Local Government Association

Funding outlook for councils from 2010/11 to 2019/20:

Preliminary modelling

www.local.gov.uk

Executive summary

Councils were cut earlier and harder than the rest of the public sector as the government began to implement its deficit reduction policy. If the same pattern of cuts to the public spending is replicated in the next Spending Review, councils will not be able to deliver the existing service offer by the end of this decade. Fundamental change is needed to one or both of:

- the way local services are funded and organised
- statutory and citizen expectations of what councils will provide.

The Local Government Association (LGA) has modelled all future sources of council revenue, including grants, local taxes, fees and charges, investment income and reserves drawdown to the end of this decade on assumptions that offset grant cuts against the potential for growth in other revenue sources. Our income forecast is optimistic.

We have also modelled future service spending demand, assuming that efficiencies could make it possible to reduce spending in real terms over the whole decade. Our demand forecasts err on the side of caution.

On these assumptions, our model shows a likely funding gap of £16.5 billion a year by 2019/20, or a 29 per cent shortfall between revenue and spending pressures.

We have also modelled the funding available for individual services within the projected resource constraint. On the assumption that demand in social care and waste are fully-funded, other services face cash cuts of more than 66 per cent by the end of the decade. Assuming that capital financing and concessionary fares are also funded in full, the modelled cash cut for remaining services rises to over 90 per cent.

We need to face up to what that means. Local government is the most efficient part of the public sector and will maintain that record, but efficiency is not enough. Without money and reform, there is no solution. Future sustainability starts with social care funding reform, allowing a genuinely free conversation between councils and local residents about how much tax they want to pay and what services they want to receive in return, and rethinking the structures of local public services as a whole.

Preliminary analysis of the funding outlook for councils

1. Introduction

The LGA has set out to identify the level of service provision that councils could be expected to be able to sustain if their revenue base were to be constrained within the spending levels first set out by the Chancellor in the Autumn Statement in November 2011 and subsequently confirmed in the Budget on 21 March 2012. This paper describes the preliminary model we have constructed.

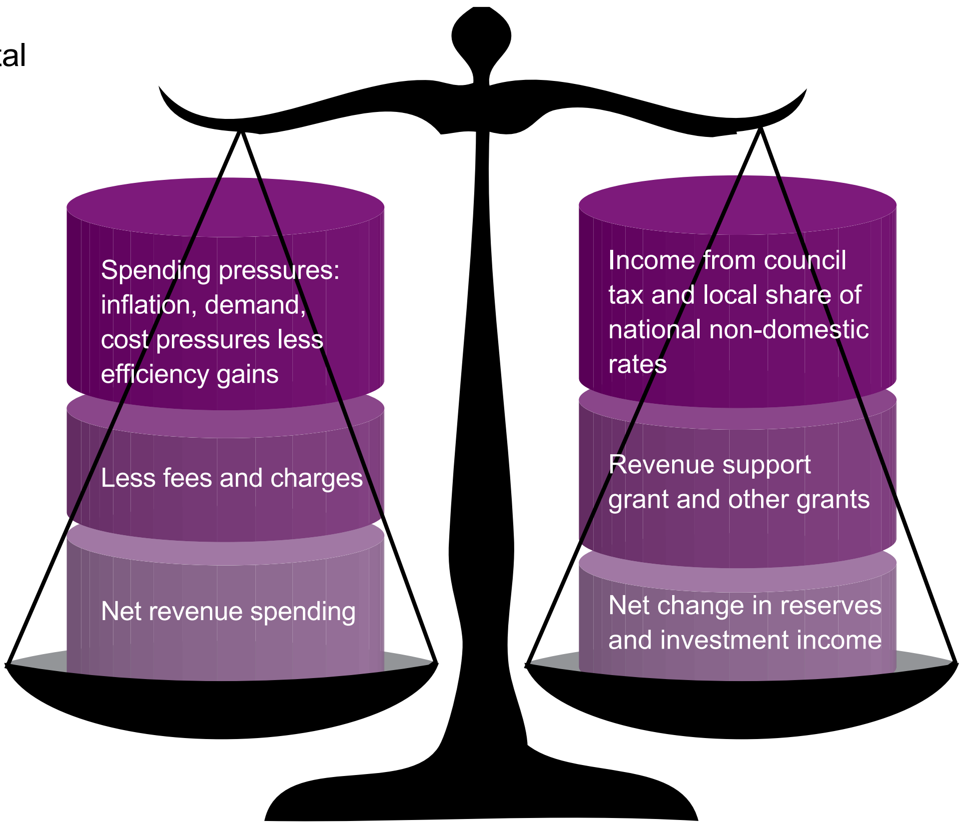
We have sought to present a credible analysis that recognises the reality beneath a headline account of council cuts based on only formula grant and simplistic assumptions about spending pressures.

Our model recognises that total council income rests on a number of sources, including non-negligible changes from year to year in fee income and reserve levels, and 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, national non-domestic rates (NNDR), grant and other income streams over the period 2010/11 to 2019/20
- projections of total annual net revenue spending in nine principal service blocks within council budgets over that same period.

The model works as follows:



2. The path of council income

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

- **Council tax:** We have assumed that council tax will be frozen until 2014/15 and will thereafter grow by 2 per cent per year. This may be optimistic.
- **National Non-domestic Rates:** We have assumed future NNDR growth at 3.5 per cent, which assumes 2.9 per cent growth in retail price index (RPI), in line with the Office for Budget Responsibility's (OBR) forecast, and 0.6 per cent of growth above RPI to reflect future growth in the tax base. We have also assumed that councils will retain 50 per cent of total NNDR yield as the "local share" from 2013/14 when the new rates retention scheme comes in and that the share will remain constant throughout the period, in accordance with the intentions published by the Government in May 2012.
- **Government grants:** Detailed information on the Government's plans for grants to local government is not expected to be available until summer 2012. For the purposes of the model, we have derived current levels of grant funding from published sources up to 2012/13. For 2013/14 onwards, we have assumed that the central share will be returned to local government through grants, and that for 2013/14 and 2014/15 other grant will be allocated in line with the total funding for local government set in the 2010 Spending Review. For periods beyond 2014/15, we have assumed that the total funding for local government will be reduced in a broadly similar manner to that set in the 2010 Spending Review, which reflects the future path for Departmental Expenditure Limits set out in the Chancellor's 2012 Budget. Overall, in the 2010 Spending Review, central government funding for local government was cut from £29.7bn in 2010/11 to £24.2bn in 2014/15. The assumption made in the model is that there could be a further reduction in funding to around £17.6bn by 2020.
- **Investment income:** Future investment income is assumed to be responsive to changes in interest rates, although we have not modelled changes to the amount that councils invest. The level of investment income will obviously be linked to future levels of reserves.
- **Transfers to and from reserves:** We have assumed reserves will be drawn down through 2013/14 in line with councils' returns to the Government but gradually rebuilt as the new business rates retention scheme and localisation of council tax support will require authorities to manage an unprecedented level of volatility at the local level. We expect that the effect of these changes will be an inclination to build up reserves as a safeguard.
- **Sales, fees and charges:** We assumed that income from sales, fees and charges would be sensitive to prevailing economic conditions for market-facing services such as parking and planning but that care fees would increase in line with the CPI. Fees and charges are an adjustment to net spending rather than being treated as a revenue item.

The revenue lines are adjusted to remove income attributable to authorities whose spending is not modelled (see section 3).

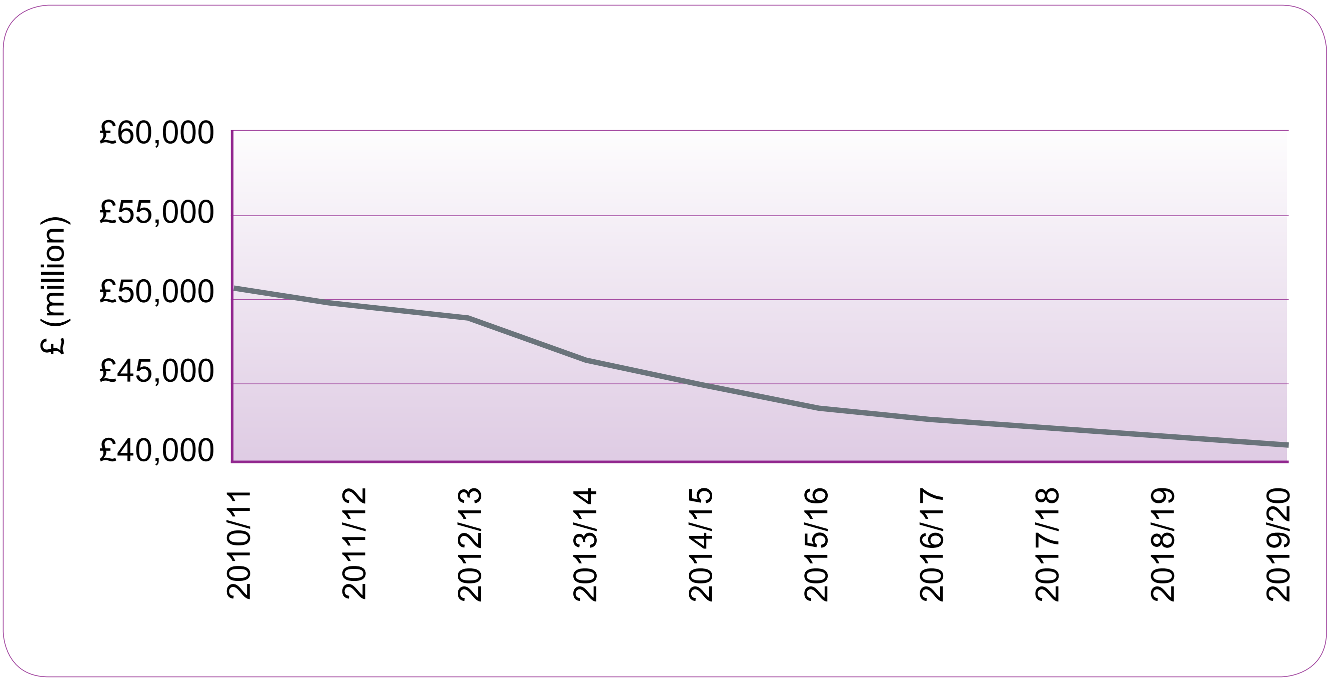
The following graph shows that total council income falls by £9.5 billlion in cash terms between 2010/11 and 2019/20. Over the period, income falls by 19 per cent in cash terms, or 23 per cent in real terms.

It should be noted that the model has not attempted to take account of volatility in income streams, particularly business rates. The model assumes that business rates grow at a uniform pace year-on-year; in reality, it is much more difficult to predict business rates yield from year to year. Some councils that are starting with a smaller tax base may find it a challenge to grow business rates at a rate that will keep pace with their spending pressures. Rates yield can go down as well as up and it is a near-certainty that some councils will face shocks from that source. Under the current system, that volatility has been smoothed out at the national level.

When the new rates retention system comes in to effect in April 2013, councils will have to manage the impacts of changes to their business rates income within their own budgets. The localisation of council tax benefit will also introduce a new source of volatility. The uncertainty is making it very difficult for councils to plan medium term financial strategies and many councils that are in a position to are considering adding to their reserves at levels beyond what has been assumed in this model as a safeguard against future volatility.

More detail on the revenue projections is set out in Annex A.

Chart 1 Projected income



3. The path of council spending

The funding model then projects the path of council spending between 2011/12 and 2019/20 in nine major service blocks:

- education (excluding the Dedicated Schools Grant)
- children's social care
- adult social care
- highways, roads and transport
- housing (not including housing revenue account (HRA) or housing benefit)
- culture, recreation and sport
- environment including waste
- planning and development
- central services.

Spending has been excluded on Fire (as a group of single-service authorities with their own precept), Police (for the same reason, as well as reflecting the likelihood that they will continue to receive differential treatment in the Spending Review and future council tax frameworks), HRA and housing benefit spending (as self- or separately-funded areas), and schools spending funded by the Dedicated Schools Grant and pupil premium. Spending has also been modelled on an assumption that council responsibilities remain unchanged from 2012/13 (so public health, which will transfer with corresponding revenue funding in 2013/14 is not included in this version of the model; nor is the outward transfer of schools support for academies).

For each service area, baseline spending has been set using 2011/12 Revenue Account data (and 2012-13 budget) and projected using the major drivers of cost for those services.

Drivers essentially break down into two categories:

- drivers of unit cost (eg inflation or efficiencies)
- drivers of service usage (eg population change).

The cost of servicing capital financing costs has also been included as an expenditure item and assumed to stay relatively flat throughout the period. This may be an underestimate since borrowing costs can be expected to return to higher levels over the decade. Although the Office for Budget Responsibility does forecast a 1 per cent increase in market gilt rates, higher interest rates will only apply to a small proportion of total local authority borrowing and the resulting cost pressures are not expected to have a material impact on expenditure for councils at a national level.

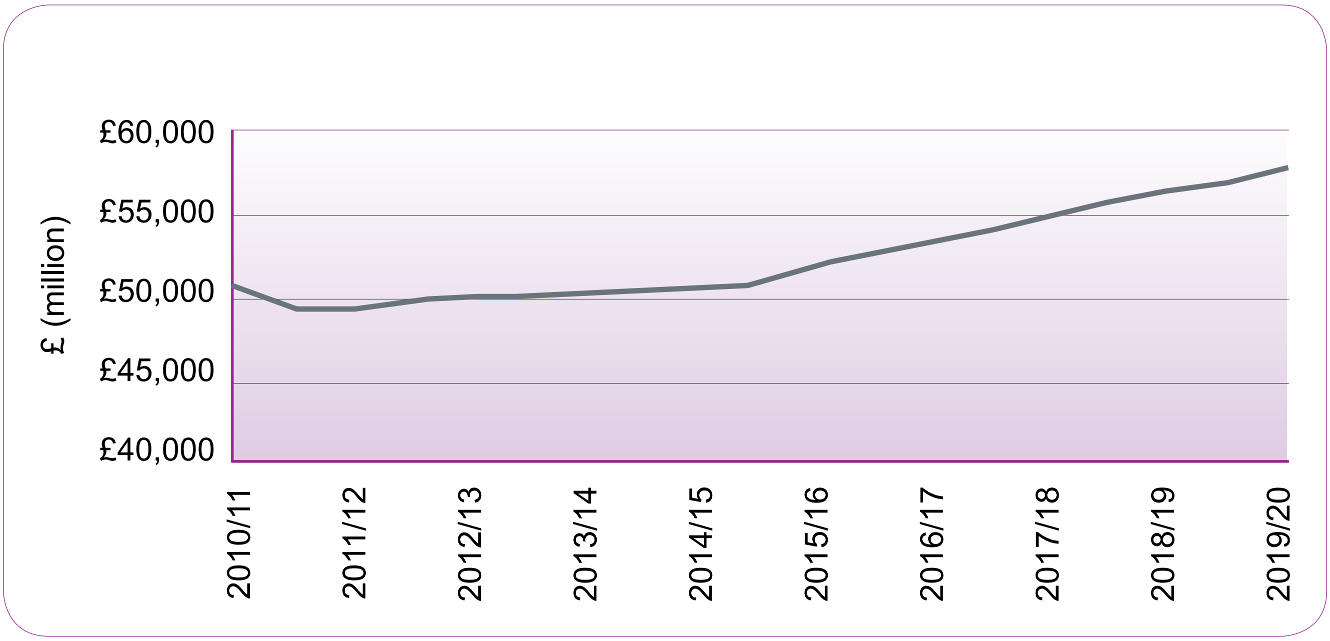
Cost drivers have only been included in the model where credible quantifiable data has been available, which means that in many instances the future expenditure on a service is likely to be higher than the estimate. Councils we have consulted on our figures have been unanimous that our estimates err on the cautious side compared to what they are expecting in their councils, in some cases significantly so. Annex B describes the block-by-block assumptions in more detail. We will be undertaking further work with councils to develop these.

The model also builds in efficiency assumptions. In this version of the model, the assumption is uniform for most services: 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. More detailed analysis will be required to estimate the scope for further efficiencies in each service block (eg savings from further outsourcing, different models of provision, sharing services, etc.)

The overall result for council spending pressures is shown in the graph below. The model shows that, thanks to assumptions about rising fees and charges and sustained efficiency increases, there is a very modest rise in expenditure demand throughout the period, with total predicted expenditure demand up in cash by only some £7 billion, or 14 per cent, by the end of the decade. This represents a historically-unprecedented real-terms fall of 6 per cent, with real terms cuts in every year for the first half of the decade and annual real increases below 1 per cent in the second. Many will question the plausibility of such a projection of success in containing spending pressures.

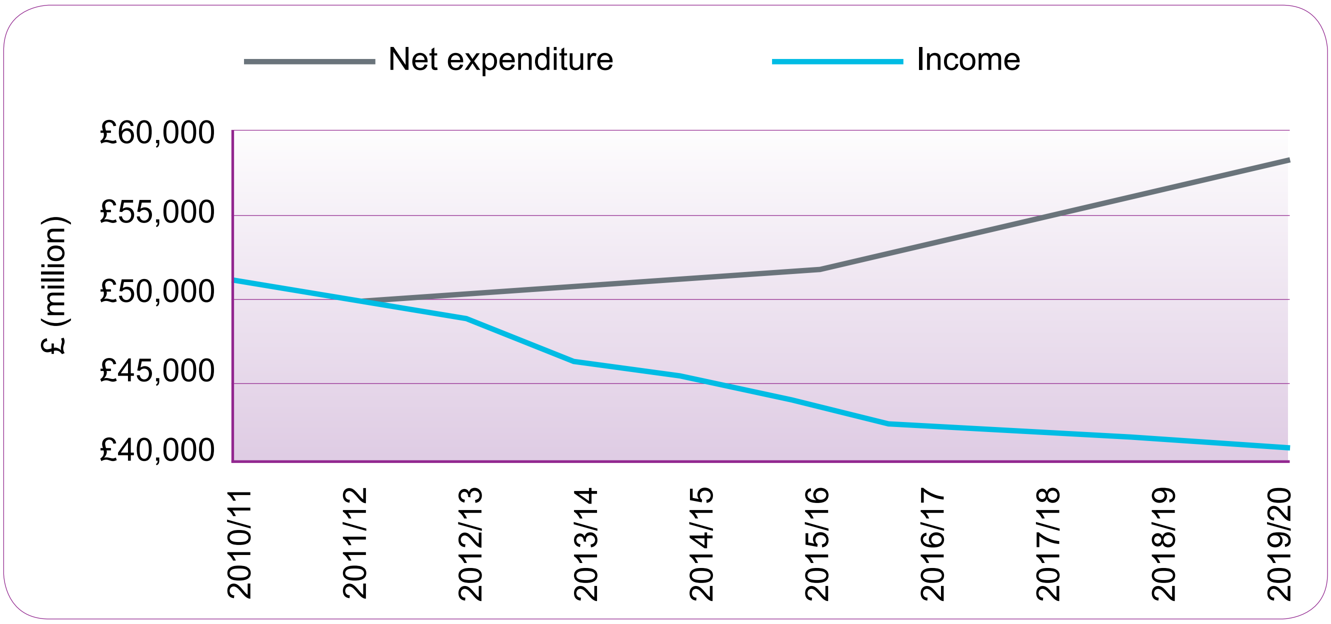
Chart 2 Projected net expenditure



4. Mapping income against spending

Our analysis then balanced projected spending against projected revenue to 2019/20. A gap opens out in 2012/13 and then continues to widen every year through to 2019/20. The overall funding gap starts at about £1.4 billion in 2013/14 in cash and amounts to over £16.5 billion in 2019/20.

Chart 3 Income vs Expenditure



In former times, such an analysis would have begun a conversation with central government about an increased path for grant income. The Government has, however, already made its broad intentions for public expenditure beyond 2015 clear. The question, therefore, is what those intentions mean for services.

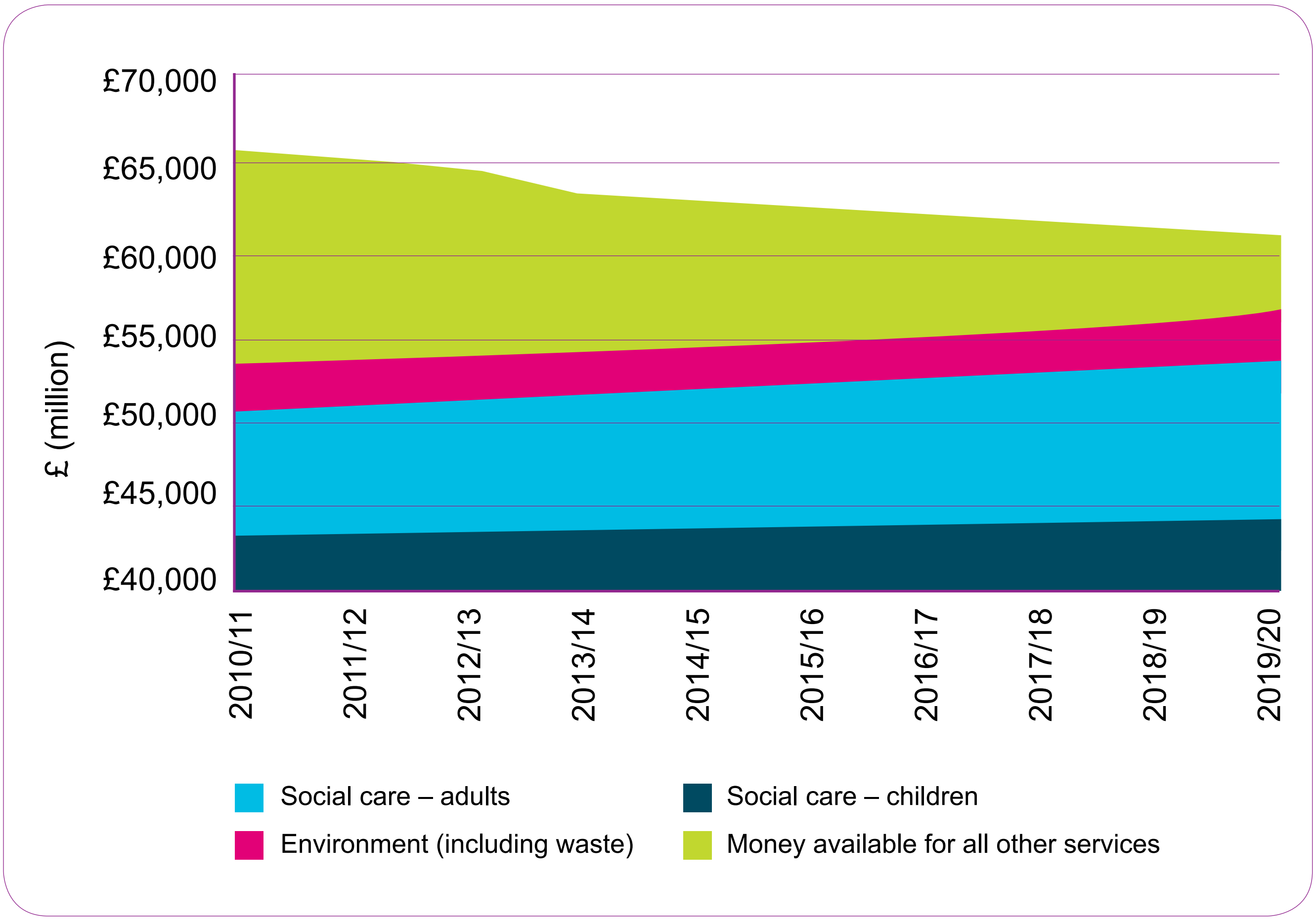
5. Funding for all council services

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

At this stage, we have made a very simplistic definition of "unavoidable statutory obligations" and deemed it to cover social care and environment/waste only. The model does, however, allow us to approach this in a more sophisticated way and we look forward to doing so.

The result, on this version of the model, is this graph:

Chart 4 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 spending drops by 66 per cent in cash by the end of the decade, from £24.5 billion in 2010/11 to £8.4 billion in 2019/20. This is the equivalent of an 80 per cent real terms cut.

If capital financing costs, worth about £4 billion a year in 2019/20, are also assumed to be an unavoidable cost, the resources available for other services drops to just under £4.4 billion by the end of the period, an 82 per cent cash cut.

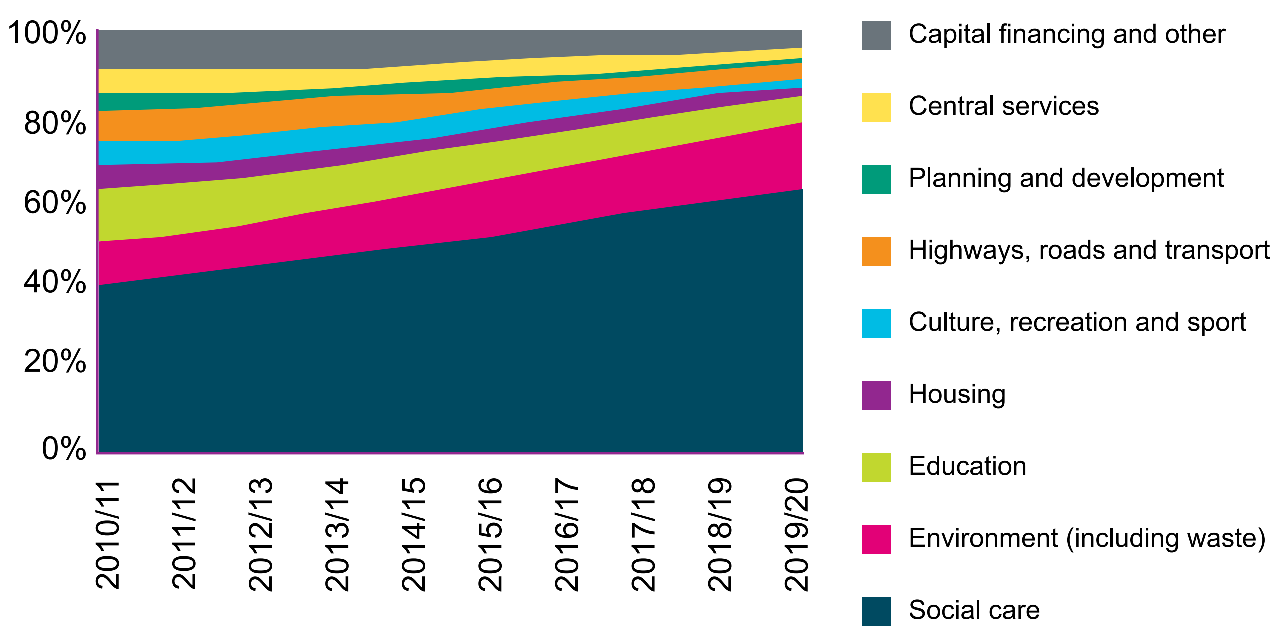
Our projections show that spending on public transportation alone, driven largely by concessionary travel – another largely unavoidable statutory obligation – is likely to amount to about £2 billion by 2019/20.

To fit within the envelope left after social care, waste, concessionary travel, and capital financing costs are taken into account, the spending projections in other service blocks would have to be cut by over 90 per cent in cash terms – which, in real terms, leaves practically no funding for them at all.

Reductions on this scale would be highly likely to 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.

It should be noted that the national picture masks a wide variation in the positions of councils within each type; this is particularly true for shire districts and unitary councils. These outliers face a number of risks which are likely to manifest themselves earlier than the end of the decade.

Chart 5 Service spending as proportions of overall budget



We also tested the assertion that sufficient savings can be achieved by sharing back office functions, or cutting senior management posts to avoid the need for frontline service reductions. The following graph shows the budgets available for each service within the modelled revenue constraint. It is clear that, with the best will in the world, cuts to central services spending could not make enough money available to protect frontline services from drastic reductions.

It is also worth considering the impact of 66 per cent cash reductions in service spending on electors and other residents. Even in the starting position, the largest amount of council spending is on the fewest people, as shown in the following charts:

Chart 6 Spending by service area

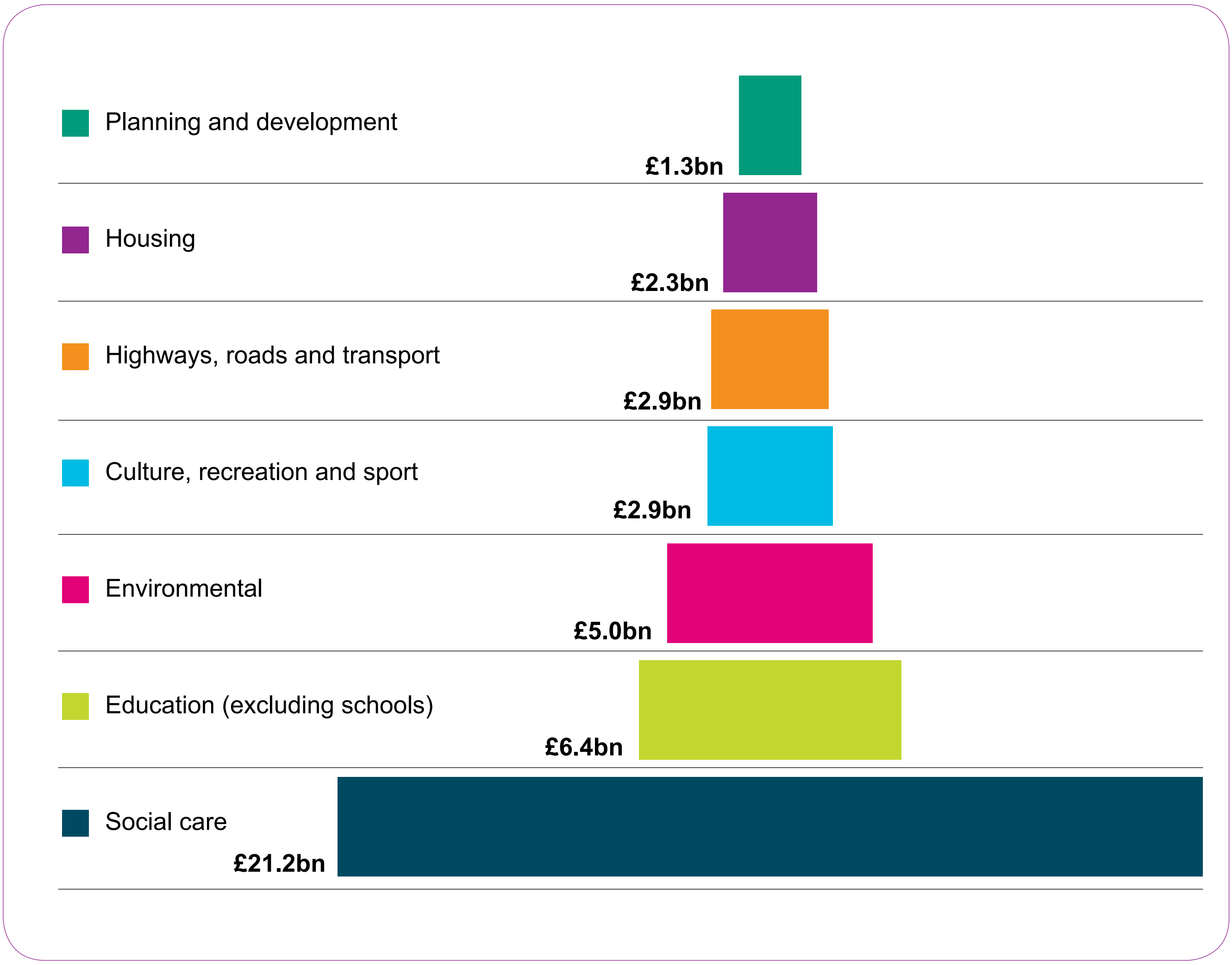
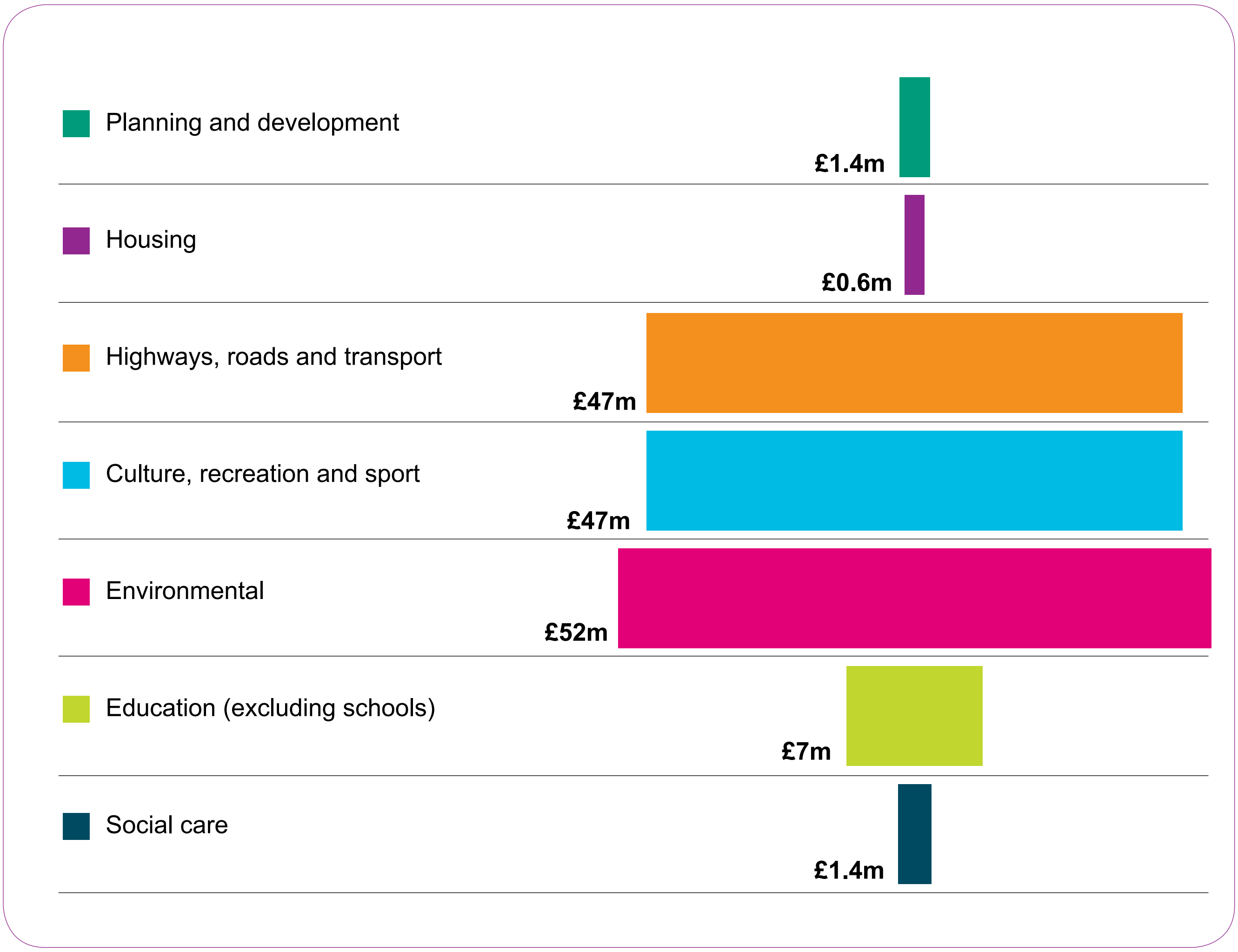


Chart 7 Numbers of service users by service area



It should be noted that chart 7 reflects only the number of care users for whom councils commission or directly provide care, which does not take into account how many people look to their council for support in this area. The majority of those receiving social care actually fund their own care, and councils have important responsibilities for market development and for ensuring the continuity and stability of care for local people. Nevertheless, there is a mismatch between where the bulk of council spending goes and the number of people who access those services. This mismatch risks being even further entrenched given the growth in social care demand that is expected by the end of the decade and beyond.

In the absence of fundamental reform to the way public services are funded and delivered in a local area, it would appear that either the statutory framework or citizen expectations for the mix of services that councils provide or commission will have to change – or, more likely, both. Our funding projections suggest that conflict between statutory duties as they currently stand may be unavoidable, leaving little room for funding of non-statutory services. This may, in turn, require a renegotiation of public expectations of services and central government expectations that councils can continue to deliver national policy outcomes that reflect less austere times. Simply put, the 'business as usual' service offer appears not to be possible for the end of the decade.

6. What does this mean for the future of council services?

This paper has modelled an extremely conservative account of the future spending pressures councils face, and a possible path for future revenue that errs on the optimistic side. All the councils with which we have discussed this work agree in telling us that their demand pressures are more acute than described here. The model shows that, even on that doubly benign scenario, councils will not be able to deliver their existing service offer and that radical change to existing policies for those services will be needed within the next few years.

Decentralising the politically difficult only works for a while

Councils were cut earlier and harder than the rest of the public sector as the government began to implement its deficit reduction policy. They have faced tougher spending cuts than most central government budgets.

It is precisely not the case that councils took the brunt of the cuts because they were perceived to be inefficient or overfunded to start with: indeed, the Prime Minister said that councils were “the most efficient part of the public sector” even as his government cut them harder than Whitehall. However, the government is fortunate that councils, with their greater local and public accountability and democratic immediacy, have shown over many years that they can manage tight budgets and take very difficult decisions. It was Ministers’ easiest course to rely on councils to keep on taking those difficult decisions in a way that central government remains unable to.

The financial analysis in this paper shows, however, that the government cannot continue decentralising the politically difficult.

Magnifying the spending protection problem

The difficult choices that councils have already faced and the financial outlook described in this paper are a direct consequence of the Government’s decisions about how to allocate public spending in the last Spending Review.

Government grants to councils were cut by 28 per cent while central government’s own budgets were only cut by 8 per cent. But many central government budgets faced cuts of far more than 8 per cent. That is because the Spending Review prioritised spending strongly: demand-led budgets such as welfare benefits and interest payments received automatic protection; the NHS and schools were protected in real terms, and overseas aid as a share of GDP. Between them, those budgets account for three-quarters of all public spending, which means that almost the entire pressure of cuts has been brought to bear on the remaining quarter (which includes grants to councils).

What this paper has shown, however, is that council spending itself includes budgets that must be protected. That gears up and magnifies the effect of the spending protection in central government’s budgeting. The 66 per cent cash cuts to non-waste, non-care budgets modelled in this paper is a residual of a residual – they are what is left behind after central government’s budgets have been prioritised to protect schools and hospitals, pensioners and bondholders, leaving council grants at the bottom of the priority list, and after council budgets have then in turn been prioritised to fund care.

As a result, spending on services such as planning and road maintenance have had to take a bigger hit – a perverse consequence, when one considers that it is councils' ability to invest in the services that help to generate economic growth that is being hampered.

There is no particular logic to this position. It is largely a by-product of how Spending Reviews are run and how the budget lines Ministers consider are labelled. We can speculate that if Ministers had considered future spending using categories based on the service being delivered, rather than on departmental labels, they would not have regarded care of the elderly as being in the lowest-priority bracket and eligible for the highest proportion of cuts.

Efficiency is not enough
Councils have now shed 200,000 jobs in this decade. With two years of the current spending review period still to go, this number will increase significantly before the next Spending Review period. Pay has been frozen for three years in a row in local government, senior salaries are on a downward slope; and local government remains the only part of the public sector that has managed to negotiate a deal with both trade unions and central government to ensure the future stability and affordability of their pension scheme. As this paper shows, the money spent on corporate and back-office functions only came to less than £3 billion at the start of the decade: the cuts to non-care and waste services required by the end of the decade are worth more than five times that.

It is simply the case that the financial outlook for councils will not pay for the services they currently provide by the later years of the decade.

Both central and local government need to face up to what that means.

Councils cannot, unaided, change the legal or institutional framework that dictates their service responsibilities, limits their scope to do things differently, and constrains their revenue base. Councils cannot repeal the statute law that requires care must be provided, library service provision must be comprehensive and efficient, roads must be maintained, equality must be promoted, or – even – that local newspapers must be provided with copies of papers for council meetings. Unlike the Exchequer, councils cannot borrow their way out of trouble or raise new taxes. At present, impact assessments on narrow policy changes are conducted by individual departments without considering the cumulative impact on councils and the demands they place on their funding. Central government and Parliament can no longer delegate their part of the responsibility for making hard choices about local services. The next wave of decision-making will require a more explicit partnership between local and central government.

Options: Reform of adult social care
Future sustainability starts with social care funding reform. The conservative model in this paper makes it clear that care spending will continue to grow strongly while councils' revenues will fall and then stagnate. In fact, the situation is even more challenging for individual councils whose demographic profile is most heavily characterised by an ageing population. We are aware of councils which are modelling social care demand growing at twice the rate of the assumptions in our model.

As the model shows, the financial future of the local government sector is driven by care spending, It will pass 45 per cent of council spending in 2019-20, eating up other budgets as it does so.

We believe that reform must involve a number of components:

- Fairer funding: a fairer funding system with clarity about what the public and the state is expected to contribute towards care costs
- Simplification: a simpler legal framework for care and support to make the system easier to understand and navigate
- Integration: progress on making the right links with health, public health and housing to improve services for the individual and efficiency for the tax payer
- Increased funding: adequate resource for the system and recognition that structural reform and increased funding must go hand in hand

However, as fundamental reform of the system will take some years to legislate for and implement, let alone to take financial effect, the immediate funding issue needs to be urgently addressed. The Treasury has to recognise that it has a strategic misallocation of spending on its hands and correct that with an injection of Exchequer funding into social care to deal with the immediate problem, alongside implementing reforms to reduce long-term public sector costs. Independent analysis by the King's Fund points to a £1.2 billion gap in social care funding by 2014/15. On the scale of Treasury spending decisions, this is modest, a third of 1 per cent of total departmental expenditure limits, and is considerably less than the best estimate of the amount by which the Barnett Formula over-provides for Scottish public spending.

It may seem that transferring responsibility for social care to a better-funded part of government might solve councils' funding problem. But it would not solve the nation's problem and would, we believe, significantly worsen the prospect of keeping spending under control in the long term. If there is one lesson from the last 20 years it is that spending on care has been better controlled, better targeted, and better focussed on the user as a result of local control than it would have been under national management. When care was last nationally funded prior to 1993, the budget was wildly out of control and if there is a problem now it is arguably because councils have managed an underfunded system too well and the lid has consequently remained on for too long.

Local government can act as an integrated commissioner bringing health, housing, transport, leisure, training and other local services to support those with care needs and care providers in a way that no other public body would be able to match. Councils have already demonstrated that they are able to develop dynamic markets with a diversity of care providers to meet care and support needs along the whole spectrum.

We believe that social care reform along the lines that we have proposed can go a long way towards securing councils the headroom they need to maintain their current service offer in future.

Options: local public services should work together better

A number of councils have now gone well beyond shared back offices and brought service delivery together in shared organisations that answer to councillors representing more than one area.

South Oxfordshire and Vale of White Horse district councils created a shared management structure in the last Spending Review period. The West London councils of Hammersmith and Fulham, Westminster and Kensington and Chelsea have developed tri-borough arrangements for social care and public libraries, while East Lindsey and South Holland Districts have an integrated delivery structure for a wide range of services. The Greater Manchester Authorities have established a formal Integrated Authority to deliver economic development and transport services on behalf of the whole conurbation. Such initiatives are already spreading widely – although it would be mistaken to think these measures can do more than make a contribution to the overall need for savings: one recent estimate suggested they might contribute £2 billion, or one-tenth of the reduction in prospect for services apart from care and waste.

Much more significant savings are potentially available from reengineering the local public sector as a whole. The costliest and most intractable public service issues are almost without exception a responsibility shared among a number of local agencies, but those agencies in general share little else: neither budgets, staff, plans, objectives, or customer information. Hospitals spend huge sums of money maintaining elderly patients in acute beds while councils firefight within the care system, while joint arrangements to commission preventive work to keep people out of hospital are rare and riddled with bureaucratic barriers.

Intuitively, bringing more services of this kind together at local level with a collective budget and strategy would save money, both now and in the future, through focussing on reducing demand.

The evidence now available to show how this is possible is growing and improving in quality. The current Whole-Place Community Budget pilots are attempting to set the evidence from their places out in a compelling business case for radical change. Should they succeed, the economic and social arguments for seeking short- and long-term savings from integrating local services and commissioning will be compelling.

At the same time, councils in other places are working with other local public sector organisations to improve their collective effectiveness and efficiency. From the partnerships developing a single caseworker approach to Troubled Families, to the Creative Councils pilots, to the Capital and Asset Pathfinders, further evidence and more developed models of collective working are emerging to feed the business case for whole-place public sector management. Over the coming months, the LGA will be working to bring that, sometimes disparate, body of work together into a coherent picture of what the future local public sector might look like and how it might work.

Options: proper dialogue with residents about the local taxes they pay

A further option to buttress the future financial stability of councils is to give them greater ability to self-fund expenditure through local taxation, agreed and voted on by local residents. This might involve removing the continuing barriers to setting council tax levels without Ministerial interference, a more thoroughgoing localisation of the business rate than is currently on the table, the transfer of a buoyant national tax to local control – many countries have local sales taxes, for example, which could be replicated in this country by hypothecating a proportion of VAT revenue – or allowing councils the discretion to raise their own supplementary local taxes from a predetermined menu of options. Allowing a genuinely free conversation with local residents about how much tax they want to pay and what services they want to receive in return is not only in the close spirit of localism, it is also fully consistent with the government's ambitions not to add further to public borrowing. The importance of this local democratic conversation with taxpayers has been highlighted in the recent work of the House of Commons Political and Constitutional Reform Select Committee on a Code for independent local government, and the LGA is pursuing it in its response to the Committee.

Options: cutting services out, not back
Finally, councils and the government will inevitably need to consider how to frame an effective conversation with electors and other residents about a service offer that is simply reduced from its current level.

The most direct option is to change the law. Parliament could repeal a proportion of councils' 1300 statutory duties and councils would cease to fulfil them. When the Government consulted on a review of councils' statutory duties in March 2011, the exercise proved to be controversial, difficult and painful. It was clear that the public is not ready to consider a significant change in the scope of what they have come to expect from the state. However, if public spending is to be constrained in the next Spending Review on the scale the Government is intending, central government must surely recognise that it will have to undertake a realistic review of the duties of the state.

In line with the government's commitment to transparency and localism, such a review would ensure that accountability rested in the right place: Parliament cannot expect to vote through spending limits that are inconsistent with the laws it itself has made.

A variation on this approach would be to exploit legal ambiguities to stretch the boundaries of what fulfilling a statutory service obligation involves. Councils could work with their communities to develop a shared and reduced set of expectations about what a park should look like or what the condition of a well-maintained road should be. As the latter example illustrates, though, providing "thinner" rather than fewer services carries legal and moral risks, as well as political ones.

Another option, though, is to reduce the scope of what councils do by transferring responsibilities to a better-funded part of government. Services which might be considered for transfer in this way might include regulatory services with a uniform statutory framework such as trading standards or animal welfare: but the sums of money at stake here are very small compared to the scale of the problem.

The need for a debate
Local government is the most efficient part of the public sector and will maintain that record. Its approach to overheads, shared services, senior salaries and procurement put central government's record in the shade.

It is also the most trusted part of government and the place where genuine and lively democratic debate with citizens about the public service offer can best be conducted. But now that the basic statutory service offer can no longer be reconciled with the funding outlook to the end of the decade, we need a debate about how to solve the problem in which local electors and councils, but also Ministers and central government, need to take a full and responsible part.

The last Spending Review decentralised the politically difficult. Over the second half of this decade, the challenge will be to prevent the consequences of that becoming politically impossible for councils and government alike. Without money and reform, there is no solution. We do not believe that this or any government would deliberately choose to do without filling potholes, funding the voluntary sector, commissioning public libraries, or planning for economic development. But planning future spending without planning the changes those spending plans require is to make that choice by inadvertence. The lines on the charts in this paper are the converging train tracks that will carry the most immediate and popular public services into history unless the passengers – government, councils and the voters – draw a new map for organising and funding local public service, and draw it now.

Annex A
Income assumptions

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

- **Council tax:** We have assumed that council tax will be frozen until 2014/15 and will thereafter grow by 2 per cent per year. We have also assumed a very modest growth in the tax base of 0.50 per cent a year from 2013/14.
- **Formula grant:** We have used the Revenue Outturn (RO) returns for 2010/11; Revenue Account (RA) returns for 2011/12 and the 2012/13 Department for Communities and Local Government (DCLG) Local Government Finance Settlement for NNDR and revenue support grant (RSG) figures.
- **National Non-Domestic Rates:** The business rates system is set to undergo massive reform in 2013/14 but very little of the operational detail is publicly available. We have tried take into account how the new system is expected to work from the information that is in the public domain, particularly the Statements of Intent released on 17 May 2012. We have assumed future NNDR growth at 3.5 per cent (equivalent to 2.9 per cent in RPI, in line with the OBR's forecast, and 0.6 per cent in growth above RPI to reflect growth in the tax base, which is roughly on trend). To project income from 2013/14 when the new rates retention scheme comes in, we have assumed that councils will retain 50 per cent of total NNDR yield as the "local share" and that the share will remain constant throughout the period as set out in the Statement of intent on central and local shares published by DCLG.
- **Revenue Support Grant and other grants:** Detail on the use of the centrally retained share of business rates income and funding of grants is not yet available, although the Government's Statement of Intent indicated that in future very substantial amounts of grant that are currently funded separately would in future come within the scope of being funded from the business rates central share. More detail is expected to be published for consultation in summer 2012. For the purposes of the model, we have derived current levels of grant funding from published sources, including the DCLG RO returns for 2010/11; RA returns for 2011/12 and the 2012/13 DCLG Local Government Finance Settlement information. For 2013/14 onwards, we have assumed that the central share will be returned to local government through grants, and that for 2013/14 and 2014/15 other grant will be allocated in line with the total funding for local government set in the 2010 Spending Review. For periods beyond 2014/15, we have assumed that the total funding for local government will be reduced in a broadly similar manner to that set in the 2010 Spending Review. For 2015/16 and 2016/17, the trajectory modelled for grant funding is consistent with the assumptions set out in the 2012 Budget Statement on the likely overall level of Resource Expenditure. It is further assumed that, beyond 2016/17, the total level of government funding for local government continues to fall. Overall, in the 2010 Spending Review, central government funding for local government was cut from £29.7 billion in 2010/11 to

£24.2 billion in 2014/15. The assumption made in the model is that there could be a further reduction in funding to around £17.6 billion by 2020

- **Investment income:** We have used the RO returns for 2010/11, RA returns for 2011/12 and thereafter assumed that yield will be responsive to the changes in the market gilt rate, although we have not included any assumptions about changes to the levels of investment.
- **Transfers to and from reserves:** We have used the RO returns for 2010/11, RA returns for 2011/12 and data from DCLG on councils' planned reserves for 2012/13. We have assumed reserves will be drawn down through 2013/14 but gradually rebuilt as the new business rates retention scheme and localisation of council tax support will require authorities to manage an unprecedented level of volatility at the local level. We expect that the effect of these changes will be an inclination to build up reserves as a safeguard.
- **Sales, fees and charges:** The RA data that forms the baseline for this model does not include data on fees and charges, so we used 2010/11 RO data on the proportion of expenditure in service blocks that come from fees and charges and applied these splits to 2011/12 RA data. We assumed that income from sales, fees and charges would be sensitive to prevailing economic conditions and applied a multiplier derived by calculating the difference between consumer price index (CPI) and the output gap to market-facing services. Then we applied the additional income from sales, fees and charges against expenditure rather than income.

The revenue lines are adjusted to remove income attributable to authorities whose spending is not modelled (see section 3).

Annex B
Cost drivers in service areas

This section sets out the primary cost drivers that have been applied to each service area and identifies other factors which are likely to drive costs but which we have not been able to quantify.

Education

- Expenditure excludes services funded by Dedicated Schools Grant, Pupil Premium, and Further Education Funding.
- Inflation and the Office for National Statistics (ONS) projections for child population were applied as cost drivers in the model.
- Child population numbers were used rather than pupil numbers because education-related services that are funded from outside the Dedicated Schools grant have a user base that extends beyond pupils.
- The impact of central government policy decisions such as increased number of academies and knock-on effects of any future changes to the schools funding formula are not reflected in the model.

Children's social care

Inflation, the change in child population, and changes in the numbers of looked after children (LAC) are applied as cost drivers.

- The increase in the numbers of LAC are derived from the historic ratio of LAC to child population.
- The model assumes that pressures on LAC increase at the beginning of the period, reflecting the trend since the Baby Peter case in 2008, but it also assumes that these pressures will start to abate by 2014/15.
- It seems highly likely that projections in this service block underestimate future spending pressures since reliable data was not available for key cost drivers such as changes to the length of time spent in care, increase in referrals, use of agency staff, complexity of care needs, etc.
- The Children and Family Court Advisory and Support Service also report that there has been a sustained increase in the number of councils applying to the courts for Care Order since the Baby P case, but the numbers are still too volatile for a trend to be predicted and the average costs for councils leading up to a court application have not been accurately determined.
- Of cost drivers that have not been applied to the model due to the unavailability of reliable data, changes to the numbers of referrals and the type of care that is provided are considered by far the weightiest cost drivers and sector advisers suggest may even outweigh the three cost drivers that have been quantified in the model.

Adult social care

- We relied entirely on the 2011 projections of the London School of Economics Personal Social Services Research Unit projections about the growth in demand in both areas (driven by changes to changes to population over 65 and changes to population of adults aged 18-64 with learning disabilities).
- We split this area into two, projecting spending on older people and other adults with care needs.
- The model assumes that post-2015 social care staff pay will increase by 2 per cent per year in real terms.

- The impact of changes to the types of care that people receive, Dilnot proposals/government changes to funding of ASC, changes to NHS spending on reablement and other services, and the impact of shortfalls in Disabled Facilities Grant funding have not been applied to the model.

Highways, roads and transport

- We split this area into two: concessionary fares and all other spending.
- For concessionary fares, we applied inflation but have made a highly ambitious assumption that demographic pressures due to increased numbers of pensioners will be offset by reductions to the discretionary element of spending, which amounted to about 18 per cent.
- However, this is likely to be optimistic as several of the key cost drivers in concessionary fares are in the hands of commercial bus operators and are factors over which councils have limited influence, eg commercial bus fares and the operating costs of bus companies.
- For other transport spending, we applied inflation and vehicle miles based on the Department for Transport's (DfT) 2011 Road Traffic Forecasts.

Housing

- We factored in inflation and changes in the number of households.
- The model does not include any estimates of the impact of housing benefit changes or the economic downturn on demand for housing advice, applications for homelessness, demand for Disabled Facilities Grant, etc.

Culture, recreation and sport

- We split this area into two: libraries and all other spending.
- For libraries, in addition to factors that increase costs such as CPI and population change, the model also takes account of deflationary pressures such as reduced library usage.
- We were not able to quantify aggregate savings from the four major reform models that libraries are using.
- Currently 50 per cent of culture and sport services are outsourced to social enterprises, charitable trusts or the private sector. This is especially so in London and big towns. We can expect this to increase although at the moment there is limited interest from most large cities.
- We also assumed that councils would be able to find a further 2 per cent a year efficiency savings either in their own operations or from contracts with other providers in the last four years of this period.

Environment

- We split this into two: waste management and all other environmental services.
- We applied the cost of landfill as a driver by multiplying estimates of household waste from Department for Environment, Food and Rural Affairs (Defra) statistics by the cost of the landfill tax.
- Figures are based on the assumption that the percentage decrease in the amount of waste landfilled will be 6.31per cent until 2014/15, based on the historic trend.
- In 2014/15 landfill tax will reach £80 per tonne. As the Government has not announced plans to increase the landfill tax further after this date, it is anticipated that the rate at which landfilling decreases

will slow because increases in landfill tax have been key in encouraging increased recycling.

- From 2015 onwards we have predicted that the percentage decrease year on year for landfill will be half the rate of previous years.
- It also will be harder to reduce the amount sent to landfill once certain levels of recycling have been reached.
- We also applied values for increases to collection costs based on the average percentage increase in the cost of waste collection from 2006/07 to 2010/11 (applied forward 2011/12 until 2019/20) and the projections for growth in households.
- On the whole, it is likely that waste management costs are underestimated as, apart from landfill tax, cost drivers associated with disposal such as volatility in the recyclates market have not been able to be factored in.
- For other environmental services, we factored in inflation and population change.

Planning and development

- The model factors in inflation and population change.
- It also projects that the number of planning applications will stay constant to 2013/14 but will thereafter increase by 5 per cent a year as a result of economic recovery and will climb gradually back to the levels received by councils at the start of the last decade.

Central services

- The model assumes that councils will continue to target corporate and back office functions to achieve maximum savings, but will reach a point about midway through the decade when they start to see diminishing returns, given the high levels of efficiency savings from these functions they have already realised.
- It is highly optimistic to assume that councils will be achieve savings that exceed their Gershon targets in this area.

Capital financing

- The Office of Budgetary Responsibility forecasts market gilt rates up to 2016/17. While methodologically it may be feasible to make an estimate of what these changes could mean for capital financing costs there are too many unknown factors for such estimates to be meaningful.
- The forecast interest rates would only apply to new borrowing that is undertaken between now and 2020. It is so far unclear what impact budget cuts will have on the level of prudential borrowing undertaken by local authorities. One outcome could be that councils borrow more to compensate from a loss of capital grant. However, it is equally plausible that councils rein in borrowing as a result of pressures on their revenue budgets.
- As it is not possible to forecast what future borrowing levels will be, it is also not possible to forecast the relationship between new borrowing and amortisation of historic debt. These unknown and unpredictable variables mean that any estimate of future financing costs that includes future interest rate changes would not be sufficiently robust.

- New borrowing was on average 7.3 per cent of the total amount of historic debt each year between 2005/6 and 2010/11, and it would optimistic to assume that borrowing levels will continue to be this high. The OBR’s forecasts see interest rates changing by 1 per cent between now and 2016/17. Applying this 1 per cent fluctuation to somewhere between 5-10 per cent (based on historic trend) of borrowing would not be expected to yield a difference in funding pressure that is significant at a national level.
- As any changes that result from including future interest rate changes would be marginal, we believe that assuming that capital financing costs stay flat will not have a material impact on the outcomes of the model.

Local Government Association
Local Government House
Smith Square
London SW1P 3HZ

Telephone 020 7664 3000
Fax 020 7664 3030
Email info@local.gov.uk
www.local.gov.uk

For a copy in Braille, larger print or audio,
please contact us on 020 7664 3000.
We consider requests on an individual basis.

L12-449