THE FINANCIAL SUSTAINABILITY OF LOCAL AUTHORITIES

Following the Committee’s report on the financial sustainability of local authorities earlier this year, the Government committed to update you on several issues set out in the Treasury Minute. I am writing separately on issues arising from the hearing on 29 November.

1. The definition of financial sustainability

In response to recommendation 1, the Department committed to set out the steps that it is taking to ensure that the sector is sustainable, and the activity it undertakes to minimise and act on the risk of financial failure.

As described in Melanie Dawes’ letter of 19 June, and at the most recent hearing on 26 November, the Department’s assessment of financial sustainability is based on a comprehensive understanding of whether the sector has the capacity to deliver the services it is required to deliver. The Department assesses this both top-down, looking at a macro level to see how much funding is in the system as a whole when set against cost drivers, demographics and opportunities for efficiencies; and bottom-up looking at financial indicators, overall capacity, leadership and governance for individual authorities.

Furthermore, the Department’s overall judgment also considers whether there is flexibility in the system to respond to events, emergencies and to be able to provide the broader local leadership expected by communities. For some services, central government provides significant oversight because of the vulnerability of the individuals involved (e.g. in Adult
Social Care and Children’s Social Care) and these have been given statutory underpinning by Parliament. These are demand-led services that occupy a significant proportion of the budgets of upper tier councils. As such, we monitor the proportion of total spending on these statutory services very closely. Clearly, depending on the proportion, the capacity of authorities to respond to events and to deliver the locally-led non-statutory services is likely to be constrained and these are, as the committee rightly pointed out, also key for local communities. This is why – in common with other public services like schools and academies – these are more than arithmetic judgments, with data forming one input into the department’s assessments across a range of indicators and information.

Indeed, as outlined by the National Audit Office (NAO) in part four of their report, the Department’s stewardship function, which monitors risk and provides advice in relation to the systems statement, means that the approach to risk identification at an individual authority level is constantly reviewed and updated so that it keeps pace with the changing financial risks, pressures and opportunities facing the sector.

Since the Committee’s hearing in May, we have enhanced further our approach by:

- Improving the methodology for prioritising councils to visit so that councils showing signs of financial, service and leadership challenges can be identified at an earlier stage. Our methodology now incorporates a broader number of factors to reflect councils’ current circumstances, making our process more reflective of emerging issues.
- Refining the financial tools and metrics used to identify councils potentially under the highest levels of financial pressure to flag these for further investigation. The Department has updated its relative risk tool, which uses eight metrics covering reserves, expenditure and income to identify which local authorities may be under the highest levels of financial pressure, according to latest outturn data and forecasts. The metrics used in the tool were reviewed by a wide range of stakeholders and compared with metrics used by external organisations such as CIPFA, the LGA and credit rating agencies to ensure the metrics selected are robust and cover an appropriate range of risks. The Department intends to continue to review metrics included in the tool, including metrics relating to emerging risks, where appropriate.
- Deeper and more systematic intelligence sharing with a broader range of government departments, as well as within MHCLG itself, to develop a more detailed understanding of local authorities’ performance, including service pressures across the full range of local services; and to more fully calibrate risks.

As we outlined in the hearing, the outputs from this work are a key input into advice to ministers, which informs local government funding decisions. We recognise that local authorities value certainty, and that is why the government agreed a four-year settlement for local government. But where we have had evidence that pressures are increasing, the Government has determined it has been right to provide additional funding. Specifically, at Autumn Budget, government provided:

- An additional £240 million in 2018-19 and £240 million in 2019-20 for adult social care to ensure people can leave hospital when they are ready, helping the NHS to free up the beds it needs over winter.
- £410m, recognising the pressures on adult’s and children’s social care.

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- £84m for DfE to support improvement in children’s services, of which £40m is for 2019/20.
- Local authorities have also been given £420m of capital in 2018/19 for potholes

As discussed in the Committee’s hearing on 26 November, the funding for winter pressures has conditions attached to ensure that it delivers certain outcomes. The additional £410m is un-ringfenced, though intended to meet adult and children’s social care pressures. In this case, Ministers judged that it was right for this funding to remain un-ringfenced; giving greater flexibility to councils, thereby supporting good, efficient financial management at a local level and giving local authorities the freedom and flexibility to make spending decisions based on their local needs and priorities.

2. Cross-Whitehall engagement and the Spending Review

In response to recommendations 2 and 4, the Government committed to write back to the committee setting out how we intend to work with other departments on an ongoing basis to understand demand pressures and how we will make the case for local government funding effectively via the spending review.

While we do not yet have precise timings for the spending review, the department has already begun work to be well prepared in the new year. We started preparations in the summer with a Permanent Secretary chaired meeting with senior representatives from all relevant departments. At that meeting the department presented elements of the NAO’s work to ensure the overall fiscal framework for local government and the key challenges are understood as departments start their spending review preparation. We also extended an offer for MHCLG to support departments with their analysis and knowledge of local areas.

The Director of Local Government Finance is the Senior Responsible Officer for our local government spending review work programme. This is managed through a formal governance structure reporting to a programme board. It is based on four project streams: cross-Whitehall engagement, sector engagement, analysis and efficiency.

Further details on these four workstreams are set out in the annex to this paper (p.5), but some key points to note are:

- Developing our analytical tools and resources to deliver a robust methodology underpinning our analysis of local government’s current and future funding needs.
- Cross-Whitehall policy roundtables chaired by the Director and Director-General agree the approach and confirm progress in advance of the Spending Review, including identify gaps and overlaps between service areas.
- Trilateral engagement with DfE and DHSC to ensure a joined-up approach to Social Care in the spending review and to build an understanding of risk in the system and to understand the scope for efficiency and transformation, and a series of joint local authority visits.
- Policy and analytical monthly meetings with individual Departments to identify key priorities and resolve emerging issues.
- Programme of engagement with the sector, including joint roundtables co-hosted with the LGA and coordinated council visits to understand implications of funding decisions on front-line services.
We are actively implementing changes in the way we approach spending reviews, in response both to the NAO’s most recent report and the recommendations of the Committee in relation to the NAO report on capital spending in November 2016. Specifically:

- In response to the recommendation that we should ensure that the interactions between revenue spending, capital spending and borrowing and the resulting pressures on local authority capital programmes are considered, we have established a specific capital workstream with dedicated analytical support. This workstream is looking at forecasting existing debt servicing costs, forecasting new borrowing, and understanding the interaction between capital investment and revenue savings.

- To address the NAO recommendation that we should ensure that the spending review process is supported by a review of unfunded pressures, in addition to the work led by departments to assess the funding pressures in their service areas, we are proposing to supplement this with analysis of ‘allocative efficiency’ which will look at the wider social costs and benefits of local authority service expenditure in particular service areas.

- We have developed our analytical capacity to look at the impacts of different funding decisions across different classes and locations of authority and statistical nearest neighbours, enabling us to address the concerns raised in the NAO report about the level of distributional analysis in the 2015 spending review.

- We are working with DfE to improve our understanding of the drivers of costs and variation in spending on children’s social care.

In the short term, the focus of our expanded departmental engagement is the spending review, but in line with the committee’s recommendation that the Department works across Whitehall on an ongoing basis, we will maintain this systematic engagement after the spending review.

We work most extensively with the Department for Health and Social Care (DHSC) and the Department for Education (DfE), reflecting the critical nature of adult and children’s social care services, the dominance of these services in local authority budgets, and the financial pressures in these areas which also adds to the pressure faced by local authority leaders and senior officers. Steps have also been taken to deepen this joint working, including the establishment of Trilateral Director General level meetings to ensure that we have a common understanding of the most important financial, service and leadership developments at an individual authority level and share the latest analysis of councils at risk so that we can take a coordinated approach towards them.

At the same time, we have also broadened our engagement on local authority sustainability and performance to include the Department for Work and Pensions (DWP); Digital Culture, Media and Sport (DCMS); Business, Energy and Industrial Strategy (BEIS); the Department for Environment, Food and Rural Affairs (DEFRA); and the Home Office.
3. Future initiatives

Business rates reform

The current business rates retention scheme is yielding strong results. Local authorities estimate that in 2018-19 they will benefit from around £2.4 billion in growth in business rates. The Government's aim is to increase local government's retention of business rates from 50% to 75% from 2020, in a fiscally neutral way.

This summer the Government invited local authorities to apply to become 75% business rates retention pilots in 2019-20. At the same time it was also confirmed that the devolution deal area pilots would continue into 2019-20.-At the provisional Local Government Finance Settlement on 13 December it was announced that fifteen areas would become 75% business rates retention pilots in 2019/20. It was also announced that the London pilot will continue in 2019/20 at 75% retention.

We also published a consultation on reform of the business rates retention alongside the provisional local government finance settlement. The consultation covers reform options for elements of the business rates retention system, following a series of technical papers that have been presented to the joint MHCLG and LGA working groups and discussed with local authorities.

Review of relative needs and resources

The Government has also listened to calls to review the methodology which underpins the distribution of funding at local government finance settlements.

The Department has worked closely with local government representatives to consider the drivers of local authorities' costs, the relative resources available to them to fund local services, and how to account for these in a way that draws a more transparent and understandable link between local circumstances and resource allocations.

We have made good progress on the review, and we will continue to test our approach with local authorities and their representatives to ensure we get this right. Our consultation, published on 13 December 2018, sets out our proposals for the measurement of local authority needs, options for a resources adjustment and principles for transition to the new system. This is a key step in the review, and all responses received will feed into further policy development.
Supporting improvement and efficiency

We are taking specific steps to support local authorities to continue to transform and become more efficient. At Autumn Budget, the Government announced an £84m Department for Education fund aimed at supporting local authorities to invest in initiatives that improve children’s social work practice and decision-making, over the next five years, so that more children can stay safely at home, where that is in their best interests. As outlined in more detail in the annex to this letter, this department is undertaking a programme of targeted engagement this year and next with local authorities, helping those LAs identify specific local measures to drive improvement.

I hope that this information is helpful to the Committee.

Yours sincerely,

[Signature]

SIMON RIDLEY
Annex A: Spending Review - Programme Outline

The upcoming spending review is key to securing long-term financial sustainability. We have a detailed programme of work underway, which contains four project streams.

1. Cross-Whitehall Engagement

- To build a holistic, Government view on the interaction between service areas and financial pressures, we have hosted a number of senior, cross-Whitehall roundtables:
  - **July:** MHCLG Permanent Secretary chaired a meeting with Director-Generals to set out priorities, vision for LG finance and extend offer to support Departments with their analysis and plans.
  - **October:** LGF Director hosted meeting with counterparts from 11 Departments to set out approach to the spending review, identify gaps and overlaps between policy areas (particularly in relation to pressures on LG), and update on efficiency modelling. The session also included a presentation from a council Deputy Chief Executive to build cross-Whitehall understanding of financial decisions being made and effects of cost-shunting on services.
  - **January 2019:** Planned LGF Director meeting again with counterparts to present analysis provided by their Departments. This will be an opportunity to quality assure contributions and take a holistic view of emerging analysis.

- We are working closely with DfE and DHSC to ensure we have robust analysis on demand and other service pressures for social care. The Local Government Finance Director meets his counterparts at least monthly and the Director-General has initiated trilateral meetings to ensure a joined-up approach to the upcoming spending review. Both policy and analysis teams meet more frequently to progress work, quality-assure approaches and test best-practice.

- We are substantially increasing our structured engagement with other government departments to cover a wider range of policy areas (i.e. beyond Social Care). Through ‘SR Account Managers’ we are building connections across Whitehall, both with policy and analytical teams, to better understand requirements of local government (and related funding requirements) and to challenge assumptions around current and future pressures and efficiency assumptions.

2. Sector Engagement

Using existing forums to update sector representative groups on plans for the spending review and testing ideas on their preferred approach to engagement (including recent Society of County Treasurers and District Council Treasurers meetings and the quarterly Business Rates Retention Steering Group).

With the LGA, co-hosting roundtables with the sector and other government departments to facilitate discussions on priority ‘themes’. Plans are still being finalised, and are dependent on SR timetables, but we intend to cover:

- Financial Sustainability
- Adult & Children’s Social Care
- Schools Funding & related services
- EU Exit
- Prevention & Early Intervention
• ‘Place’ (i.e. environmental / cultural services)
• Welfare Reform, Housing & Homelessness

3. Analysis

• Developing our analytical tools and resources to deliver a robust methodology underpinning our analysis of local government’s current and future funding needs. This will enable us to identify and assess the risks of under-funding.

• Establishing approach to determine the SR Baseline, through analysis and cross-Whitehall engagement. This will enable us to collectively take a broader view of the areas of spending that could impact on sustainability, e.g. schools and capital.

• Updating with increased sophistication our work on technical efficiency, on which we are taking forward analysis on unit costs, to gain a fuller understanding of the potential scope for future efficiency in the sector. [See also 4. Efficiency]

• Ongoing enhancements to the Local Authority Sustainability Tool. In addition to tracking sector-wide financial sustainability, we will use this to assess the impact of different income distributions on sector sustainability resulting from the review of relative needs and resources and/or SR19.

• Building on the recommendations from the 2016 hearing on capital finance, we have a dedicated work stream looking at the wider interactions between capital and revenue, and the implications of funding decisions for borrowing.

4. Efficiency

• Undertaking a programme of targeted engagement this year and next with LAs. This will help those LAs identify specific local measures to drive improvement.

• Collaborating with OGDs – particularly DHSC and DfE – to understand where there is scope for future efficiencies, how we can help LAs to unlock savings and drive improvements, and build evidence base around time needed to deliver these changes.

• Developing a self-help toolkit (maturity model) with the LGA which sets out the characteristics of an efficient organisation and will aid LAs to improve their performance.

• Through our Digital Declaration and £7.5m Local Digital Fund, we are developing common building blocks that will enable local authorities to build services more quickly, flexibly and effectively.