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How services are funded

An LGiU essential guide

essential guides

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Contents

Introduction

It is well known that local authority budgets are experiencing a period of unprecedented pressure. However, it is rare to find someone with a good understanding of the nature of this pressure. There is no shortage of data on local authority budgets, but few people are sufficiently familiar with it to carry out meaningful analysis, even within the local government world. Also, nearly every area of local government finance has been subject to radical change since 2010, if not complete overhaul, and there is poor understanding of the complex interplay between the many policy changes. This Essential Guide tries to unpack much of this.

Nonetheless, in a guide of this length, it is important to limit the scope and focus in on particular areas. It cannot possibly cover the whole of local government finance – the subject is far too broad. We have chosen to focus on the core funding used to provide mainstream revenue services and on the pressures on these budgets. It therefore may be useful to point out some of the areas it doesn't cover, other than in passing mentions: the capital finance system; housing finance relating to the council's own stock – the Housing Revenue Account (HRA) and investment in the stock; Housing Benefit; rent allowances and Universal Credit; sixth form funding and other expenditure for which councils are reimbursed by Government; pension funds; reserves; investment of balances; and treasury management.

We start by looking at some basic concepts. Council accounts are divided into capital and revenue. We describe how these are defined. Also, a council's landlord account is kept separate from its general revenue account. This is explained in Section 1, as well as describing the requirements on councils to report budget, outturn and other data to the government.

The government compiles the budget and outturn data into a number of publications released throughout the year, with totals at the national level and totals for each class of authority. In Section 2, we describe these publications and look at how the totals have changed over the last five years. We look at how the total income received by English local government is made up and what it is spent on. In doing so, two further concepts are described: Aggregate External Finance (AEF) – funding from Government which isn't simply reimbursement for payments which local government administers on its behalf – and Net Current Expenditure (NCE) on services. We then compare budgeted NCE for each broad service area with outturn over the period.

In Section 3, we look at how General Fund NCE is funded. This starts with a brief look at Council Tax. We then turn to the funding provided within AEF. The funding streams within AEF that councils expect to deliver more than £0.5 billion in 2014-15 are listed. We explore each of these in turn, together with some interconnected features of the local government finance system.

In the final section, we look ahead to forthcoming years. We consider the outlook for the public finances and what approach the next government might take to local government finance. We briefly consider the effect of demographics on council budgets. Finally, we outline some ways in which local authorities may address these challenges, flagging up publications in which these issues have been explored in detail.

Section 1: Budgets, accounts and reporting

Capital and Revenue

A council's capital expenditure is defined in law as expenditure which increases the value of its assets. This can be by creating, purchasing or improving assets. These include immovable assets such as houses, council offices, roads and bridges, movable assets such as dust carts and printers, financial assets such as shares, and other intangible assets such as software licenses.

All other expenditure is revenue expenditure. This includes employee costs, utility bills, supplies, service contracts, and maintenance and repairs which don't increase the value of assets. In practice, in some projects it can be difficult to separate improvements from repairs, so to avoid wasting resources on nit-picking accounting, most councils have a "de minimis" (threshold) level before expenditure is treated as capital.

Capital grants, receipts and borrowing can be used to fund capital expenditure, but in general they cannot be used to fund revenue expenditure. (There are a few exceptions, such as some small amount of expenditure incidental to disposals, or when the Secretary of State has granted an order for a council to "capitalise" a cost.) This means that capital and revenue budgets tend to be managed separately. Transfers may be made from revenue budgets to capital budgets, but not from capital to revenue. However, capital budgets impact on revenue accounts in one way: money must be set aside each year to repay the principal and interest on all outstanding loans.

Capital budgets can vary substantially from year to year, depending on what projects are underway. By contrast, revenue budgeting tends to start with the previous year's budget and consider what growth or reduction is needed.

General Fund and Housing Revenue Account

Where a council has housing stock (including that managed by ALMOs – Arm's Length Management Organisations), it always keeps a ringfenced Housing Revenue Account (HRA). This is the council's landlord account – it receives rents, pays for maintenance and so forth.

The rest of the revenue account is known as the General Fund Revenue Account (GFRA) or General Fund for short. This covers all other services, including some housing services such as support for homeless citizens and advice to householders in other tenures.

Budgeting, Outturn and Reporting

Councils work on their budgets up until they set their council tax, in advance of the start of the new financial year. Once the budgets are finalised, they must report their plans for spending to the Department of Communities and Local Government (DCLG). This is done using the RA suite of forms which DCLG issues to all local authorities.

Similarly, following the end of a financial year, councils compile their final accounts. Once these are complete, they must report the outturn figures using the RO suite of forms. These are much more detailed and comprehensive than the RA forms.

There are other forms through which councils provide data to DCLG and other central government departments – for example the CER and COR suites of forms, which relate exclusively to capital budgets. In recent years, DCLG has maintained a "single data list", which lists all the forms used to collect such data. There is a "gateway group" which vets any proposed additions to this list. Government departments cannot impose a requirement on councils to collect any data which is not on this list, unless the department pays for its collection.

Once DCLG has received the RA or RO forms, it compiles them into a set of spreadsheets which it publishes on its website. Usually, national totals are published first, with an accompanying "Statistical Release", and local authority-level data follows later. The data is usually published in "provisional" form, then after DCLG has carried out some (limited) verification of the data, a "final" version is released. However, there are frequently "revised" versions released subsequently, sometimes up to a year or so after the "final" release. DCLG also uses the RO data, plus some small amounts of other data, for its annual report on local government finance, Local Government Financial Statistics England (LGFSE).

In the next section, we look at what this data tells us about trends in income and expenditure over the last five years.

Section 2: Income and Expenditure – the last five years

DCLG's annual publication Local Government Financial Statistics England provides useful summaries of local government finance at the national level. A link to the LGFSE is given in the Useful Links at the end of this guide. Chart K.1b, for example, illustrates local government's national expenditure – how it breaks down and how it is funded. This draws on data in its Table 1.6b. A modified version of this table, given below, is very useful for the purposes of this guide. To understand these modifications, and the entries in this table, we need to introduce some terms.

Aggregate External Finance (AEF): there is no widely-used definition of this term. However, it can essentially be seen as follows. There are certain payments local authorities are required to make when administering services on behalf of central government. AEF basically represents the sum of all funding given by central government to local government, excluding reimbursements for these payments. So it does not include mandatory rent rebates or funding for post-16 education from the relevant agencies, but does include Dedicated Schools Grant and Pupil Premium (see Section 3). AEF is composed of Specific Grants, ABG/LSSG and Formula Grant/SUFA/SFA (see below).

Specific Grants: these are also known as special grants (at one time there was a subtle distinction between the two terms, but now they are used interchangeably, including by DCLG). These are grants provided for a particular purpose. Some are "ringfenced", that is, there are conditions on how they may be used, others are not.

Equalisation: some councils have greater ability to raise Council Tax than others. Some councils have greater spending needs than others. Equalisation is the process of providing funding to councils differentially to take account of these differences.

Formula Grant (FG): a large, general grant provided to local authorities for equalisation until 2012-13. It was funded through combination of Business Rates (BR), Police Grant and Revenue Support Grant (RSG). Further detail is given in Section 3.

Start-Up Funding Allocation (SUFA): a quantity introduced in Business Rate Retention (BRR) in 2013-14 (see Section 3). It was formed from FG and a number of specific grants, with various adjustments. It represented the sum of RSG, locally-retained BR and, for each authority, the relevant tariffs or top-up in 2013-14. It also forms the baseline for each local authority in the BRR system.

Settlement Funding Allocation (SFA): the name for the sum of RSG, locally-retained BR and, for each authority, the relevant tariffs or top-up from 2014-15.

Financial Reporting Standard (FRS): an accounting system used in local government from 2009-10.

Area Based Grant (ABG): Several specific grants were bundled together and provided under this heading from 2008-09 until 2010-11. Not considered a specific grant itself.

Local Services Support Grant (LSSG): Several specific grants have been bundled together and provided under this heading since 2011-12. Not considered a specific grant itself.

Tables 1 and 2 show a breakdown of the total income and expenditure of English local government over the period 2008-09 to 2012-13 (note that the totals at the bottoms of the tables equate). As explained in Section 1, these figures are mainly drawn from Revenue Outturn (RO) data, but the relationship between the source data and the LGFSE tables this is based on is complex, and some limited additional data is used. At the time of writing, a partial set of provisional RO data for 2013-14 has been released. This has been used to extend the part of the tables relating to general fund revenue to 2013-14. We have also used other tables in the LGFSE publications to break down general fund revenue expenditure by service. The calculation of both "Other income" and "Other expenditure & recharges" relies on data not published for 2013-14. We have therefore estimated these by the rather simplistic method of scaling back the figure for 2012-13 in proportion to the remainder of GF spend.

In addition, the LGFSE tables present separate figures for "Redistributed NNDR" (business rates), RSG and Police Grant. Here, we have used files from local government finance settlements to break the total of these into Police Formula Grant and Other authorities Formula Grant. This allows more ready comparison with 2013-14 – see below. For the period up to 2012-13, the figures for Council Tax stated in the LGFSE - and hence Table 1 below - are those given in RS returns (one of the RO forms) as Council Tax Requirement, net of Council Tax Benefit grant. For 2013-14, we have just used the Council Tax Requirement.

It should be noted that the 2008-09 figures for general revenue fund expenditure are given on a different accounting basis from the later years. To make the totals comparable, we need to adjust the 2008-09 total to the Financial Reporting Standard (FRS) basis. This is done in a separate row. There are also other minor differences in the definitions of the service areas and their accounting procedures between years, but these are unlikely to affect the conclusions of this analysis. Mandatory housing benefits are included in the row "Housing (excluding Housing Revenue Account)".

Table 1 – Local government income 2008-09 to 2012-13

	2008-09 Out-turn	2009-10 Out-turn	2010-11 Out-turn	2011-12 Out-turn	2012-13 Out-turn	2013-14 Outturn (provisional)
General Fund Revenue						
Specific grants inside AEF and ABG/LSSG	46.0	49.0	50.2	45.8	42.1	40.4
Sales, fees and charges	11.6	11.9	11.7	11.1	11.3	11.6
Council tax	21.2	21.6	22.1	22.2	22.5	23.4
Council tax benefit grant	3.5	4.1	4.2	4.3	4.2	0.0
Specific grants outside AEF	15.0	17.1	19.1	18.6	18.8	18.4
Police Formula Grant	7.4	7.7	7.9	7.9	7.4	0.0
Other authorities Formula Grant	20.0	20.6	21.1	21.5	20.4	0.0
SUFA						26.1

Other income (after adjusting for recharges)	10.4	11.2	11.7	10.5	10.1	7.5
Sub-total	135.3	143.1	147.9	141.9	136.9	127.5
HRA						
Rents	6.2	6.3	6.3	6.6	6.9	
Government subsidies & other income	0.7	1.2	0.9	0.9	0.0	
External trading service revenue accounts	1.1	1.2	1.1	1.1	1.1	
External interest receipts (all accounts)	1.9	0.8	0.7	0.9	0.8	
Capital						
Capital grants	7.7	8.8	9.6	8.6	9.7	
Capital receipts	1.4	1.4	1.5	2.0	2.1	
Met from financing movements	6.1	6.2	4.7	0.2	-1.3	
TOTAL	160.4	168.9	172.7	162.2	156.3	

Table 2 – Local government expenditure 2008-09 to 2012-13

	2008-09 Out-turn	2009-10 Out-turn	2010-11 Out-turn	2011-12 Out-turn	2012-13 Out-turn	2013-14 Out-turn (provisional)
General Fund Revenue						
Education	47.4	49.9	50.9	44.8	41.6	41.2
Highways and transport	8.6	9.5	8.5	8.1	7.6	7.6
Social services	24.5	26.6	27.0	26.5	26.7	27.1
Housing (excluding Housing Revenue Account)	18.2	21.2	22.0	23.1	23.7	24.0
Cultural, environmental and planning	14.5	15.3	15.0	13.9	13.4	13.2
Public Health						2.7
Police, fire & rescue	14.9	15.3	15.2	14.9	14.5	14.1
Central services	13.6	14.2	13.8	13.1	13.2	12.9
Other expenditure & recharges	-10.5	-13.0	-11.4	-11.3	-11.2	-11.3
FRS adjustment	0.6					
Sub total	131.8	138.9	141.0	133.0	129.5	131.3

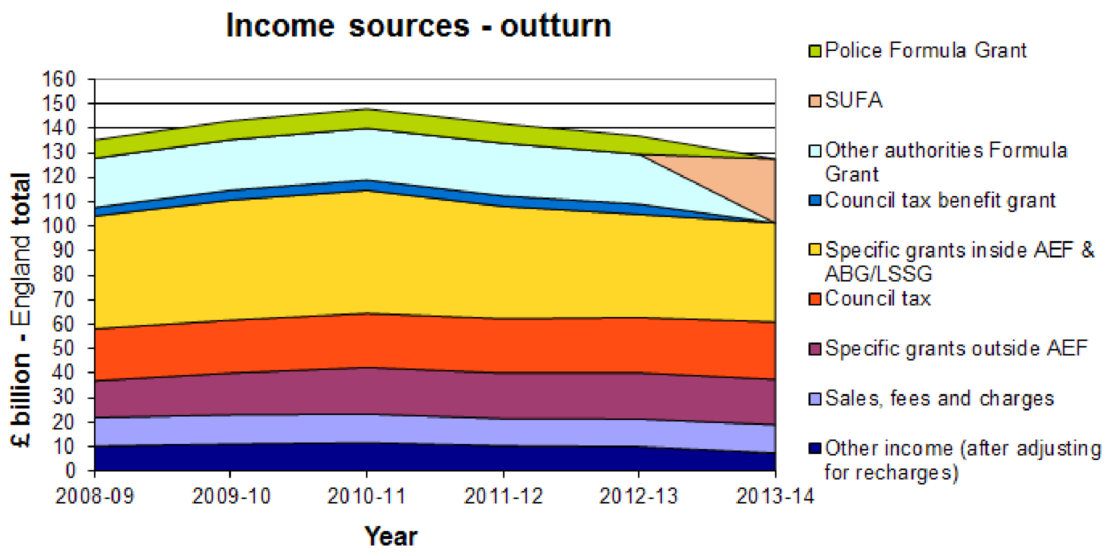
Housing revenue account	4.4	4.3	4.3	4.5	4.1	
External trading services revenue account	0.8	0.9	0.8	0.8	0.8	
External interest payments (all accounts)	2.9	2.7	3.1	3.4	2.7	
Capital						
Capital expenditure	19.8	21.4	23.1	20.0	18.9	
Capitalised revenue expenditure and pooling of housing capital receipts	0.6	0.6	0.4	0.4	0.2	
TOTAL	160.4	168.8	172.7	162.2	156.3	

In the next two subsections, we focus on the GFRA, looking in turn at the income and expenditure figures.

General Fund Revenue - Income

Much of a local authority's income is beyond its direct control and expenditure tends to be budgeted to fit the available funding envelope. In this subsection, we illustrate the key features of how the general fund revenue income has varied over the period we are considering. We discuss the various income streams in more depth in the "Comment" section, but a graph showing them over time brings out a few key issues:

Chart 1 – general fund revenue income from 2008-09 to 2013-14



- The overall funding levels rose over the first two years of the period. While the funding in 2010-11 was lower than expected at the start of the year due to some funding streams receiving in-year cuts, the outturn was still greater than that in 2009-10.

- The overall total fell back over the following three years, only falling below 2008-09 levels in cash terms in 2013-14.

- The greatest fall between 2010-11 and 2012-13 was in Specific Grants inside AEF & ABG/LSSG. This continued to fall in 2013-14, despite the introduction of the Public Health Grant, due to several grants rolling into SUFA (see Section 3).

- Specific grants outside AEF increased rapidly over the first two years but did not fall particularly rapidly over the last three years.

It may also be of interest to see the proportions of the total represented by the eight income sources, at the start and end of the period:

Chart 2 – Income sources as proportions of general fund revenue in 2008-09

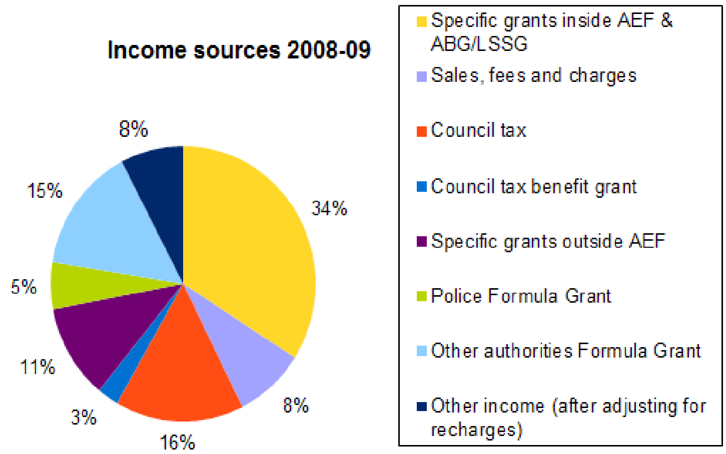
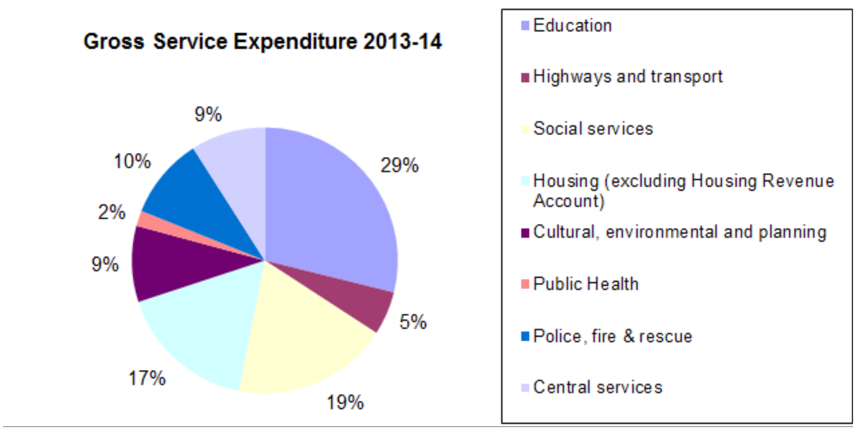


Chart 3 – Income sources as proportions of general fund revenue in 2012-13



It may seem surprising that total general fund income isn't falling faster over the final two years of the period. However, there are several points it's worth bearing in mind:

- Some funding streams relate to demand-driven payments, such as Council Tax

Benefit (CTB) grant and certain specific grants outside AEF, and are ring-fenced for these purposes.

- Council Tax yield continues to rise, albeit slowly (see below).

- We are looking at cash amounts here, but councils provide services at ever increasing cost. This is partly due to inflation – both wage inflation and inflation in running costs, such as the prices of purchased goods and rental costs. But in addition, many services face increasing demand pressures - for example, the number of older adults requiring social care, and the amount of waste requiring collection and disposal. Adjusting the income figures for inflation alone can significantly alter the picture.

The totals for many of the income sources appear to reflect identifiable trends:

- Formula Grant – the core part of this was cut back in 2011-12 and 2012-13, but the total was boosted in 2011-12 by rolling in a number of specific grants, such as Concessionary Fares and Supporting People. Formula Grant for police authorities was treated as part of local government funding (part of AEF) until 2012-13. After this, it was taken out of local government funding and the remainder of Formula Grant was rolled into SUFA.

- Specific grants inside AEF and ABG/LSSG – being cut back in 2011-12 and 2012-13 in response to cuts to the budgets of the government departments that provide them. There were additional cuts in 2011-12 and 2013-14 due to existing grants being rolled into Formula Grant and SUFA.

- Council Tax – yield rose rapidly in the first two years. Since then, many councils have frozen their rates (see Section 3), but the tax base continued to rise, albeit slowly.

- CTB grant – the amount of CTB paid out rose until 2011-12, as could be expected during a recession. In 2012-13 it dropped slightly. In 2013-14 it was replaced by Council Tax Support (CTS) which was rolled into SUFA (see Section 3).

- Sales, fees and charges – reduced from 2009-10 to 2011-12 and has then increased again in the last two years. Again, this might be expected during period of recession followed by a period of recovery.

"Other income" is rather too complex a category for the reasons behind its movements to be clear.

To understand the changes in government funding over the whole period, it is useful to look at the sum of non-police Formula Grant, specific grants inside AEF, ABG/LSSG and CTB grant. This fell by 11.9% between 2010-11 and 2013-14, from £75.5 billion to £66.5 billion. However, of the latter amount, £2.7 billion is funding for local authorities' new public health duty.

Reductions in funding from central government over the course of this Parliament have therefore been masked by two effects:

- Core funding (Formula Grant then SUFA) being maintained at times by rolling in special grants. This means that business rates are covering increasing proportions of local government funding.

- Total funding from central government including new "incentive" payments, such as Council Tax Freeze Grant and New Homes Bonus (see Section 3) and payments for new duties, in particular public health.

General Fund Revenue - Expenditure

Having identified the total amount of funding available each year, we can use the data to analyse how it is spent. The following two charts show the percentages of spending in each general fund service area in the first and last year of the period. (In Table 2, we netted recharges off "Other Expenditure" to give a negative figure – this category is left out. Also, for 2008-09, we are neglecting the FRS adjustment; nonetheless, the percentages are very similar in 2009-10.)

Chart 4 – Gross expenditure on each service in 2008-09 as percentage of total

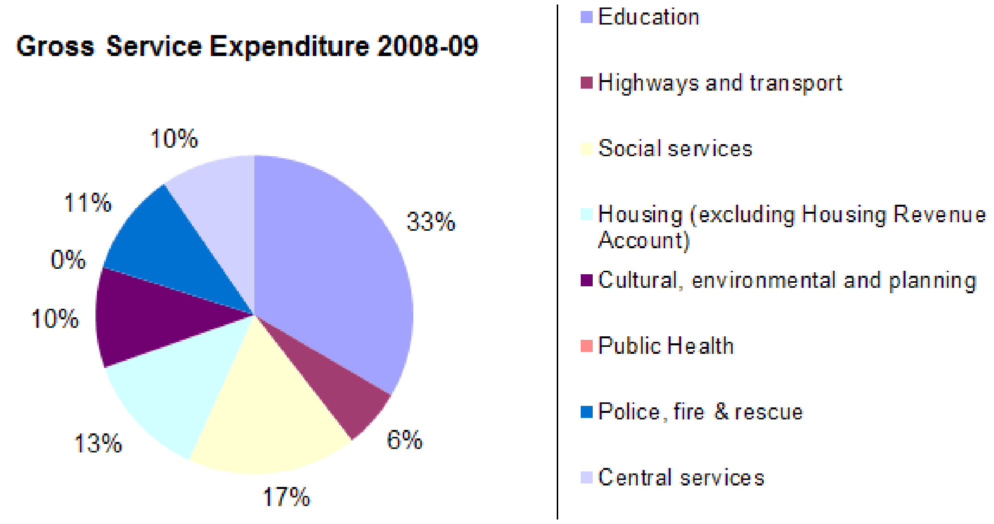
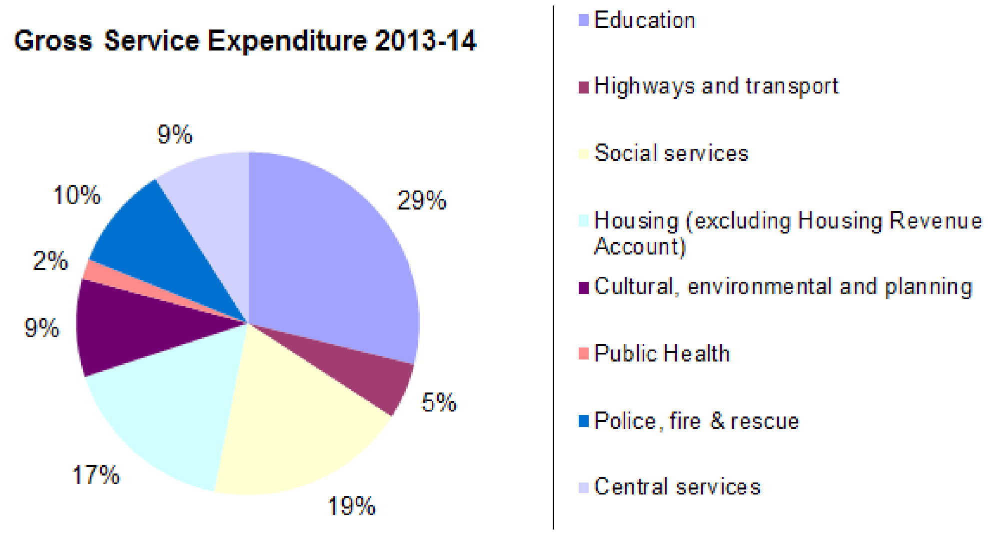


Chart 5 – Gross expenditure on each service in 2013-14 as percentage of total



Charts 4 and 5 show that for most services, spend has reduced over the period as a whole pretty much in line with total service expenditure. However, there are a few notable exceptions:

- Education – spend has dropped rapidly from 2010-11. This is likely to be at least partly due to schools converting to academies.

- Social services – despite shrinking resources, demand has continued to rise.

- Housing – the bulk of this is mandatory housing benefit, which has risen substantially over the period.

- Public health – this is a new responsibility for 2013-14.

This suggests that either councils have not achieved savings in the remaining services by radical service transformation, or if they have, it has been achieved fairly evenly across services.

It is also of interest to see how outturn expenditure compares with budgeted expenditure. Budget figures are collected in Revenue Account (RA) forms. RA data does not, however, include gross expenditure. To get a comparison between outturn and budget data, we therefore have to move from the gross expenditure shown in Table 2 to looking at Net Current Expenditure (NCE) – that is, spend net of Sales, Fees and Charges and net of Other Income.

As above, RO data is available for the period 2008-09 to 2013-14 (for 2013-14 it is provisional). RA data has been published up to 2014-15, but for consistency we just go up to 2013-14. The following graphs are based on figures from the Statistical Releases accompanying these data releases.

Chart 6 – Education NCE budget and outturn

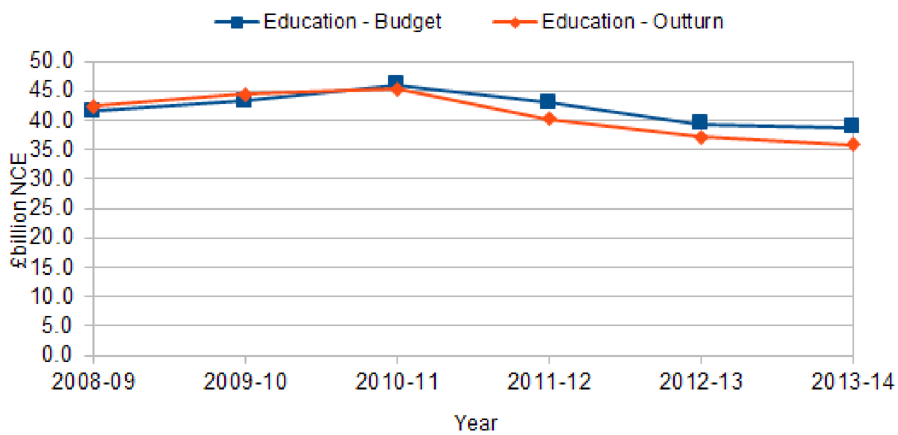


Chart 7 – Highways and transport NCE budget & outturn

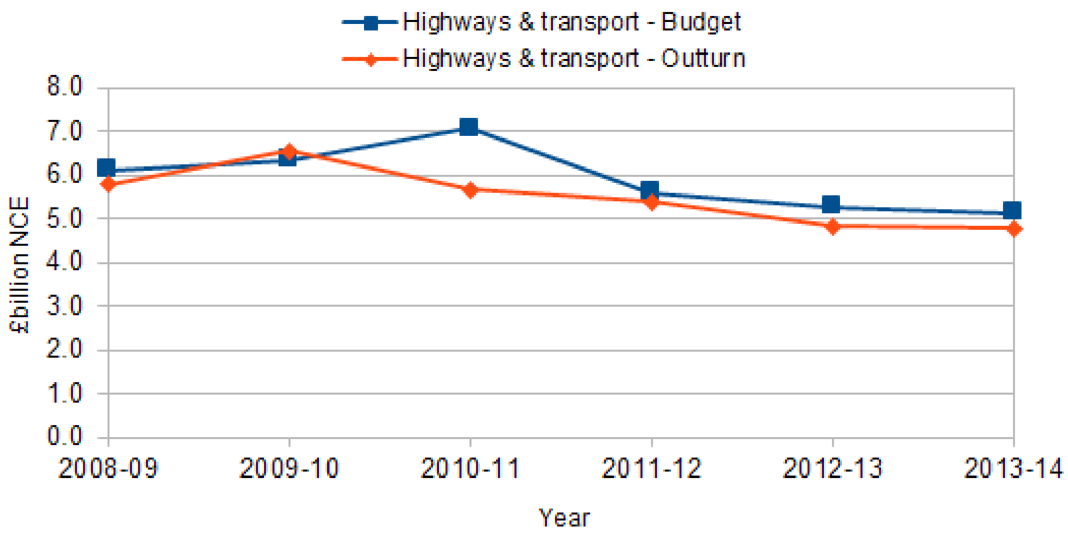


Chart 8 – Social care NCE budget & outturn

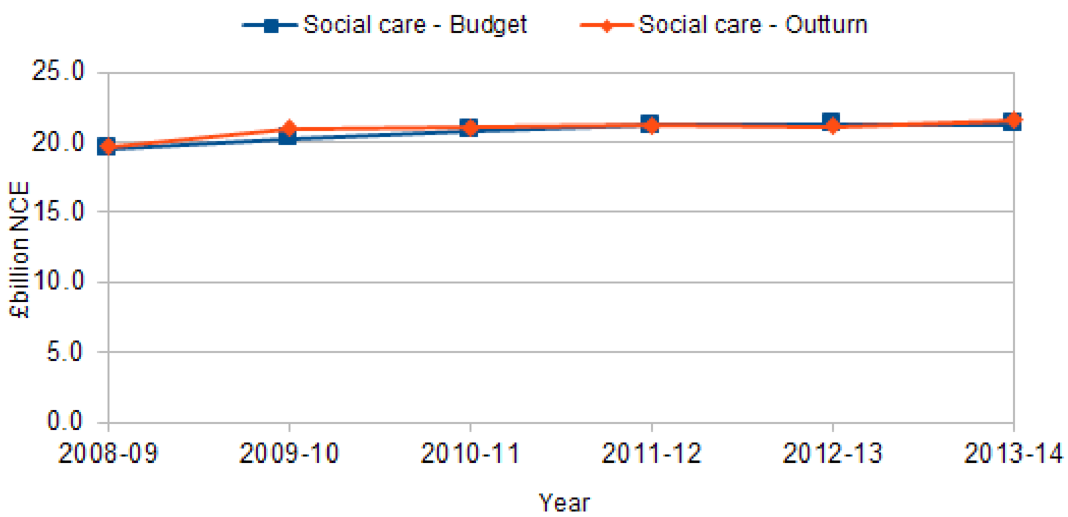


Chart 9 – Housing NCE budget and outturn

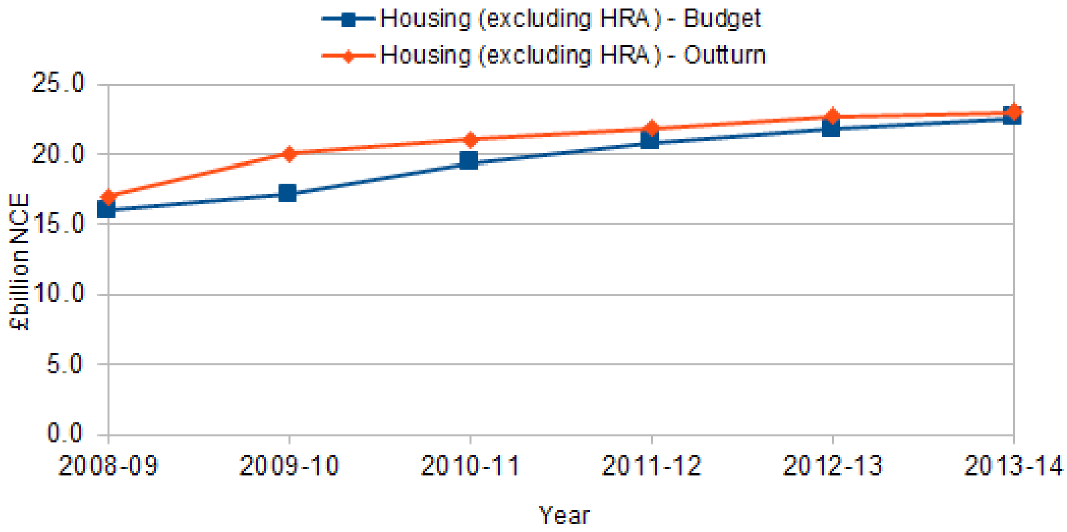


Chart 10 – Cultural, environmental and planning services NCE budget and outturn

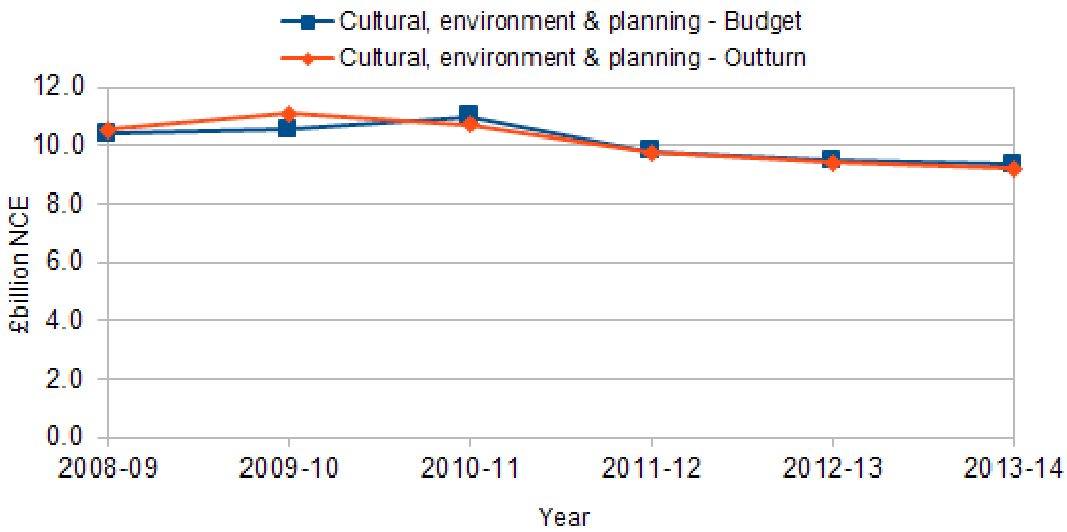


Chart 11 – Police NCE budget and outturn

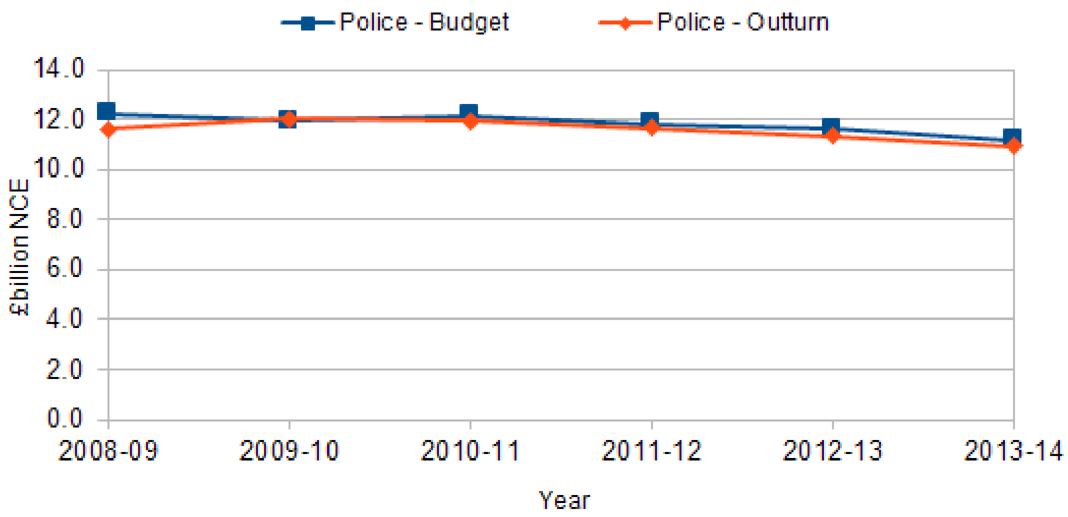


Chart 12 – Fire and rescue NCE budget and outturn

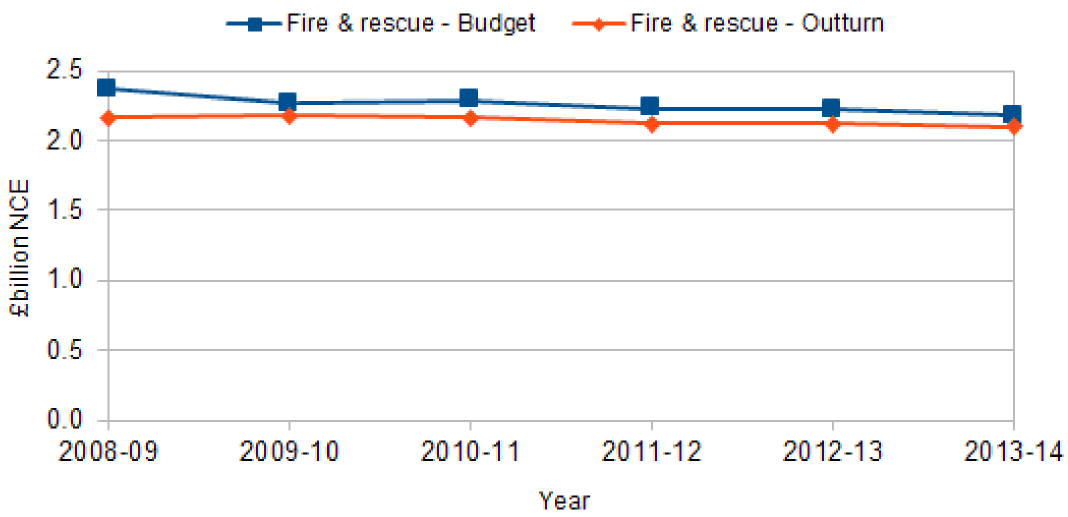
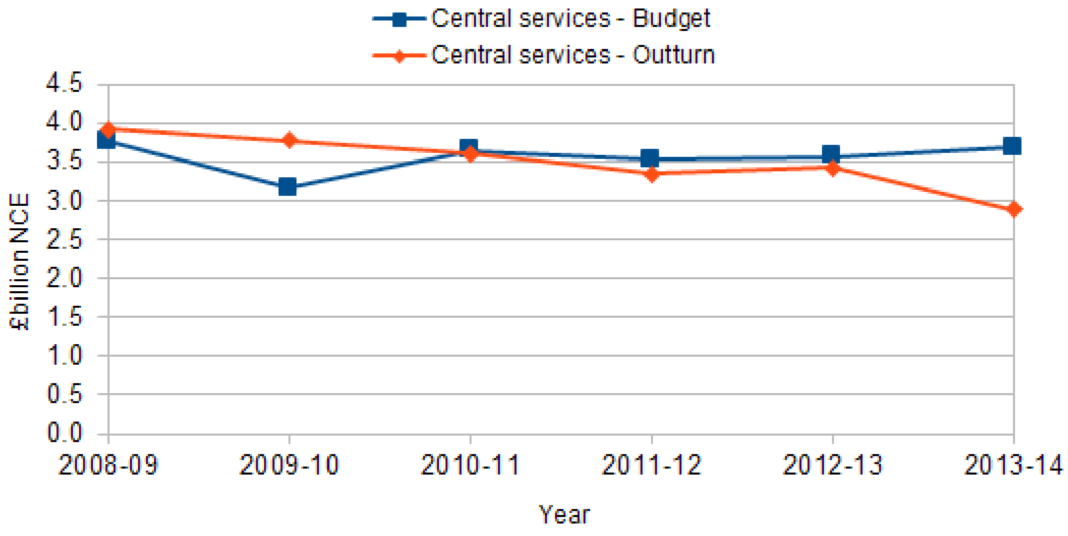


Chart 13 – Central services NCE budget & outturn



The general features we note for these services are:

- For several services which are cut from 2010-11 – education, highways and transport, and fire and rescue – budgets don't seem to have recognised the severity of the cuts required each year.

- For highways and transport, budgeted spend increased in 2010-11 but in actual fact spending was cut significantly that year. This is likely to be as a result of in-year cuts made to transport grants.

- Similarly, spend on cultural, environmental and planning services, which was under-budgeted in 2009-10, was budgeted to rise in 2010-11 but actually saw a cut. Since then, the budgeting seems to have been fairly accurate on the national level.

- Expenditure on fire and rescue seems to have been fairly constant over the period, but budgets consistently over-estimate spend.

- Social care was slightly under-budgeted in 2009-10, but since then has been budgeted for fairly accurately, seeing a very slight rise over the period.

- Police spending has also been fairly accurately budgeted for, with a gradual reduction over the period.

- Housing outturn has continued to rise quite sharply and exceeded budgets for most of the period, though budgeting was fairly accurate in 2013-14.

Section 3: Funding streams - detail

In this section, we take a closer look at particular sources of general fund income: Council Tax and the largest funding streams within AEF. Some of these we cover fairly briefly, particularly where they are relatively simple or well understood, while for others we go into much more detail.

According to RA returns, finance officers expect there to be eight funding streams within AEF which total more than £0.5 billion across England this year:

Table 3 – the largest funding streams within AEF, 2014-15

Funding stream	£m (England total)
Dedicated Schools Grant (DSG)	29,470
Settlement Funding Assessment	23,786
Public Health Grant	2,795
GLA Transport Grant	1,919
Pupil Premium Grant	1,677
The Private Finance Initiative (PFI)	1,033
New Homes Bonus	851
Education Services Grant	711

(Usually, DCLG provide a more accurate forecast of all Specific Grant totals in a spreadsheet released in the Local Government Finance Settlement (LGFS), but the spreadsheet wasn't provided this year, and the above is sufficient for our purposes.)

Council Tax

Council Tax is fairly well understood by most people working in local government. In this subsection, we recap a few points which are necessary for a proper understanding of some of the grants streams discussed below.

Every residential property lies in one of eight council tax bands, from Band A to Band H. The ratios between the council tax bills for these bands are set down in law, so billing authorities just need to set the tax rate for Band D properties and the bills for all other properties are automatically specified. The actual bill paid by a resident or householder will also depend on such factors as whether they are in receipt of CTS, whether they are a student, whether the property is empty or is a second home and what precepts and levies are applied by precepting authorities and levying bodies.

The ratios between the bands allow one to calculate the number of "Band D equivalent properties" in a local authority area. This figure is sometimes referred to as the "tax base" for the area. There are in fact a number of measures of tax base, which differ in the extent to which they take into account the reliefs, discounts, precepts and so forth mentioned above.

The yield generated by Council Tax is the tax base multiplied by the Band D rate, taking into account reliefs, discounts, precepts and so forth and losses on collection.

Dedicated Schools Grant

Local authorities receive funding for education and educational establishments through a number of grants, including DSG, Pupil Premium and Educational Services Grant.

DSG funds a variety of educational establishments and services, including mainstream schools, special schools, early years provision and alternative provision (such as Pupil Referral Units). This funding is provided in two stages: first, the government provides the grant to a local authority, then the authority distributes the grant to the local educational establishments.

Allocations to local authorities

At the start of this Parliament, DSG was allocated per pupil to local authorities on a "spend plus" basis, which is based largely on historical data. While many authorities may be adequately funded from the "spend plus" funding system, it was sharply criticised by the National Audit Office and the House of Commons Public Accounts Committee and the need for reform is widely recognised. (The system has produced anomalies, such as local authorities with very similar characteristics having widely difffering levels of funding.)

In its November 2010 white paper, the government stated its intention to introduce a National Funding Formula (NFF) for schools. The current "spend plus" system would be replaced by a formula which uses current data.

Since the white paper, there have been a number of consultations on the principles on which the formula should be based. Following consultation in 2012, the government announced in July 2012 that DSG would be split into three notional blocks: Schools, High Needs and Early Years. This split was implemented in 2013-14.

High needs funding is to support pupils and students whose education costs significantly more than most school places – defined using a cost threshold. This includes pupils and students in many establishments, including special schools, mainstream schools and academies and Pupil Referral Units.

In 2013-14, high needs funding was moved to a "place plus" basis. This means that base funding ("place funding") was given to local authorities to distribute to institutions for them to provide such places on an on-going basis. This was supplemented with "top-up funding" which follows individual pupils and students. The top-up funding provided to local authorities includes funding for central services to support these high cost places.

In 2014-15, the government had more funding to distribute than in 2013-14. The additional funding was used to meet increased demand for high needs places; the remainder was allocated to local authorities by distributing a flat rate amount per capita of population aged 2 to 19.

The Schools Block and the Early Years Block have not been reformed in this way, although some reforms are now in the pipeline. This is explained in the following subsection.

Allocations from local authorities to schools

Local authorities also pay Schools funding, High Needs funding and Early Years funding to local education establishments. However, the totals for each of these may not exactly equal the totals for the three blocks of DSG, as there is flexibility for local authorities to move funding between the three blocks, subject to the Minimum Funding Guarantee (MFG). This covers most funding for schools and dictates that funding per pupil cannot drop by more than 1.5% per year. Also, authorities may hold back some DSG for central purposes, provided that they have the agreement of their Schools Forum or the Secretary of State on any increase in these budgets, where such approval is required under the regulations.

Local authorities distribute Schools funding using a "local formula" (see below) and pay Early Years funding to all early years providers, including academies and maintained schools, through the Early Years Single Funding Formula.

Local authorities set their own local formulae, within parameters set down by the Government. There are two compulsory factors that must be used in the formula:

- Basic per pupil entitlement - Age-Weighted Pupil Units (AWPUs)
- Deprivation - either based on Free School Meals (FSM) data or Income Deprivation Affecting Children Index (IDACI) bands, or both

and 11 optional ones:

- Looked After Children (LAC)
- Pupils with low prior attainment
- English as an additional language (EAL)
- High pupil mobility
- London fringe
- Post-16 provision
- Schools lump sum
- Sparsity
- Split sites
- Rates
- PFI

London fringe is an optional scaling factor which may be applied to other factors by Buckinghamshire, Essex, Hertfordshire, Kent and West Sussex County Councils. In addition to the above factors, local authorities may apply to the EFA to include certain exceptional factors relating to premises.

Local authorities must allocate at least 80% of the delegated schools block funding through pupil-led factors – that is, the two compulsory factors and the top four optional ones, with the London fringe uplift where relevant.

Details of how these factors are defined and how they may be used are set out in the Operational Guide issued by the Department for Education (DfE) each year. For many of these, local authorities have some discretion over the precise definition they use. A helpful summary by the House of Commons Library of changes between the start of this Parliament and the situation before the July documents were released can be found in House of Commons Standard Note SN06702.

Free schools, studio schools, UTCs and academies

New and expanding free schools, studio schools and University Technical Colleges are funded by the Education Funding Agency (EFA). This funding is on the basis of estimated pupil numbers. This differs from the allocation of DSG to local authorities: they receive their funding for a financial year (April to March) based on a lagged approach using the pupils who were on the previous October census.

A consultation released on 1 May 2014 proposed that from 2015-16 the government continue to fund free schools through the EFA for their first year after opening. After this, though, the EFA would recoup the cost of each free school from the relevant local authority. From the free school's second year, the local authority will receive some funding for the pupils in that school, as those that were there the previous year will appear in the school census that DSG is based on. However, the new year group and any other new pupils will not appear in these figures, unless they had been in another school in the local authority's area the previous year.

Most respondents to the consultation opposed this proposal, many on the basis that the new pupils may have predominantly been in schools in other local authority areas the previous year. However, the government has decided to go ahead with this proposal, with the modification that the recoupment would be based on pupil numbers estimated by the local authority, rather than by the free schools themselves.

Academy funding is covered in a separate subsection below.

Minimum Funding Levels for 2015-16

On 13 March 2014, DfE published a consultation on school funding for 2015-16 including the next steps towards introducing a NFF. The main part of the consultation related to funding through the Schools block in 2015-16 only. It proposed using some of the new factors brought in for local formulae in 2013-14 to set "Minimum Funding Levels" (MFLs) for each local authority area. It proposed to provide £350 million more nationally through the Schools block in cash terms than in 2014-15. If the final MFL for a local authority area is greater than in 2014-15, the authority would be given a share of this £350 million to bring it up to the MFL.

On 17 July 2014, the Government announced it would press ahead with its proposed methodology. However, the £350 million is to be increased to £390 million. Also, in the March consultation, the government consulted on whether the sparsity MFL should be differentiated by phase – that is, whether there should be a different sparsity amount for primary schools and secondary schools. Having looked at the final local authority formula data for 2014-15, the government has decided it will use different amounts.

Pupil Premium

All three main parties proposed a pupil premium in their manifesto, but it was developed in most detail by the Liberal Democrats. The idea of the Pupil Premium is to use money from outside the schools budget to support disadvantaged children from Reception to Year 11. The Pupil Premium supports three categories of children: children from deprived families, children looked after by a local authority and children from armed service families. It is provided to local authorities which then transfer it directly to the schools at which the children are enrolled.

The grant was introduced in the 2011-12 financial year. The allocations for deprived and looked after children were increased in October 2011 and the final allocations over the course of the year were: deprived children of all ages – £488 per pupil; looked after children – £488 per pupil; service children – £200 per pupil.

There have been many changes to eligibility criteria and allocations per pupil since this. The current eligibility criteria are:

- deprived children – registered for free school meals in one of the last six years
- looked after children – children currently in care for at least one day, children adopted from care and children who leave care under a special guardianship order or residence order
- children whose parent or parents are currently in the Armed Forces, have been in the Armed Forces in one of the years since 2011-12, were killed in action or divorced

Note that children do not need to be taking free school meals to be supported, but need to be registered for free school meals with the school – eligibility for free school meals is insufficient.

The current allocations for the 2014-15 financial year are: deprived children – £1300 per primary school pupil, £935 per secondary school pupil; looked after children – £1900 per pupil; service children – £300 per pupil. However, allocations are often revised in-year following receipt of pupil numbers, around the turn of the calendar year.

Formula Grant and Business Rates Retention

As mentioned in Section 2, FG was a large, general grant provided to local authorities for equalisation until 2012-13. In 2013-14, it was renamed "Formula Funding" and formed part of SUFA, the needs baseline, in the new BRR system. It is now effectively "frozen" inside SUFA until the first "reset", expected in 2020, as described below. The following subsections describe how FG was calculated, the way the Government funded it and the BRR system.

The Four-block Model

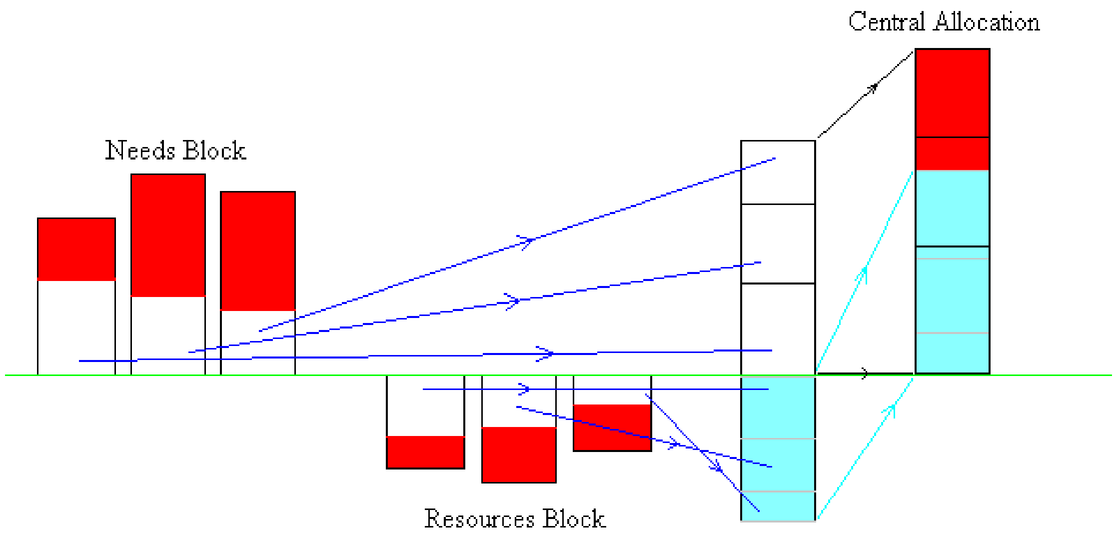
The structure of Formula Grant was the "four-block model". The first block was the Needs Block, the second was the Resources Block, the third was the Central Allocation and the fourth was the Damping Grant Amount.

The calculations in the Needs Block started with a number of separate formulae which estimate the relative need of each authority to spend money on a particular service – known as Relative Needs Formulae or RNF. These were grouped together into sets based on the responsibilities of the different tiers of local government and for each set, the authority with the lowest RNF per head was designated the "threshold authority". A sum of money called the Needs Equalisation Amount is then granted to each authority in proportion to their total RNF above the thresholds. (Once the next two blocks have been explained, this will be shown in a diagram below.)

The Resources Block took account of the ability of the local authority to raise Council Tax. It assumed the amount each local authority area could raise was in proportion to its tax base (the number of Band D equivalent properties). For tier of local government in that area, a "share" of this tax base was calculated. Once again, for each tier (including police and fire authorities), the lowest share per head for any authority was designated the "threshold" and each authority was allocated a "Resource Equalisation Amount" in proportion to the total of its tax base shares above the thresholds. This was always a negative amount – a deduction from the amount a local authority is to receive.

The Needs Block and the Resources Block dealt with the amounts above the thresholds. The Central Allocation dealt with the amounts below the thresholds. The amounts per head under all the thresholds were added up for each authority and re-multiplied by their population and they were awarded an amount in proportion to this total. However, the proportionality was not exactly the same as if the amounts had remained in the Needs and Resources block – it was slightly scaled. The effect of this was to allocate a very small amount per head of population. This is represented diagrammatically below:

Chart 14 - The four-block model



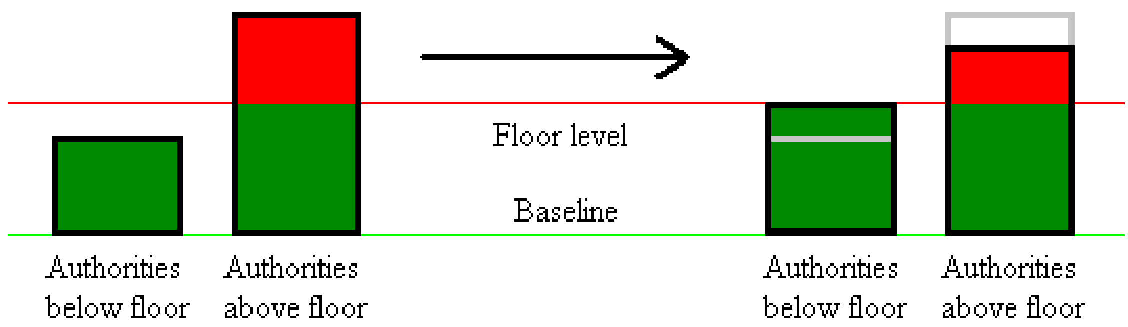
In summary, the amounts above the needs threshold determined the amount of Needs Equalisation the authority received, the amounts beyond the resources threshold determined the amount of Resources Equalisation that was deducted, and the amounts below the needs thresholds (i.e. the levels of the thresholds) minus the amounts below the resources thresholds, multiplied by a scaling factor, determined the Central Allocation the authority receives.

Having calculated the positive Needs Equalisation and Central Allocation and the negative Resources Allocation, these were all added together, along with the Police Grant for police authorities, and the total - known as Formula Grant before damping - was fed through the damping mechanism.

The purpose of the damping mechanism in years of increasing grant was to ensure every authority receives at least a minimum or "floor level" increase in grant over the previous year, without changing the total amount received by all authorities. For years of declining grant, damping ensured that there was a floor level of cut and no authority's grant was cut more than this. This was done by dividing local authorities into four "floor groups": Shire Districts, Fire Authorities, Police Authorities and "EduPSS" authorities (those with upper-tier responsibilities), and setting a floor level for each group.

Take, as an example, the Shire Districts. In 2009/10, all shire districts were to receive at least a 0.5% increase on their grant for 2008/09. Any districts which had a Formula Grant before damping less than this level were awarded an extra sum to bring them up to this level. To ensure that this was revenue neutral, this was achieved by scaling back the grant above the floor level for all the other districts. This was done for each floor group, with its own floor level:

Chart 15 - Floor groups



Thus the damping block added grant for some authorities and subtracted grant from others. Making this change to the total we had before gives us the final value of the Formula Grant for each authority.

Sources of Formula Grant

The money distributed as Formula Grant came from three distinct sources: police grant, business rates and revenue support grant – we now look at each of these in turn.

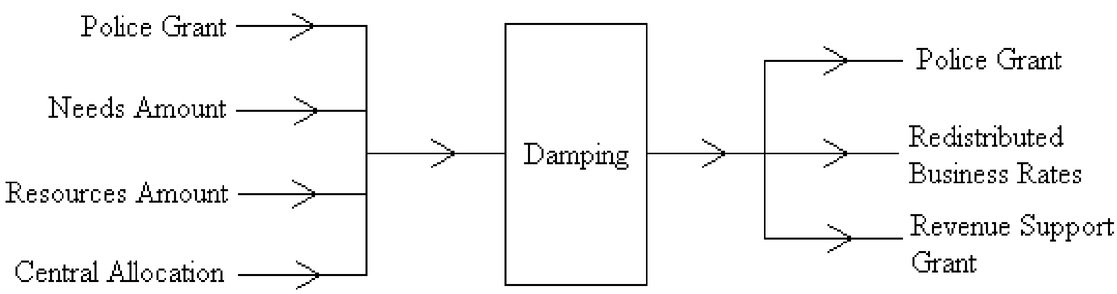
Police grant was allocated by the Home Office to authorities with police responsibilities: pure police authorities, the City of London and the Greater London Authority (GLA). It was calculated using a formula similar to the RNFs. These allocations were, as mentioned above, added to the totals of the first three blocks in the four-block model to give the formula grant before damping. The damping calculations were then carried out to give the total formula grant for each authority and the allocations formed part of this total; the rest was provided from a combination of redistributed business rates and revenue support grant (this will be shown graphically below).

Business Rates – known as National Non-Domestic Rates (NNDR) - are largely collected by the "Billing Authorities": the same local authorities that collect Council Tax. All commercial properties are subject to NNDR, even including, for example, the coin-operated binoculars on the sea fronts of coastal resorts. Only two factors go into deciding the NNDR bill for most commercial property: the rateable value of the property, determined by the Valuation Office Agency (part of HMRC), and a number of pence in the pound, set nationally by Government. (This number of pence in the pound, called the "multiplier", normally increases with the Retail Prices Index (RPI), but the Government has the option of holding down the increase to a lower level, and sometimes does so.) Local authorities have no discretion over either of these factors. Some types of property are exempt, such as places of worship, parks and fish farms, while some are subject to some form of relief, such as rural shops and those owned by charities and small businesses. This money was paid straight into a national pool, so local authorities are essentially acting as collection agents for a national fund. The only discretions local authorities had were to grant discretionary reliefs and/or to levy a small supplement on the NNDR, known as Business Rate Supplement (BRS).

Each local authority keeps a "local list" of properties within its area and paid the Business Rates from these properties into a national pool. To this was added the Business Rates from the "central list" of properties in more than one local authority area (such as underground cables) and Business Rates from those crown properties which do not appear on the local lists.

In the autumn prior to the start of a financial year, the Government estimated the amount that it would receive into the national pool in Business Rates during that financial year. Inevitably, this would be either an underestimate or an overestimate, leading to a surplus or a deficit. The estimate plus the surplus/deficit carried over from the previous year was known as the "Distributable Amount" and it's actually this quantity that was redistributed as part of Formula Grant.

Police Grant and the Distributable Amount together made up the bulk of FG for England. Any shortfall was covered by RSG which comes from DCLG budgets. Thus the system looks like this:



Business Rates Retention

In this subsection we don't attempt to explain all the many complexities of BRR, we just seek to give a flavour of the basics.

BRR was introduced because there was a view in government that when it came to local growth, all the incentives went the wrong way. The more deprived an area became, the more grant the local authority would get. This would be paid for from business rates taken out of more successful areas. The mechanism was worked up over 2011 and 2012 and went live in April 2013.

The system is easiest to understand if we start with 2013-14. Under BRR, councils still collect business rates. Half of this is denoted the local share and half the central share. In 2013-14 they were also allocated a "Start-Up Funding Allocation" (SUFA). This was the sum of their FG for 2013-14 – now renamed Formula Funding (FF) – and a set of other grants (see Table 4 below). Nationally, the local share of business rates only totalled 40% of SUFA. The remaining 60% was provided through a revamped RSG. At the local level, each authority's SUFA was also split in this same 60:40 ratio into an RSG allocation and a "Baseline Funding Level". A local share of business rate yield was predicted for each authority before the start of the year – this is known as the Business Rates Baseline. (We won't go into the details of how this was predicted here – they can be found in [The Local Government Finance Report (England) 2013/2014] and in DCLG's publication [Business rates retention and the local government finance settlement: a practitioner's guide]). If the Baseline Funding Level was greater than the Business Rates Baseline, the difference was termed the authority's "top-up". If, conversely, the Business Rates Baseline was greater than the Baseline Funding Level, the difference was termed the authority's "tariff". The intention was that the tariffs and top-ups would sum to zero at the national level. The tariffs would then be deducted from the "tariff authorities" and used to fund the top-ups.

Whatever yield was actually raised from business rates, the local authority would keep the local share of it. This meant that if the local share were above its predicted value – the authority's Business Rates Baseline – the authority would, in total, receive more than its SUFA. Conversely, if the local share were below the Business Rates Baseline, the authority would receive less than its SUFA. This provides a great deal of risk and reward for local authorities in relation to business rates growth. To put a limit on this risk and reward, there is a "levy" and "safety net" mechanism. This is intended to catch only the outliers. If the local authority sees very large, disproportionate growth in its business rates base, a levy is applied to its additional yield. This, together with some funding from government, funds safety net payments to those authorities which have seen a sharp fall in business rate yield.

Another way the system allows local authorities to reduce risk is for them to come together in "pools". These are treated as though they were single authorities for the purposes of calculating tariffs, top-ups, levies and safety net payments.

The incentive to grow business rates base really kicks in from the second year of the scheme (2014-15) onwards. An authority's Baseline Funding Level is not updated to take account of changes in needs indicators, it is frozen in real terms – it is simply increased in line with business rates multiplier (see above). In 2014-15, for example, the Government decided to hold down the multiplier below RPI (and take other measures), which led to Baseline Funding Levels increasing by 1.95% (see Table 4 below)[1]. This real terms freeze will continue until the government decides to "reset" the system – the current intention is for the first reset take place in 2020. Similarly, the Business Rates Baseline, and hence the tariffs and top-ups, are also increased in line with RPI. There can therefore be a growing divergence over time between the Business Rates Baseline and the actual yield.

Under BRR, each year the government determines by what percentage it is going to increase or reduce each component of the RSG part of SUFA. These uplifts are then applied to these components of each individual local authority's RSG (see Table 4 below – note that lower tier, upper tier and fire parts of FF are treated as separate components). The resulting new RSG figure plus the increased Baseline Funding Level is known as the Settlement Funding Allocation (SFA).

1 This meant that local authority income was reduced from what it would have otherwise been. To compensate for this, the Government awarded the shortfall as a separate grant. See our briefing analysing the provisional LGFS (link on pg 41).

The calculation of each authority's SFA is now the main part of the LGF Settlement, replacing the calculation of FG.

Table 4 – Components of SUFA/SFA in 2013-14 and 2014-15

	2013-14 Baseline Funding (£m)	2014-15 Baseline Funding (£m)	Increase	2013-14 RSG (£m)	2014-15 RSG (£m)	Increase
Upper-Tier Formula Funding	5,342	6,488	N/A	8,029	7,752	N/A
Lower-tier Formula Funding	1,469	1,726	N/A	2,208	1,907	N/A
Fire and Rescue Formula Funding	425	505	N/A	639	638	N/A
Council Tax Support[1]	1,316		N/A	1,979		N/A
2011-12 Council Tax Freeze Compensation	237	242	1.95%	356	349	-2.04%
Early Intervention Funding	683	696	1.95%	1,026	880	-14.21%
GLA General Funding	18	19	1.95%	27	23	-14.77%
GLA Transport Funding[2]	758	773	1.95%			N/A
London Bus Services Operators Grant[2]	44	45	1.95%			N/A
Homelessness Prevention Funding	32	33	1.95%	48	46	-3.79%
Lead Local Flood Authority Funding	8	9	1.95%	13	12	-3.79%
Learning Disability and Health Reform Funding	564	575	1.95%	848	851	0.29%
Rural Services Delivery Funding[3]					10	
2013-14 Council Tax Freeze Compensation[3]					174	
Returned Holdback[3]					31	
Total	10,897	11,110	1.95%	15,174	12,673	-16.48%

Notes:
1. CTS was rolled into FF in 2014-15 – see below
2. these two grants are only included in Baseline funding, not in RSG
3. these three grants were added to RSG in 2014-15 – see separate subsection below for CTFG

The central share of business rates, together with the yield from the central list (see Subsection "Sources of Formula Grant"), are paid to central government which then redistributes them to local authorities in other grants. In 2014-15, RSG appears to be slightly more than the sum of the central share and central list income.

Transfers and adjustments

Many government policies have an impact on how services are funded or run locally when they are implemented. Often, this results in a transfer of funding into or out of core funding (FG or SFA).

Under the FG system, this would usually be achieved by changing the RNF corresponding to that service and increasing or decreasing the Needs Equalisation Amount for the year in question. Sometimes, it would be a simple topslice from the total grant amount (for example, for New Homes Bonus – see below). Often, there would also be an adjustment to the value for the prior year's grant used in the damping calculation, to ensure that this calculation was on the basis of a like-for-like comparison.

In 2011-12, the government decided to roll a large number of Specific Grants into FG. Rather than changing the RNFs, they added them to grant before damping using their own formulae, based on the existing distributions. In effect, this created a fifth block: "grants rolled in using tailored distributions".

Under BRR, the funding may be added to or taken out of RSG, or simply supplied as a separate Specific Grant.

Since 2011-12, the largest transfers, other than the grants rolled in using tailored distributions, were:

- removal of Formula Grant for police authorities in 2013-14 (until 2012-13, this was effectively considered to be part of local government funding; it no longer is)
- adult personal social services
- concessionary fares
- academies
- CTFG
- NHB

The last three of these are described in separate subsections below. In addition, CTS was one of the grants included SUFA in 2013-14 (it was localised that year) but in 2014-15 it was rolled into FF.

Funding for Academies, including Education Support Grant

Most revenue funding in relation to schools is provided through DSG, Pupil Premium and other Specific Grants. However, there are a few exceptions, including:

- the EFA funds free schools, studio schools and UTCs (see subsection "Dedicated Schools Grant" above)
- the EFA funds academies, basing an individual academy's budget on the local formula of the academy's local authority. About 10% of academies are "non-

recoupment" academies which the EFA receives funding for directly. For the remainder, the "recoupment" academies, the EFA recoups the cost from the local authority

- central expenditure: there are costs relating to the strategic oversight of education. Until 2010-11, councils were funded for the provision of these services in relation to all schools through FG.

The Coalition Government massively boosted the academies programme and launched free schools. It soon became clear that large-scale central expenditure would be needed for academies. The government therefore made a transfer out of FG before damping in 2011-12 and 2012-13 to fund the central expenditure for local authority schools converting to academies, known as Local Authority Central Spend Equivalent Grant (LACSEG). The methodology used was not popular, so it consulted on what the ideal methodology would be. The result was that in 2013-14, a complicated calculation reinstated this money that had been taken out, then made a deduction after damping to cover central expenditure for all schools. This money is now distributed back to local authorities and academies; for local authorities it is in the form of a Specific Grant, called Education Support Grant. Local authorities received £15 per pupil in 2013-14 to cover statutory duties; the remaining funding was then split between academies and local authorities on a per-pupil basis.

A consultation on 1 May 2014 (the same one that dealt with funding for free schools etc) proposed to turn all non-recoupment academies into recoupment academies from 2015-16. The consultation set out how additional DSG would be provided for these academies, and how the EFA would recoup funding for them from the local authority. Once again, there were concerns raised in responses to the consultation about the burden of additional central expenditure.

In light of the responses to the consultation, the government decided to proceed with the proposal to convert non-recoupment academies into recoupment academies. Additional DSG would be provided, including, in response to the concerns expressed, an additional sum to cover central expenditure. The details of the way this will be calculated and paid will be published later this year. In essence, though, the proposal is to add the greater of:

- the amount of central expenditure the EFA paid the academies in 2014-15

- the amount of central expenditure the local authority pays to the academies in 2015-16.

CTFG and NHB

The present government has provided a number of grants to local authorities as "incentives" to carry out particular policies. Two of these relate to the tax base for Council Tax: CTFG and NHB. Both grants have seen a lot of changes over the course of the Parliament.

CTFG rewards councils for freezing Band D Council Tax, by paying them the equivalent of a set percentage of their Council Tax yield in a particular year. Under NHB, councils are paid for each new home built in their area for six years. There are additional payments for bringing empty homes back into use and for building affordable housing. (Full details of the payments are given in the final scheme design and helpfully summarised in our briefing from 3 December.)

The award of CTFG depends on whether the Band D Council Tax is raised, while NHB allocations depend (mainly) on increases to the tax base. Furthermore, Council Tax yield can be increased either by increasing the Band D rate, or by increasing the tax base, or both, and as described above, Formula Grant/Formula Funding contains an equalisation for ability to raise Council Tax. With some years' CTFG becoming part of SFA and some NHB funded by top-slicing, there is thus a very complex interplay between Council Tax, CTFG, NHB and Formula Grant/SFA.

In the next two subsections, we look at the key features of CTFG and NHB year-by-year. In the following subsection, we look more closely at some aspects of the interplay between the various funding streams.

CTFG – year-by-year

In most cases, as we describe below, the grant relating to a particular year's freeze is paid annually from that year forward. This is because if the grant were just paid for one year, a council receiving it would still need to raise Council Tax the following year to make up for the shortfall. Effectively, this would simply delay the rise by a year.

We now look at each year's freeze in turn and describe the key facts and figures about the grant allocated to cover that freeze. There is a summary of the figures in Table 5 below.

2011-12

Spending Review 2010 set aside £0.7 billion from the Department for Communities and Local Government's main budget (known as "LG DEL" or "DCLG Main") for the whole of the Spending Review period, for the grant relating to the 2011-12 freeze.

The grant was announced on 21 October 2010 and was equivalent to a 2% increase in the 2010-11 Council Tax. Every local authority took up the offer, resulting in a payout of £652.2 million.

As the allocations weren't known until each authority had set its Council Tax – that is, after the final LGFS – it was paid as an un-ringfenced Special Grant in 2011-12. In 2012-13, it was included in Formula Grant as a sum added on after damping. For local authorities, this change was purely cosmetic, but it meant that it was included in DCLG's budget for Formula Grant.

In 2013-14, with the introduction of the BRR system, the grant was taken out of Formula Grant/Formula Funding. For police authorities, it returned to being a separate grant, but for other authorities, it was kept within the new Start-Up Funding Allocation. This meant that from 2013-14 onwards, this funding is provided to councils through a combination of their business rate baseline, their tariff/top-up and RSG, as described above.

2012-13

Grant funding to cover a freeze in 2012-13 was announced on 3 October 2011, with further detail on 14 November. This was equivalent to an increase of 2.5% of 2011-12 Council Tax (or 3% for police and fire authorities), but the grant was only for one year. Central Government accounted for this grant in 2011-12, putting aside £675.9 million to cover it. In the event, the total payout was £597.1 million.

2013-14

Grant funding to cover a freeze in 2013-14 was announced on 8 October 2012. This was equivalent to an increase of 1% of 2012-13 Council Tax. £265.1 million was put aside to cover it, but the final payout was £181.3 million.

In its first year, this grant was paid as an un-ringfenced Special Grant. The LGFS Technical Consultation issued in July 2013 proposed rolling it into the Settlement Funding Allocation (SFA) from 2015-16. However, the 2014-15 LGFS revealed that it is actually being rolled in from 2014-15.

2014-15 and 2015-16

The Spending Round 2013 announced that there would be funding for a freeze in these two years. A DCLG press release issued on the same day stated that "Authorities that freeze or reduce their Band D Council Tax will receive a grant equivalent to a 1% increase on 2013 to 2014 Band D Council Tax levels". The precise details of the 2014-15 grant were not clear until a letter was sent to Chief Executives on 15 January 2014. This stated that the grant would be provided as a Special Grant in both 2014-15 and 2015-16. No concrete assurances were given beyond 2015-16; the letter stated that

> *"Ministers have agreed that the funding for 2014-15 (including 2015-16) freeze grant should be built into the spending review baseline. This gives as much certainty as possible at this stage that the extra funding for freezing council tax will remain available."*

It also stated that no further detailed be given at this point about the 2015-16 freeze grant – this would be subject to a separate procedure next year.

Table 5 – summary of CTFG amounts and method of provision

						Year funding provided				
		% rise equivalent	**Amount-police**	**Amount-other**	**Amount-total**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
Year grant relates to	**2011-12**	2.5% of 2010-11 CT	£58.8m	£593.4m	£652.2m	SG	FG post damping	SUFA	SFA	SFA
	2012-13	2.5% of 2011-12 CT (3% for police & fire)	£41.2m	£556.0m	£597.1m	-	SG	-	-	-
	2013-14	1% of 2012-13 CT	£7.3m	£174.0m	£181.3m	-	-	SG	SFA	SFA
	2014-15	1% of 2013-14 CT	£2.7m	£145.2m	£147.9m	-	-	-	SG	SG
	2015-16	1% of 2013-14 CT(?)	Depends on take-up	Depends on take-up	Depends on take-up	-	-	-	-	SG(?)

NHB – year-by-year

In Spending Review 2010, £196 million was set aside for NHB payments in 2011-12 and £250 million for each of the subsequent years of the spending review period.

From the outset, it was assumed that for each of these subsequent years, additional funding would be needed to cover the payments to councils. This additional funding was found as follows.

2011-12

Payments totalled £199 million. The additional £3 million was accounted for as an update to the budget for the grant.

2012-13

Payments totalled £432 million. £176 million was taken in advance from top-slicing 2012-13 Formula Grant and the remaining £6 million from 2013-14 Formula Funding.

2013-14

Under BRR, the Government has adopted the practice of top-slicing the maximum amount they believe may be necessary, then repaying any funding that hasn't been paid out as NHB though an "adjustment grant". In 2013-14, they took out £500 million, of which £418 million was paid out (together with the £250 million from the Spending Review). The NHB adjustment grant was therefore £82 million.

2014-15

When the 2013-14 LGFS was published, a draft LGFS for 2014-15 was also published. This showed a top-slice of £800 million. The LGFS Technical Consultation published in July also worked on the assumption that £800m would be top-sliced. However, the 2014-15 LGFS showed that the top-slice was actually £700 million. The final allocations were published on 3 February 2014 and show the total payout to be £917 million, making the adjustment grant £33 million.

Nationally, the allocations show:

- 42,862 new affordable homes, down 26% on last year's total of 58,107;
- 132,998 other new homes, down 7% on last year's total of 142,484;
- 38,009 empty homes brought into use, up 112% on last year's total of 17,945.

2015-16 - LEPs

Spending Round 2013 proposed that in 2015-16, £400 million of NHB payments would be top-sliced for the use of Local Enterprise Partnerships (LEPs), as part of a £2 billion Local Growth Fund. A consultation was launched in July on how this would be done. As reported in an LGiU policy briefing on 17 December, this proposal was not popular within local government.

The Autumn Statement announced that this policy would not be implemented, "except for £70 million for the London Local Enterprise Partnership, which is chaired by the Mayor of London".

Table 6 – summary of NHB amounts

		Year funding provided			
		2011-12	**2012-13**	**2013-14**	**2014-15**
Year of refurbishment / completion grant relates to	**2011-12**	£199m	£199m	£199m	£199m
	2012-13	-	£233m	£233m	£233m
	2013-14	-	-	£236m	£236m
	2014-15 (provisional)	-	-	-	£248m
TOTAL NHB		**£199m**	**£432m**	**£668m**	**£916m**
of which:					
funding set aside in SR 2010		£196m	£250m	£250m	£250m
additional funding		£3m	£182m	£418m	£666m
NHB Adjustment Grant		-	-	£82m	£34
TOTAL NHB TOP-SLICE		**-**	**-**	**£500m**	**£700m**

Sustainability and efficacy of the grants and interplay between them and other funding policy

The objective of CTFG is to reduce the burden on residents paying Council Tax. Funding for this must ultimately come from general taxation – from raising other tax yields and/or from savings in public spending. Given that each Government department's expenditure must be met from its own declining budget, this inevitably means that it comes at the expense of reductions in other local government funding.

The justification for using general taxation to relieve the burden of Council Tax is that some taxpayers will have serious difficulty in meeting rising Council Tax bills – particularly those who have properties in the high bands but low disposable income.

Initially, this policy was extremely successful in keeping down Council Tax – in its first year, every local authority froze its Band D rate. However, as NHB allocations show, local authorities are finding it difficult to expand their tax base. Consequently, tax yields are not keeping pace with expenditure pressures. This makes it more difficult each year for councils to afford to freeze their Council Tax, even with CTFG.

It is also getting harder to fund. Each year, the Government needs to continue to fund previous freezes (apart from 2012-13 - see above) and find further money for a new freeze. The 2013-14 CTFG and subsequent years' CTFGs are accounted for within LG DEL, and along with 2011-12 CTFG they are being maintained in cash terms. However, LG DEL is not just falling in line with Spending Review 2010, but has received further cuts. This inevitably means other grants being cut by more than they would otherwise be, pound for pound[2].

2 We need to be careful with phraseology when talking about the sources of funding for new grants. Given that the LG DEL is falling year on year, talking about new freeze funding being "taken from" particular existing grant budgets could lead to confusion. It is therefore best to stick to this sort of statement, about what is likely to have happened to other grants had a policy not been implemented in a given year.

This is particularly clear in 2014-15. In 2014-15, SFA contains both 2011-12 CTFG and 2013-14 CTFG, which are frozen within it. Therefore to achieve the 1% reduction required by the Budget 2013, other components of SFA need to be cut more radically.

As long as CTFGs are separately identifiable within SFA, this protection is likely to remain. For authorities which are concerned about keeping this funding, it is worth bearing in mind that this may well cease at the first "reset" of the BRR system, which the Government intends to hold in 2020.

Councils considering freezing their Council Tax will individually weigh up their desire to protect their residents from a rise against the loss in income net of CTFG. However, it is worth considering the cumulative effect. While the reduction in SFA caused by any one authority being allocated CTFG may be relatively small, the cumulative effect of most authorities taking it can reduce the other components of SFA considerably. This will impact most on authorities which rely most heavily on these other components, such as Formula Funding.

The timing of announcements on the details of CTFG can make this consideration more difficult; for example, the details of the 2014-15 CTFG were not announced until 15 January, around the time many councils are concluding their budget-setting process.

The motivation for introducing the New Homes Bonus is often not clearly understood. In theory, councils are already "rewarded" for new homes being built: it adds to the tax base and therefore results in greater Council Tax yields. However, as we have seen, FG contained an equalisation for differing ability to raise Council Tax. This meant that councils which were not on the damping floor (sometimes called "scaled" authorities) lost much of the increase in yield through the equalisation. (This is explained in the House of Commons Library Standard Note SN/SP/5724.)

The purpose of NHB was to ensure that all councils were rewarded for new homes:

- regardless of whether they were "scaled" or "floor" authorities;
- regardless of the level that they set Council Tax at;
- with additional payments for returning empty homes to use, or building affordable homes.

The funding set aside in Spending Review 2010 was taken from the budget previously used for Housing and Planning Delivery Grant (HPDG), which it replaced. NHB is widely seen as more transparent and simpler to administer than HPDG.

The increasing tax base would then increase resource equalisation, creating a saving for DCLG on the Formula Grant budget, which could be ploughed back into NHB – essentially, a revolving fund.

Under a system where there are annual allocations of Formula Grant, this appears an efficient use of funding[3].

3 Nonetheless, "floor" authorities still received a greater "reward" than "scaled" authorities, as they got NHB and increased Council Tax yield, without losing any to equalisation. It might have been possible to deal with this by taking resource equalisation outside damping, although this may have introduced greater volatility into the system for some authorities, or had other unintended consequences.

However, under the BRR system, there is no year-on-year increase in resource equalisation. Councils retain all increases in Council Tax yield.

Consequently, DCLG has to find increasing amounts each year to fund NHB[4]. This is top-sliced from RSG, so effectively councils with new homes are paid twice – once from Council Tax and once from NHB – with the latter being at the expense of other local authorities. Councils have to achieve an "above average" performance to get a net benefit from NHB – although, as pointed out in a policy briefing on 3 December 2013 (see pg 41 for links), the system design favours some councils above others (for example, shire districts above shire counties).

The interplay between NHB and BRR also causes confusion for finance officers. For example, to get like-for-like comparisons between SFA for two different years, you must remember to add on the NHB Adjustment Grant.

Nonetheless, local authorities do find it useful to have a funding stream that is as predictable as NHB. It assists long-term planning for strategic growth. In theory, future NHB can also be borrowed against, making greater investment in housing possible (this could be viewed as a form of "Tax Increment Financing").

A National Audit Office report in March 2013 concluded that NHB had so far mainly rewarded home creation that was *not* incentivised by the Bonus. In this context, the 2014-15 allocations make interesting reading. They suggest that councils are still finding it difficult to promote new build, including affordable housing, but are making increasing progress with returning empty homes to use. The concerns of the National Audit Office as to whether NHB leads to increasing volumes of new build should therefore be taken seriously.

Public Health Grant

The Health and Social Care Act 2012 amended the NHS Act 2006, transferring most public health responsibilities to local authorities. A few services, such as health protection services which are better done at national level and services which need to be commissioned at scale, are delivered by a new body, Public Health England (PHE). Local authorities took over their new responsibilities in 2013-14.

Funding for these responsibilities is provided through a ringfenced grant. This grant is allocated using a complex formula developed by the Advisory Committee on Resource Allocation (ACRA), a large advisory body whose members include senior local government officers, senior NHS staff, academics and civil servants.

Following consultation, it was decided that allocation should eventually be based on indicators of the need for public health expenditure. However, moving to such a basis overnight could cause major disruption to services. A "Pace of Change" mechanism was therefore included in the formula.

The starting point (the "baseline") was the existing levels of public health spend in each local authority area. In February 2012, the Government published the results of surveys of Primary Care Trusts (PCTs) which showed levels of spend in 2010-11 and how much each local authority

4 This may change in the seventh year of the scheme – it covers six years of new homes, so in the seventh year, the payment for the first year drops out. Whether the total cost of the scheme then goes up or down depends on whether year seven payments are more than year one payments. If the costs do continue to rise, they will at least do so more gradually.

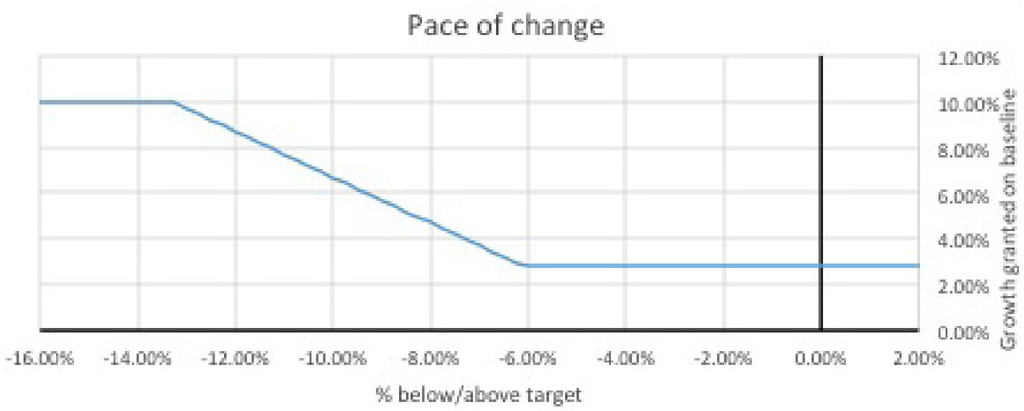
would have spent then, had the proposed structure been in place at that point. (This was the latest year for which such expenditure data was available.)

As well as a baseline, a "target" allocation was calculated for each local authority area. The primary measure used to calculate the target allocation was the area's population. However, it was clear that some areas would need greater funding per head than others ACRA recommended using a measure called "SMR<75" as a good indicator of a population's need beyond a simple per head basis. This is the standardised mortality ratio for under-75s – a measure of how many more or fewer deaths there are in the local area compared with the national average, having adjusted for the differences between the age profile of the local area and the national average.

The SMR data was combined with a range of population measures to produce a "SMR<75 weighted population" for 2013 for each local authority area. From these figures, the following stages were applied to produce the target allocations:

- multiply by a Market Forces Factor Index, which accounts for unavoidable geographical variations in costs of providing public healthcare services
- Split this figure into weighted populations for mandatory services, substance misuse services and other non-mandatory services (see below), using the ratios of spend on these areas at the national level
- apply a separate age and gender adjustment for each of these three categories – adjustments which represent the differing needs for these services between different age and gender groups
- add the results up to create a total weighted population
- allocate the total national pot of £2.66 billion in proportion to the total weighted populations.

The Pace of Change mechanism looks at how far the baseline amount is below or above the target allocation, and increases the baseline amount according to the following graph:



That is, if an authority's baseline is more than 13.31% below the target, the authority is allocated its baseline amount plus 10%; if an authority's baseline is less than 6.11% below the target (or is above the target), the authority is allocated its baseline amount plus 2.8%; between these, the uplift increases linearly with the difference between the baseline and the target.

Some public health services run by local authorities are mandatory or "prescribed", while others (including drug and alcohol misuse services) are discretionary or "non-prescribed". Local authorities must spend their public health grant on services on these lists. They demonstrate that they have done so by stating their expenditure on each of these services their RO form, and by the Chief Executive submitting an accompanying Statement of Assurance. If a council does not spend all of its public health grant within the financial year, it may carry over the remainder in a public health reserve; however, where there are large under spends the Department of Health reserves the right to reduce allocations in future years. If the council fails to comply with the conditions of the grant, the Department of Health may cancel further payments or claw back payments already made.

PFI

Until Spending Review 2010, local authorities could bid to the government for "PFI credits". These were essentially guarantees that the government would pay for grants to support the capital element of a scheme under the Private Finance Initiative, once payments were due by the local authority.

From Spending Review 2010, this system is closed to new PFI deals. Nonetheless, the Government is largely honouring existing credit arrangements and this grant is composed of payments for PFI deals dating back before the Spending Review. A large proportion of these relate to schools PFI schemes.

Section 4: A look ahead

The public finances and political parties

In 2010-11, large cuts happened in-year, to grants that were already being paid out. Between 2010-11 and 2013-14, as explained in Section 2, the sum of non-police Formula Grant, specific grants inside AEF, ABG/LSSG and CTB grant fell by 11.9%, from £75.5 billion to £66.5 billion. This will fall again in 2014-15.

Autumn Statement 2013 shows that without policy changes, Resource AME (the bit of spending government can't directly control - mainly welfare & pensions) is set to increase by 20.3% between 2014-15 and 2018-19. Without tax policy changes, to stay within the overall envelope, departmental spending needs to fall by 8.0% in cash terms over this period. In real terms, this is 17-19%, depending on whether the Consumer Prices Index or Gross Domestic Product is used as the inflation measure (using OBR central forecasts). Unless there are policy changes that prevent this, it will inevitably lead to further large cuts in local government funding.

What those policy changes might be, and what happens after this, obviously depends on the party or parties in power after the next general election. If Labour is in power, we have a clear idea of their approach to local government. In June 2013, Ed Miliband announced formation of the Local Government Innovation Taskforce, composed of leaders of local authorities and a directly-elected mayor. It published its final report in July 2014. This proposed a "New English Deal", based around five pledges:

1. provide people with the care they need to live independently
2. give every young person the opportunity to get a decent job
3. increase community safety and reduce crime
4. help excluded families to overcome challenges for good
5. give every child a good start in life.

This would be delivered with a package of measures devolving power and funding to local areas, including long-term funding settlements for local services. The task force made 25 recommendations, based on three core principles:

- people power
- collaboration
- prevention.

If the Conservatives or Liberal Democrats are in the Government after the election, we could expect their approach to be similar to that in this Parliament. George Osborne has stated that if the Conservatives are voted back into Westminster in 2015, they would make £25bn of fresh public sector cuts. Welfare would make up about half of this, but the rest would be squeezed from departmental budgets. Key features of the Coalition Government's approach to local government finance include:

- re-focusing of funding from needs-based allocations to incentives and sharing in growth (as we described in Section 3)
- cutting ringfenced grants, rolling them into un-ringfenced funding, or removing the ringfences
- joined-up provision across public services, in particular in relation to adult social care and health and troubled families, and through community budgets
- setting up Local Enterprise Partnerships to lead on growing local economies
- devolution to cities through negotiating City Deals
- stimulating business growth in local areas through Enterprise Zones and New Development Deals
- allowing greater local authority discretion over things like CTB and Business Rates discounts while expecting savings to be made

Views from the sector

Local government and the wider public sector have also put forward views and proposals on both what councils need to do and what government needs to do to allow services to be delivered more effectively at lower cost. For example:

- the Greater London Authority's London Finance Commission recommended in its report "Raising the Capital" that London government should have fewer borrowing constraints and greater devolved tax powers, starting with property taxes and matching tax devolution pound-for-pound with grant reductions
- Core Cities followed this up with a set of essays from experts in urban growth: "Keys to the City: Unlocking Urban Economies Through Devolution"
- APSE developed the concept of "The Ensuring Council"
- the Local Government Association (LGA) published reports on "Rewiring Public Services" and have recently set up the Independent Commission on Local Government Finance

Surviving budget pressures

Whichever party or parties are in power after the general election, reductions in funding – particularly in AEF – are likely to be severe. There must be a question mark over whether the Government, if it were so minded, could continue to fund council tax freezes for a number of years. However, without significant reform, councils would find it hard to raise Council tax rates by any significant amount without considerable distress to the electorate.

Perhaps a greater challenge for local government, though, is increasing service demand. Some services will see a reduction in demand as the economy recovers, but most services will be under greater pressure in areas of increasing population. Some of the most expensive services, such as adult social care, will face the greatest pressures in most areas of the country, due to demographic changes. As the LGA's "Future Funding Outlook" publications have shown, together with similar work by London Councils, service expenditure faces a compound pressure from a growing user base and rising prices. Price pressures fall into two categories, both of which may be significant in forthcoming years:

- staff costs – internal and contracted out, including wages, pensions and National Insurance
- running expenses – for example building rental, utility bills and supplies

To avoid cutting services below a basic level voters expect, councils will need to

- ensure the growth of their local economies, and that they benefit from it, using the incentive mechanisms described in Section 3, planning gain, City Deals and earn-back agreements
- find ways to maximise revenue from sales, fees and charges and other income, without placing undue burden on service users
- completely overhaul the way they deliver services, joining them up internally and with other parts of the public sector, through community budgets and other partnership arrangements, and bringing in the expertise of the private and community and voluntary sectors
- help people stay healthy and able to work, using public health powers, to stimulate the local economy and reduce pressure on services
- invest to save - for example investing in prevention, early intervention and energy efficiency.

Useful links

- House of Commons Standard Note SN06702
- Audit Commission findings (see our briefing on 13 January)
- Audit Commission: Formula funding of local public services
- House of Commons PAC formula funding report
- Schools White Paper 2010
- Spending Round 2013
- Autumn Statement 2013
- Spending Review 2010
- Raising the Capital - GLA
- Keys to the City - Core Cities
- The Ensuring Council - APSE
- Rewiring Public Services - LGA
- Future funding outlook - LGA
- London Councils long term financial outlook

LGiU briefings

- DSG – MFLs
- DSG – other
- LGFS 2014-15, inc Baseline Funding Level increase
- Trends in Funding and Spending
- NHB and CTFG
- Consultation on school funding reform
- School funding reform
- Analysis of provisional local government finance settlement 2014/15

- New Homes Bonus: PAC and NAO reports
- DfE Academies funding consultation
- DfE fairer schools funding consultation

DCLG links

- RO and RA data
- LGFSE (annual publication)
- Quarterly revenue outturn
- RO and RA forms
- LGFS 2013/14 (including provisional 2014/15 settlement)
- LGF Technical consultation
- New Home Bonus and the local growth fund: technical consultation

This Essential Guide will be of interest to anyone wishing to learn about local government finance, particularly revenue expenditure and how it is funded. This will include, but is not limited to, councillors and finance officers. It takes an overview of the local government finance system, but also drills down into particular funding streams and issues, highlighting trends and challenges for the forthcoming years. It is therefore suitable for those who are new to the subject, those who wish to get up to speed on recent changes and current challenges, and those who have a working knowledge of the subject but want to learn more of the detail.

LGiU (Local Government Information Unit) is a think tank and membership association, with c 200 local authorities and other organisations subscribing to its services. LGiU's mission is to strengthen local democracy to put citizens in control of their own lives, communities and services. LGiU is a registered charity run by its members for its members.

LGiU works with NDPBs, NGOs, and private and voluntary sector partners, as well as councils: providing briefings on emerging national and regional policy, publishing its own policy reports and recommendations, and seeking to influence decision-makers and policy teams locally, regionally and centrally.

LGiU
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