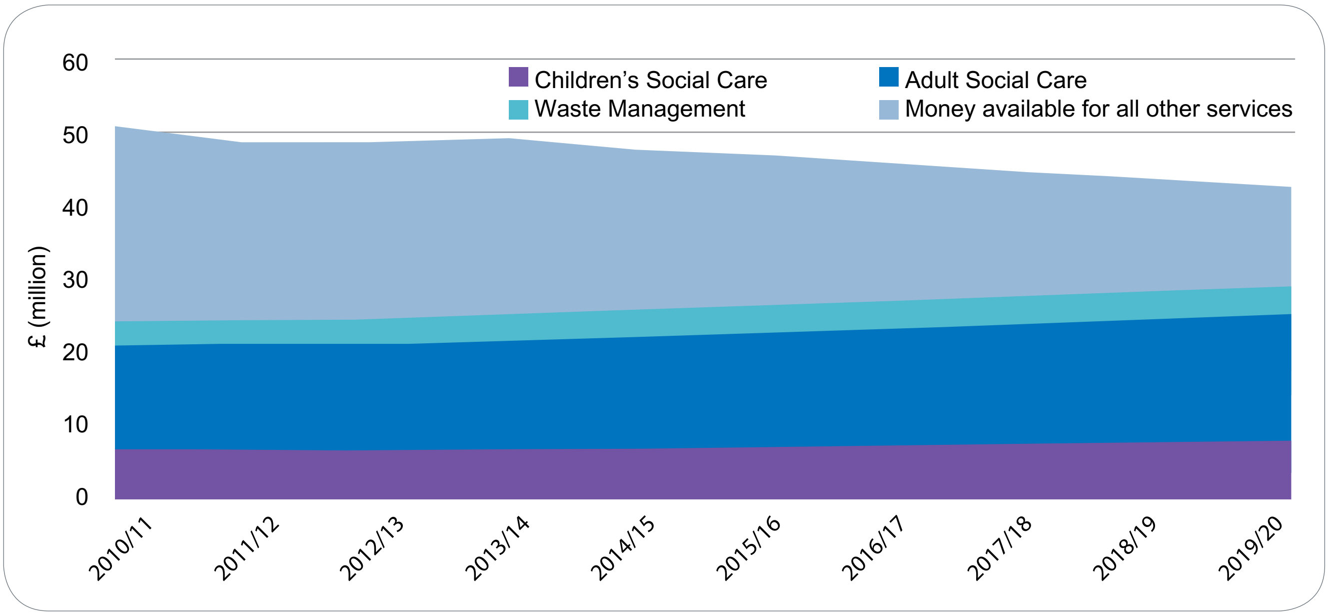
In practice authorities will already have closed the gap for 2013/14 in order to comply with their duty to set balanced budgets and they will have done this either through cuts, further efficiencies or the use of reserves. Once full data sets for 2013/14 budgets have been published, it will be possible to say more about how they have done this. Most authorities will already have in place savings plans to close their budget gap still further in 2014/15 and beyond.

Funding for all council services

The model provides an opportunity to test councils' ability to deliver their statutory obligations within the available resource envelope.

In the previous model the initial definition of these obligations covered social care and waste management services only. The result of this analysis is shown in Figure 7.

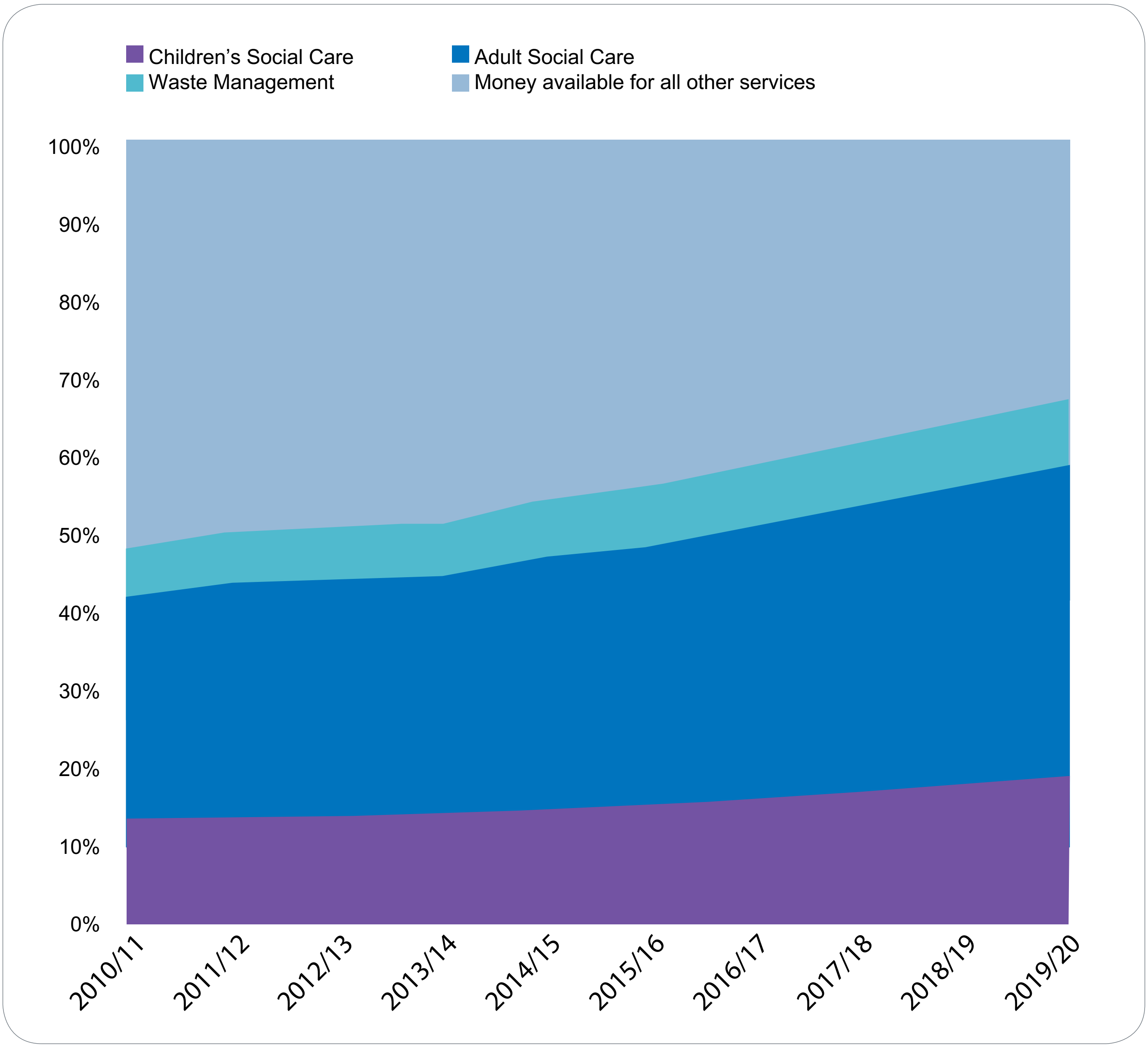
Figure 7: Social care and waste spending within the overall funding envelope



With social care and waste spending absorbing a rising proportion of the resources available to councils, funding for other council services drops by 46 per cent, or £12.3 billion in cash terms by the end of the decade, from £26.6 billion in 2010/11 to £14.3 billion in 2019/20.

An alternative way of looking at this data is to compare how the percentage of expenditure on each service changes over the period, as shown in Figure 8 below.

Figure 8: Social care and waste spending within the overall funding envelope

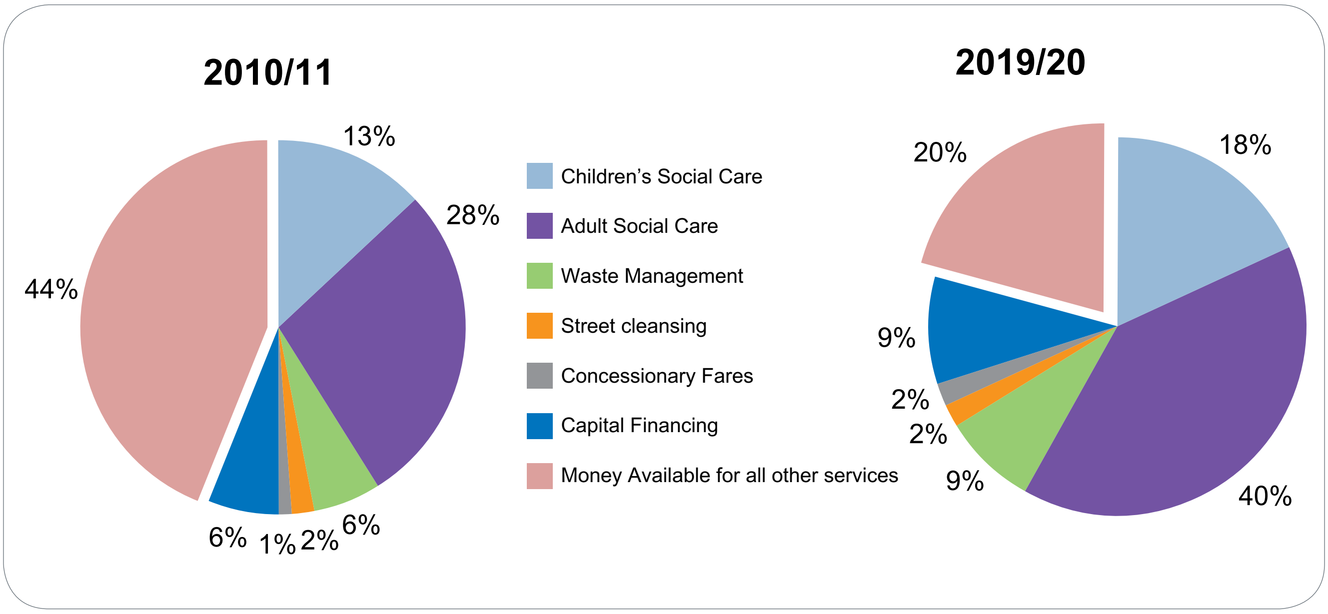


There are many other areas of expenditure where reducing costs quickly can prove problematic. Here we will just focus on three. Concessionary travel is a largely unavoidable statutory obligation and is likely to amount to about £0.9 billion by 2019/20. It is unlikely that many savings can be made to capital financing costs and, although we have assumed this has a flat cost throughout the period, this still amounts to £3.7 billion.

Street cleansing is a highly visible service that has been protected from the worst of the cuts thus far and equates to £0.8 billion in 2019/20.

If we assume that these three areas of expenditure are also protected it leaves just £8.9 billion for other services the equivalent of a 60 per cent cash cut as illustrated in Figure 9.

Figure 9: Possible protected expenditure within the overall funding envelope



Reductions on this scale leave councils vulnerable to legal challenge. Many of these service blocks have statutory elements which may not necessarily be prescriptive but have already proven to be highly contested, such as spending on libraries and road maintenance.

The impact of using reserves

Councils have often been labelled as irresponsible for building reserves while at the same time reducing front-line services. Auditors have long acknowledged councils have good reasons to hold reserves which constitute a sensible part of strategic financial planning and risk management.

Both the National Audit Office and the Chartered Institute of Public Finance and Accountancy have explicitly recognised that a reserves strategy is very much a local decision to meet local needs, and there is no one-size-fits-all strategy which will be suitable for all councils. Uncertainties, such as the unknown impact of welfare reform, need to be taken into account. Delivering major structural change takes time and costs money which normally needs to be met from reserves.

However, for the purposes of our model, we have had to make some broad assumptions about the use of reserves. We believe that, at an aggregate level at least, these assumptions are the most reasonable we can make.

The central assumption of the model is that councils will use up to 5 per cent of their reserves to plug any spending gaps in year, decreasing their reserves to 5 per cent of their overall annual expenditure. This results in usable reserves falling from their current level of £9.2 billion to £7.3 billion by 2019/20. In practice, authorities will have their own strategies for allocating reserves based on local circumstances and their own assessment of risks.

What happens if authorities use more of their reserves to plug the funding gap? If, for example, we model on the basis that councils place no limit on annual reserve use, and bring the minimum reserves level down to just 3 per cent of annual expenditure the funding gap in 2019/20 rises only slightly, but usable reserve levels fall to £2.7 billion.

This may seem counterintuitive, but if councils used their reserves as an alternative to making cuts, such resources would be used up rapidly. Reserves can be used to smooth cuts, but they cannot be used to avoid them. If no restraint is shown in the use of reserves then most are used up by 2015/16 and councils will have the same budget gap to fund in 2016/17. Using up reserves also means that it is less likely that unforeseen events can be funded without the need for immediate further savings.

It is perhaps worth mentioning at this point that many councils that have contributed to their reserves in recent years have cited uncertainty over future funding levels as the main reason for doing so. If local government could be offered more certainty over its future funding, councils could change their approach.

Figure 10: the impact of reserves strategy on the funding gap

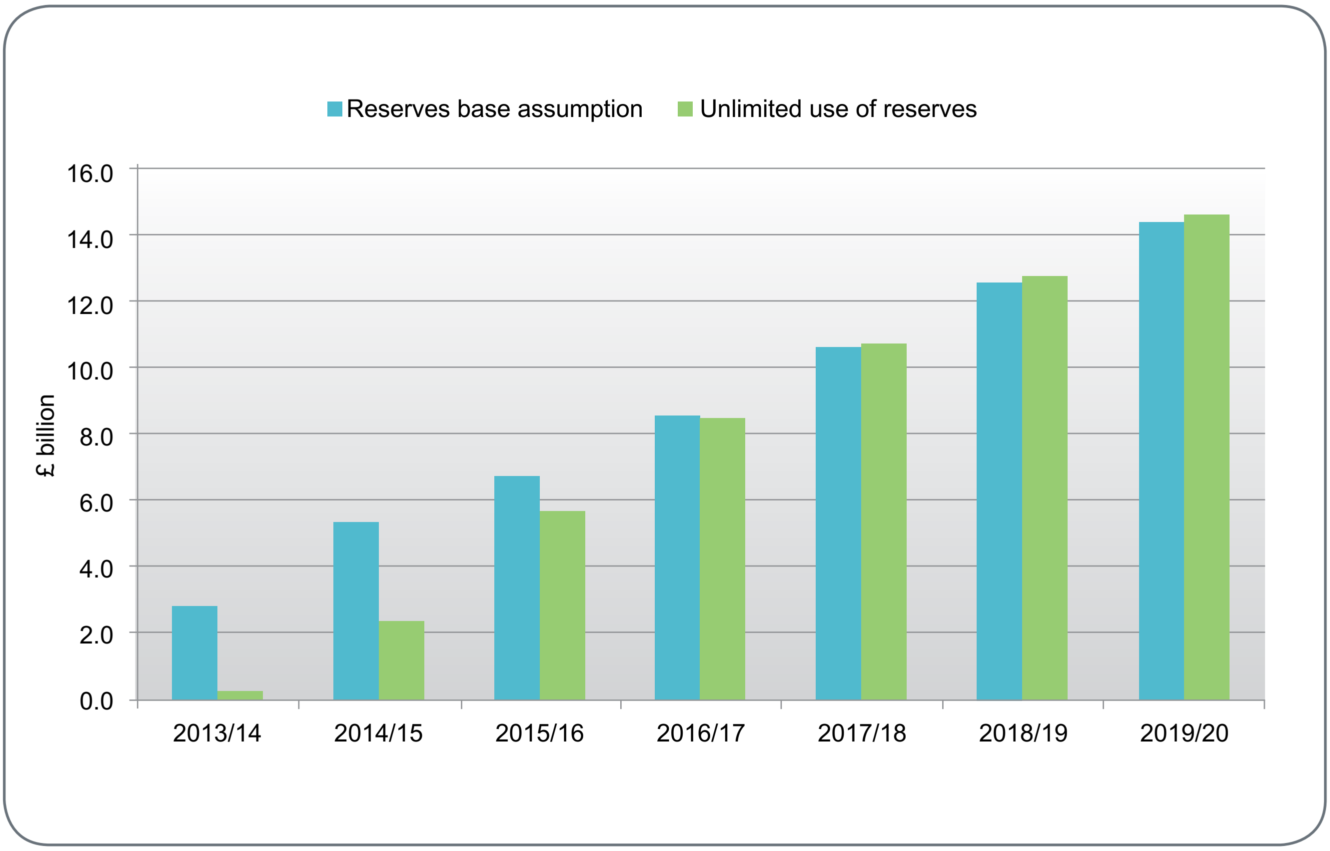


Figure 10 shows the total size of the funding gap for all English councils over the period covered by the model using two of the reserves strategies outlined above.

Under the base assumptions, the funding gap grows at a fairly steady rate each year, reserves are slowly depleted, and councils will hold approximately £7.3 billion in reserves at the end of the period.

If there are no restrictions placed on the use of reserves:

- Most councils will be able meet all their expenditure pressures in the current year 2013/14. The small funding gap in 2013/14 is due to the handful of English councils that do not hold enough in reserve even to meet one year's funding gap.
- In 2014/15, the gap grows as more councils begin to exhaust their reserves.
- By 2016/17, the funding gap is almost identical to that under the base assumptions.
- By 2019/20, the funding gap under this scenario is actually wider than that under the base assumptions, because councils can no longer "drip-feed" reserves to meet their expenditure pressures once reserves have been exhausted.
- In the event that the funding gap is larger than anticipated, councils will have exhausted their reserves and would have to make emergency cuts.

If, on the other hand, no reserves are used whatsoever, the funding gap will again be larger than that under the base assumptions, because councils cannot use the drip-feed method to offset each year's funding gap, but councils will at least hold the same amount in reserves that they did at the beginning of 2013/14.

This serves to illustrate that the most councils can hope to achieve through the use of reserves, in terms of their funding gap, is to postpone the inevitable. The potential effect of reserves on the gap in the long-run (and in fact by 2016/17) is marginal, and their depletion leaves councils vulnerable to unexpected events and economic shocks.

Impact on individual authorities

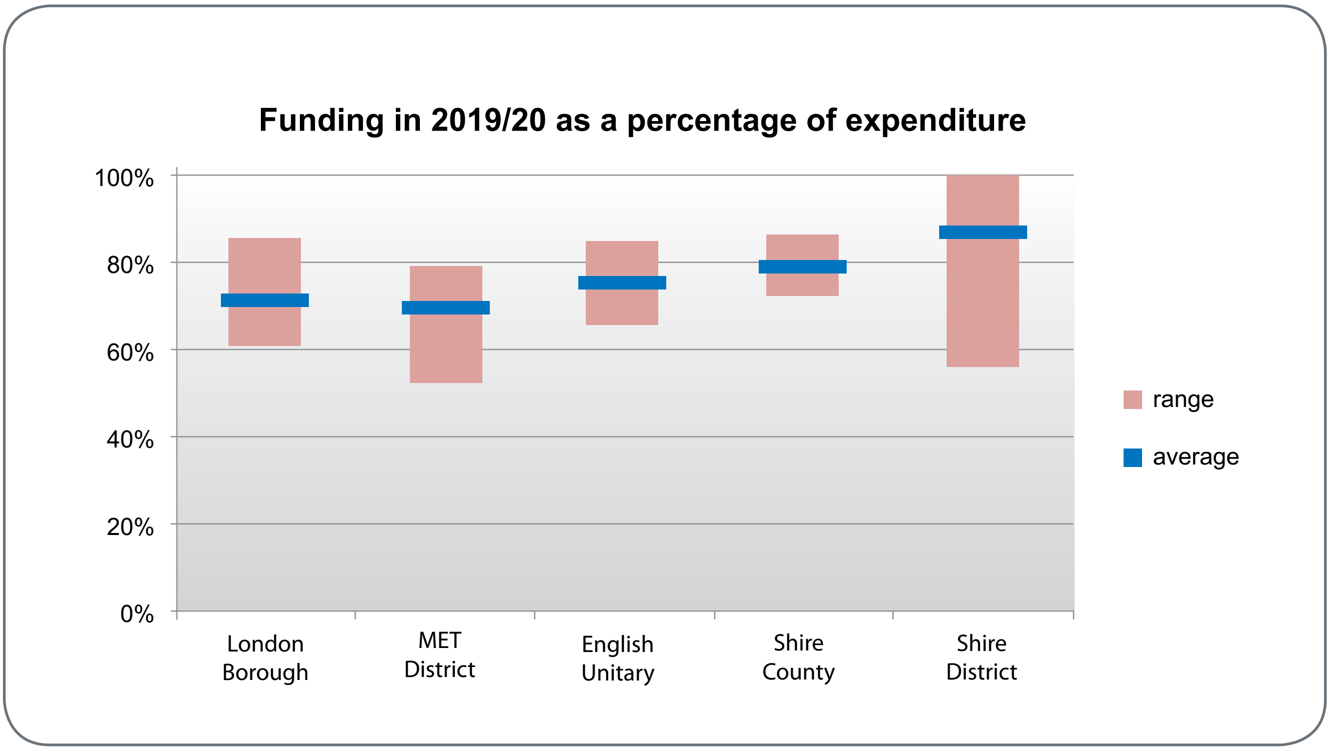
All authorities are experiencing cuts, but there is variation in the way individual authorities are affected, due to differences in the way both funding cuts and spending pressures impact at a local level. Authorities in relatively deprived areas, being more dependent on government grant, are the worst affected. Social care authorities, which have the benefit of NHS social care funding from the Spending Round, still have to deal with an increasing funding pressure as the decade goes on.

Cuts in overall funding levels are not experienced evenly across different types of authorities. The local government finance system works by allocating more grant to authorities which are deemed to have greater need and lesser capacity to raise income locally from taxation or fees and charges. Historically, this has allocated more money to authorities in relatively deprived urban areas, and thus taking money out of the system tends to withdraw funding from these authorities at a faster rate.

The projected expenditure pressures also vary significantly between authorities. A large proportion of the disparity can be accounted for by the demands of social care spending within single tier and county councils, which is only partially mitigated by additional funding from the NHS. In two tier areas, however, district councils will be affected by the cost implications of welfare reform which cannot currently be modelled accurately and are therefore not fully reflected in these figures.

Putting together the data on expenditure and funding, it is possible to assess the distributional impact of the overall funding gap as it affects the various authority types, regions and relative levels of deprivation. But even among classes of authority there is often a large variation in the total funding gap. The charts below attempt to draw all of this together by showing the total funding level for the group (ie total income as a percentage of expenditure), as well as the maximum and minimum funding level for individual councils within that group[4].

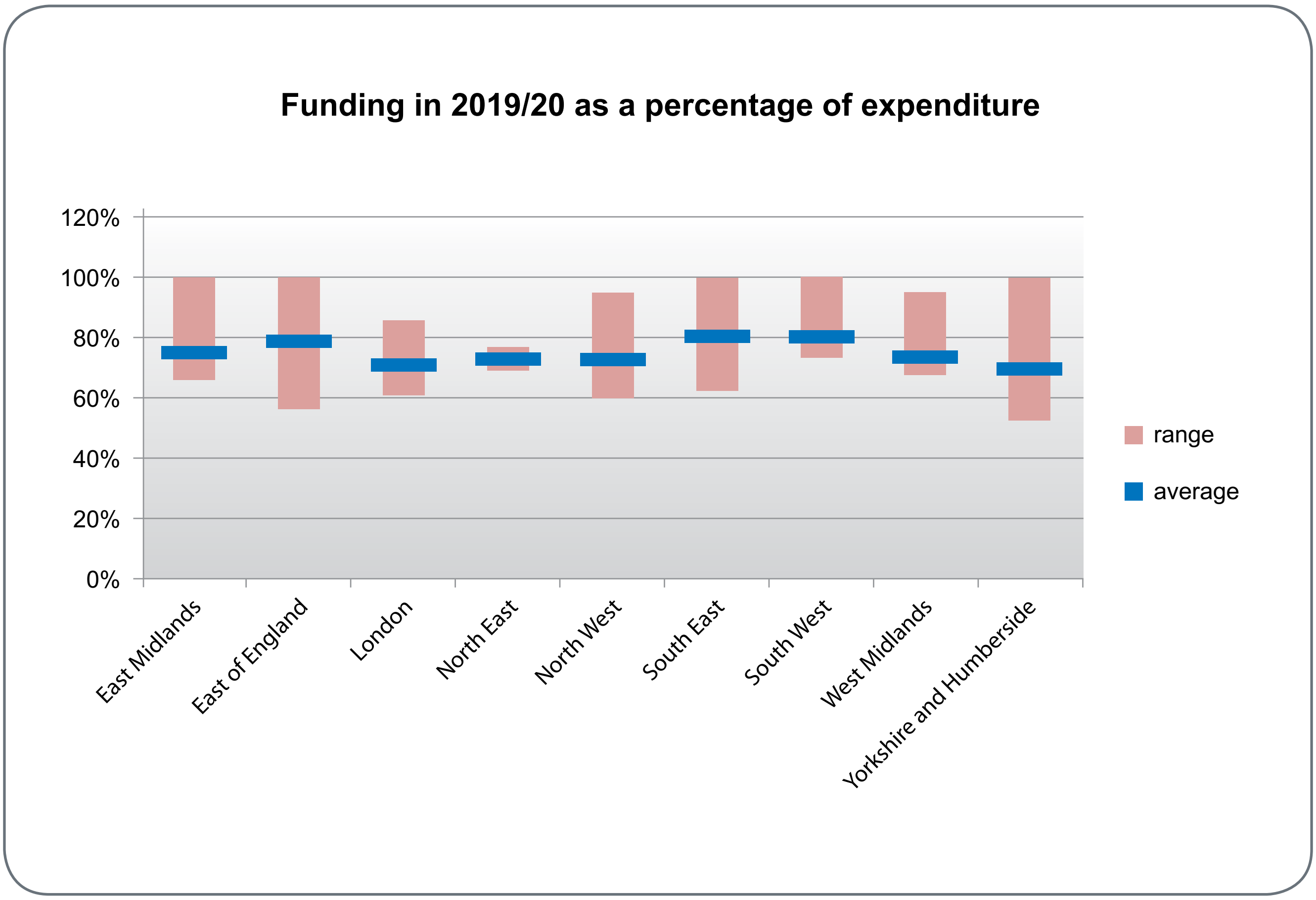
Figure 11: Authority type range analysis



CLASS BREAKDOWN	Min	Average	Max
London Borough	61%	71%	86%
Metropolitan District	52%	70%	79%
English unitary	66%	76%	85%
Shire county	73%	79%	86%
Shire district	56%	87%	100%

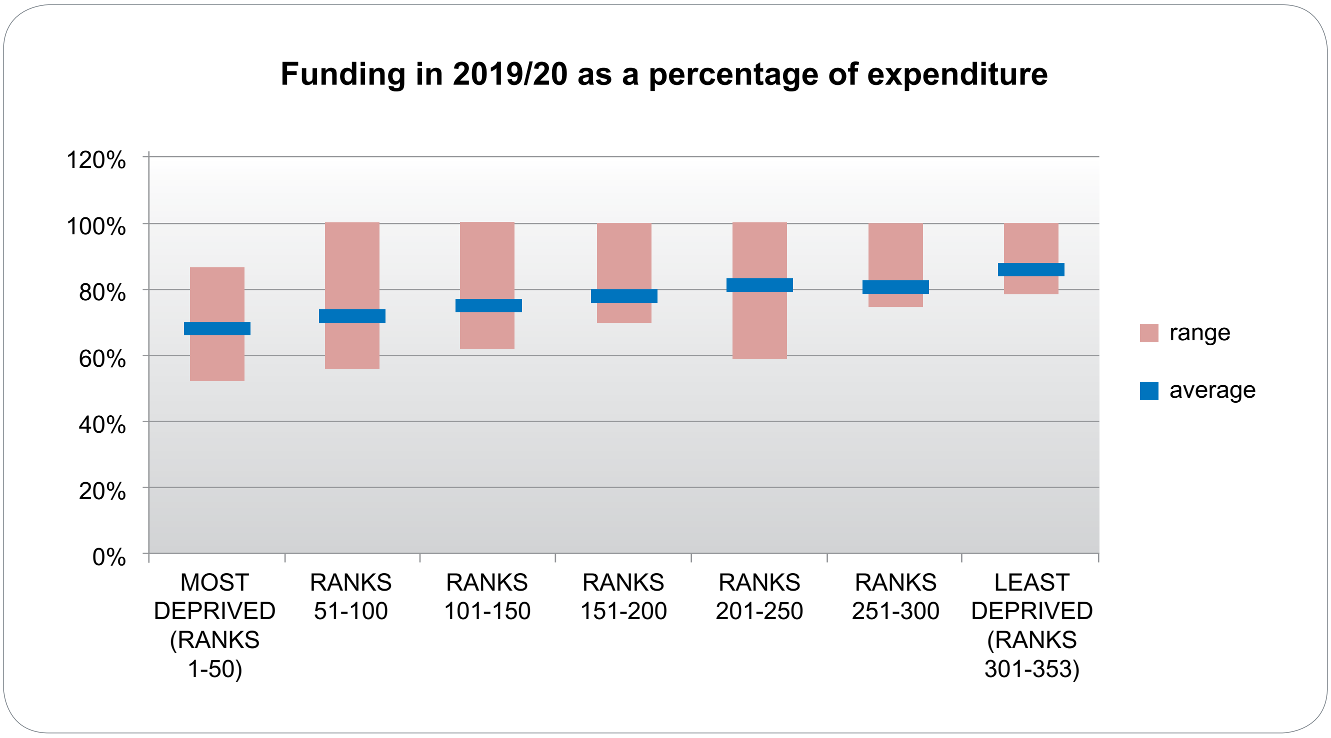
4 The City of London has unique funding arrangements and is therefore excluded from the charts and tables below.

Figure 12: Region range analysis



REGIONAL BREAKDOWN	Min	Average	Max
East Midlands	66%	75%	100%
East Of England	56%	79%	100%
London	61%	71%	86%
North east	69%	73%	77%
North west	60%	73%	96%
South east	63%	81%	100%
South west	70%	80%	100%
West Midlands	68%	74%	96%
Yorkshire And Humberside	52%	70%	100%

Figure 13: Deprivation range analysis



INDICES OF DEPRIVATION	Min	Average	Max
Most Deprived (Ranks 1 - 50)	52%	68%	87%
Ranks 51 - 100	56%	72%	100%
Ranks 101 - 150	62%	76%	100%
Ranks 151 - 200	69%	78%	100%
Ranks 201 - 250	59%	82%	100%
Ranks 251 - 300	75%	80%	100%
Least Deprived (Ranks 301 - 353)	79%	86%	100%

This analysis underlines the variance between authorities and also within classes of authorities. All authorities are experiencing cuts in funding and are having to take difficult decisions to deliver savings over the forthcoming period. The model assumes that efficiencies will continue to be delivered at a rate of 1-2 per cent per annum. Within this there are certain pressures that cannot currently be modelled and which fall disproportionately upon some of the authorities that may appear to be the least affected by cuts.

The impact of spending pressures does not reflect, for example, the impact of welfare reform which in two-tier areas is expected to fall mainly on district councils.

This illustrates the extent to which the local government finance system, through its complexity and lack of transparency, creates large variations in the way its funds individual authorities which are not easily explained. It makes the case again for the reform of local government funding to a more transparent, more accountable, and more locally responsive system.

What does this mean for local people?

The model confirms the findings from last year's analysis that the funding gap for local services will continue to grow. The updated model predicts that the gap will widen by around £2.1 billion per year until the end of the decade, bearing out the results of last year's analysis.

This is based on assumptions that authorities tell us are, if anything, rather on the optimistic side, including an assumption that authorities will continue to make 1-2 per cent efficiency savings each year, adding up to £8.4 billion over the period up to 2019/20.

Local authorities will need to act to close this gap, if not through further efficiencies then through cuts or increases in charges. How they choose to do this is a matter for local councils themselves, but options are diminished by the need to meet statutory duties and a strong desire by authorities to boost economic growth and prosperity in their area.

Councils will always strive to find further efficiencies, and acknowledge that more can still be done, but there is something of a law of diminishing returns from further efficiency savings. Every saving that councils find reduces the scope for future savings.

The "quick wins" such as stopping first-class travel and reducing refreshments spend have all but disappeared and solutions restricted to back-office functions such as shared service arrangements, are running out because significant savings have already been achieved. Councils have increasingly been forced to take difficult decisions about front-line services.

To help users understand how these figures impact at a local level we produced acompanion paper to the LGA's submission to the 2013 Spending Round. The 'AnyCouncil' analysis shows how the kinds of analysis illustrated in the model are translated into decisions by a typical local council and how they impact on people. With this analysis we are publishing a suite of three papers: AnyDistrict, AnyCounty, and AnySingleTier to illustrate the impacts of the model on different types of councils.

In its new model for local government, 'Public services rewired: Rejuvenating democracy', and in other recent submissions to government, the LGA sets out a vision for what needs to be done.

It involves generating and using resources more effectively within local areas to boost economic growth and to transform local services to prevent problems instead of always picking up the pieces.

The LGA has also called for changes to the local government finance system which allow more flexibility for authorities to tackle the funding gap and to address the need for economic growth and service improvement. Ringfencing and the protection of certain budgets prevents services at a local level from acting together to achieve service improvement. Rigid rules about borrowing and national decisions on local taxes and fees and charges reduce authorities' ability to respond to local circumstances. We need to address top-down control of local finances and allow local people to be involved in these decisions.

Above all we need to stabilise local government funding, which can be done immediately by not asking local authorities to continue to deliver more than their fair share of spending cuts.

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