Written evidence submitted by TRL Insight [FSF 046]

About TRL Insight

TRL Insight is the trading name of Tom Lawrence. Tom has provided policy advice, analysis and other services to the public sector for over 20 years. Some of this has been delivered under the TRL Insight brand; some through associate and core staff posts, in a range of organisations in and supporting local authorities and schools and their partners. The contents of this response represent the views of TRL Insight only.

This policy advice and analysis has included reports, case studies, briefings, guides, magazine/journal articles and training sessions.

More information about TRL Insight can be found on my website, including the services that TRL Insight can provide, links to TRL Insight's outputs and more information about them on the About and Feeds pages and in TRL insight's May 2023 newsletter.

Summary

This document responds to many, but not all, of the questions posed in the Call for Evidence. It is laid out as follows. Our response to the first main question on which the Committee is seeking evidence is in the form of a narrative overview of the issues, broken up with sub-headings.

This describes systemic problems with the local government finance system:

- A lack of financial autonomy for local government;
- A "messy and complex" Business Rate Retention system, in particular in the way in treats equalisation for ability to raise council tax and business rates differently;
- Problems resulting from an over-reliance on property taxes and grants for funding local government;

It then lists five further problems that have arisen with the system in recent years.

Responses to later questions (including the sub-questions of the first question) are then used to dive more into the detail. These discuss:

- The outdated nature of the needs assessment in the Business Rate Retention (BRR) system, and the grants used to top it up;
- Various ways the Government tinkers with the parameters of local taxation and constrains local authorities' ability to put together a financing package that is suited to their local circumstances;
- The fragmentation of grant funding in recent years and the proposed consolidation of grants;
- How lack of control of income sources causes difficulties for budgeting for the long-term and investing in service transformation;
- How devolution and the Prudential System are welcome and can be most helpfully expanded;
- Thoughts on a future system for responding to financial distress, should the local government sector as a whole be returned to financial sustainability;

- The need to replace the use of capital receipts for revenue purposes with a much more flexible capitalisation regime for unavoidable and otherwise unaffordable costs and for upfront investment in service transformation;

- The importance of MHCLG being involved in policies led by other departments which affect local authorities.

Many of these points will be covered more systematically or from different angles in a report that I am currently writing, including:

- Reforms to unlock borrowing against income resulting from future growth in housing and rateable value;

- Broadening the local tax base;

- Resetting the BRR system.

Response to call for evidence

Is the local government finance system fit for purpose? If not, what needs to change?

Need for financial autonomy

It is widely recognised that the United Kingdom, and England in particular, is a very centralised country. Decisions on key matters of public policy, particularly those which involve spending public money, are largely made in Westminster and Whitehall. The principle of "he who pays the piper calls the tune" is amply demonstrated in central-local relations: most of the factors which determine local authority budgets and spending decisions stem from Government policies, and consequently it's not councils' residents who are in charge of setting their priorities, it's central government. This will always be the case while councils operate in a system whose parameters are constantly tinkered with by central government and are so heavily dependent on grant funding.

Central government's spend is largely financed by taxes raised at the national level, giving it considerable autonomy. If the policies of each council are truly to reflect the desires and needs of its own citizens, and councils are to be freed up to think creatively and aspirationally, they need far greater financial autonomy. This requires higher proportions of local government funding to be raised by local government, and a much more hands-off approach from central government.

Need for clarity in equalisation

Now, England's geographic communities are extremely variable in their affluence and their need for local public services. Some have poor infrastructure, weak local economies and entrenched deprivation, but even these have latent strengths. With sufficient investment and a clear vision of how to build on the strengths of those communities, cycles of decline can be turned around to create cycles of success.

But until this success is achieved, councils in which such disadvantaged communities predominate will have greater need for public spending and less ability to raise local taxes and charges to fund this spending. There is therefore a considerable need for equalisation or redistribution *within the local government sector*.

Under the previous system of Formula Grant, and its predecessors such as Formula Spending Shares and Standard Spending Assessments, equalisation for needs and for ability to raise council tax took place *within a grant system*.

Business rates, on the other hand, were collected by local authorities, but they did not receive the proceeds. These were paid across to central government, which then added in funding from national taxation (Revenue Support Grant and Police Grant) and then doled out the combined national total according to the formula.

While Business Rates Retention (BRR) has many flaws and problems, it does at least embody the principle that business rates should be maintained within the local government sector and that equalisation for differing ability to raise council tax should also take place within the sector (i.e. between authorities). (Initially, only 50% of business rates income was maintained within local government; the remainder was still distributed as grant. However, many authorities are now parts of 'pilot' areas where higher percentages are retained locally. The previous Government expressed an intention to move the whole sector to 100% retention.)

When the BRR system was introduced by the Coalition Government in 2013, there were many different interests, concerns, policies and trends it was trying to accommodate. The result, as I used to say in my training sessions for councillors and council officers, was a system that was "messy and complex". The calculation of tariffs and top-ups does incorporate equalisation for both business rate base and council tax base, but in different ways. Authorities' Baseline Funding Levels, from the outset of the system, included a share of their Formula Funding – an adjusted version of what they previously received as Formula Grant, the calculation of which included an equalisation for differing ability to raise council tax. An authority's Baseline Funding Level was then compared to its Business Rates Baseline – a share of the amount of business rates it was expected to collect in the first year – to calculate its tariff or top-up.

There is no clear reason for this multi-stage process. The system would be clearer and less confusing if council tax and business rates – both property taxes which have predecessors in the same rating system – were treated in the same way within the calculations. The advantages of such a change would not just be clarity. Firstly, the system would then be capable of being extended to additional local funding sources, as described in the next section. Secondly, it could form part of a system to capture uplifts in local taxes with sufficient certainty to allow greater borrowing, as described below and in more detail in a report I am currently writing.

Need for a broader tax base

There are advantages and disadvantages of councils raising such a large share of their funding from property taxes. The major advantage is that they provide a very stable source of income – there is little fluctuation between years. The major

disadvantage is that the amount raised from a business or resident is not directly related to their ability to pay. Without some form of protection, taxpayers with large assets but little disposable income (household or profit margin) would often be unable to pay their bills. These bills do not flex with the state of the economy, so taxpayers are often more stretched during economic downturns.

The Government has responded to these pressures on taxpayers in three ways. For council tax payers, it has constrained the rate at which the Band D council tax bill can rise – with capping, then council tax freeze grant, then maximum rates before a referendum is needed. For businesses, where the multiplier rises with the Consumer Prices Index by default, it has kept introducing ever more reliefs and exemptions, at nearly every Budget. This pulls money out of the BRR system, for which it then compensates local authorities with yet more grants. In addition, it has on occasion held the multiplier increased down below CPI.

With the localisation of council tax support and the option of discretionary business rates relief, billing authorities are given free reign to cut bills, but are highly constrained in raising council tax rates and can't increase business rates multipliers, denying true financial autonomy.

Councils should have much more freedom in deciding with local residents and taxpayers the best ways of raising funding for local services, based on local circumstances. This could include supplements to national taxes, such as income tax and corporation tax, and could include bespoke local taxes and charges, such as on overnight stays.

With a system of equalisation that treats council tax and business rates in the same way, this could be expanded to cover these new ways of raising local funding. With more funding raised locally, grant funding from national government could be reduced, avoiding an increase in the overall burden on taxpayers.

Additional problems since 2013

Besides the major systemic issues with the local government finance system described above, we have seen various other problems arise over recent decades. Since the introduction of BRR, several other factors have caused the system to deteriorate to the point where many councils are ceasing to be financially sustainable. These include:

- No 'reset' of the BRR system – no recalculation of needs or business rate base;
- No reconsideration of the split of business rates between tiers;

- Other changes to the system, largely agreed between central and local government in 2016-2018, such mechanisms for reducing the impact of business rates appeals on council finances, not being implemented;
- Growth in local spending needs (for example, on social care, SEND and temporary accommodation) rising faster than local tax yields, and the shortfall being funded by neither new local taxes nor grant funding;
- Government providing new grants in small pots, subject to competitive bidding, for short timescales, often to be spend on new ministers' pet projects.

Many of these additional factors appear to be addressed either in the Government's consultation *Local authority funding reform: objectives and principles* or in the Budget and what it says about the 2025 Spending Review. If it emerges that they are effectively tackled by Government policy, that will considerably ease the pressures that have built up over the last decade, but the systemic issues listed above in the previous sections still remain to be addressed.

Does the local government finance system match funding to the relative needs of local authorities?

No. The needs assessment which was incorporated into the baseline funding levels in 2013-14 was flawed. But it was a far more robust assessment of spending needs in 2013 than in 2025 – the relative needs of local authorities have changed considerably since then, but the system has not been reset. Consequently, funding to local authorities is based on hugely outdated measurements of needs, topped-up with ad hoc funding streams to tackle individual areas of shortfall (often on the basis of overly simplistic assessments or assumptions).

Does the funding system allow and incentivise local authorities to make sensible long-term choices about their finances and budgets, to better serve their residents?

The word "incentivise" is hugely patronising to local authorities and stems from a "Whitehall knows best" attitude. Local authorities do not need to be "incentivised" to make good long-term decisions in the best interests of their residents; this is something they desperately want to do. They need to be allowed the financial

freedom to take the best decisions, and to have “perverse incentives” within the system removed.

In response to the rest of the question, no – in recent years the funding system has not allowed local authorities to make sensible long-term choices about their finances and budgets. They are having to fire-fight and keep adapting to changes of circumstance. They have been unable to plan accurately for more than a year or two, largely because they haven’t known how much external funding they will receive. This has made setting budgets for their usual spend difficult, but has made it even harder to invest for the future, either in large-scale transformation of services or in capital projects.

How will this be affected by the introduction of multi-year funding settlements?

Multi-year revenue funding settlements will help immensely in mapping out the financial trajectories of council services. For long-term capital projects, multi-year capital and infrastructure budgets could also be hugely beneficial.

What parts of the local government finance system are working well and should be built on further?

Devolution of funding to combined authorities and through city/growth deals is to be welcomed. This should be built on; the further devolution and “integrated settlements” that are promised are a good step, but should be more ambitious and centred on citizens and communities. This should not be tied to particular governance structures; the appropriate governance should be a matter for authorities to decide with their residents.

The Prudential System of capital finance is also working well and could be expanded to cover investment for transformational projects.

Where are the most significant funding pressures in local government, and how does the finance system address them?

TRL Insight does not wish to comment on this; we would rather leave this question to individual authorities and their sectoral representative organisations to answer, given their first-hand knowledge.

Does the current statutory regime for identifying and responding to financial distress in local authorities support local authorities to get out of financial distress?

TRL Insight does not wish to comment on the current regime and how it works in the current circumstances; we would rather leave this question to individual authorities and their sectoral representative organisations to answer, given their first-hand knowledge. (This applies to the three sub-questions too.)

However, we set out above the need for far greater financial autonomy for local government. Even if this need were to be addressed, there would still be a need for a regime for identifying and responding to financial distress. We believe it is worth considering what such a system might look like. It might, for example, involve mutual aid between authorities, coupled to peer support; it could also involve elements of mutual insurance against adverse economic circumstances. It would be worth involving the Government as an observer in arranging any such schemes, so that the Government would be alerted to any system-wide problems developing.

How much control do local authorities have over the levels of funding they receive, including from local taxation, business rates, central Government grants, and returns on commercial investments?

Council tax

Council tax income is mainly determined by two factors: tax base and the Band D rate. (Other aspects of the system also have an effect, such as discounts/council tax support and collection rates.) Councils can take steps to promote housing growth, which will increase the tax base. However, they are very limited in how much they can raise Band D rates. If they wish to increase the rate beyond a limit set out each year in the Local Government Finance Settlement, they need to hold a referendum. To my knowledge, only one such referendum has been held since the system was introduced. The reasons usually given for this are as follows. To hold such a referendum, two alternative budgets need to be prepared: one for a yes vote and one for a no vote. The costs of holding a referendum are high in proportion to the increase in funding that would result; with this and the difficulty caused by running two alternative budgets, with the outcome unknown until very late in the budget cycle, the gains do not seem worth the cost. Consequently, the referendum requirement is effectively a bar on increasing the rate beyond the limit. On the other hand, many figures the Government publishes on local

government funding assume that all councils will raise their council tax up to this limit.

If there were greater certainty over future funding for councils, it may that there would be scope to bring the planning and the relevant dates forward. This could mean that the result of any referendums would be known earlier in the budget cycle. It would be interesting to see whether this would result in greater use of the referendums.

If budget planning were more advanced at an earlier stage in the year, the decision-making over increasing the Band D rate above the limits could still be left in the hands of citizens without the need for an automatic referendum. This could be done with an ‘initiative’ process: the council sets out its proposed budget and council tax bills, then there is a short window for public objections. If more than a set percentage of taxpayers register an objection in this time, a referendum takes place. Otherwise, the council continues with its proposals.

TRL Insight has not seen this suggestion made elsewhere and has not had a chance to consult with local authorities on its potential efficacy. It may be there are practical difficulties with it, but if greater certainty over forward planning did allow budget planning to become more advanced in the year, it might be worth exploring with local government.

Business rates

Business rates are determined largely by the rateable values of properties and the multipliers applied to them. Just as for housing, councils can take steps to promote the construction and improvement of hereditaments. They also have extensive powers to introduce discretionary reliefs. TRL Insight is not aware of any impediment to an authority applying an even percentage relief to every hereditament with a particular multiplier and thus effectively cutting the rate of that multiplier. Equally, TRL Insight is not aware of any authority having done this, although Croydon Council introduced a 100% relief applying to every business moving to Croydon or expanding, for one year. Nottingham introduced a similar scheme for businesses starting up or relocating into its Creative Quarter, with rateable values up to £18,000.

However, powers to increase the multiplier are very limited. The legislative power to levy a small “Business Rate Supplement” does exist, but is sufficiently tightly constrained that it has only ever been used in one case (in London for part of the funding of CrossRail). A proposal for directly elected mayors to add a premium to business rates to pay for infrastructure, subject to a vote on the Local Enterprise Partnership, was announced by the Government in 2015, but was never enacted.

Meanwhile, the Government has kept introducing ever more reliefs and exemptions for businesses at a national level.

It would help local authorities considerably if reliefs were to be determined locally by default, according to local circumstances, particularly if this were accompanied with powers to set local multipliers.

Central Government grants

As mentioned above, in recent years, these have often been provided in small pots, subject to competitive bidding, for short timescales. These have often been described as funding “trailblazer authorities” or for “piloting” new initiatives. This allows the Secretary of State of the sponsoring department to announce to the media that they are launching a bold new policy intervention, while in reality it is simply funded from departmental underspends and may only last for a year or two. For the years 2015-16 to 2019-20, these issues and the problems that they have caused for councils trying to deliver services, are thoroughly documented in TRL Insight’s report for the Local Government Association, *Fragmented Funding*.

Autumn Budget 2024 announced that the Government will “simplify the wider local funding landscape, reducing the number of grants and consolidating them into the Local Government Finance Settlement”. The consultation *Local authority funding reform: objectives and principles* speaks of “consolidating funding streams to reduce the number of funding pots, providing local authorities with more flexibility to judge local priorities, meet the needs of local people, and decide how best to deliver on our national priorities”. This proposal to consolidate funds will be very welcome to local authorities, and including them in the Settlement will help transparency and budgeting. However, grants which are “consolidated into the Local Government Finance Settlement” should not be merged with grants already in the Settlement in such a way that their distributions are altered, unless for very good reasons. This can happen if, for example, they are merged with the undamped amount of a grant which then has a damping mechanism applied to it.

Returns on commercial investments

TRL Insight does not wish to comment on this; we would rather leave this question to individual authorities and their sectoral representative organisations to answer, given their first-hand knowledge.

Consequences of the lack of control

The way in which the Government keeps tinkering with the grant regime and the parameters of local taxation causes extreme difficulty for long-term budgeting. It

also makes most borrowing against future income impossible. Councils cannot generally rely on New Homes Bonus or business rates income to repay capital financing debt. This holds back investment in sub-national infrastructure and local economic growth.

How does this differ between different types of local authorities and between authorities with different devolution agreements?

TRL Insight does not wish to comment on this; we would rather leave this question to individual authorities and their sectoral representative organisations to answer, given their first-hand knowledge.

What are the impacts of statutory restrictions preventing the use of capital returns (e.g. from asset sales) as revenue funding, and are those restrictions beneficial for local authorities?

Capital projects undertaken by local authorities often span many years. They generate asset value and debt on the council's balance sheet, which needs to be financed over long periods. It makes sense that this is governed by a separate framework from revenue finance, the Prudential System. The system has proven to be a robust one which allows for sensible long-term decision making.

Councils need to be brought into a financially sustainable position, in which they do not need to rely on capital receipts to fund revenue budgets.

However, if the Government is successful in returning the sector as a whole to financial sustainability, that is no guarantee that some authorities, or indeed the sector as whole, might not find itself in financial difficulties again in the future. Situations might again occur in the future where unavoidable and otherwise unaffordable costs arise. If these are unaffordable, they are unaffordable. Paying for them should not depend on whether the council has assets to sell, nor should the system push councils into selling when this is not prudent. Instead, a capitalisation regime should be available for councils to meet these costs from their general revenue budgets, from whatever capital funding sources are appropriate, including borrowing. This should not be constrained by a national limit. (There was a capitalisation regime in place until 2014-15. However, the national total was constrained. Furthermore, an equivalent sum was docked from revenue funding for local government – in the first year of BRR, this was an explicit top-slice from grant funding.)

Many major service transformation programmes also require upfront investment from revenue budgets, which will be recouped over the longer term. Councils should be permitted to borrow to fund these. If councils were to have a broader tax base, as suggested above, which includes buoyant taxes, then revenue borrowing may also be needed to mitigate fluctuations over the economic cycle.

How much control do local authorities have over their costs, including on mandatory services (which they are required to deliver by statute) and demand-led services (for which the level of cost is determined by the needs of residents)?

There are often various reforms to how councils deliver services which can help bring down costs, which I have written about and given training sessions on in the past. But when councils are having to fire-fight and don't know what budgets they have from year to year, undertaking such reforms becomes impossible. The upfront investment costs mentioned above are also unaffordable when revenue budgets are squeezed so tight and borrowing is not permitted for them.

How does this differ between different types of local authorities and between authorities with different devolution agreements?

TRL Insight does not wish to comment on this; we would rather leave this question to individual authorities and their sectoral representative organisations to answer, given their first-hand knowledge.

Where local authorities cut costs by reducing the services they pay for or provide, what services are most affected and what is the impact on residents?

TRL Insight does not wish to comment on this; we would rather leave this question to individual authorities and their sectoral representative organisations to answer, given their first-hand knowledge. We hope that respondents will comment on actual reductions to service and that the Committee will appreciate the difference between this and cutting costs by *transforming* services (which can sometime improve service quality or volume).

How well does the Government understand the consequences of funding and mandatory service decisions?

On these specific issues of these consequences, TRL Insight has no comment. However, I have experience of interacting with the Government on a wide range of funding matters. In my experience, much of MHCLG has a relatively good understanding of the needs and operating environment of local authorities, but this is often sadly lacking in other departments. For this reason, it is helpful for other departments which are enacting policies which affect local authorities to collaborate with MHCLG on them.

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