

## IV Local authority finance in a recession

Two questions are routinely and consistently asked at the time of the local government finance settlement each year – how much has a particular authority received? Is it enough? The answers to both of these questions were known before the 2009/10 settlement was announced for consultation on 26 November 2008.

The amount of funding that local authorities will receive in 2009/10 has not changed from the levels confirmed in January 2008 as 2009/10 is the second year of the multi-year settlement. Local authorities were concerned that the settlement provided insufficient funds claiming they faced the dilemma of increasing council tax levels or cutting services.<sup>i</sup> When the initial announcement was made twelve months ago local authorities claimed the same thing and the economy has since entered recession.<sup>ii</sup>

The economic slowdown will have a direct effect on the finances of local authorities. Two recent surveys were carried out in an attempt to find out what impact the recession is having on local authority budgets in the current year and is expected to have in the future:

- *Crunch time? The impact of the economic downturn on local government finances* – Audit Commission, December 2008
- *IDeA/LGA/SOLACE Survey of the impact of the economic slowdown on local authorities* – Local Government Association, December 2008

The fieldwork for the Audit Commission survey was carried out between October and November 2008 while the fieldwork for the LGA survey was carried out between 10<sup>th</sup> and 30<sup>th</sup> November 2008.

## 1 The problems faced

Last year before the recession local authorities were facing spending pressures particularly in the areas of adult social care and waste. The recession will have a direct impact on local authority finance as they face an increased demand for the services they provide as well as seeing the income they receive from fees and charges fall. In addition to this they have also faced increased costs.

### 1.1 Higher demand

As mentioned earlier local authorities had already been facing pressures on the services they provide before the economy entered the recession. The recession has led to further pressures on local authorities, although the impact on individual local authority finances is likely to vary.

#### *Family breakdown*

Times of economic slowdown, and the associated financial pressures, tend to lead to family breakdown as people struggle to keep up with mortgage repayments and face the threat of repossessions. This has a knock on effect on the demand for local authority services.

There is growing concern in the social care sector that the downturn will lead to more family breakdowns, with more children being taken into care, an increase in demand for residential places for the elderly, increased drug and alcohol abuse and an increase in demand for financial advice.

Only a quarter of chief finance officers had observed additional demand for elderly care in 2008/09, but over half are expecting demand to increase in 2009/10.<sup>iii</sup>

The LGA survey asked local authorities whether they had experienced increased demand for particular services as a result of the economic slowdown.<sup>iv</sup>

- 93% of councils said there had been an increase in demand for debt counselling
- 17% of councils said there had been an increase in demand for relationship counselling
- 69% of councils said there had been an increase in demand for housing advice
- Half of councils said there had been an increase in demand for employment advice

### ***Benefit applications***

During a recession as unemployment rises more people will become eligible for benefits administered by local authorities such as housing benefit and council tax benefit. In response to the Audit Commission survey over 90% of local authorities said they expected an increase in the number of benefit applications. In response to the LGA survey 45% of authorities said that they had already experienced an increase in housing benefit applications, with a further 45% anticipating increases.

This rise in the number of benefit recipients increases the workload and administration costs of the local authority as does the increase in the number of unsuccessful benefit applications, as observed by some authorities.

### ***Homelessness***

The downturn in the housing market and an increase in unemployment witnessed during a recession are likely to lead to a

rise in the number of mortgage repossessions. Local authorities have a responsibility to house those who become statutorily homeless. The Audit Commission reported that one-third of authorities have already witnessed increases in homelessness, with two-thirds predicting higher homelessness in 2009/10.

An increase in homelessness will have cost implications for local authorities: more staff will be needed to manage the projected increase and additional temporary accommodation will be required, which normally has cost implications for authorities. The profile of homeless clients shows that many rely on housing benefit. In a number of cases benefit does not adequately cover the full rental and management costs of either hostels or properties leased from private landlords, so authorities may have to subsidise this accommodation.

The slowdown in house building is reducing the amount of new social housing and therefore the number of social properties available to let. This will be a particular problem in areas of high housing stress where homeless families and individuals already take up a significant proportion of available lettings.<sup>v</sup>

### ***State school places***

The current recession started in the financial services sector and has affected many higher income households that may have educated their children privately. During an economic downturn you would therefore expect to see demand for state school places increase as people look to save the money they previously spent on private education.

Of those local authorities surveyed by the Audit Commission 9% had already witnessed increased demand for state school places

for those previously educated privately, with 19% anticipating such an increase in 2009/10.

### ***Free school meals***

Children whose parents receive certain benefit payments are entitled to receive free school meals. During a recession, as more people receive benefits, more children would be entitled to this.

Of the respondents to the LGA survey 5% had already experienced an increase in requests for free school meals with a further 36% anticipating an increase in the future.

## **1.2 Reduced income:**

Although the vast majority of local authority expenditure is financed by central Government grants and council tax income, local authorities do receive income from other sources such as charges for parking and fees for planning and building control. The importance of this funding stream to local authorities varies. In tourist areas local authorities can make significant sums from parking fees. According to the Audit Commission district councils get more income from fees and charges than from council tax.<sup>vi</sup>

According to the Audit Commission almost 80% of authorities have seen either a moderate (1-3%) or significant (>3%) decrease in the level of total income as a direct consequence of the recession. Similar findings came out of the LGA survey with 83% of authorities reporting a drop in income from fees and charges in 2008/09.

Local authorities had not anticipated the likely fall in income as they had the fact that they would need to increase expenditure. The Audit Commission suggests that approximately 40% of authorities had not anticipated the reductions in income at all, while around

90% had, to some extent, anticipated the increases in demand for services that would be required in a recession.

The following investigates why income received from fees and charges may fall during an economic slowdown.

### ***Parking fees***

The Audit Commission research suggests that income from parking fees has already begun to fall. This has a significant impact on the finances of some LAs, especially those small tourist localities that rely more heavily on this funding stream.

The survey of chief finance officers found that 52 per cent of authorities had measured a reduction in income from car parking fees of 3 per cent or more, with 24 per cent stating that they had seen a decrease of 5 per cent or more. One authority reported that income from parking fees was down by 15 per cent. Another had seen a fall of 5 per cent with a loss in income of £200,000.<sup>vii</sup>

The reasons behind such a fall are not immediately apparent. It may be that consumers aren't visiting shopping centres as often as they used to because of financial worries or they may be choosing to use other forms of transport to avoid paying for parking or the relatively high price of fuel.

### ***Developmental activity***

Housing market downturns and recessions lead to decreases in the amount of developmental activity that takes place. The Audit Commission reported that over 80% of local authorities have seen falls in the levels of developmental activity in 2008/09. A higher proportion (92%) predicted further reductions in 2009/10. This is a concern for local authorities as it affects a variety of their income streams.

- Reduction in developments, due to the fall in land and property prices, will reduce the income that authorities receive from Section 106 agreements.
- Income received from planning and building control fees will fall as homeowners postpone or cancel improvement works to their properties.
- Land fees are usually paid as part of a house purchase. Income from these fees has fallen due to the reduction in housing transactions.

### **Arrears**

As the economy slows down there is an increased possibility of council tax and rent arrears. The LGA survey reported that 24% of councils had already seen a drop in income from council tax and rent collection. The Audit Commission reported that nearly 75% of councils surveyed were anticipating increases in council tax and rent arrears. As well as the reduced income there is the associated increase in administration and legal costs to pursue these arrears.

### **1.3 Increased costs**

In certain circumstances local authorities' expenditure patterns are similar to that of the households that they serve, as they too are affected by the high rises in petrol, food and utilities that have had such an impact on the general population. The significance of this should not be overstated however as costs are increasing in those areas that make up a relatively small proportion of total expenditure. It has been estimated that less than 2% of local authority expenditure is on these high inflation areas – gas, electricity, vehicle running costs including fuel and catering costs including food.<sup>viii</sup>

As inflation abates the impact will flow through to local authorities. Low levels of inflation will ease pressures on pay and recruitment costs which are particularly significant as expenditure on salaries accounts for almost half of local authority expenditure.

## **2 What action to take?**

Local authorities face difficult choices in dealing with these pressures. They must either fund the increased demand by raising extra money or they must make savings.

The Audit Commission has suggested that 'without action to make savings in-year there could be an overall shortfall in local authority accounts of £2.5 billion'.<sup>ix</sup> In order to fund this gap through the council tax, the only funding stream that the authorities have direct control over, an extra £135 would need to be charged on a band D bill, a 10% increase on the average 2008/09 bill.

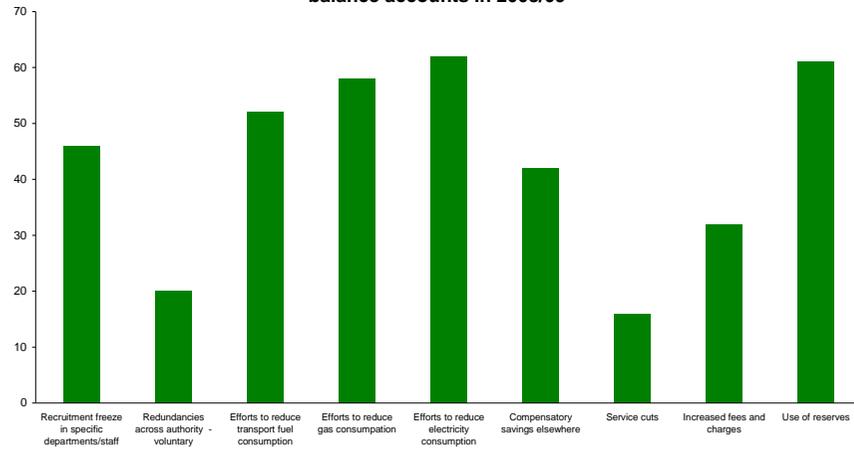
Such a large rise in bills will not be accepted by the Government that has told authorities it expects bill increases to be 'substantially below 5%' and have not ruled out capping the budgets of authorities that breach the capping criteria.<sup>x</sup>

As they are unable to significantly raise income to the levels that they require local authorities are faced with the options of providing the same services at a lower cost, reducing the services that they provide, increasing fees or using their financial reserves.

Chart 1 shows that 16% of local authorities were looking to cut services in order to balance their accounts in 2008/09, while other savings were to be made by imposing a recruitment freeze or making redundancies. The majority of authorities were making efforts to reduce their consumption of fuel and utilities and 61% of local authorities planned to use their financial reserves to avoid

service reductions. Almost one third of authorities were looking to increase fees and charges in order to raise extra income.

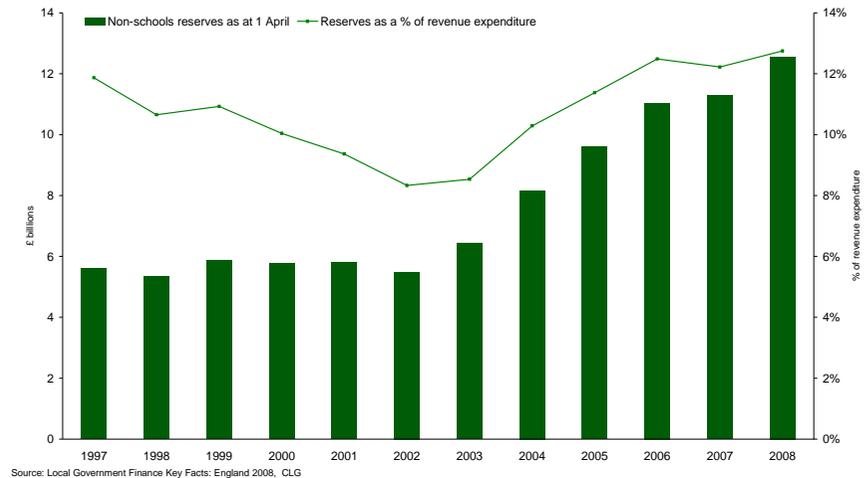
**Chart 1: Proportion of authorities who have and/or plan to take action to balance accounts in 2008/09**



Source: Audit Commission, December 2008

Chart 2 shows councils have adequate reserves to be able to cope with the financial pressures brought about by the recession. Between 1997 and 2002 non-school reserves remained below £6bn and fell, as a proportion of revenue expenditure, from 12% to 8%. Since 2002 the level of reserves has doubled and as at 31 April 2008 local authorities held £12.6bn in non-school reserves, approximately 13% of revenue expenditure.

**Chart 2: Local authority reserves, England**



Source: Local Government Finance Key Facts: England 2008. CLG

It should be noted that there is a wide variation in the level of awards held by individual authorities.

As well as the difficulties posed the economic slowdown will also create opportunities for local authorities. The most obvious being the chance to form or improve co-operation with different agencies and local authorities of all political persuasions and the possibilities for buying land given falling land values which may be used to provide affordable housing

Although 2008/09 has been a difficult year for local authorities most are confident that will be able to cope with the increased financial pressures, although there are concerns regarding the full affect of the coming recession for finances in 2009/10 and beyond.

It has been 16 years since the last recession. Many current local authority senior officers will not have faced the

challenge of managing their authority, and their area, through hard economic times. They will need to learn fast.<sup>xi</sup>

## Gavin Berman

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- <sup>i</sup> *LGA responds to Local Government Finance Settlement*, LGA press release - 26 November 2008
  - <sup>ii</sup> *Councils to face tough choices in local government finance settlement*, LGA news release - 24 January 2008
  - <sup>iii</sup> Paragraphs 116-7 Audit Commission report
  - <sup>iv</sup> Paragraph 19, LGA report
  - <sup>v</sup> Paragraphs 111-2, Audit Commission report
  - <sup>vi</sup> Paragraph 82, Audit Commission report
  - <sup>vii</sup> Paragraph 72, Audit Commission report
  - <sup>viii</sup> Table 4, Audit Commission report
  - <sup>ix</sup> Paragraph 80, Audit Commission report
  - <sup>x</sup> HC Deb 26 November 2008 c726
  - <sup>xi</sup> Paragraph 141, Audit Commission report