Written evidence submitted by Grant Thornton UK LLP [FSR 054]

Executive Summary

Every local authority shares a common aim – to secure the best possible outcomes for local communities and a healthy and productive local economy.

But local government has been significantly affected by a decade of austerity. The sector is facing unprecedented demand and financial pressures, and the risk of financial failure has never been more acute. The very public struggles of Northamptonshire and Somerset County Councils last year demonstrate the significant challenges many councils, and in turn their citizens, are facing. As the largest auditor of local government in England, including Somerset County Council, we feel well placed to provide written evidence on local government finance.

In June 2017, we published our Blueprint for the UK and many of our recommendations are relevant to this review, with an extract below.

The government should continue to explore devolving powers from Brussels and Westminster to local areas, in ways that encourage innovation, collaboration and trust. The government should give cities and shires across the UK powers and frameworks to support collaboration on strategic issues and raise the finance for investment in their infrastructure priorities. These should include:

- greater flexibility for local experimentation in models of leadership, governance and delivery of public services - supporting different ways of enabling strategic decision making in and across shire counties as well as city regions; and collaboration between public, private and not-for-profit sectors

- devolution to strategic local bodies of services and policies including immigration, skills, health and social care, housing, local and regional transport – with freedom to develop holistic solutions across these areas

- giving local bodies the flexibility and freedom to support innovation and infrastructure investment – including local bonds, borrowing and tax raising powers and the ability to experiment with alternatives to business rates.

Ensuring their financial sustainability is now the number one issue facing councils, and the extreme lack of certainty beyond the current financial year – at a time of wider uncertainty such as the impact of Brexit – is the worst possible situation for councils to be managing their medium to long-term financial sustainability in.

We need to move to a basis where councils are able to own their own future and support their communities. This requires a twin track approach of fiscal devolution and choices over taxation – for which the local electorate should hold politicians accountable - together with major regional post Brexit infrastructure investment, to enhance the current LEP led Industrial Strategy work in regional localities.
Our key recommendations are:

- Embark on a strategy to drive meaningful fiscal devolution to local government by 2025 – to include considering the abolition of council tax setting caps, powers to introduce new taxes and drive new opportunities for investment income.
- Central and local government to work together to agree a shared understanding of demand led services, supported by independent and objective analysis.
- Consider the options for creating greater certainty to councils over their medium to long-term funding (beyond the Fair Funding Review and Business Rates Retention review) such as currently provided for the NHS. As well as providing strategic financial planning certainties for local government, this would also put place-based integration across these key public services on a much stronger footing.
- Use the current Industrial Strategy, led by regional LEPs, to make game changing investments in England’s regions and drive sustainable growth. It should also aim to share dividends from growth and give councils an opportunity to effectively execute devolved fiscal powers and invest in their local economies, so they are not left behind economically.

1) The current and forecast funding needs of local government and how these needs can be better understood at both a national and local level

Current financial health of local authorities:\n
- 49.1% reduction in government funding for local authorities between 2010/11 and 2017/18
- 28.6% reduction in local authorities’ spending power (government funding plus council tax) between 2010/11 and 2017/18
- £901 million overspend on service budgets by local authorities in 2016/17
- 66.2% of local authorities with social care responsibilities drew down their financial reserves in 2016/17.

As part of our investment in data and analytics for the local government sector, we have developed a Financial Foresight model that provides a long-term forecast of expenditure and income for all councils in England over a fifteen-year horizon. Our analysis of this model makes it clear that, without doing something differently, most councils will run through their reserves. For a small handful of councils, the time when reserves run out is now. But the data also tells us that up to 100 councils face reserves depletion within five years.

Forecast financial health of local authorities using Grant Thornton’s Financial Forecast model:

- 36% of all councils in England are at risk of financial failure in the next ten years\(^2\), with one in five (17%) at risk of financial failure by 2021.
- London boroughs are the most exposed with 78% (25) forecast to be at risk of financial failure over the next decade.
- 49% (27) of unitary authorities and 50% (18) of metropolitan councils are at risk over the next decade, making these the two next most vulnerable authority types.
- 44% (12) of county councils are forecast to be at risk over the next decade, with three likely to be at risk in the next three years.
- By contrast, only 21% (43) district councils are set to become at risk – reflecting the fact that these councils do not have statutory responsibility for demand-led social care services

---


2 “At risk” has been defined as reserve levels at or below 5% of total expenditure.
**The demands of social care**

Forecasting has long been a challenge for the sector, becoming especially difficult given the inexorable rise in demand led services and their increasing disproportionate impact on the budget.

Our analysis shows that in 2017/18 demand led services as a percentage of total spend continued to rise, reaching up to 80% in some cases and well over two thirds of spending in a large number of councils.

Forecasting the rise in the number of adults and children needing services is challenging but not impossible, whereas the increasing complexity of cases is very challenging to plan for.

The adult social care precept was introduced in 2015 and, since then, there has been a 6.89% increase in adult social care net expenditure nationally. The graph below shows the projected increase in spend on adult social care services compared to 2017/18 levels.

Income growth is easier to measure when considering council tax base growth, local fees and charges, and estimated commercial returns. More control over income however would be very useful in building local government resilience, accountability and focus.

Currently, local government financial pressures may be understood by government but are not prioritised. In effect, the end to austerity was marked by giving the NHS the 10-year plan funding and raising local government spending by 1.5 to 2%. This is insufficient to meet the growing pressures facing local authorities from demand led services.

**Recommendation**

- Central and local government need to work more closely together. Using the wide range of data already available, and working with independent organisations such as the IFS, they can effectively model future demand and predict each region’s future funding needs.
- This can then be used in independent assessment funding needs - to be partly funded by the redistribution of business rates, but also by using the local fiscal opportunity available to councils (but not currently permitted by government) such as council tax rises, hotel taxes, additional infrastructure taxes and even local income taxes.

<table>
<thead>
<tr>
<th>Time period</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015/16 - 2017/18</td>
<td>6.89</td>
</tr>
<tr>
<td>2017/18 - 2024/25</td>
<td>19.18</td>
</tr>
<tr>
<td>2017/18 - 2029/30</td>
<td>35.72</td>
</tr>
<tr>
<td>2017/18 - 2039/40</td>
<td>73.99</td>
</tr>
</tbody>
</table>
2) Lessons that can be learned from past changes to local government funding

Local government finance has always been complex, and the various sources of funding have not always sat well with councils, the public, businesses or central government.

In the past 40 years we have seen business rates be politicised locally, then centralised and now seen as the engine of local growth and redistribution - all within a changing economy where occupying space and the profitably of a business are increasingly unrelated. Business rates are a big issue for struggling high street businesses but are much less of an issue for the internet giants.

Council tax is even less popular. Valuations are still those undertaken in 1991 and underplay the growth in property prices in London and the South East, leading to extreme disparities in the rates being paid by households, that have nothing to do with either service quality or political choice.

The last 20 years have seen a significant increase in funding for the sector, during the Blair and Brown governments, which came with a very long list of targets and an inadequate inspection and regulatory regime. This was followed by a period of austerity under the Coalition and Conservative governments, marked by a combination of; significant reductions in funding, a major reduction in central oversight, a real concentration of spending on core services - such as adults and children’s - and a degree of innovation and creativity in the sector, rarely seen elsewhere in the public sector.

The key lesson from this period relates to Whitehall giving up power. In the years of extra funding, this came with increased inspections to check up on local government. In the years of austerity, Whitehall has controlled local government by reducing its funding and its capacity to invest in its communities. This has had impacts on the public realm and also created a sense for those who work in senior roles, both in local government and local politicians, that they have limitations on their ability to engender change locally.

Recommendations

- Trust local government with their local finances and, most importantly, tax raising powers. Business rates devolution achieves some of this, but government needs to go further and release the shackles on local decision-making.
- Consider the options for creating greater certainty to councils over their medium to long-term funding (beyond the Fair Funding Review and Business Rates Retention review) such as currently provided for the NHS. As well as providing strategic financial planning certainties for local government, this would also put place-based integration across these key public services on a much stronger footing.

3) Efficiency and sustainability of the current system (including central government funding, business rates retention, council tax)

The current challenges of local government funding have been well documented (such as by the NAO and Institute of Fiscal Studies) and the pressures facing the sector have never been more acute. In the 2017/18 financial year, our analysis shows that 43% of councils overspent on their budgets – led mainly by increasing costs for homelessness and adults and children’s services.

The current system has many weaknesses, but there are also a few strengths.

- Council tax is a regressive tax and, while its current distribution is ripe for review, it is easy to collect, as is business rates.
- The current funding from central government, though often confirmed late in terms of local government budget setting timescales, is relatively easy to forecast most years, given signals from MHCLG and Treasury.

---

Our view is that local government could be empowered by removing its reliance on central
government funding and the highly centralised approach that has been in place over many
governments in recent decades.

Local government may have had more funding a decade ago, but its status and ability to drive local
choices was arguably no better than it is now. In our view, local government funding should be driven
by local political choice where local leaders are fully accountable for the money they spend, the taxes
they raise and have the power to decide what is best for their area.

For this to become a reality, it would require a mind-set change in central government, regardless of
which government was in power. Council tax would need to be reformed, with a clear revaluation as
soon as possible. Business rates redistribution seems here to stay but is hugely complex and difficult
to understand. Whether it is a genuinely sustainable model for the 21st century is also debateable,
amid the inexorable rise of online retail models.

Council tax reform should include the lifting of the referendum cap. This would enable local taxes to
be introduced to meet specific local needs and move us to a place where local government is not
dependent on the political colour in Westminster but rather the political colour in the Town
Hall. Providing some form of fiscal devolution - such as a local income tax or tourism tax – while not
the perfect solution, would go some way in helping councils better support their local priorities.

Government’s role should be to enable regional growth by supporting infrastructure investment in the
regions and continue to put skills funding in the hands of employers, as has taken place with the
apprenticeship levy. Our discussions with communities in cities across England identified
infrastructure as one of the main priorities. Local priorities include broadband, airport capacity in the
North, housing in London, East-West transport links, and linking smaller towns to larger urban
centres.

Business rates
By allowing councils to retain 75% of business rates, the government hopes the sector will be able to
grow its funding by creating the right conditions for growth. The sector will be allowed to keep
additional funding generated by a dynamic economy - but this model has two main flaws.

First, the business rates model is increasingly under attack from business. It penalises high-street
brands, who are big property owners compared to their internet rivals who pay far less in tax. (Local
independents also feel the impact). Business is also becoming aware that it will provide the majority of
funding for local services and, as a result, increasingly wants a say. This leads to some fundamental
questions, such as whether business should pay for services such as local children’s care and
homelessness challenges.

Second, the growth incentive to local government bumps up against Brexit. The government’s own
figures show that whatever form of Brexit is agreed will have a negative impact on predicted economic
growth4. This impact is also skewed across regions, with the North East forecast to experience the
biggest downturn.

Our own research into the local implications of Brexit revealed that that the geography of vulnerability
to the potential impacts of Brexit is varied, with highly vulnerable areas spread across England.5 The
most vulnerable local authorities to the impacts of Brexit, according to our assessment, include areas
from across five different regions in England.

While the business rates retention plan will reflect fair funding and redistribution, Brexit looks likely to
make the overall cake smaller.

Recommendation

28_November_EU_Exit_-_Long-term_economic_analysis__1_.pdf
5 http://publicsectorinsightslibrary.grantthornton.co.uk/post/102fiil/adaptability-in-a-post-brexit-world-the-
socio-economic-measures-that-matter
Business rates devolution needs to be supplemented by two things. Firstly, the granting of other fiscal powers around additional tax raising powers, and the abolition of caps and prohibitions on local government tax raising powers. Secondly, giving local authorities the ability to generate investment income from sources other than property or group company dividends.

4) The approach government should take to local government funding as part of the 2019 Spending Review

We believe the following could be considered as part of the 2019 Spending Review:

- Lift the referendum cap on council tax.
- Consider the options for creating greater certainty to councils over their medium to long-term funding (beyond the Fair Funding Review and Business Rates Retention review) such as currently provided for the NHS. As well as providing strategic financial planning certainties for local government, this would also put place-based integration across key public services on a much stronger footing.
- Start to pilot new fiscal powers such as the tourism tax, as is happening in Scotland.
- Give the sector a much greater say in NHS commissioning - poor commissioning decisions by the NHS have a major impact on local government costs and vice versa.
- Create a culture where local government has permission to act in the interests of its residents and businesses and can own its risk appetite. This can only be created by government accepting that the centralised model of the last 40 years has been unsuccessful and was at the heart of the Brexit vote, as many communities feel as ignored by Westminster as they seem distant from Brussels. Fiscal devolution coupled with increased regional infrastructure funds are the only way out of this logjam.

About Grant Thornton
Grant Thornton UK LLP is part of one of the world's leading organisations of independent advisory, tax and audit firms. We help dynamic organisations unlock their potential for growth by providing meaningful, forward looking advice.

We are the leading firm in the local government audit market and are the largest supplier of audit and related services and count one-third of local authorities in England as external audit clients. We also audit local authorities in Wales and Scotland via framework contracts with Audit Scotland and the Wales Audit Office. We have over 180 local government and related body audit clients in the UK and over 75 local authority advisory clients. This includes London boroughs, county councils, district councils, city councils, unitary councils and metropolitan authorities, as well as fire and police authorities.

We have significant insight, data and analytics capabilities, which help to shape location and customer strategies, make commercial decisions and drive financial performance improvement. Our team comprises consultants, analysts, researchers and developers with backgrounds that range a number of industries and the public sector. Local government use a number of our data and insight platforms, such as CFO Insights, Place Analytics and Adult Social Care Insights, and our Financial Foresight model, which we have drawn on in this response.

In the UK, we are a Shared Enterprise, led by more than 185 partners and employing 4,500 of the profession's brightest minds. We provide assurance, tax and specialist advisory services to over 40,000 privately held businesses, public interest entities and individuals nationwide. We are the largest employer of CIPFA members and students in the UK due to our public sector work.

April 2019