Levelling Up, Housing and Communities Committee

Rt Hon. Michael Gove MP
Secretary of State for Levelling Up, Housing and Communities
Minister for Intergovernmental Relations
2 Marsham Street
London
SW1P 4DF

27 November 2023

Dear Michael,

I am writing to you, on behalf of my Committee, regarding our inquiry into *Financial Distress in Local Authorities*. We are grateful to Simon Hoare MP, Parliamentary Under Secretary of State (Local Government), for providing oral evidence to us in connection with this inquiry on 20 November 2023. We look forward to hearing from you in relation to this inquiry and our wider work on 6 December 2023.

In advance of our session with you, we would like to highlight some of the key items of evidence provided to our inquiry and our early thoughts. We would also be grateful for a response to our questions, which are set out below, by **Friday 1 December 2023**.

Overview of inquiry

Throughout our inquiry, we have heard from councillors, officers, and independent experts who have informed us that many local authorities face a difficult financial situation, with severe demand and cost pressures impacting on local authorities' ability to deliver key services to their residents.[1] This situation is becoming untenable for some local authorities and greater central Government support is clearly required.

Whilst it is clear that there have been some failures of leadership and decision-making which have caused acute financial distress in specific local authorities, we have heard that there are now system-wide issues which are driving general financial distress across the sector. For example, Councillor John Fuller OBE, leader of South Norfolk District Council and speaking on behalf of the Local Government Association (LGA), told us that:

> We are probably at an inflection point, where the number of authorities contemplating issuing 114 notices is becoming more general, as opposed to the specific reasons we have seen thus far […] there is a general understanding that if not this year, next year, about half of the authorities will be in distress. That is a significant number.[2]

Similarly, Gary Fielding, section 151 officer at North Yorkshire Council, told us that:

[1] Oral evidence: Financial Distress in Local Authorities, HC56, Q1, 08/11/2023; Oral evidence: Financial Distress in Local Authorities, HC56, Q62, 13/11/2023
[2] Oral evidence: Financial Distress in Local Authorities, HC56, Q1 & Q2, 08/11/2023

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> We have moved from having one or two councils, with particular issues—whether it is maverick behaviour or leadership—being affected, to having what I regard as good councils, run by good officers and with political stability, now facing existential challenges.[3]

Given the above, we have questions about the key issues related to (i) funding; (ii) children's services; (iii) homelessness; and (iv) adult social care which are set out in further detail below.

1. **Funding**

Funding Gap:

We heard evidence from councillors, officers, and independent experts that the amount of funding available to local authorities has not kept pace with increased demand and inflationary pressures on statutory service delivery; and the LGA estimates local authorities face a funding gap of £4bn over the next two years.[4]

Councillor John Fuller OBE told us that there is a structural funding gap:

> When you have social care going up by 19% and children with complex needs going up by 23%, but your income is only going up by 3% to 5%, it does not take a maths genius to work out that there is going to be a gap at some stage. I think all authorities can see a gap crystallising at some point in the next three to four years, because structurally our costs, many of which are driven by statutory and regulatory pressures, are exceeding the income coming in. It is a structural problem.[5]

This comes in a context of significant reductions in spending power of local authorities over the last decade, as Minister Hoare acknowledged in giving evidence that "it has been difficult and the local government family has sustained a very significant reduction in its spending power".[6]

David Phillips, Associate Director at the Institute for Fiscal Studies, explained to us that:

> We really need the Department to be working with local government and with researchers and others to look at what is happening to service demand, service costs and productivity within the sector [...] Together, that can help with an assessment of the quantum of funding across the sector as a whole.[7]

We understand that, following the Autumn Statement, existing departmental settlements have not been adjusted to reflect higher than expected inflation forecasts, and that this will increase

[3] Oral evidence: Financial Distress in Local Authorities, HC56, Q99, 13/11/2023
[4] Oral evidence: Financial Distress in Local Authorities, HC56, Q2, 08/11/2023
[5] Oral evidence: Financial Distress in Local Authorities, HC56, Q3, 08/11/2023
[6] Oral evidence: Financial Distress in Local Authorities, HC56, Q139, 20/11/2023
[7] Oral evidence: Financial Distress in Local Authorities, HC56, Q66, 13/11/2023

cost pressures on departmental budgets.[8] According to the OBR, spending in 'unprotected' areas will need to fall by 2.3% per year in real terms from 2025-26.[9]

What work is the Department currently doing, and what work does it plan to undertake, with local authorities to understand their specific demand and cost pressures and to use this as a basis for setting the local government finance settlement for 2024-25?

Funding distribution and delayed reforms:

In February 2016, the Department announced a review of the needs assessment formula used to determine the distribution of central government funding between local authorities.[10] This became known as the Fair Funding Review.[11] However, the Department is still yet to implement the Fair Funding Review and business rates reset and it has announced that it will not do so in this spending review period.[12]

We have heard that the continued use of outdated needs assessments and formulae when distributing funding is causing many local authorities with high spending needs to be disadvantaged, while allowing others to accumulate spending power. Indeed, David Phillips of the Institute for Fiscal Studies told us that "the system of allocating funding between councils is untethered from any assessment of their overall relative needs or ability to raise revenues themselves".[13] Consequently, the poorest councils are receiving less funding, relative to their needs, than the richest councils with Mr Philips explaining to us that:

> When you look at it relative to the assessments of the needs and update, as far as possible, the data that underlies those assessments, the poorest fifth of councils get about 10% below their share of assessed needs, and the richest fifth of councils get about 15% above their share of needs.[14]

In a context of reduced grant funding from central government over the last decade, local authorities are increasingly reliant on revenue from council tax.[15] This penalises those authorities with relatively low value council tax bases, and is itself an increasingly regressive tax which has not been updated for changes in property values since 1991.

Previously, we recommended in our 2021 Report on *Local Authority Financial Sustainability and the Section 114 regime*, the Government should implement the Fair Funding Review and business

[8] Office for Budget Responsibility, Economic and fiscal outlook: November 2023, CP944, p.26
[9] Office for Budget Responsibility, Economic and fiscal outlook: November 2023, CP944, p.103
[10] Final local government finance settlement 2016 to 2017 - GOV.UK (www.gov.uk)
[11] Fair funding review: a review of relative needs and resources (publishing.service.gov.uk)
[12] Local government finance policy statement 2023-24 to 2024-25 - GOV.UK (www.gov.uk)
[13] Oral evidence: Financial Distress in Local Authorities, HC56, Q66, 13/11/2023
[14] Oral evidence: Financial Distress in Local Authorities, HC56, Q66, 13/11/2023
[15] Oral evidence: Financial Distress in Local Authorities, HC56, Q1 & Q5, 08/11/2023

rates reset, and reform council tax by undertaking a revaluation of properties and updating the banding structure.[16] In October 2021, the Department responded that:

> We now need to take stock of the impact the pandemic has had on both local authority resources and service pressures to determine the direction of local government finance reform. Decisions on the way forward will be taken at the ongoing Spending Review [2021].[17]

However, we heard from Minister Hoare that now, two years on, "there is no work at hand to reform the funding formula today or casting forward".[18]

What is your understanding of the consequences for specific local authorities of non-reform of the funding system; and do you intend to take any steps in the short-term to support those which are negatively impacted by the decision to defer reform of the system?

In November 2022, in oral evidence to my Committee, when asked about the possibility of council tax reform, you said:

> It is a challenge, and it is one that we want to look at [...] I know that both the Chancellor and Lee Rowley want to look at it as well [...] he [Lee Rowley] has been looking at this at the Chancellor's and my own request. [...] Work is going on now. I think it would be premature to ask either me or Lee to come back to the Committee before Christmas, but hopefully we will be able to say more in the new year.[19]

However, on 20 November 2023, we heard from Minister Hoare that "there is not a review in the formal sense of the term"[20] and there is "some evidence to suggest that that piece of work has been in hand, but it would be described as a work in progress rather than a finished piece".[21]

What were the preliminary findings of the Department's early work on reforming council tax? When can we expect the Department to complete this work and present its proposals for reform?

[16] Second Report of Session 2021–22, Local authority financial sustainability and the section 114 regime, HC33, p.14 & p.15

[17] Government response to the Housing, Communities and Local Government Select Committee report on Local Authority financial sustainability and the section 114 regime, p.6

[18] Oral evidence: Financial Distress in Local Authorities, HC56, Q148, 20/11/2023

[19] Oral evidence: The Work of the Department for Levelling Up, Housing and Communities 2022, HC808, Q39-39, 21/11/2022

[20] Oral evidence: Financial Distress in Local Authorities, HC56, Q154, 20/11/2023

[21] Oral evidence: Financial Distress in Local Authorities, HC56, Q155, 20/11/2023

Uncertainty and Flexibility:

We heard evidence that local authorities cannot effectively manage their finances without clarity over their medium-term funding. For example, from Dr Jonathan Carr-West, Chief Executive of the Local Government Information Unit (LGIU), who told us that:

> One chief executive said to me, "It's not just that we don't have enough money; it's that we never know how much money we don't have." You are constantly guessing at what the situation might look like, because we get one-year financial settlements; you have bid funding, which is competitive and uncertain. So you do not even have a set foundation on which to make decisions.[22]

While we acknowledge that the Department has made attempts to improve clarity by publishing a two-year local government finance policy in December 2022,[23] the detailed finance settlement remains for the one subsequent year.[24] Issues with the current funding system have been raised with us throughout our inquiry, including:

- Steve Thompson, section 151 officer at Blackpool Council, recalled a four-year settlement in 2016-17 enabling more straightforward budgets and financial planning in his council.[25]

- Gary Fielding, section 151 officer at North Yorkshire Council, also told us that the funding landscape has become increasingly complex with the proliferation of specific ring-fenced grants and competitive funding pots; he has 140 different funding sources, and would welcome simplified funding with more local flexibility.[26] This echoes recommendations made by my Committee in our 2022 Report on *Long-term Funding of Adult Social Care*.[27]

- Councillor John Fuller OBE said that "Local Government is being set up to fail…" with insufficient funding for new burdens.[28] He gave the example of recent Government reforms to recycling, with insufficient funding provided to local authorities for purchase of refuse collection lorries and storage space.[29]

- Councillor Sam Chapman-Allen, leader of Breckland Council and chair of the District Councils Network, requested specific flexibilities over fees and charges for planning, licensing, and environmental health, for which his council was currently having to offer subsidised services due to central Government caps on fee levels.[30]

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[22] Oral evidence: Financial Distress in Local Authorities, HC56, Q64, 13/11/2023
[23] Local government finance policy statement 2023-24 to 2024-25 - GOV.UK (www.gov.uk)
[24] Final local government finance settlement 2023 to 2024: policy impact statement - GOV.UK (www.gov.uk)
[25] Oral evidence: Financial Distress in Local Authorities, HC56, Q127, 13/11/2023
[26] Oral evidence: Financial Distress in Local Authorities, HC56, Q126, 13/11/2023
[27] Second Report of Session 2022–23, Long-term funding of adult social care, HC19, p.38
[28] Oral evidence: Financial Distress in Local Authorities, HC56, Q19, 08/11/2023
[29] Oral evidence: Financial Distress in Local Authorities, HC56, Q19, 08/11/2023
[30] Oral evidence: Financial Distress in Local Authorities, HC56, Q33, 08/11/2023

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Furthermore, in our 2021 Report on *Local Authority Financial Sustainability and the Section 114 regime*, we recommended that the Government should give local authorities more flexibility over local taxes and other revenue raising powers.[31] Minister Hoare, in giving evidence to us, said:

> We have the system that we have. Is anybody saying it is perfect and beyond reform? No, nobody is […] we keep a weather eye on that. It would be clearly part of the mix in a wider review of how local government is funded but it is not going to be changing any time soon.[32]

In the Autumn Statement, the Chancellor announced that the Government plans "[…] to allow local authorities to recover the full costs of major business planning applications in return for being required to meet guaranteed faster timelines".[33]

Is the Government considering further reforms to grant local authorities greater flexibility over local taxes and revenue raising powers?

2. **Children's services**

The market for placements: We have heard evidence of a "broken"[34] market for children's services, with increasingly complex needs driving high demand against an insufficient supply of residential and fostering placements. Councillor Graham Chapman of Nottingham City Council told us that:

> The market is broken. That is a major issue for us. The costs are rising inexorably. There is almost no way through…children are very often being processed rather than looked after. There are cases in which a child will cost between half a million and £1 million a year. That is utterly unsustainable, and is utterly inexcusable…Think of the impact that has on every other service…We are talking about up to 75% of your expenditure going.[35]

We also heard evidence from witnesses with concerns that the market for children's services is not operating efficiently. Their concerns are aligned with those expressed in the McAlister review,[36] regarding profiteering by private suppliers driving up costs to unsustainable levels for local authorities. For example, Stephen Jones, Director of Core Cities UK, emphasised to us that:

> We have some concerns that some of the private providers are passing through more than they could do. Is the market for care service provision both on the adult and children's side operating as efficiently and…fairly as it could do? We have some doubts.[37]

[31] Local Authority Financial Sustainability and the Section 114 Regime (parliament.uk), p.17
[32] Oral evidence: Financial Distress in Local Authorities, HC56, Q169, 20/11/2023
[33] HC Deb, 22 November 2023, vol.741, col.330
[34] Oral evidence: Financial Distress in Local Authorities, HC56, Q97, 13/11/2023
[35] Oral evidence: Financial Distress in Local Authorities, HC56, Q2, 08/11/2023
[36] The-independent-review-of-childrens-social-care-Final-report.pdf (nationalarchives.gov.uk), pp.120-121
[37] Oral evidence: Financial Distress in Local Authorities, HC56, Q44, 08/11/2023

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This was acknowledged in evidence from Nico Heslop, the Director of Local Government Finance at DLUHC. Mr Heslop told us that:

> One of the issues is to do with the market in children's social care, and the Department for Education published a document called 'Stable Homes, Built on Love' earlier this year which recognised problems with that market.[38]

We welcome that, as we heard from Minister Hoare and Mr Heslop, the Department for Education has accepted all recommendations made by the Competition and Markets Authority on reforming the market for children's social care.[39]

Minister Hoare committed to providing us with a written submission produced jointly between your Department and the Department for Education setting out the Government's plan to tackle these problems.[40] **Please could this information be provided to us?**

Special educational needs and disabilities:

Local authorities use the high needs block of their Dedicated Schools Grant to fund most costs associated with delivering services for children with special educational needs and disabilities (SEND). We have heard that costs associated with providing such services have been significantly outstripping the funding received. Lorna Baxter, President of the Association of Local Authorities' Treasurer Societies and section 151 officer at Oxfordshire County Council, explained that:

> The challenges being faced across all 152 authorities on SEND—not only the deficits in-year, but the accumulating deficits […] We expect a deficit of about £3.6 billion across the country by the end of the statutory override.[41]

The Department recently extended a statutory override, allowing councils to build these ring-fenced deficits, until March 2026.[42] We heard from witnesses who are concerned that the causes of the deficits are not being addressed, and the problem is just being deferred into the future. Lorna Baxter said:

> That is a bit of a no-brainer on the statutory override: the money has gone, the money has been spent—the statutory override is in place, but the money has gone. Therefore, that is a real issue for local authorities to manage. I am aware of one county, for example, that is having to borrow to pay for the deficit, because that will be a reduction in cash. Significant issues are beginning to materialise across all sectors that are struggling.[43]

[38] Oral evidence: Financial Distress in Local Authorities, HC56, Q177, 20/11/2023
[39] Oral evidence: Financial Distress in Local Authorities, HC56, Q177 & Q180, 20/11/2023
[40] Oral evidence: Financial Distress in Local Authorities, HC56, Q176, 20/11/2023
[41] Oral evidence: Financial Distress in Local Authorities, HC56, Q101, 13/11/2023
[42] Local government finance policy statement 2023-24 to 2024-25 - GOV.UK (www.gov.uk)
[43] Oral evidence: Financial Distress in Local Authorities, HC56, Q101, 13/11/2023

Minister Hoare told us, of those local authorities with concerns about what will happen to them when the statutory override ends, that "we will not stand idly by…and see key public service providers topple over".[44]

How is your Department working with the Department for Education to address the causes of these deficits, to prevent further accumulation of deficits, and to enable local authorities to clear them?

Will the Government commit to writing off these deficits, or will local authorities be expected to pay for them or issue a section 114 notice, when the statutory override ends in 2026?

3. **Homelessness**

Local Housing Allowance: The local housing allowance rates have been frozen at 2020 levels while property prices have significantly increased. Abdool Kara, executive director at the NAO, told us that this is:

> The single biggest issue driving increased homelessness […] the freezing of local housing allowance rates does two things: it creates more people who are homeless, because their housing benefit cannot afford rising rents, but more importantly it means that local authorities cannot discharge their duty towards households once those people are homeless, because they cannot find them properties in the local area that are within the local housing allowance rates.[45]

We also heard that increased demand for statutory homelessness services, alongside a shortage of supply of temporary accommodation, is putting significant pressure on local authority budgets, in particular in cities and urban areas. Councillor Claire Holland, chair of London Councils and leader of Lambeth Council, made clear to us that:

> What is really driving the crisis in London is homelessness and the housing crisis. Boroughs are forecasting to overspend over £90 million on temporary accommodation this year. One in 50 Londoners is homeless; that is one child in every classroom across London. That is a massive cost to us. We have 170,000 people in temporary accommodation. In my own borough, it is sadly going up consistently and constantly.[46]

We asked Minister Hoare and Mr Heslop whether the Government had assessed the impact on homelessness of the freeze on the local housing allowance. Neither were able to provide an answer at that time and **Minister Hoare committed to write to us on this matter.**[47] **Please could this information be provided to us? Additionally, has the Government**

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[44] Oral evidence: Financial Distress in Local Authorities, HC56, Q184, 20/11/2023
[45] Oral evidence: Financial Distress in Local Authorities, HC56, Q87, 13/11/2023
[46] Oral evidence: Financial Distress in Local Authorities, HC56, Q11, 08/11/2023
[47] Oral evidence: Financial Distress in Local Authorities, HC56, Q211, 20/11/2023

considered the impact on homelessness when determining local housing allowance rates?

We welcome the Chancellor's announcement in the Autumn Statement that the Government is increasing the Local Housing Allowance (LHA) to cover the 30th percentile of local market rents.[48] However, we note the Office for Budget Responsibility's assessment that "The measure also freezes LHA rates from 2025-26 onwards, thereby eroding its generosity over time as rental prices rise".[49] Our *Reforming the Private Rented Sector* Report recommended that:

> If the Government believes the PRS is the right place for those on the lowest incomes, it should at least make sure housing benefit does what it was designed to do and covers benefit recipients' housing costs. For this reason, it should increase LHA rates to realign them with the 30th percentile in each broad rental market area; and commit to conducting a review as soon as possible into whether they should once more be aligned with the 50th percentile.[50]

Can you confirm that Local Housing Allowance rates are likely to be re-frozen after they are increased in 2024/25? If so, what impact assessment of this policy decision has the Government conducted, and will you publish it?

And will the Government commit to conducting a review into whether Local Housing Allowance rates should once more be aligned with the 50th percentile?

4. **Adult social care**

The levels of funding to local authorities remain insufficient to meet increased demand and inflationary pressure on delivery of adult social care. Councillor Barry Lewis, leader of Derbyshire County Council and speaking on behalf of the County Councils Network, told us:

> Adult social care has been the key driver around costs in previous years, and the Government have provided little resources around that. They delayed the introduction of care reforms last year until we got that model right and worked through that. They allowed councils to retain £2.9 billion of additional funding for core services this year and the next—helpful, but it is still a key pressure as we move forward.[51]

While we appreciate that the Government has committed additional funding to adult social care for 2023-24 and 2024-25, the amounts committed are short of those we recommended in our 2022 Report on *Long-term Funding of Adult Social Care*.[52] We also recommended in this Report that:

[48] HM Treasury, Autumn Statement 2023, CP977, p. 88
[49] Office for Budget Responsibility, Economic and fiscal outlook: November 2023, CP944, p. 66
[50] Fifth Report of Session 2022–23, Reforming the Private Rented Sector, HC624, para.117
[51] Oral evidence: Financial Distress in Local Authorities, HC56, Q43, 08/11/2023
[52] Second Report of Session 2022–23, Long-term funding of adult social care, HC19,p.73

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> Given how fundamentally social care policies made by DHSC affect local authorities' capacity, budgets, and residents, it is vital that DHSC and DLUHC work together closely on developing and delivering such policies…The Government's 10-year plan should be developed jointly between DHSC and DLUHC, with relevant input from the Department for Work and Pensions.[53]

We asked Minister Hoare whether he had, in his short time in office, found the long-term plan for social care funding. Minister Hoare replied "I have seen…lots of thoughts and ideas and thinking on this".[54]

Can you confirm whether the Government has developed, or is developing, a 10-year plan for how its vision in the People at the Heart of Care White Paper will be achieved, as we recommended in our 2022 Report on Long-term Funding for Adult Social Care?

I look forward to discussing these matters with you further on 6 December 2023.

Best wishes,

Clive

Mr Clive Betts MP
Chair, Levelling Up, Housing and Communities Committee

[53] Second Report of Session 2022–23, Long-term funding of adult social care, HC19, p.76
[54] Oral evidence: Financial Distress in Local Authorities, HC56, Q201, 20/11/2023

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