

# Crunch time?

The impact of the  
economic downturn  
on local government  
finances



**Local government**

National report

December 2008



**audit**  
commission

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# Summary

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## **2008/09 has been a difficult year, but most local authorities are coping**

- 2008/09 has been a difficult year; nine out of ten councils are concerned about inflation and falling property prices.
- Some authorities have had to take steps to keep costs under control, but most are confident they can cope.
- At present, it is not the crisis that has been portrayed in the media.

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## **Inflation and falling land and property prices are causing cost pressures**

- Prices have risen faster than assumed when the government set the level of council grant for 2008/09; 77 per cent of councils received a real-terms cut in grant funding.
- Councils have been hit hard by increases in fuel bills; for example, the cost of lighting the streets is up 40 per cent in a year.
- Four-fifths of councils say development activity has fallen; half have had reduced income from deals with developers.
- In the first six months of 2008/09 just under half of authorities reported both falls in income and increases in expenditure of at least 1 per cent. If no action was taken the total impact of this on council budgets could be around £2.5 billion.
- Councils with deposits in Icelandic banks are particularly concerned about the increased risks associated with investments.

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## **And demand for services is starting to rise**

- About a quarter of councils report increases in demand for care for elderly people.
- A third are already dealing with increases in homelessness.
- One in ten councils have seen higher demand for state school places for children that were previously educated privately. This was a particular problem in London with a third of London boroughs reporting higher demand.

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# Summary

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## There is some financial relief for councils

- Around half of council spending goes on staff salaries; the April 2008 pay award of 2.45 per cent (subject to arbitration) was below general inflation.
- Four out of ten councils have gained from investing cash in the money markets.
- The level of council reserves has been rising in recent years, and now averages about 13 per cent of annual expenditure.
- The expenditure that has seen the highest levels of inflation – gas, electricity fuel and food – make up less than 2 per cent of total local authority spending.
- Inflation is now reducing, easing some of the in-year pressures; fuel prices are now lower than they were in April 2008.

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## Most councils are confident they can cope in 2008/09

- Fewer than half of councils feel they need to take major steps to deal with the current cost pressures.
- Two-thirds of those that need to act are confident that they can cope.
- However, around 5 per cent of authorities need to take action to deal with financial pressures, but are not confident that they will be successful.
- One in seven councils has made compulsory redundancies or have plans to do so; many councils are reviewing recruitment or leaving posts unfilled.
- One in six councils have already cut services or has plans for service cuts.

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## Demand will increase further as the recession starts to bite

- Unemployment will increase the demand for benefits, and financial and other advice.
- Home repossessions will increase the need for social housing.
- Nine out of ten councils predict reductions in development, reducing the number of new social housing units and generating less income from planning deals with developers.
- There are likely to be more family breakdowns, leading to more children being looked after. More older people are also likely to need council-funded care.
- A fifth of councils are expecting increased demand for state school places, due to children transferring from the private sector.

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## **The picture for 2009/10 is less certain, but there is some positive news**

- The economy has moved into recession and the outlook for 2009/10 is poor; much depends on the length and severity of the economic downturn.
- About 75 per cent of local government income comes from central government grant; this will increase by 4.2 per cent in 2009/10, leading to more councils receiving a real-terms increase.
- If inflation reduces, this will ease the pressure on budgets. Interest rates have fallen, so the cost of borrowing should reduce.

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## **Councils need to plan ahead and show local leadership**

- Most local authorities are proactively managing their finances to deal with the pressures that may arise.
- Achieving better value for money is imperative for all councils.
- Some local authorities are using their statutory powers, their position as major local employers and their local leadership role to help local businesses and people cope with the recession.
- All local authorities should consider how they could do so.
- It has been 16 years since the last national recession; members and officers that have not recently faced an economic downturn will need to learn quickly from past experience.

# 1 Introduction

1 Prospects for the UK economy have significantly deteriorated since the publication of the Comprehensive Spending Review (CSR 07) in October 2007. Inflation measured by the consumer price index (CPI) has risen above the government's target, with particularly large increases in the price of fuel and food. Property and land prices have fallen, unemployment has started to rise, and the UK economy has started to contract.

2 The worsening economy affects all sectors and local authorities have to live within their means. Much of their income is fixed once the amount of government support is known and they have set the level of council tax. They have no powers to levy supplementary taxes to make up any shortfall in-year.

3 At the same time, the impact of the economic downturn on individuals may lead to increases in demand for council services. Councils must therefore set a budget for the financial year and use reserves or adjust spending if necessary. This has been particularly difficult in 2008/09 and some press coverage has implied something approaching a crisis for local authorities.

*'Battening down the hatches'*  
*Municipal Journal*

*'When the credit crunch begins to bite'*  
*Local Government Chronicle*

*'Council projects hit by credit crunch'*  
*Financial Times*

*'What will we do when the money runs out?'*  
*The Guardian*

*'Credit crunch crisis may hit Worthing Council services'*  
*Littlehampton Gazette*

*'Newcastle City Council in cash warning'*  
*The Newcastle Journal*

4 Bearing in mind their local area leadership role, local authorities have to consider not only how to balance their own books, they must also identify how the people and businesses in their areas will be affected and whether the local authority can take action to help during the economic downturn.

5 Local authorities are well placed to do this. They play an important role in their local economies:

- as large local employers and purchasers of goods and services. In total local authorities spent £140 billion in 2005/06 (Ref. 1),<sup>1</sup> and in some local authority areas, the council is the largest employer (Ref. 2); and
- in promoting economic development. This is done through the exercise of their planning powers, their role in large regeneration schemes, in deals done with private developers to provide additional benefits to the local area, and in their partnerships with other public sector providers.

<sup>1</sup> Including capital and revenue spending.

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- 6 Local authorities have been encouraged by central government (Ref. 3) to use all the mechanisms at their disposal to promote economic development in their areas including using their ‘well-being power’ (Ref. 4). This power allows authorities to do anything they consider likely to promote the economic, social and environmental well-being of their area, short of raising taxes.
  - 7 The economic downturn presents local authorities with a potential conflict: how to balance their own books while helping their areas through the recession. In other words they need to both save money and spend money. To succeed on both fronts will be a challenge.
  - 8 But the downturn may also present authorities with opportunities. Recruitment and retention of staff with skills in short supply may be easier. Low land and building prices may allow purchases that were previously unaffordable and falls in interest rates will lead to lower borrowing costs.
  - 9 This research looks at the impact of recent economic changes on local authorities’ finances. It considers how authorities are responding to the in-year cost pressures and to the longer-term challenge of managing through a recession.
  - 10 The impact of the economic situation is still emerging. This report is not intended to be comprehensive but rather to present evidence of how it is starting to affect local authorities.

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## Methodology

- 11 This work was carried out between October and November 2008. It involved a survey of chief finance officers,<sup>1</sup> work with seven local authorities, and an analysis of nationally available data, for example information on inflation rates and patterns of local authority spending. One hundred and forty-five chief finance officers responded to the survey with a 37 per cent response rate.

# 2 | Economic challenges

**12** The country is facing a number of issues including higher inflation, falls in land and property prices, shortage of credit, lower growth and rising unemployment. This section considers how these are affecting local authorities.

## Higher inflation

**13** Since September 2007, inflation measured by the CPI has been higher than the government target rate of 2 per cent. It rose month on month from 1.8 per cent to a peak of 5.2 per cent in September 2008, the highest level since March 1992 (Ref. 5).

**14** There have been large increases in specific areas of expenditure, particularly those associated with the intensive use of energy. In the same period some other costs have fallen, as illustrated in Table 1.

**15** It is difficult to say what the overall impact of these cost changes has been on local authorities. The headline inflation rates (CPI or the retail prices index) are not good measures of how much local authority expenditure increases, as councils do not buy a full basket of consumer goods but rather tend to purchase heavily in certain areas. Additionally, around half of their expenditure is on staff costs. There is no standard measure of local authority inflation.

**16** The GDP deflator provides a broad measure of inflation in the UK economy. This is used by HM Treasury as its key inflation measure for assessing public sector expenditure in real terms. In 2008/09, the deflator is expected to rise to 3.25 per cent (Ref. 7) but fall back over the following years.

**Table 1**  
**Inflation rates October 2007 to October 2008**

	Inflation rate 2007 - 2008 (%)	Inflation rate April 2008 to October 2008 (%) <sup>1</sup>
Natural gas	51	31
Electricity	31	16
Food costs	11	7
Fuel	11	-3
Computing equipment	-21	-8

Source: Office for National Statistics

<sup>1</sup> These are not seasonally adjusted

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- 17** There is some evidence, however, that local government costs have been rising at a faster rate than overall inflation:
- The Director of the National Institute of Economic and Social Research has suggested (Ref. 6) that the cost of government consumption between 1997 and 2006 had increased by 1.4 per cent per annum more than the general economy.
  - According to the services producer price index (Ref. 5), waste service inflation ran at an average of 7.7 per cent over the past three years.
- 18** However, towards the end of 2008, general inflation appeared to be in rapid decline. In its 2008 *Pre-Budget Report*, the Treasury forecasted that CPI inflation in 2009 would be 0.5 per cent. The causes are evident from the fuel inflation in Table 1. The price level of fuels and lubricants increased by 10.4 per cent between April and July, then fell by 11.9 per cent from July to October. Prices are now below the level in April 2008.

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## Interest rates and shortage of credit

- 19** Interest rates have been high during 2008, although they have started to fall since October. Local authorities generally pay more in interest on loans than they earn in interest on deposits.<sup>1</sup> Usually both are linked to the bank rate so, in general, high interest rates would cost councils more in extra loan payments than they could make in investments, having a negative net effect on their finances. However, the turmoil in the financial markets throughout 2008 has produced an unusual set of circumstances, that have weakened the link to the bank rate, creating a brief period in which local authorities have been able to make windfall gains on their investments without seeing the interest on borrowings increase.
- 20** Borrowing from the Public Works Loan Board (PWLB) has not been affected in the same way by the shortage of available credit. The borrowing rates for local authorities were, in some cases, less than available interest rates on deposits.

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<sup>1</sup> In 2006/07, local authorities paid £2.75bn on borrowings, and earned £1.48bn interest on investments (CLG data).

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## 2 | Economic challenges

**21** PWLB interest rates have fallen sharply. For example, the variable short-term lending rate has fallen from over 5.5 per cent in January 2008 to less than 2 per cent in December 2008. Fixed rates have also fallen markedly. Local authorities will now have access to much cheaper funds than have been available for some considerable time.

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### Falls in property values

**22** Property and land values have fallen sharply,<sup>I</sup> and the volume of activity in the housing market is currently very low. Only half as many new build houses were started in the third quarter of 2008 as in the same period in 2007.<sup>II</sup> Local authorities rely on development in their areas which delivers additional income from Section 106 (s106) agreements<sup>III</sup> and from planning applications, and stimulates the local economy. If the shortage of credit, and falls in property values reduces the level of development, it will reduce local authorities' income. The impact on local authority income is covered later in this document.

<sup>I</sup> House prices fell by 8 per cent between September 2007 and 2008 in England and Wales. Source: Land Registry.

<sup>II</sup> Housing Association starts were up (4,790 compared to 4,000) but overall starts fell from 42,660 to 22,210. Source: CLG house building statistics.

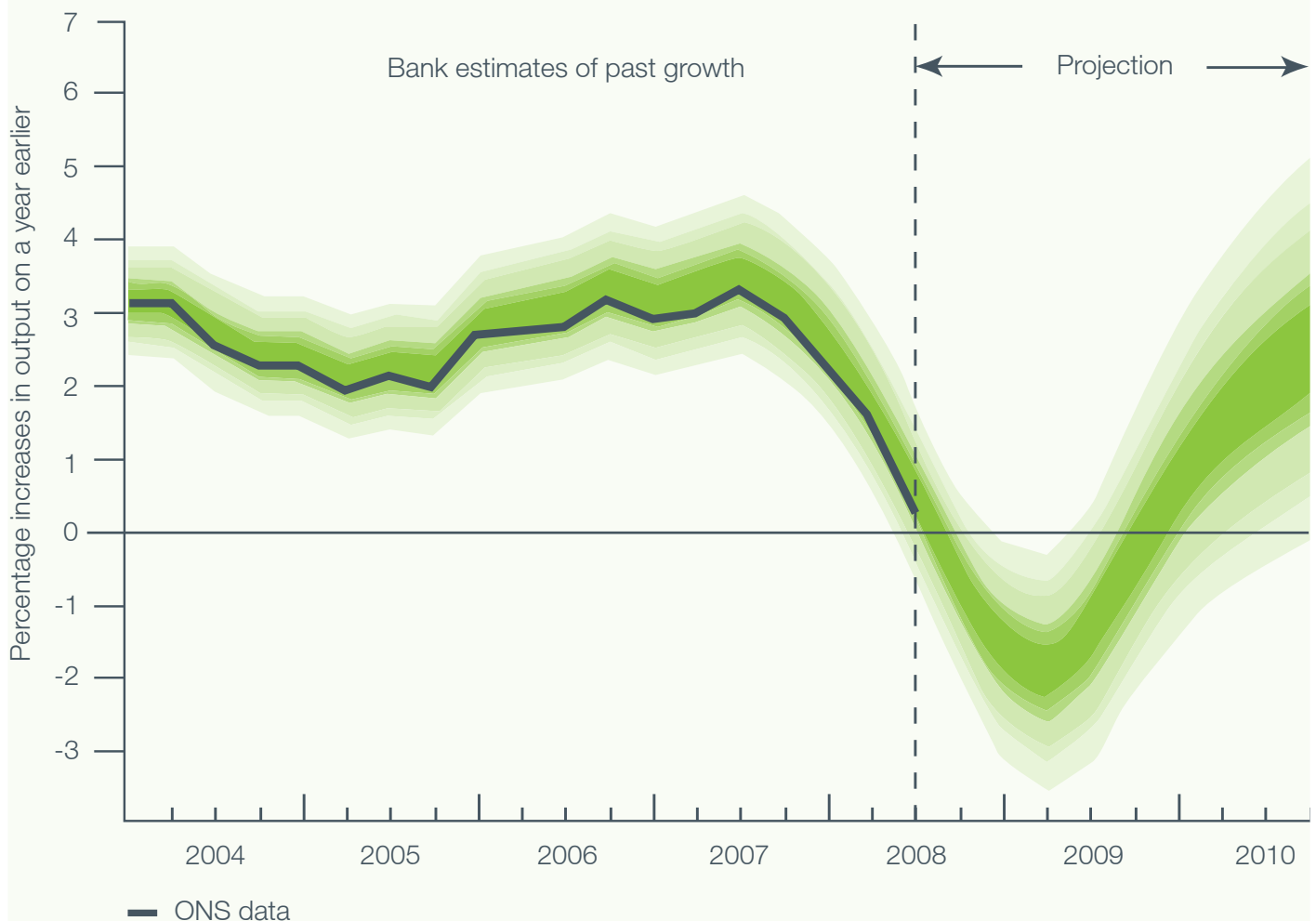
<sup>III</sup> Section 106 of the Town and Country Planning Act 1990. The guidance that planners use to discuss agreements states that 'Planning obligations (or 's106 agreements') are private agreements negotiated, usually in the context of planning applications, between local planning authorities and persons with an interest in a piece of land (or 'developers')'.

## Downturn in world economy – growth rates, UK economic change

**23** The UK has seen a period of consistent economic growth from 1992 to 2008. However, falls in UK growth are now predicted. Most forecasters are predicting a contraction in the UK economy of over

1 per cent in 2009 with different views on the speed of recovery. Figure 1 shows the latest forecast from the Bank of England (including a margin of error around the central forecast). Historically, in an economic slowdown local authorities see higher levels of demand for services such as benefit claims, social care and social housing. There may also be a risk of higher levels of fraud.

**Figure 1**  
The economy is forecast to contract in 2009/10



Source: Bank of England

# 3 | The Comprehensive Spending Review 2007

- 24** CSR 07 set out the details for all government spending for the years 2008/09 to 2010/11. It also introduced a revised efficiency regime.
- 25** The CSR was based on a number of assumptions about the economy that have proved to be optimistic for 2008/09, as shown in Table 2 and Appendix 1.
- 26** Clearly, much has changed since the CSR 07 was published. Inflation was much higher than expected in the first year but looks as though it will be much lower in subsequent years. Economic growth is much lower than previously forecast. Unemployment is higher and is now forecast to rise faster than anticipated over the review period.

## Local authority financial settlement

- 27** The largest source of income for local authorities is the grant they receive from central government. It represents around 75 per cent of an authority's total income. The overall level of this grant was set for the next three years for the first time in CSR 07 to give local authorities more certainty for their medium-term planning.
- 28** The settlement was less generous than in previous years, providing local government with an average annual increase of 1.4 per cent above the assumed level of inflation (2.75 per cent) across the CSR period.<sup>1</sup> This compares to real-terms increases of 3.3 per cent per annum in the previous spending review period and a 39 per cent real-terms increase in central government funding over the past ten years.

**Table 2**  
**CSR 2007 core assumptions**

	CSR assumptions for 2008/09	Current estimate for 2008/09 (Ref. 7)
Economic growth forecast	2.5%	-0.25%
CPI inflation forecast	2.25% for 2007/08, 2% thereafter	3.75%
UK claimant count (measure of unemployment)	Rising from 0.86 to 0.92 million by 2009	Rising from recent levels of 0.98 million to 1.41 million by end 2009
GDP deflator	2.75%	3.25%

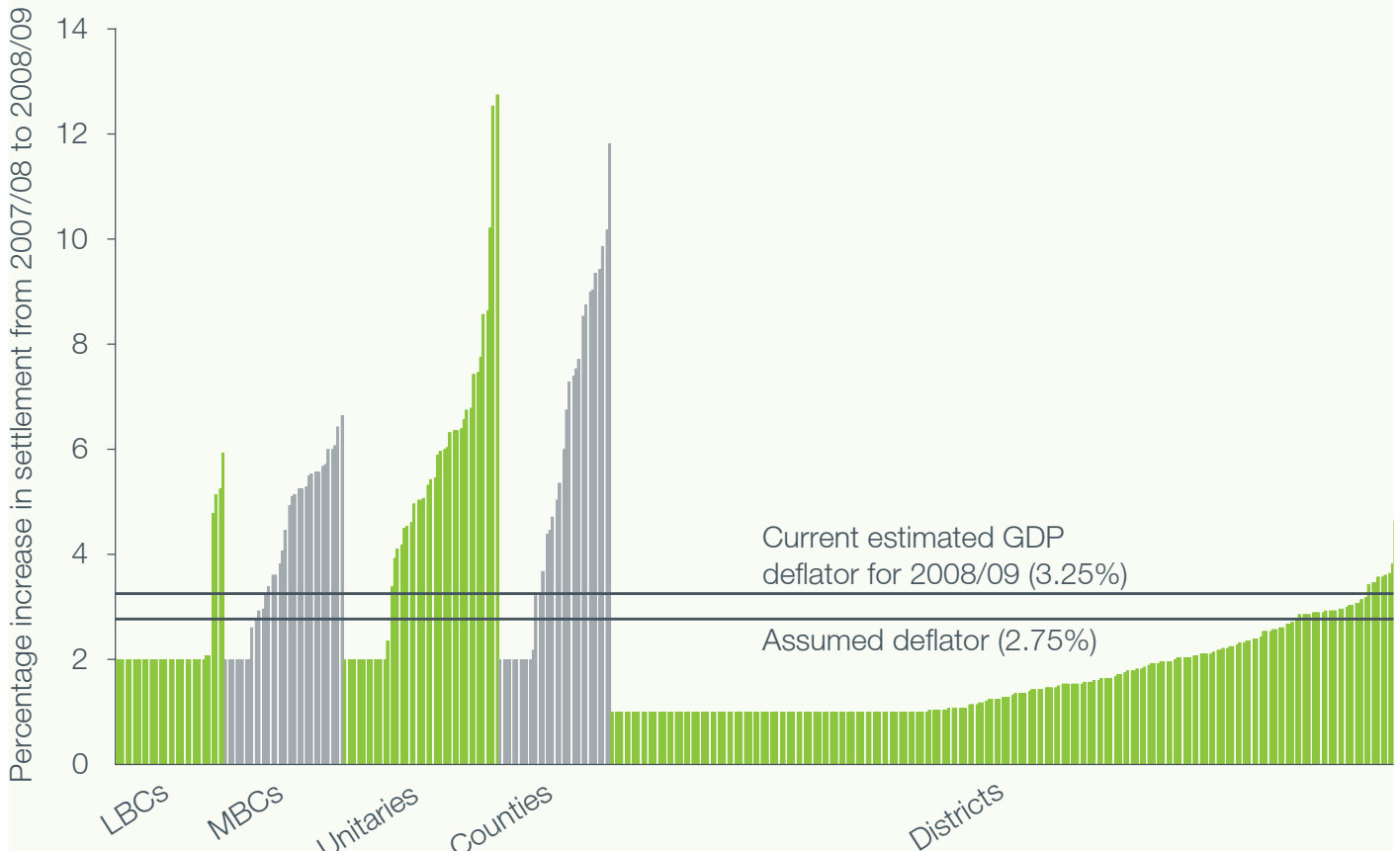
<sup>1</sup> Real terms changes of 1.2 per cent in 2008/09, 1.4 per cent and 1.6 per cent in 2009/10 and 2010/11 respectively, averaging 1.4 per cent each year over the three year period of CSR 07.

- 29** Whether an individual local authority received a real-terms increase for 2008/09 depended on:
- the amount it was allocated by the formula used to distribute the grant between authorities; and
  - the actual level of inflation it faced compared to the level of increase in grant allocation.

- 30** The government uses a formula to calculate how the government grant is shared between local authorities. It is designed to redistribute grant based on need, but this can result in large variations from the historic level of spending in a local authority. To avoid significant drops in income, a minimum level of increase is set. This is called the 'floor'. The flat sections in Figure 2 are the floor levels for each type of authority – 1 per cent for district councils, 2 per cent for all other types of authority.

**Figure 2**  
**Increase in individual authority formula grant allocation 2008/09**

Very few local authorities received a real-terms increase in funding.



Source: Audit Commission analysis of CLG data

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# 3 | The Comprehensive Spending Review 2007

- 31** Figure 2 shows that 270 authorities (70 per cent) received formula grant increases below the government's assumed inflation rate (2.75 per cent). There are differences by type of authority. Almost nine out of ten London boroughs and district councils received increases below the assumed level of inflation, compared to only a quarter of metropolitan districts. A small number of authorities received large increases.
- 32** The actual level of the GDP deflator for 2008/09 is forecast to be 3.25 per cent which is higher than the government's assumption of 2.75 per cent. Compared to this rate, 77 per cent of local authorities have received a below inflation increase.
- 33** This analysis demonstrates that even without the economic downturn, many authorities would be facing real-terms cuts in the level of their formula grant in 2008/09. The economic downturn has exacerbated the situation. The scope to make up any shortfall in income through council tax increases is constrained as it cannot rise by more than 5 per cent. Since council tax only makes up about 20 per cent of local authority income, even the maximum allowed increase would only produce 1 per cent more total income on average.
- 34** However, the picture for 2009 to 2011 is more positive. The predicted lower level of inflation for those years means that over the whole settlement period the real value of the grant may prove to be higher than expected.
- 35** The grant settlement from the government has been set until 2010/11, so this element of income is fixed. The next sections consider the impact of economic change on expenditure and locally controlled income, both in 2008/09 and the longer-term.

# 4 | Impact on local authority finances

**36** This chapter uses the results of an Audit Commission survey, in conjunction with data from local authorities and data in the public domain, to assess the impact of the current economic changes on local authority finances.

**37** The analysis separates the effects in the current financial year and the longer-term effects anticipated for 2009/10 and beyond.

## What is concerning chief finance officers?

**38** Chief finance officers were asked how concerned they were about a number of changes in the economy (see Table 3).

**39** Over 90 per cent of chief finance officers agreed, and most strongly agreed, that these were risk areas for local authorities. The biggest worries were higher inflation and falling land and property values.

**Table 3**  
**Areas of concern for local authorities**

	Strongly agree (%)	Agree (%)	Neither agree nor disagree (%)	Disagree/strongly disagree/don't know (%)
High inflation, in particular areas of spending	58	39	2	1
Falls in property and land values	54	37	6	3
Increased risks associated with investments	50	42	4	4
Slowdown in growth in the general economy	34	56	9	1

Source: Audit Commission survey of chief finance officers

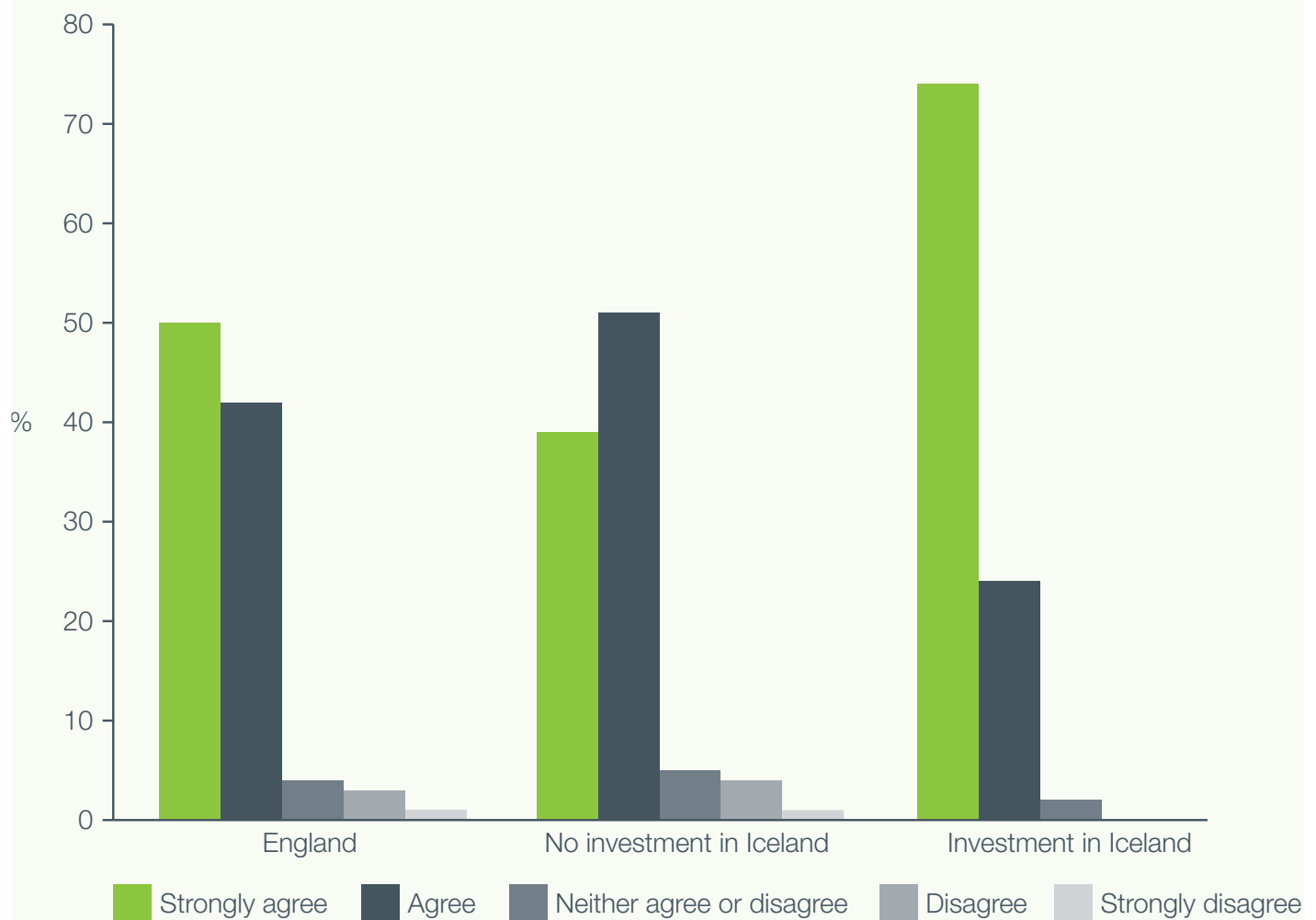
# 4 | Impact on local authority finances

40 Unsurprisingly, those authorities with deposits in Icelandic banks were particularly concerned about the increased risks associated with investments (see Figure 3).

**Figure 3**

## Level of concern over risks associated with investments<sup>1</sup>

Those with investments in Iceland were more concerned about the risks.



Source: Audit Commission survey of chief finance officers

<sup>1</sup> The questionnaire asked 'To what extent would you agree or disagree that the following are a concern to your local authority?' This question is the response to the option 'Increased risks associated with investments caused by the banking sector crisis'.

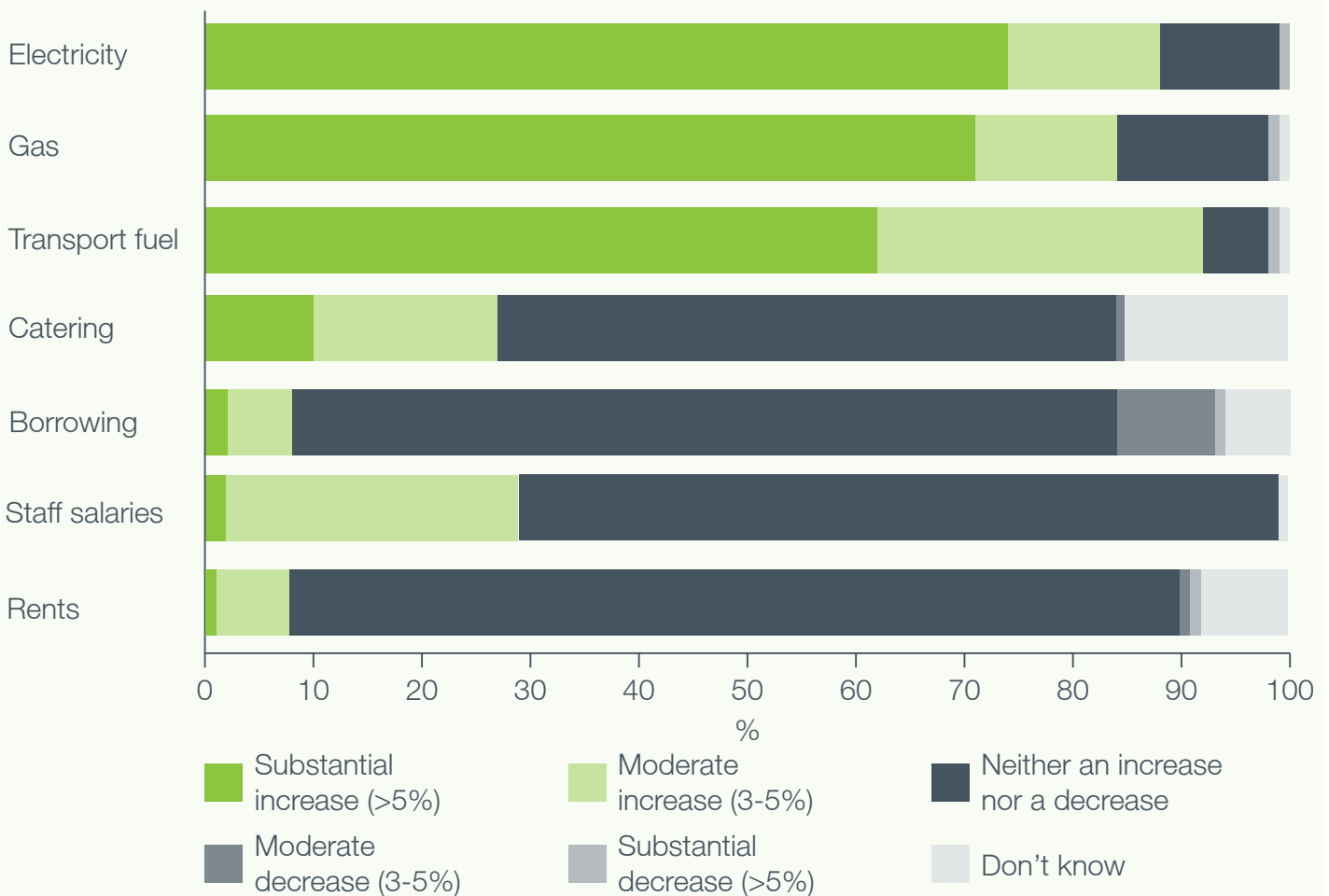
## Expenditure

**41** Inflation in certain key areas such as fuel, food and utilities has caused pressures for local authorities. These cost increases have an immediate effect in the current financial

year. Chief finance officers were asked to identify which areas of spending were increasing as a consequence of economic change, and to estimate the scale of the change (see Figure 4).

**Figure 4**  
**Proportions of councils reporting changes in spending – 2008/09**

Councils were most concerned about increases in the costs of energy and fuel. More than seven in ten councils have seen the cost of electricity rise substantially.



Source: Audit Commission survey of chief finance officers

# 4 | Impact on local authority finances

**42** The costs of electricity, gas and fuel have clearly increased for many authorities' – with over two-thirds reporting rises of more than 5 per cent. In other areas, such as staff salaries, rents and the cost of borrowing, costs have stayed about the same. What these changes mean for an authority's overall financial position depends on how much they spend in these different areas, and how large the cost increases have been. This is explored in the following section.

## Analysis of local authority spending patterns

**43** Table 4 estimates how local authority expenditure is comprised.

**Table 4**

### Analysis of local authority expenditure 2007/08

Almost half of local authority expenditure is on salaries; less than 2 per cent is on the areas that have seen significant cost increases.

Expenditure	2007/08 Council spending (£m)	% of total spending	Most common survey response on change in costs
<b>Total salaries expenditure</b>	<b>49,300</b>	<b>45.6</b>	No change
<b>Total premises expenditure</b>	<b>6,299</b>	<b>5.8</b>	
Of which - energy costs - electricity	570	0.5	>5% increase
Of which - energy costs - gas and other	322	0.3	>5% increase
<b>Total transport expenditure</b>	<b>2,555</b>	<b>2.4</b>	
Of which - vehicle running costs	278	0.3	>5% increase
<b>Total services and supplies expenditure</b>	<b>16,889</b>	<b>15.6</b>	
Of which - catering	822	0.8	No change
<b>Third party payments</b>	<b>25,951</b>	<b>24</b>	
<b>Other</b>	<b>7,066</b>	<b>6.5</b>	
<b>Total gross revenue expenditure</b>	<b>108,060</b>	<b>100</b>	
Spending on high inflation areas - gas, electricity, vehicle running costs (including fuel) and catering (including food)	1,992	1.8	>5% increase

Source: Subjective Analysis Return, Local Government Finance Statistics, Communities and Local Government

**44** This analysis allows us to put the description of cost changes in various areas into context. Local authorities spend almost half of their money on salary costs and a further quarter on payments to contractors for services provided. Less than 2 per cent of their spending is on the areas where costs have been rapidly increasing. However, large increases in relatively small areas of expenditure can still cause a financial problem – particularly if there are rises in more than one area, and the increases have not been anticipated.

## Electricity

**45** The cost of electricity rose by 17 per cent between April and October 2008 (see Table 1). Our survey confirmed that this was an issue for local authorities, with 74 per cent reporting overall rises of greater than 5 per cent. The cost of un-metered electricity, used by local authorities for street lighting, has risen by 40 per cent in one year (Ref. 21).

**46** Chief finance officers have reported the increases in costs in stark terms. One from a large metropolitan district council stated that ‘our electricity charges have doubled in the past three years’. The same authority reported that in the past six months ‘electricity prices have risen by between 18 and 30 per cent depending on the billing rate and size of premises’.

<sup>1</sup> Another county authority in the East of England has reported that electricity costs have increased by £1.1 million, with £250,000 spent on street lighting alone.

**47** Nationally, councils spent £570 million on electricity in 2007/08. The increase of 17 per cent so far in this financial year could potentially cost an extra £97 million, or over £250,000 per authority. However, despite the large rises in percentage terms, only around 0.5 per cent of total spending is on electricity.

## Gas

**48** Natural gas has seen the largest increase in the CPI of 31 per cent between April and October 2008, and 100 per cent since 2005 (Ref. 5). These increases are being felt by local authorities, with 70 per cent of chief finance officers stating that their gas prices have risen by over 5 per cent.

**49** Councils have been reporting big jumps in the cost of gas, as their long-term contracts come up for renewal. In an authority in the East Midlands the annual gas bill increased by 150 per cent – from £3 million to £4.5 million on renegotiation of its contract. Another authority in London reported in October that its gas bill for small sites (such as libraries, and social services centres) was likely to rise by 61 per cent, over £600,000, in 2008/09.

**50** Local authorities use less gas than electricity, but the cost increases have been higher. Nationally, £322 million was spent on gas in 2007/08. The increase of 31 per cent so far in 2008/09 adds a further cost pressure in 2008/09 of £100 million nationally, or £257,000 per authority. Again, this needs to be put in context. Only around 0.3 per cent of total local authority spending is on gas.

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## 4 | Impact on local authority finances

**51** The wholesale price of gas tracks the price of oil on the commodity markets. As the price of oil has been falling, the price of gas should also reduce in the short to medium-term.

### Transport fuel

**52** The cost of fuel rose by 12 per cent between April and July 2008, then fell by 12 per cent between August and October (see Table 1).

**53** The high inflation on fuel in the early part of 2008/09 has placed additional burdens on local authorities' finances. Over 60 per cent report increases of more than 5 per cent. County councils appear to be worst affected with more than 80 per cent reporting such high increases.

**54** Local authorities are reporting the impacts of these price rises in their budget monitoring statements. One county authority in the East of England has seen an increase of £300,000 in its children's services bill for transport to and from school. A metropolitan authority in the North East stated that its current transport fuel bill was £400,000 more than it had anticipated at the start of the year.<sup>1</sup>

**55** However, the oil price has fallen since October 2008 (see Appendix 2), and petrol prices have started to reduce. This will ease the immediate cost pressures. For the future much depends on the price of fuel compared to the level assumed in medium-term financial plans. One metropolitan authority in the West Midlands stated that, 'If prices remain at current levels [which were less than the peak rates over the summer] the cost pressure would still be around £1 million per year'.

### Food (catering)

**56** Food prices rose by 8 per cent between April and October 2008. The Local Government Association (Ref. 9) estimates that the cost of providing school dinners has increased by up to 15 per cent since October 2008, which would equate to an increase in costs of £80 million for England and Wales in 2008/09.

**57** However, chief finance officers are not seeing price increases at these levels. Only 10 per cent had seen increases in food costs of 5 per cent or greater, and over half (57 per cent) reported no increase. In many authorities the service areas in which catering costs might be a concern, such as school catering and adult social care, are contracted out. Where this is the case the increased cost of food falls on the contractor rather than the council. The impact of the food cost rises may yet be felt when contracts for outsourced services are renewed.

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## Cost of borrowing

- 58** Commercial interest rates have started to fall since October and are forecast to fall further following reductions in the Bank of England's base rate. This should mean that that borrowing costs for local authorities will be reduced. The benefits of this are not yet being felt, with 76 per cent of authorities reporting that spending on interest payments has stayed about the same.
- 59** As discussed in paragraphs 19 to 21, 2008/09 has been an unusual year in terms of the relationships between interest rates, income from investments and the cost of borrowing. The findings of our survey, and the views of case study authorities are that cheaper borrowing will not make up for the loss of the windfall gains on deposits.

## Salaries

- 60** Almost 50 per cent of local government spending is on salaries, but most authorities (70 per cent, see Figure 4) are reporting that salary costs have not contributed to the increased cost pressures. Local government workers received a pay award of 2.45 per cent with effect from April 2008, although the final settlement is subject to arbitration.

# 4 | Impact on local authority finances

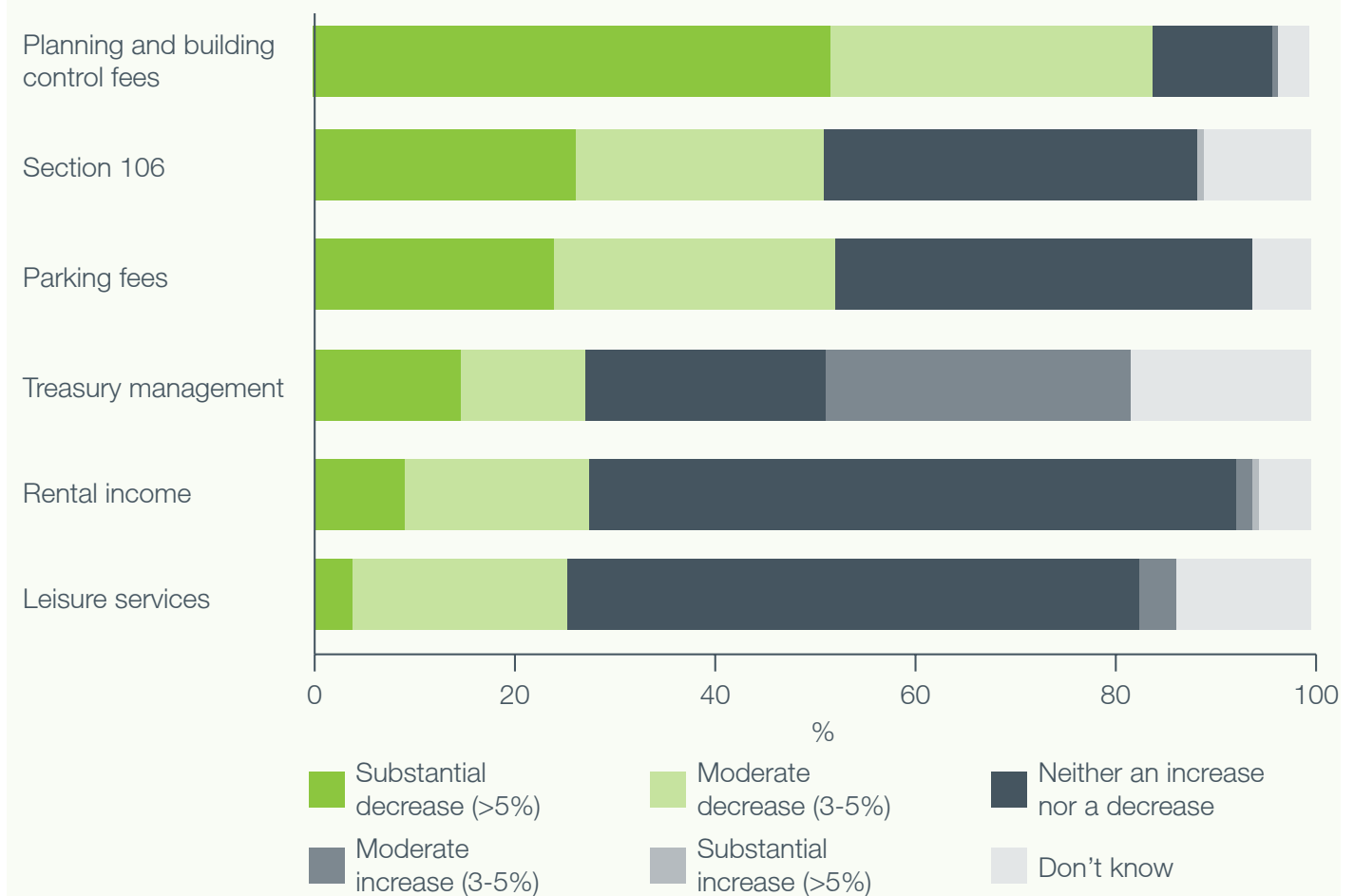
## Income

**61** In addition to the main sources of income, government grant and council tax, councils receive several other important sources of

capital and revenue income. Chief finance officers were asked to identify how income from a number of sources was changing as a consequence of economic change (see Figure 5).

**Figure 5**  
**Proportion of councils reporting changes in income – 2008/09**

The largest concern reported by councils is the reduced income from planning fees, with almost half reporting substantial falls.



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## Income linked to building and development

**62** The slump in the property market has both depressed the value of land and property, and reduced the level of activity. Over 80 per cent of authorities reported falls in development activity in 2008/09. Councils are concerned about this because it affects a number of their income streams, including income from planning fees, building control and s106 agreements.

## Level of private development and s106 income

**63** Local authorities work with private developers in determining planning applications. They can also negotiate agreements with them known as s106 agreements, which are used to provide public assets such as roads or schools. S106 agreements are an important source of income that is used to deliver benefits for the community, such as affordable housing or community facilities.

**64** The fall in land and property values has changed the underpinning economics of some development schemes, causing private developers to pull out of deals or to try to renegotiate terms. As a result, the income councils receive under s106 agreements appears to be falling significantly; income has reduced in over half of authorities, with a quarter reporting falls of more than 5 per cent (Figure 5).

**65** This was confirmed by the case study authorities. One unitary authority in the South West of England is expecting s106 income to be 80 per cent lower than its projected levels, with the loss estimated at £4 million.

**66** S106 income is also used by authorities to provide affordable housing. One recent report (Ref. 10) suggested that 'about half of the affordable housing supply in recent years has been provided under s106 agreements'. The reduction in private development and s106 could make it more difficult to meet increased demand for affordable housing in the forthcoming recession.

## Planning and building control fees and land charges

**67** The charges local authorities make from planning and building control fees are an important income stream; in 2007 local authorities received £243 million from planning fees alone (Ref 11).

# 4 | Impact on local authority finances

**Table 5**  
**Changes in income from planning fees**

Average income from planning fees in the first six months of 2008/09 fell by £12,000 (4 per cent) per authority.

Average planning fee income, and change, first two quarters 2007 and 2008				
	First two quarters 2007 average income (£000)	First two quarters 2008 average income (£000)	Change in income (£000)	Percentage change (%)
District	267	256	-11	-4
Unitary	448	426	-22	-5
Metropolitan borough councils	593	527	-65	-12
London borough councils	554	605	+51	+12
Average per authority	346	334	-12	-4

Source: Audit Commission analysis of CLG data

**68** The survey of chief finance officers painted a very clear picture of change in local authorities: 84 per cent said they had seen planning fees fall by 3 per cent or more; 52 per cent of respondents stated that they had seen planning fees fall by more than 5 per cent this view is confirmed by CLG figures on planning fee income illustrated in Table 5.

**69** These concerns were echoed by some of the case study authorities. One large metropolitan authority reported that, 'at this stage, the shortfall [in planning fees] is estimated to be approximately £215,000'. Another stated that, 'planning and building control are both down by nearly £100,000'.

**70** Although most authorities in England have reported falls in planning fee income, these losses are not uniformly spread.

The situation was worse for metropolitan borough councils. They saw an average fall of £65,000 – a 12 per cent drop. A fifth of all authorities, and 29 per cent of metropolitan districts, saw losses of more than 25 per cent. In some areas income continued to grow; London boroughs were the only type of authority to see an increase in income (12 per cent) from planning fees for the period.

**71** Income from land charges, usually paid as part of a house purchase, has also been falling due to the downturn in housing market activity. When asked to highlight any other areas where income had fallen, over a third of local authorities raised land charges. These figures, combined with the data around planning fees and s106, reflect the extent of reduction in development resulting from the current economic turbulence.

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## Parking fees

**72** For some local authorities parking fees make up an important income stream, especially smaller authorities in popular tourist localities. 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.

## Interest on deposits

**73** One positive effect of the economic downturn on local authorities has been the increase in the interest rates they can get on their deposits. Councils generate significant sums through investing surplus cash in the money markets. Chief finance officers confirmed in the survey that this income has increased in almost 40 per cent of authorities.

**74** Comments such as, 'short-term interest rates have benefited the council, worth approximately £400,000' and, 'the current economic climate has resulted in interest rates being higher than budgeted' were reported. One local authority in the South West has stated that, 'we assumed 5 per cent earned in 2008/09. Outturn is likely to be at least 0.5 per cent above this. So an extra £750,000 interest has been earned'. Another authority in the North stated that, 'we had budgeted for interest at 5 per cent, and it is currently 6 per cent. This is a difference in income of £1 million'.

**75** This is likely to be a short-term benefit as interest rates are now falling. Councils have benefited from the higher levels of interest receipts on their investments due to the ongoing differential between bank rates and the London Interbank Offered Rate (LIBOR). This is now narrowing.

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## Overall impact on accounts

### Expenditure changes

**76** The increases in the costs of gas, electricity and fuel have been significant, and have undoubtedly been difficult to manage within the current financial year (2008/09). However, as Table 4 shows, these items of expenditure represent less than 2 per cent of total spending, implying that the overall financial impact has been relatively modest.

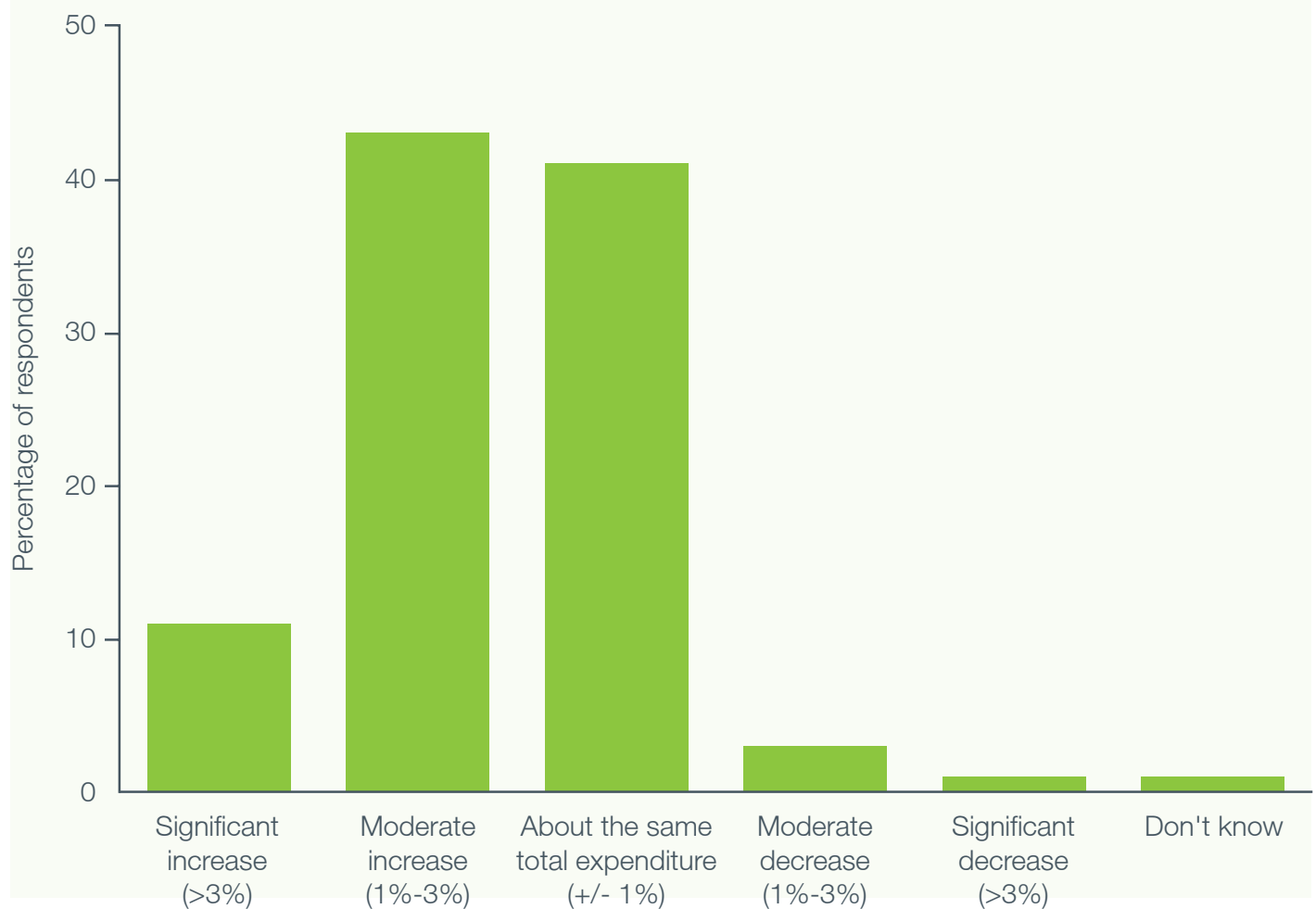
# 4 | Impact on local authority finances

**77** The consensus from the survey of local authorities is that for most, the economic downturn has left expenditure about the same (41 per cent) or has caused a 1 to 3

per cent increase (43 per cent) (see Figure 6). To put this in context, 1 per cent of local government expenditure is £1.25 billion.

**Figure 6**

**What, if any, increase or decrease have you seen in the level of total expenditure of your authority so far in 2008/09 as a direct consequence of economic change?**



Source: Audit Commission survey of chief finance officers

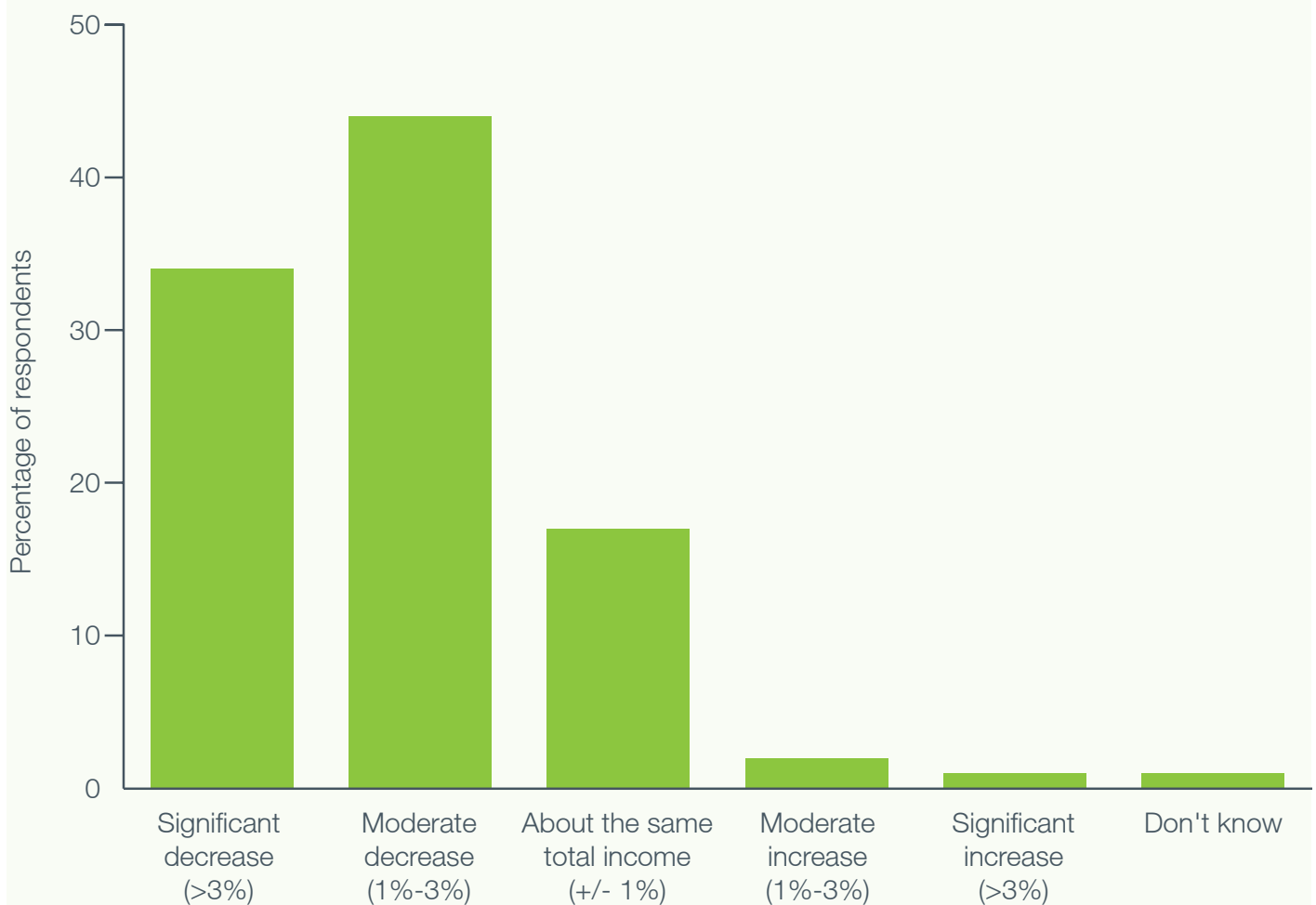
## Income changes

**78** A substantial part of local authority income – from government grants, business rates and council tax – is determined at the start of the year and does not vary. The remainder mainly arises from fees and charges, some

of which have fallen significantly. The overall impact on income, based on the views of chief finance officers in the survey, is that up to October 2008 the total had fallen – by 1 to 3 per cent in 44 per cent of authorities, and by more than 3 per cent in 34 per cent of authorities (see Figure 7).

**Figure 7**

**What, if any, increase or decrease have you seen in the level of total income of your authority so far in 2008/09 as a direct consequence of economic change?**



Source: Audit Commission survey of chief finance officers

# 4 | Impact on local authority finances

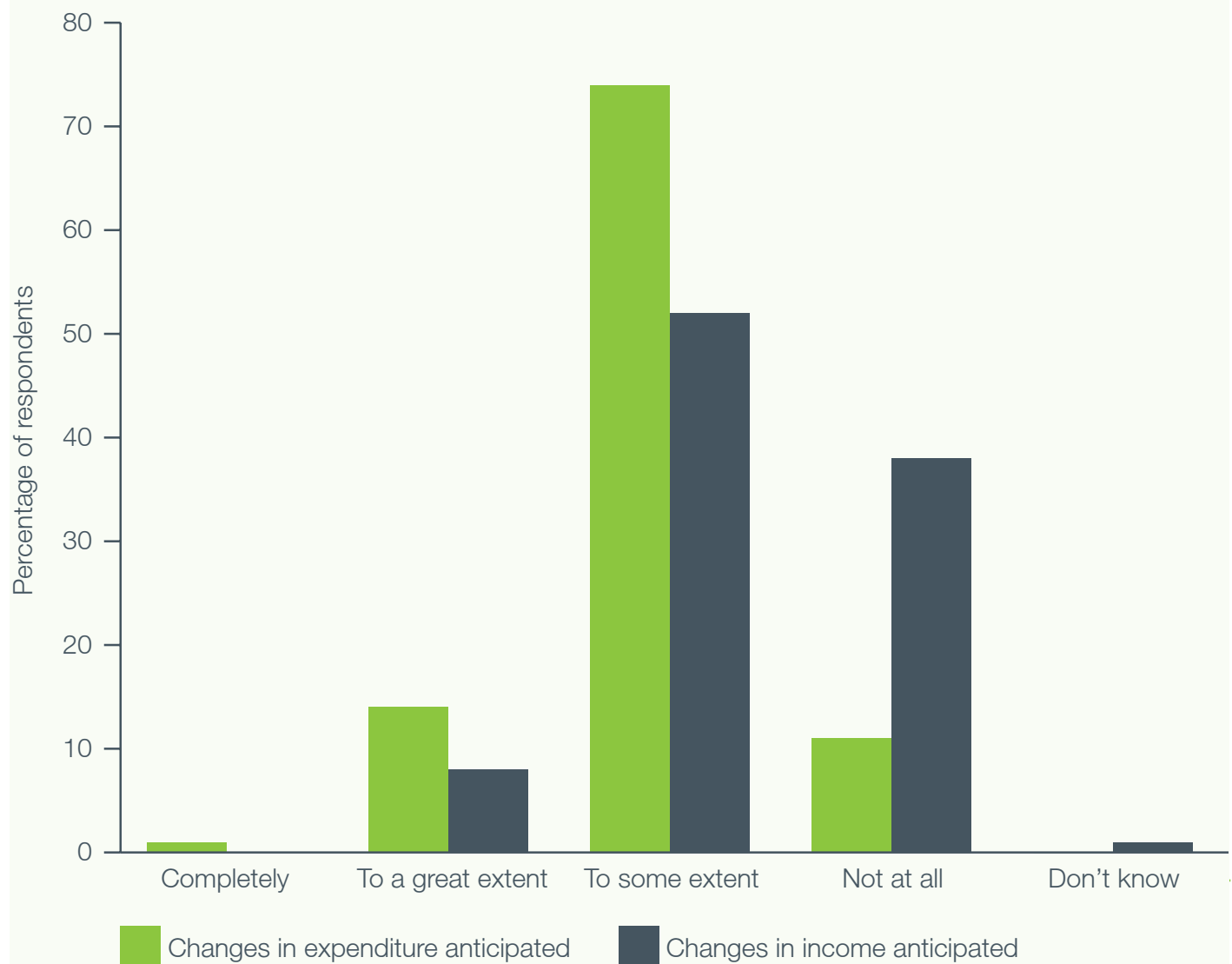
**79** These changes in income appear to have caught some authorities unaware, with 38 per cent not anticipating these changes in income. This contrasts with the picture for

expenditure, where local authorities seem to have been better prepared (see Figure 8).

**Figure 8**

## Had changes in income and expenditure been anticipated?

Local authorities were less prepared for the reductions in income than increases in expenditure.



Source: Audit Commission survey of chief finance officers

**80** Based on the most common response from local authorities (that the overall impact on local authority expenditure of the economic downturn was between 1 and 3 per cent) this would represent around £1.25 billion to £3.75 billion (Ref. 1) of extra spending nationally, with a similar fall in income.<sup>I</sup> This indicates that, without action to make savings in-year, there could be an overall shortfall in local authority accounts of £2.5 billion,<sup>II</sup> averaging around £7.5 million per authority. However, authorities are taking actions to offset cost pressures, and these are considered later in this report.

### Most local authorities are confident of coping in 2008/09

**81** Despite the cost increases and falls in income set out above, chief finance officers have expressed some confidence that the situation is manageable. Over half (55 per cent) are coping, but 45 per cent need to take significant steps to deal with the financial pressures (see Table 6).

**82** This variation in the reported severity of the situation may be because some authorities are better at managing their finances than others, or that the full effects of the economic changes have yet to be felt by all authorities. Another explanation could be that particular authorities have been more badly affected than others because of their particular spending or income profiles. For example:

- Some councils are more reliant on income from fees and charges than others. Some in tourist areas make significant sums from parking fees. District councils get more income from fees and charges than from council tax (Ref. 24).
- County councils, which tend to cover large, and sometimes rural areas, are more concerned about increases in fuel costs. More than four in ten authorities reported increases of over 5 per cent, compared to three in ten for all authorities (see Table 6).

**Table 6**  
**Financial position of local authorities in 2008/09**

Response	Per cent
Significant steps have been taken or are planned to address financial pressures	45
Some cost pressures, but can be managed without the need for significant remedial action	49
No serious financial pressure	6

Source: Audit Commission survey of chief finance officers

- I** Based on the same assumption, in other words using the most common response from the survey which was a 1 to 3 per cent decrease in income.
- II** This is based on an assumed shortfall of 2% on income, and 2% on expenditure (the mid point of the most common responses in the survey ie 1–3%) and an annual income and expenditure of around £125 billion. These income falls and expenditure rises were reported for the first six months of 2008/09, so this figure represents the half-year effect.

## 4 | Impact on local authority finances

**83** Of the authorities that are taking significant steps to address financial pressures, two-thirds are still confident that they can manage the situation (see Table 7).

**84** The majority of local authorities either do not have a significant problem or are confident they can take the remedial action needed to balance the books by the end of the year. However, a small number of authorities (nine survey respondents, which could equate to around 20 nationally) feel that they need to take significant steps but are unsure or very unsure that they will succeed.

**Table 7**

### Confidence of dealing with financial pressure

Most of those who need to take significant steps are confident they can cope.

To what extent do you feel confident you can take measures in-year to deal with any negative effects of the economic situation on your finances?	Percentage of the 45% who needed to take significant steps (see Table 6)
Very confident	8
Confident	59
Neither confident nor unsure	19
Unsure/very unsure	14

Source: Audit Commission survey of chief finance officers

## How are local authorities responding to in-year pressures?

### Actions taken to address cost pressures

**85** A number of options have been taken by local authorities, or are planned, in order to make ends meet in 2008/09 (see Table 8).

Local authorities typically use a combination of options, such as:

- providing less – through service cuts;
- providing the same at less cost – for example, by reducing consumption of fuel or cutting staff;

**Table 8**  
**Local authority responses to cost pressures**

Responses to cost pressures	Percentage taking action	Percentage with plans in place	Percentage who have taken action and plan further action	Total who have and/or plan to take action (%) <sup>1</sup>
Recruitment freeze across authority	16	11	0	28
Recruitment freeze in specific departments/staff groups	25	17	3	46
Redundancies across authority - voluntary	9	8	2	20
Redundancies across authority - mandatory	4	2	1	7
Redundancies in specific departments/staff groups - voluntary	10	7	5	21
Redundancies in specific departments/staff groups - mandatory	3	2	2	7
Efforts to reduce transport fuel consumption	30	20	2	52
Efforts to reduce gas consumption	34	20	4	58
Efforts to reduce electricity consumption	35	23	4	62
Compensatory savings elsewhere	27	11	4	42
Service cuts	11	6	0	16
Increased fees and charges	17	13	2	32
Use of reserves	33	25	3	61

Source: Audit Commission survey of chief finance officers. This question was answered by 122 local authorities.

<sup>1</sup> Columns may not sum due to rounding

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## 4 | Impact on local authority finances

- charging more – increasing fees and charges; or
- using their reserves.

**86** Authorities are employing a number of different strategies, many linked to staffing such as recruitment freezes, or redundancy. The *Municipal Journal* (Ref. 12) recently listed ten authorities in the UK that have announced staff cuts. Our survey found that 14 per cent had made, or plan to make mandatory redundancies.<sup>1</sup> This

equates to approximately 50 authorities. Higher numbers were considering voluntary redundancy. More than two out of five authorities had taken action or have firm plans in place to make voluntary redundancies. Authorities stated that they were planning reviews of recruitment or to make savings through leaving posts unfilled. One authority was planning to hold all posts vacant for three to four months, and another was to offer early retirement to all staff over 55 years old.

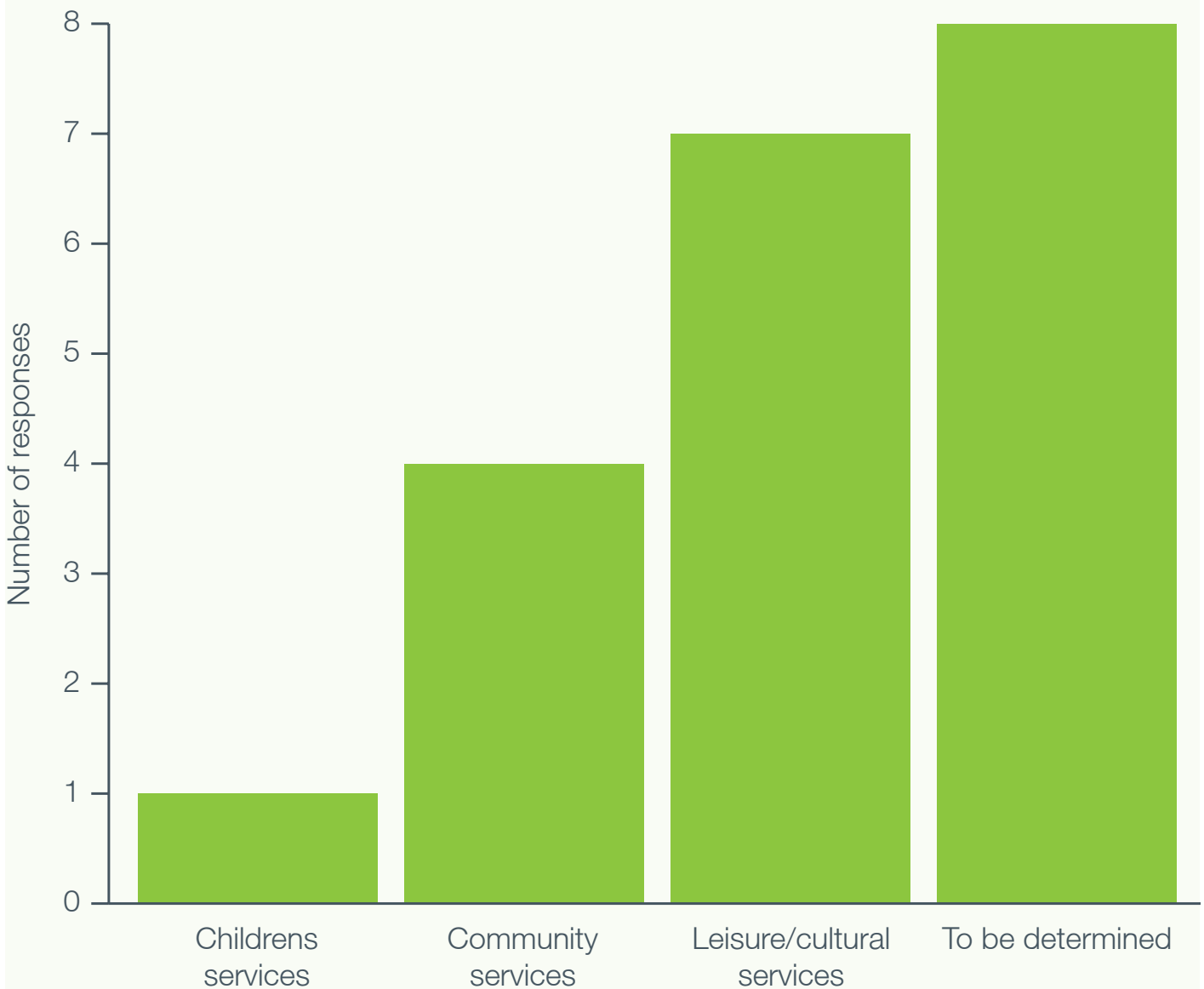
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<sup>1</sup> Total of those who have and/or plan to make mandatory redundancies across the authority and those who have and/or plan to make mandatory redundancies in specific departments/staff groups.

**87** Eleven per cent had made service cuts, and 6 per cent were planning service cuts. Chief finance officers were asked to identify up to

three areas where service cuts were likely to take place. Some common themes emerged (see Figure 9).

**Figure 9**  
**Most common services identified for cuts**



Source: Free text responses to Audit Commission survey of chief finance officers base of 44 responses

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## 4 | Impact on local authority finances

**88** The main area highlighted was cultural and leisure services, including art galleries, tourism and sports development. A survey (Ref. 13) published in April 2008, found that 50 per cent of local authorities would cut sport and leisure services if they needed to save money.

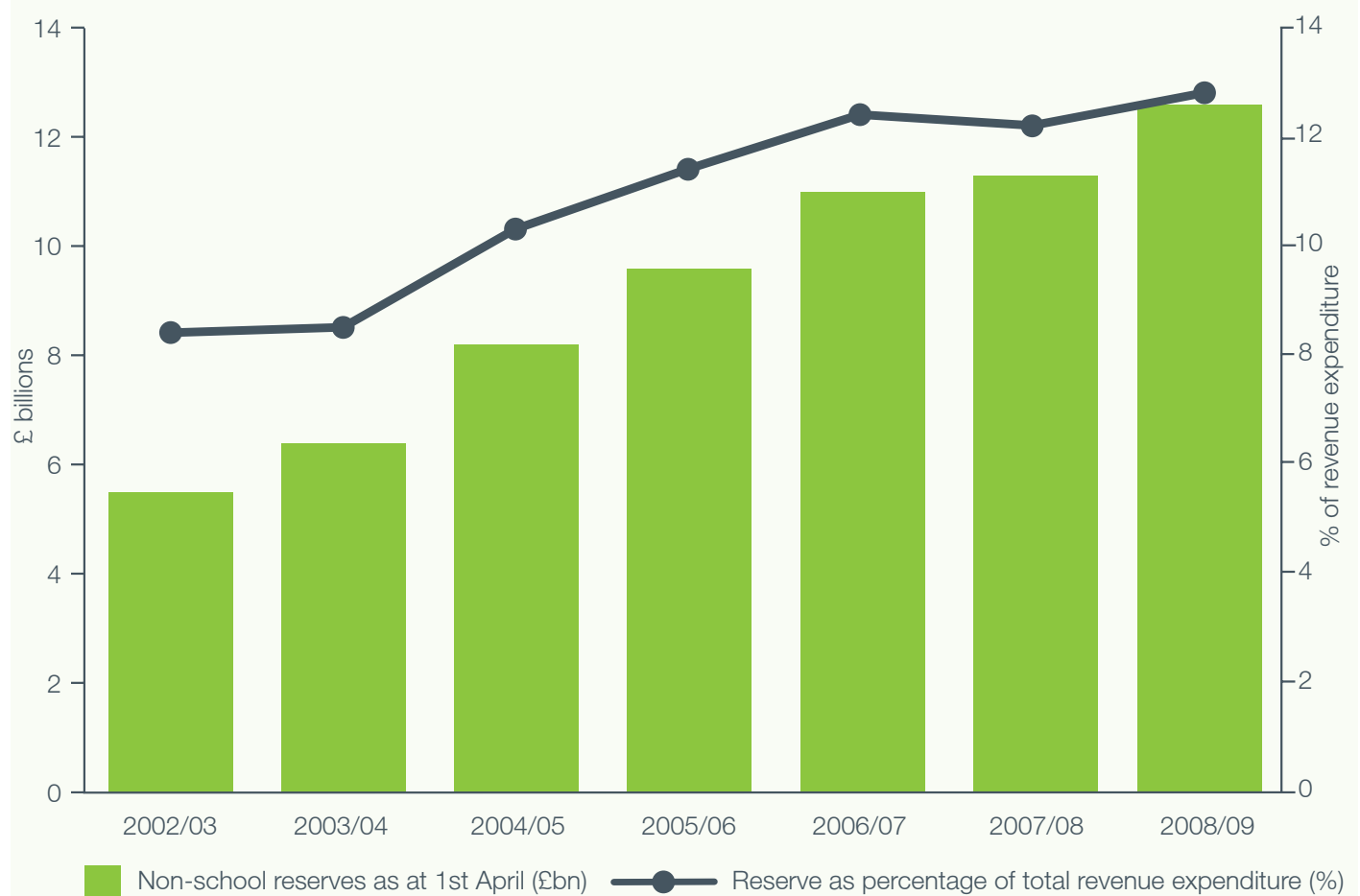
**89** Many chief finance officers were planning to meet some of the costs through improved efficiency, for example through better procurement and minimising floorspace. The additional income from invested deposits has been used to make up shortfalls in other budgets.

**90** Local authorities have reserves that can be used to cushion the blow of unexpected events. The level of these reserves has more than doubled in recent years – from £5.5 billion in 2002 to £12.6 billion in March 2008 (see Figure 10). Local authorities now have

around 13 per cent of annual expenditure in reserves compared to 8 per cent in 2002/03.<sup>I</sup> Over 60 per cent have used or are planning to use reserves to maintain spending levels.

**Figure 10**  
**Local authority reserves 2002/03 to 2008/09<sup>II</sup>**

Reserves have been increasing and now stand at 13 per cent of revenue spending.



Source: *Local Government Finance Key Facts: England 2008*, Communities and Local Government

<sup>I</sup> Ref 2 – reserves figures page 5, revenue expenditure figures page 3.

<sup>II</sup> Ibid.

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# 4 | Impact on local authority finances

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## Overall impact on the financial position in 2008/09

**91** There are a number of indications that the situation for local authorities is worsening including:

- potential shortfalls in local authority accounts are being widely reported in the local and national press;
- the costs of gas, electricity and food increased by 7 to 31 per cent between April and October 2008, although the cost of fuel has fallen by 3 per cent (see Table 1);
- some sources of income such as planning fees, and s106 have fallen significantly;
- demand for some services has started to increase as a result of the economic slowdown; and
- local authority finance chiefs are reporting increases in their costs of 1 to 3 per cent and falls in income of a similar level.

**92** But there are also some grounds for optimism:

- Less than half of chief finance officers feel the situation is serious enough to require major steps. Of those that do, two-thirds are confident they can manage the situation.
- Although the percentage increases in the costs of gas, electricity, food and fuel have been significant, authorities spend less than 2 per cent of their budgets on these items.

- Increased income from investing deposits, due to higher interest rates, has offset some of the cost pressures.
- Inflation is predicted to reduce significantly in 2009/10 to levels below that assumed when the local government settlement was determined. This will ease the financial pressures arising from cost increases.
- Most local authorities are taking the action needed to bring costs back into line, even though this has, in some cases, involved decisions to cut staff and services.
- Many local authorities have enough reserves to cushion the blow of higher costs and give them some flexibility to manage in-year pressures.

**93** Overall it seems that it has been a difficult year, but most authorities expect to cope. There are, however, a minority (estimated at around 5 per cent) who face serious problems and do not feel confident that they will be able to address them.

**94** There are also concerns about the full impact of the coming recession and how this will affect demand for services and finances for 2009/10 and beyond. This is explored in the following section.

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# 5 | Longer-term challenges

**95** The economy is heading for a recession, and almost certainly higher unemployment. When people are struggling, more of them turn to local and central government for help. Increased demand for services will mean increased costs. Local authorities have recognised these trends, and most (87 per cent) have revised their medium-term financial plans.

**96** But balancing the books during a recession is only part of the answer. Local authorities can also take a proactive role in helping their areas get through the downturn.

**97** This section identifies the issues that concern local authorities. It discusses the financial pressures, the potential for local authorities to promote economic development and the greater efficiencies that will be required.

# 5 | Longer-term challenges

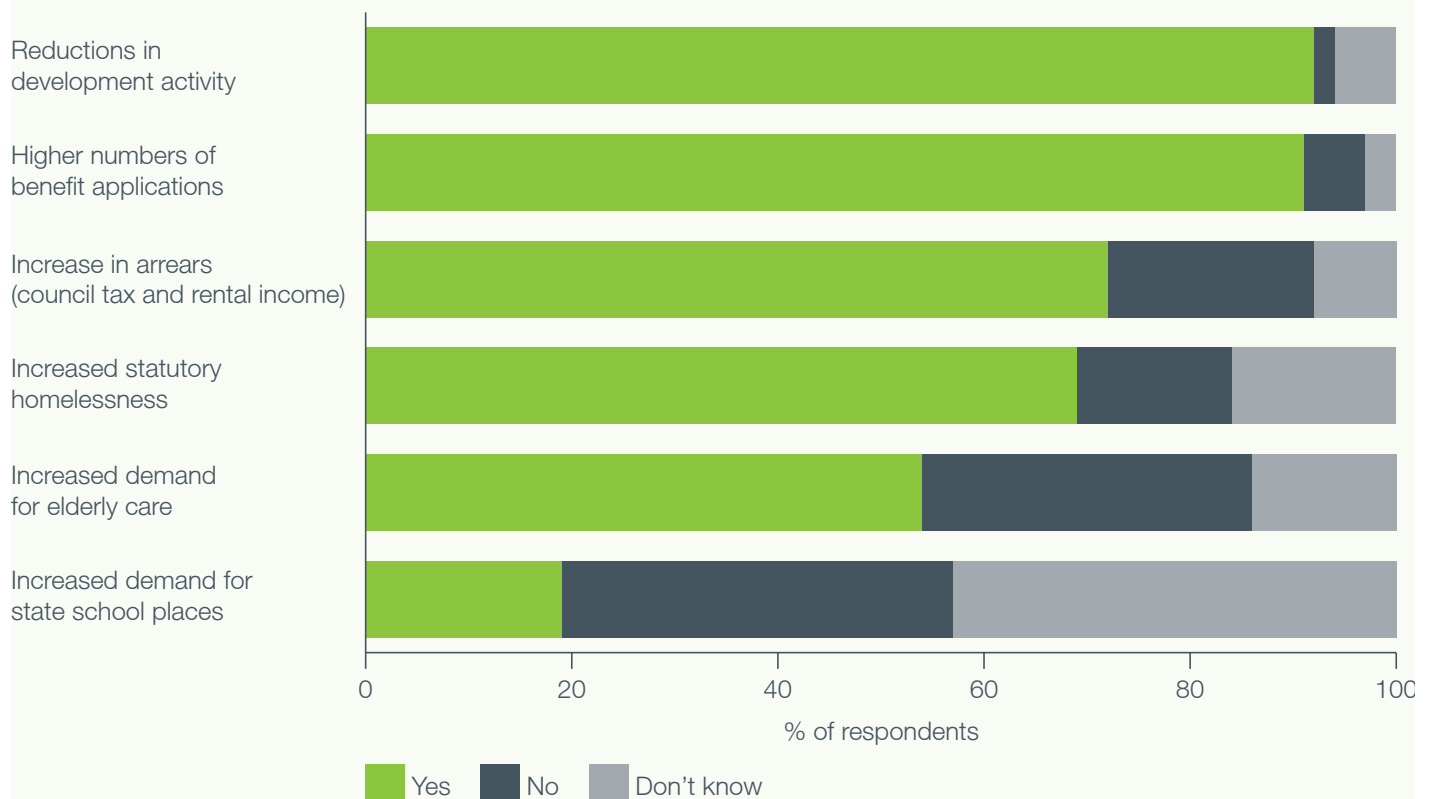
## Financial pressures in 2009/10 and beyond

**98** In 2008/09 the cost pressures mainly arose from higher inflation and the impact on income of the fall in property values. In 2009/10 inflation is likely to fall, but demand for services may increase as the recession begins to bite. Chief finance officers are concerned about a number of areas (see Figure 11).

**99** The impact of the recession on income derived from fees and charges is uncertain. It will depend on a number of factors including the ability of residents to reduce their use of a service and the nature of the service for which the charges are made. For some authorities, mostly district councils, charges are a bigger contributor to income than council tax. These authorities may be more adversely affected than others by falls in fees and charges.

**Figure 11**

**Are you anticipating any significant changes in demand in the following areas as a direct consequence of the current economic climate?**



Source: Audit Commission survey of chief finance officers

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## Reduced development

- 100** Reduced development generates less income for the authority and affects the economy of the area. The survey found that 84 per cent of authorities had seen falls in the level of development activity in 2008/09. They were even more pessimistic for 2009/10, with 92 per cent predicting further reductions (Figure 11).
- 101** One authority has recently had to postpone making a decision on investment in a development project in the area, because of the current economic position. Another large metropolitan district council reported that half of the deals with developers currently in the pipeline have had to be renegotiated with a projected loss of £2 million.
- 102** Less development could mean:
- a decrease in capital receipts: as developers pull out of deals to buy land, and council houses purchased by residents under the Right to Buy scheme reduce in value;
  - less new affordable housing, which is often provided as part of a bigger development of private properties; and
  - lower income from s106 as deals with developers are renegotiated or terminated. In some cases planned projects will have to be completed or carried out without expected developer contributions, which may mean additional local authority funding is required.

## Benefit claimants

- 103** Unemployment is likely to increase; recent estimates suggest that 1.4 million people could be unemployed in 2009. Local authorities administer housing benefit and council tax benefit. The demand for these is likely to rise in the medium term.
- 104** Over 90 per cent of all responding authorities were forecasting higher numbers of benefit claimants in 2009/10 (Figure 11), and some were already experiencing an increase. One metropolitan authority in the North reported that there has been an increase in benefit claimants of 6 per cent in 2008/09. Another authority from the South East reported that its caseload had increased by almost 5 per cent in just six months.
- 105** Several authorities had observed an increase in the number of unsuccessful applications, as well as an increase in the number of claimants. Unsuccessful applications resulted in additional processing work for an authority that is not reflected in the benefit claimant figures. While the cost of the benefit is covered by a specific government grant, an increased caseload increases administration costs.

# 5 | Longer-term challenges

## Increased council tax and rent arrears

**106** Almost three-quarters of councils are anticipating increases in council tax and rent arrears as the recession and rising unemployment affects household incomes. A higher level of arrears reduces income and increases the administration and legal costs associated with pursuing the arrears.

**107** Rental income from commercial properties could also be affected. A large metropolitan authority in the North had reported that its industrial units and enterprise workshops are currently forecasting a deficit of £207,000. This is primarily due to higher than expected numbers of vacant units in industrial estates.

## Homelessness and housing

**108** Increases in unemployment, coupled with a fall in the value of housing will combine to increase the number of people losing their homes. Some of these will be eligible for local authority support under

homelessness legislation. Mortgage arrears and repossessions in the second quarter of 2008 were already considerably higher than in the same period in 2007 (Table 9). While a number of the repossessions were from those who had buy-to-let, these may still result in tenants losing their homes.

**109** Central government made a commitment to reduce homelessness in 1999, and a commitment to halving the numbers of people accepted as homeless who are waiting in temporary accommodation by 2010 (Ref. 14). The achievement of these targets is likely to be affected by the economic downturn.

**110** Local authorities have a responsibility to provide housing for those who become statutorily homeless, and many authorities are concerned about this issue. A third of authorities have already observed increases in homelessness; two-thirds are predicting higher homelessness in 2009/10.

**Table 9**  
**Increases in mortgage arrears and repossessions 2007- 2008**

	Second quarter 2007	Second quarter 2008	Change 2007/08 (%)
Over six months in arrears (UK)	51,000	68,000	+32.4
Mortgage repossessions (UK)	13,000	19,000	+47.7

Source: CLG Private Sector housing live tables, November 2008.

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- 111** 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.
- 112** 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.
- 113** Housing and homelessness present significant challenges to local authorities, but there may be some positive aspects of the slowdown:
- A number of homes built for shared ownership are being converted into social homes for rent and are being let to those with no prospect of entering the market. The properties are typically being let because of the difficulty in selling shared ownership properties while house prices are falling. This change may cause problems for those associations relying on significant sales.
  - The collapse in overall house prices and sales has led to an increase in the number of properties in the private rented market, as potential sellers turn to renting. In a number of areas rents are starting to fall. This may provide opportunities for ongoing mobility in the market while credit flows are restricted.
  - The pressures on the market will require local authorities, associations and developers to work more proactively together and to forge genuine partnerships to fulfil the local area agreement (LAA) targets. Two thirds of areas have included housing targets in their LAAs.
- 114** The medium-term impact of the downturn on the amount and location of new social housing is uncertain. The funding for many current developments by housing associations<sup>1</sup> is based on an assumed percentage income from selling a proportion of the homes, either for shared ownership or on the open market. Expected profits will not now be achieved. This is affecting the financial position of developing housing associations and may make it harder for some to borrow in future in order to start further new developments.

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**1** Housing associations that have development partner status with the Homes and Communities Agency and receive funds to build social housing under the National Affordable Housing Programme.

# 5 | Longer-term challenges

**115** Central government has taken steps to try to reduce the impact that the current slowdown is having on the housing markets. Schemes worth £400 million to deliver an additional 5,500 homes, including social homes, have been brought forward (Ref. 15). The government has also agreed to spend £200 million to help homeowners and landlords through shared ownership and buy-rent-back schemes (Ref. 16). It is too soon to say how effective these measures will be.

## Elderly social care

**116** 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.<sup>117</sup>

**117** 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.

## Increased demand for school places

**118** This recession started in the financial sector, and has affected many higher income households. Some councils are reporting early signs that this may be having an effect on the private education sector.

**119** Our survey reported small numbers of local authorities (9 per cent) that have already seen increased demand for state school places for children who had previously attended private schools. 19 per cent were anticipating this effect for 2009/10.

**120** This issue has been most keenly felt in London, with four of the 13 London boroughs that responded to the survey (31 per cent) already experiencing higher demand for school places in 2008/09, and 38 per cent planning for increases from 2009/10.

## Risks to contractors and suppliers

**121** All local authorities depend, to a greater or lesser extent, on the private sector to provide direct services to the public; to provide back office functions or to act as suppliers. Therefore, councils are at risk if major local suppliers, contractors or partners get into financial difficulty as a result of the economic downturn.

**I** Ref 17 and 18. Also the Association of Directors of Adult Social Services President, John Dixon, has said that 'all the pointers are showing red alert' and that 'Adult Social Services Departments were warned... to brace themselves for 'significant and substantial' increases in the number of people being referred to them during the coming year'.

**122** Many front-line services such as school meals and elderly care are provided by private firms under contract to the local authority, and many contractors will have been affected by the economic downturn. Fuel and food costs may have risen above the levels assumed when contracts were agreed. Also the value of recyclable materials has fallen sharply which could affect waste contractors.<sup>I</sup> The impact of the recession on the cost of contracted services is hard to assess. Price increases could have reduced the margins for contractors, resulting in higher tenders when contracts are re-let, or even bankruptcy. However the greater competition for work in a tougher economic climate could result in a better deal for councils.

**123** There are risks to councils if major suppliers or partners go out of business. This is already happening, with private sector developers renegotiating or pulling out of deals with the councils. The shortage of credit is also affecting some Private Finance Initiative (PFI) deals.<sup>II</sup>

**124** Local authorities should be actively assessing the risk to services if this occurs and ensuring they take steps to mitigate those risks.

**I** Prices for recovered paper fell sharply in November, with mixed paper and board falling by 100 per cent. The price obtained for recovered bottles of all types fell sharply in November, with mixed plastics falling by 62 per cent WRAP (Source: Waste and Resources Action Programme).

**II** The treasurer of Manchester Waste Authority wrote in Public Finance magazine (14 November 2008) that ‘the current turmoil within the financial markets has alerted the authority to potential difficulties for the preferred bidder in securing the full amounts required to financially close the PFI contract.’

**III** Forecast GDP deflator for 2009/10 from *Pre-Budget Report*, November 2008.

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## Overall picture on financial pressures in 2009/10

**125** Local authorities are bracing themselves for an increase in demand for services and the extra costs this will entail.

**126** However, there are some positive messages for local government finances. The economic picture for the first six months of 2008/09 was one of high inflation, high interest rates and turmoil in the financial markets. These factors combined to make 2008/09 a difficult year for local authorities. But the economy is now moving towards lower inflation and lower interest rates, which means that:

- The settlement for 2009/10 will be worth more in real terms than was assumed when the CSR 07 was announced. It will increase by 4.2 per cent, while inflation for 2009/10 is forecast to be 1.5 per cent.<sup>III</sup>
- Lower inflation will ease cost pressures on budgets. Some costs may reduce - for example the cost of fuel has fallen by 11.9 per cent between July and October 2008. It is now lower than in April 2008.
- The cost of borrowing will fall, although for some authorities this may be offset by reduced income from deposits.

# 5 | Longer-term challenges

**127** It is difficult to predict how significant the increases in demand will be, and whether these will seriously stretch local authority finances. This will depend on how badly each area is affected by the recession.

## Local authority role to promote economic development

**128** Local authorities are not simply victims of the economic downturn. They have a role in helping their area to cope, and in encouraging recovery. There are a number of powers and responsibilities they can use:

- a role, with partners, to deliver benefits to an area through the local strategic partnership;
- planning and development control powers;
- a role in delivering regeneration projects, often with other partners such as the regional development agencies; and
- the well-being power (Ref. 4), which allows authorities to do anything they consider likely to promote the economic, social and environmental well-being of their area, short of raising taxes.

**129** There are plans to extend the role of local authorities:

- The Sub-National Review of Economic Development and Regeneration envisages local authorities taking a more proactive role in economic development. This is being taken forward in legislation through the Local Democracy, Economic Development and Construction Bill (Ref. 25).

- There is a duty on local authorities to undertake an economic assessment of their area.<sup>1</sup>
- More recently, central government laid out its expectations for local authorities within the CLG *Framework for Regeneration* (Ref. 19). The government expects that local authorities will: **‘Lead the delivery of economic development, and physical and social regeneration in their areas, marshalling the input of all partners within the priorities set out in this framework, and shaping and playing a role in delivering regional strategies.’**
- The interim report of the Tackling Worklessness Review (Ref. 27) envisages a bigger role for local authorities in addressing worklessness.
- Local authorities have new powers related to 16-19 education (Ref. 23). They will be responsible for offering a range of options up to the age of 19, including A-levels, GCSEs, and apprenticeships.

**130** In addition to these roles and responsibilities, local authorities have purchasing powers. They play an important role in their local economies as both employers and purchasers of goods and services. The decisions that a council makes about spending can have a significant impact on local economies and labour markets. The Tackling Worklessness report states that, ‘the public sector as a whole should also be doing more in their role of significant local employers and procurer of services.’ (Ref. 27)

**I** Government response to Prosperous Places: Taking forward the Review of Sub–National Economic Development and Regeneration.

**131** Local authorities should, through the exercise of these powers, be proactively considering the actions they can take to promote recovery.

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## The efficiency challenge

**132** The 2004 Spending Review made improving efficiency a priority and introduced the Gershon target<sup>I</sup> which required 2.5 per cent efficiency savings across all government spending, with half being cashable.<sup>II</sup> The aim of this target was to release money to support frontline services. Settlements were not based on the assumption that these savings would be made, so any savings made could be regarded as new money.

**133** The CSR 07 was more challenging in the push for increased efficiency, and introduced:

- an increase of the efficiency target to savings of 3 per cent, all cashable;
- a change to the definition of efficiency savings to those which are achieved without any reduction in the quantity or quality of service; and
- the inclusion of efficiency targets in the calculation of the settlements. This means that efficiency savings are required not just to finance additional activities, but to deliver mainline programmes.

<sup>I</sup> Those savings proposed as a consequence of Sir Peter Gershon's report *Releasing Resources for the Frontline: Independent Review of Public Sector Efficiency*.

<sup>II</sup> Those savings which are cash releasing, rather than improving the quality of a product or service for the same inputs (which are non-cashable). Cashable savings for government may not be made through reductions in the delivery or frequency of products or services – hence a cut in service does not meet the definition of an efficiency saving.

**134** Figures were produced alongside the *Pre-Budget Report* (November 2008) showing that councils expect to make new efficiency savings of just over £1 billion in 2008/09. The Minister for Local Government called for councils to go even further and find more than £1.5 billion new savings every year. (Ref. 26)

**135** In a climate of economic change, lower increases in grant settlements than in previous spending reviews and potentially higher demand arising from the recession, it is even more important that all local authority resources are spent efficiently.

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# 5 | Longer-term challenges

**136** A number of previous Commission studies have set out key actions that can be taken to improve efficiency. Recent studies have included:

- *Back to Front* - this report examines whether councils are taking a strategic approach to managing back-office functions, including reviewing current practice, working with partners to improve efficiency, benchmarking and taking efficient make or buy decisions.
- *Seeing the Light* - this report encourages local authorities to consider innovation as one way of achieving sustained performance improvement. By providing practical advice and support, based on authorities' own experiences of innovating, it aims to assist in creating the conditions in which innovation is fostered, developed and managed effectively.
- *Positively Charged* - this report examines the contribution made by charging to council finances, and how decisions on charging can support other strategic objectives for local government. It discusses how councils can improve their approach and communicate better with councillors and the general public about the purposes of charging.
- *Healthy Competition* - this report considers the potential for councils to use competition and contestability to generate cost savings and service improvements. It gives practical examples of councils successfully using competition and contestability, and explores the pre-conditions that councils must have in place to make effective use of these mechanisms.

**137** The Commission will continue to support local authorities as they strive to deliver efficient, high quality services.

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## The outlook for 2009/10

**138** Local authorities should be proactive in managing their finances to deal with the pressures that may arise, and in using all their powers, both legal and those that come from being a significant participant in the local economy, to help their areas to cope with and recover from the recession. There are already some examples of councils working to counteract the effects of the recession, although many of these are still on a relatively small scale. Examples include (Ref. 22):

- supporting debt counselling services;
- provision of interest-free loans to people at risk of having their homes repossessed;
- initiatives to improve benefit and tax credit take-up;
- the creation and support of credit unions;
- efforts to help address fuel poverty;
- helping local businesses to bid for council services; and
- paying small business quickly to help with their cashflow.

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- 139** The recession will almost certainly result in increased demand for some public services. How serious this will be for local authorities will depend on the length and severity of the downturn. There is substantial uncertainty regarding all aspects of the looming recession, making it difficult for local authorities to plan.
- 140** The evidence from this report is that despite these uncertainties most local authorities are trying to plan for the future impact on their finances. However, their plans for helping their areas through the recession do not appear to be as well developed as their financial planning.
- 141** The imperative to achieve efficiency will be greater than ever as budgets are squeezed by increased demand and falling income. 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.

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# Appendix 1: The CSR 07

**142** The government sets the parameters and priorities for its spending for the next three years through its spending reviews. The current spending review - CSR - was announced in November 2007 and applies for the three years from 2008/09 to 2010/11 (see Table 10).

**144** The government continued with its policy of prioritising health and education expenditure, with increases in these areas above the general level of change.

**143** The government increased the overall level of public spending by 2.1 per cent per annum over the period of CSR 07. This was lower than previous spending rounds. The previous spending review included a 4.9 per cent real-terms increase in spending per year.

**Table 10**  
**Percentage increases in nominal and real-terms<sup>I</sup> spending by Departmental Expenditure Limit**

	2008/09		2009/10		2010/11	
	Nominal	Real terms	Nominal	Real terms	Nominal	Real terms
Local government <sup>II</sup>	4.1	1.4	3.5	0.7	3.4	0.6
NHS	6.7	4.0	6.7	4.0	6.7	4.0
Department for Children Schools and Families	5.5	2.8	5.0	2.3	7.1	4.3
Total government	4.6	1.9	4.7	2.0	5.0	2.3

Source: Audit Commission Analysis of HMT Data

<sup>I</sup> Using the Government 2.75 per cent GVA deflator.

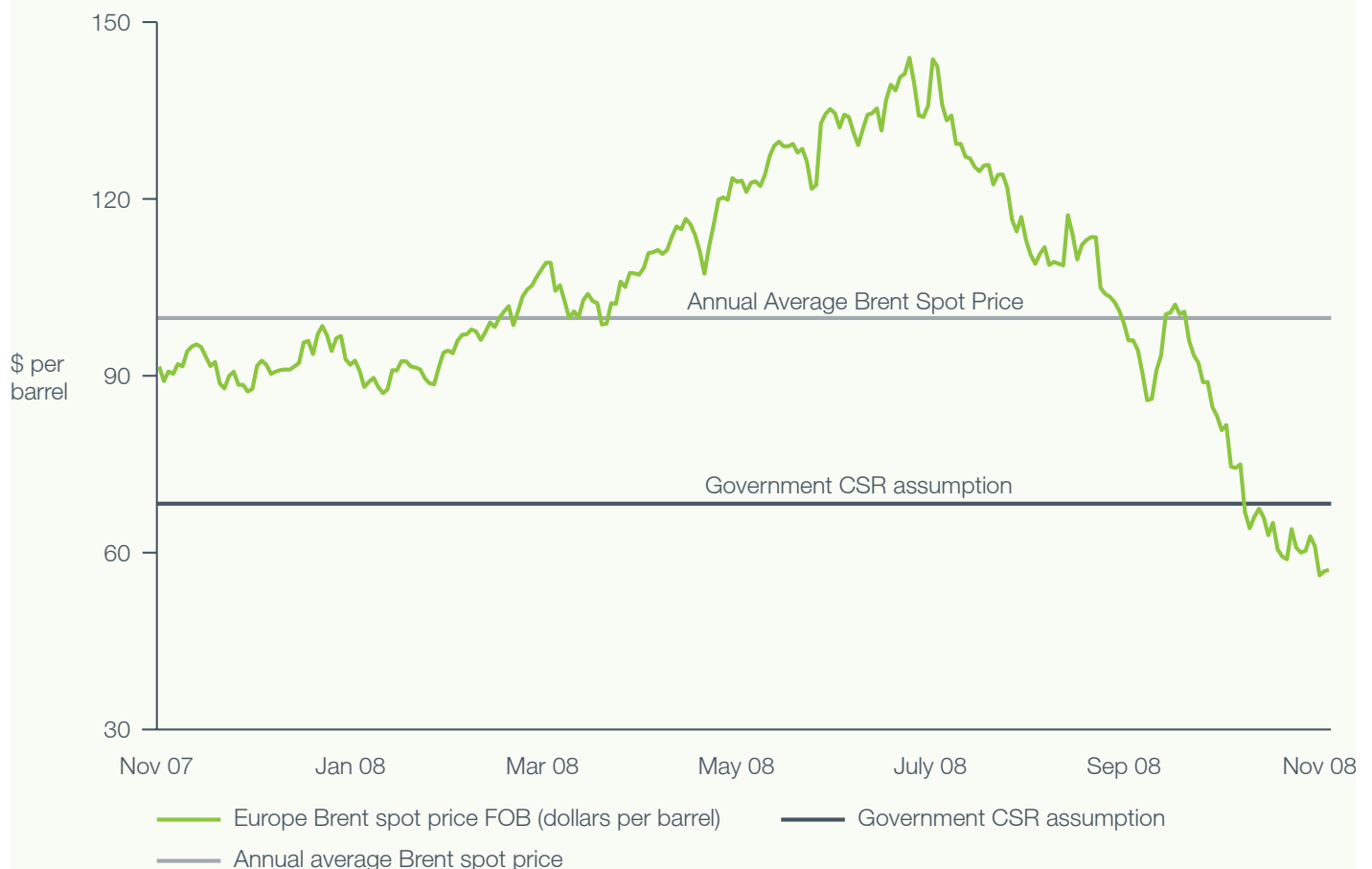
<sup>II</sup> The Departmental Expenditure Limit includes all spending on local government by central government. This includes money distributed to local government, and money spent by central government on behalf of local government. This is different to the financial settlement for local government, which is outlined in paragraphs 28 and 30.

# Appendix 2: Oil prices

**145** The government made an assumption that oil would average \$68 per barrel over the period of CSR 07. However the average price for oil (Ref. 20) between November 2007 and October 2008 was \$102.24 according to OPEC (see Figure 12).

**146** This graph illustrates the changes that have taken place during 2008/09, with significant rises from April to July then falls in the price from July to October.

**Figure 12**  
**Brent crude oil price (Ref. 8)**



Source: US Energy Information Administration



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