

# Surviving the crunch

Local finances in the recession and beyond

Local government report, March 2010



**The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.**

**Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.**

**As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.**

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# Summary and recommendations

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## Summary

### **The financial impact of the recession has been manageable for most councils up to January 2010.**

- The government has honoured the three-year grant settlement up to 2010/11; on average, grant is two-thirds of council income.
- Staff pay increased by 1 per cent in 2009/10, less than expected.
- Many councils received a windfall VAT refund.
- Many councils, especially districts, have enough reserves to cover short-term funding pressures.

### **However, some councils – often districts – have been hit hard by falling local income.**

- Development-related income has reduced; planning applications are down by 22 per cent.
- Investment income fell by £544 million (43 per cent) in 2008/09, and the fall continued in 2009/10.
- Capital receipts are down from over £3.5 billion in 2007, to just £800 million in the first three quarters of 2009.
- Some districts that rely heavily on local income are struggling.

### **The future for local government finances is challenging, although there is little clarity about the size of any public spending cuts.**

- Public finances have deteriorated in the recession. Cuts in government support to councils are likely, but there is little clarity on the extent of cuts.
- Demand linked to the recession is increasing; for example, housing and council tax benefit claims, child poverty and youth unemployment.
- Housing concerns, the ageing population, the rising birth rate and the cost of child protection are longer-term financial pressures, particularly on single-tier and county councils (ST&CCs).
- Overall, short-term income losses are the major concern for districts. Meeting rising demand for services with shrinking resources is the main worry for most ST&CCs.
- The public-private model of funding regeneration, infrastructure in growth areas and affordable housing, relies on availability of credit for private developers and house buyers, and on rising land and property values. This funding model is not working in the recession, potentially threatening recovery in some areas.

### **Councils should be responding now to minimise the impact on frontline services.**

- Some councils do not have financial plans beyond 2010/11. They should be planning their finances for the next three to five years, despite the lack of clarity on future funding.
- Those councils that understand how their different income sources and services could be affected by the aftermath of the recession will be more financially resilient in an uncertain environment.
- Major efficiency projects that preserve services take time and investment; quick savings are more likely to involve cuts.
- 2010/11 will be the last year of prerecession funding levels, after which funding is likely to be squeezed. Councils should use this time to plan and invest in achieving reductions in their cost base.

### **Most councils are making some savings and planning more, but the quality of planning is variable.**

- Some councils have plans to cut costs by up to 15 per cent over the next three to five years through efficiencies and constraining demand.
- Efficiencies alone may not be enough; cuts may be needed. Few councils are acknowledging this in current plans.
- Those with a track record of delivering efficiencies are well placed, but others, particularly some districts, lack the capacity for major change.
- Some plans rely too heavily on one initiative, often requiring joint working with other councils or partners to deliver major savings or transform service delivery. There are risks inherent in these more ambitious plans.
- Good leadership from members is important, but some are unwilling to take radical steps without clarity on future funding.

### **Public sector job cuts could damage local economies ; all options for reducing the pay bill should be considered.**

- Local public services are major employers, particularly of women.
- In places where the private sector is weak, more than 30 per cent of the female workforce is employed by councils, police, fire, schools and the NHS.
- Half of local government spending is on staff. Efforts to reduce costs have focused on cutting posts.
- But job cuts can damage local economies, redundancies are costly and skills and capacity can be lost.
- Few councils are exploring all the other options to reduce the pay bill, such as more flexible working, reduced expenses and overtime, pay freezes or pay cuts.

## Recommendations

### **Councils should:**

- prepare now for the leaner times ahead;
- develop a detailed understanding, using scenario planning, of how different levels of grant and income affect their financial resilience;
- ensure that members and officers provide strong leadership over difficult resource allocation decisions;
- engage early with staff and the public about options for coping with shrinking resources;
- develop rolling medium and longer-term financial plans despite the uncertainties. Plans to meet estimated budget gaps should combine basic efficiency measures with more ambitious options to transform service delivery and manage demand;
- ensure they have capacity for financial planning, cost reduction and change-management; and
- consider all options for managing pay bills, not only staff cuts.

### **Government should:**

- provide early clarity on expected future levels of council, police, fire, health and education funding to enable effective planning; and
- recognise the uncertainty around the future financing of regeneration, sustainable communities and affordable housing strategies in current market conditions, and consider alternative funding models.

### **The Audit Commission will:**

- continue to publish research on how local public bodies can plan ahead and achieve more with less; and
- consider councils' financial resilience in our audit work, to help those most at risk.

# Introduction

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**1** The Audit Commission has published two reports on the recession: *Crunch Time?* (December 2008, Ref. 1) and *When it Comes to the Crunch* (August 2009, Ref. 2).

- *Crunch Time?* looked at the early impacts of the economic decline on councils.
- *When it Comes to the Crunch* looked at councils' responses to the recession.

**2** The country moved back into positive gross domestic product (GDP) growth in the fourth quarter of 2009. Official statistics show that the contraction of the economy, and the first stage of the recession, may be over. But the future path of the economy remains uncertain, and the effects of the downturn, on councils and public finances more widely, will continue to be felt for some time. The aims of our third report are to:

- establish how council finances and services have been affected by the recession;
- look at the differences in local impact;
- review the actions taken to address financial pressures; and
- assess the resilience of council finances to financial shocks.

## Methodology

**3** The work is based on:

- analyses of published data on local government finances and service demand;
- interviews and data collection by audit staff in 40 councils;
- an analysis of council reserves from audited accounts; and
- an analysis of the local importance of public sector employment.

**4** We reviewed relevant research by the Commission and other bodies, and material from council websites on budget positions and plans.

## Structure of report

**5** This report covers:

- the path of the recession and how it has affected the public sector;
- the impact on council finances;
- recession-related and other financial pressures;
- how impact and pressures vary between councils;
- the factors that affect financial resilience;
- councils' responses to bridging any funding gaps; and
- the potential impact on employment of efforts to control the pay bill.

There are three [Appendices](#) to support this work available on the Commission's website.

# The path of the recession

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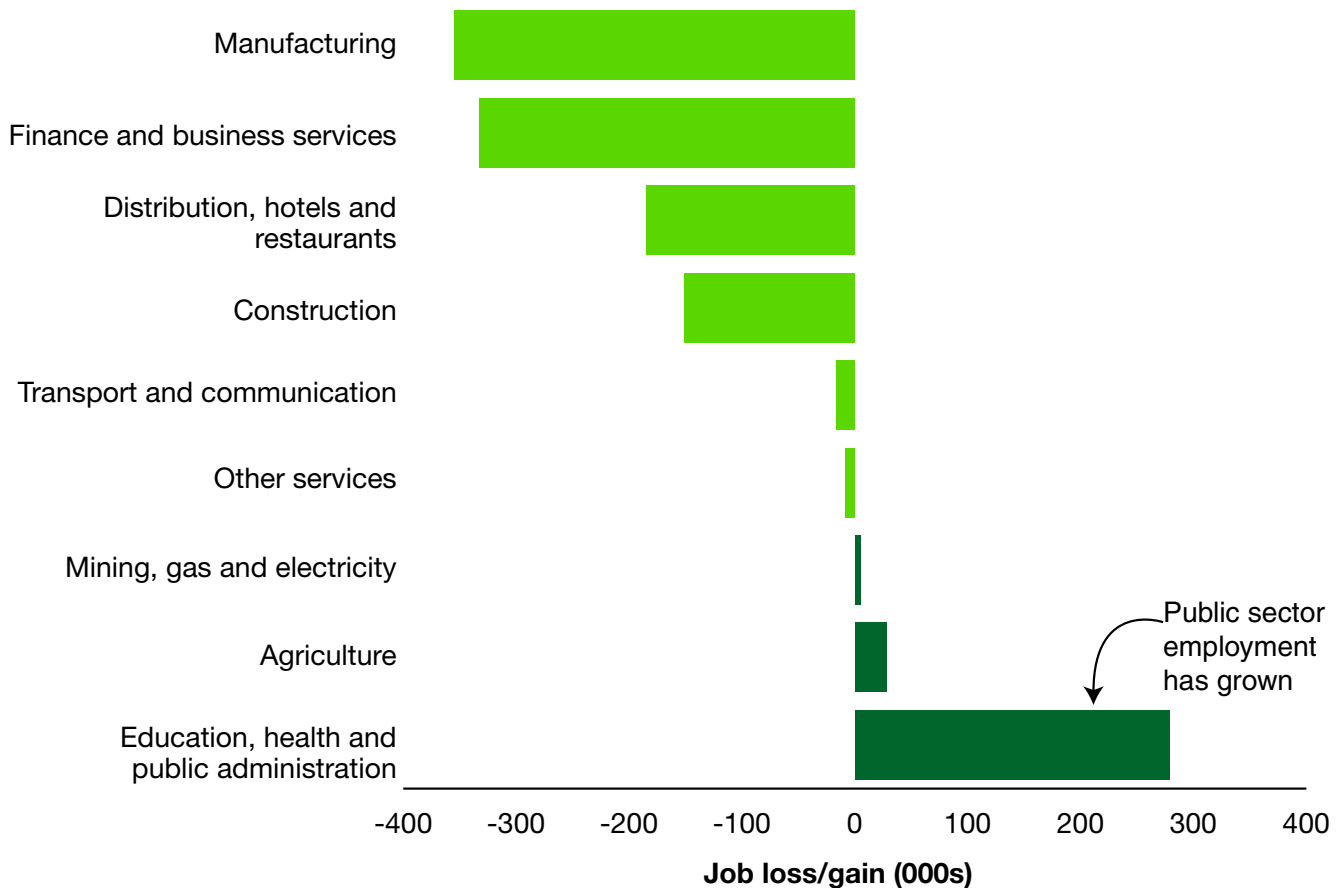
## A recession of two halves

**6** The recession has so far mainly affected the private sector. The three-year public spending settlement for 2008/09 to 2010/11 has been honoured by the government, despite worsening economic circumstances over that period. This has cushioned the public sector, protecting services and jobs, during the recession. Public sector employment and spending have continued to rise as the private sector has contracted.

**7** The public sector is the only major part of the economy to have seen employment growth during the recession, with over 250,000 new jobs in the UK since September 2007. This includes jobs in government departments as well as in councils, schools and the health service.

Figure 1: **Public sector employment in the UK<sup>i</sup> has increased during the recession**

Job change by sector during the recession – Quarter 3 2007 to Quarter 3 2009.



Source: Office for National Statistics, *Employee Jobs by Industry (United Kingdom)*

<sup>i</sup> Sections L, M and N of the 2003 Standard Industrial Classification which covers Public Administration and Defence, Compulsory Social Security, Education, Health and Social Work. Hence it includes people employed in the UK by government departments as well as in councils, schools and the NHS.

## Local public services in the recession<sup>i</sup>

**8** The growth shown in Figure 1 has not been caused by councils. There have been more jobs in schools and health, but council employment in England (excluding schools) fell by around 2 per cent in 2008/09.<sup>ii</sup>

**9** Local government spending has continued to increase above the level of inflation during the recession; a real-terms increase of 2.5 per cent from 2007/08 to 2009/10.<sup>iii</sup>

**10** But the balance is starting to shift. Although recovery remains fragile, the economy is starting to grow again. After six quarters of falling GDP there was an increase of 0.3 per cent in the fourth quarter of 2009.<sup>iv</sup> However, during the recession, public finances have deteriorated, with government net borrowing projected to rise to over 12 per cent of gross domestic product (GDP) in 2009/10 compared with 2.4 per cent two years earlier. The government has set out plans to reduce the amount of borrowing. Cuts in government support to councils are likely.

i Local public services include councils, police, fire, education and health.

ii Estimated – see Paragraph 122.

iii Real-terms growth in spending between 2007/08 and 2008/09 was 2.2 per cent, and budgets for 2009/10 show a further 0.2 per cent rise; an overall real-terms increase of 2.5 per cent over the two years. Actual spend in recent years has been greater than draft budgets because of in-year grants, so this figure may increase.

iv ONS statistical bulletin [www.statistics.gov.uk/pfdir/gdp0110.pdf](http://www.statistics.gov.uk/pfdir/gdp0110.pdf)

# The impact of the recession on council finances

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**This chapter sets out how the economic downturn has affected the income and spending of councils, and the demand for local services. It focuses on 2009/10, but uses data for 2008/09 where it is the most recent available.**

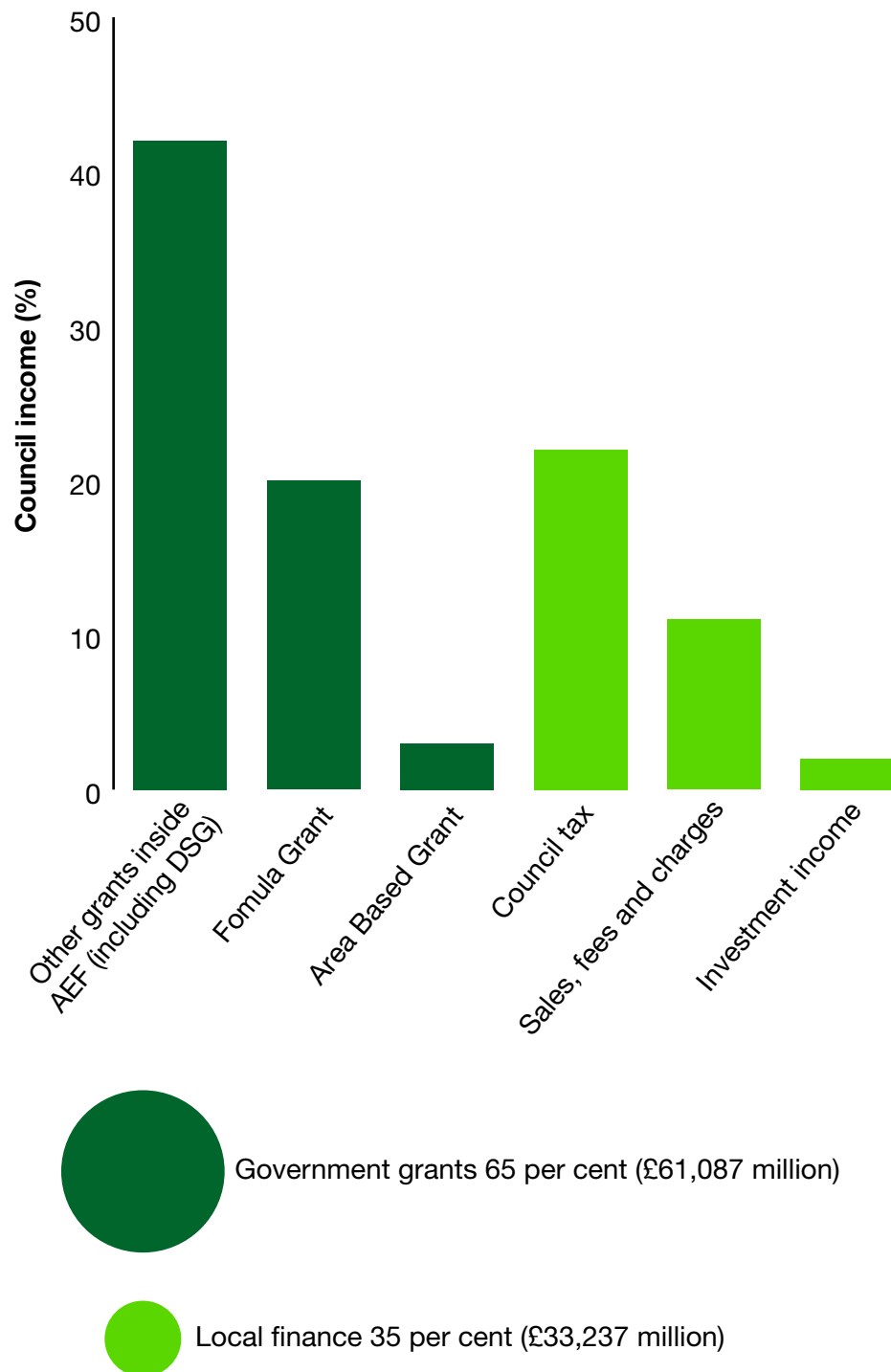
## **Income**

**11** Councils' income comes from a number of sources (Figure 2).<sup>i</sup> The main source is the various government grants that make up 65 per cent of income. The largest is the Dedicated Schools Grant (DSG), followed by Formula Grant. As DSG is passed straight to schools, Formula Grant and the Area Based Grant are key funding sources for council services other than education. These national averages conceal important differences between and within council types. This is discussed in Chapter 5.

i Government grants to local councils are described as either inside or outside Aggregate External Finance (AEF). Grants outside the AEF are mainly demand-led but passed through local councils. The most important are for housing and council tax benefit. This money is passed to individual claimants and does not fund local services. They are excluded from this graph. Grants inside the AEF include Formula Grant, which is shown separately here, and other grants such as the Dedicated Schools Grant (DSG). Formula Grant includes National Non-domestic Rates (NNDR), Revenue Support Grant (RSG), Greater London Authority Grant and Police Support Grant. This analysis excludes:

- council house rents and housing subsidy (there is a separate national housing revenue account);
- capital receipts and grants to support capital spend;
- trading account income including any net profit; and
- other income and accounting adjustments.

Figure 2: **The main source of council income in 2008/09 is government grant, followed by council tax receipts**



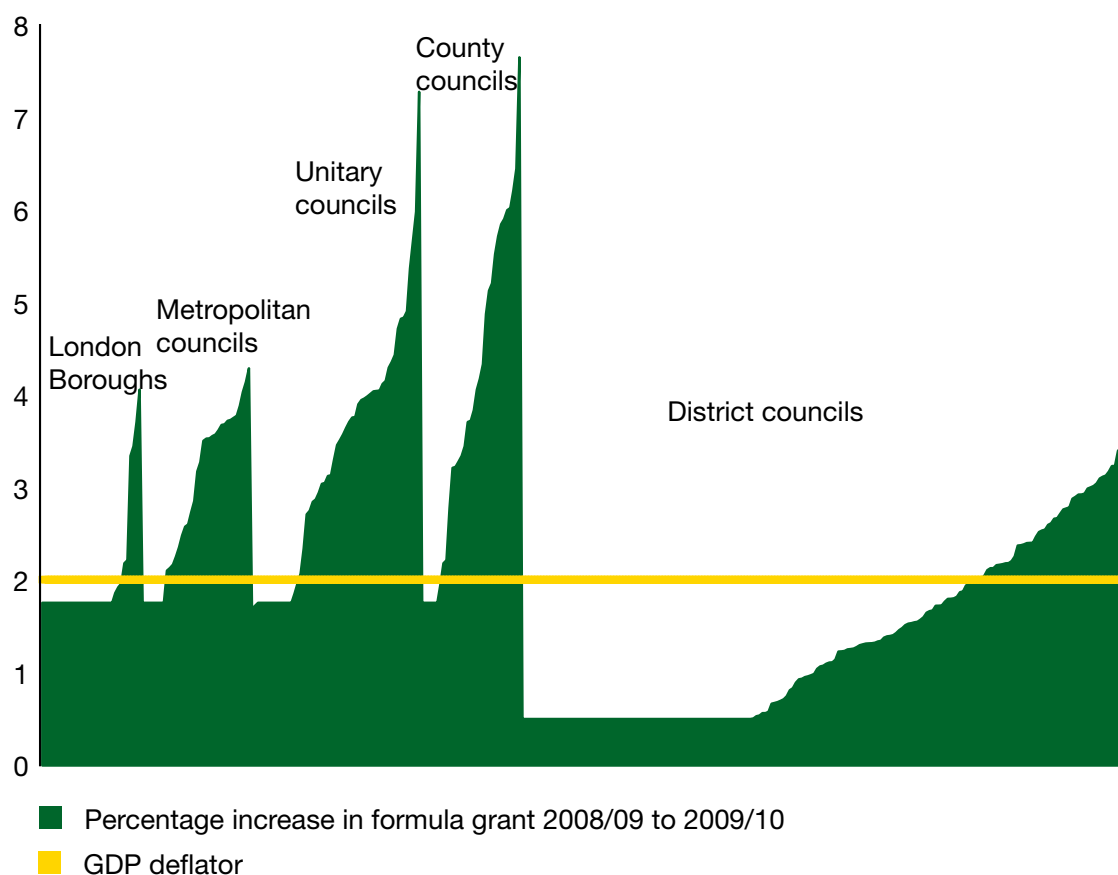
Source: *Communities and Local Government (CLG) Summary Revenue Out-turn (RO) returns 2008/09. Sales fees and charges from individual service RO forms 1-6*

## Government grant

**12** The three-year spending review 2008/09 to 2010/11 was agreed before the recession, in October 2007. It set out a 4.1 per cent real-terms increase in grant to local government over the period, and was not significantly changed when economic conditions deteriorated.

**13** Also, the value of the 2009/10 grant was greater than expected due to lower than predicted inflation. The GDP deflator was forecast to be 2.75 per cent for 2009/10 when the settlement was agreed. It is actually 2 per cent. Two-thirds of ST&CCs received a real-terms increase in Formula Grant (Figure 3). Only a quarter of district councils got an above-inflation rise.

Figure 3: Increase in grant settlement for 2009/10 compared with inflation



Source: CLG Financial Statistics, HM Treasury deflator

**14** Councils are constrained in how they can spend some government grants, so locally-generated income is important for financial flexibility.

## Council tax

**15** Council tax is 22 per cent of income. Bills increased by an average of 4 per cent for 2008/09 and 2.6 per cent for 2009/10,<sup>i</sup> although a number of councils limited their income by freezing or reducing levels.

<sup>i</sup> CLG statistical release. Average increases for Band D properties were 3.9 and 3 per cent.

**16** Council tax arrears have not significantly increased. The national collection rate fell by just 0.1 per cent in 2008/09. Councils report that the collection rate is still good in 2009/10.

### **Other locally generated income**

**17** Income from sales, fees and charges was £11 billion, 11 per cent of total income in 2008/09. Some income, including planning fees, car parking and commercial rents, fell below budget during 2008/09. Lower budgets were set for 2009/10, which will see a full-year effect of the reductions. Few councils expect improvements in 2010.

- Councils lost development-related income.
- Capital receipts have reduced substantially.
- Investment income fell by £544 million (43 per cent) in 2008/09, mainly due to lower interest rates and more cautious investment strategies following the Icelandic banks collapse. The fall will be greater in 2009/10 as medium-term investments at higher rates come to an end.
- Councils report on going falls in car parking income and commercial rents.

### **Development-related income**

**18** Credit shortages have made private developers less willing and able to pursue major projects. This, combined with lower house sales and property prices, meant that councils lost development-related income in 2008/09, particularly from planning and building control fees and land searches. Less house building meant fewer new taxable properties.<sup>i</sup> Only a few councils report evidence of a recovery in 2009/10.

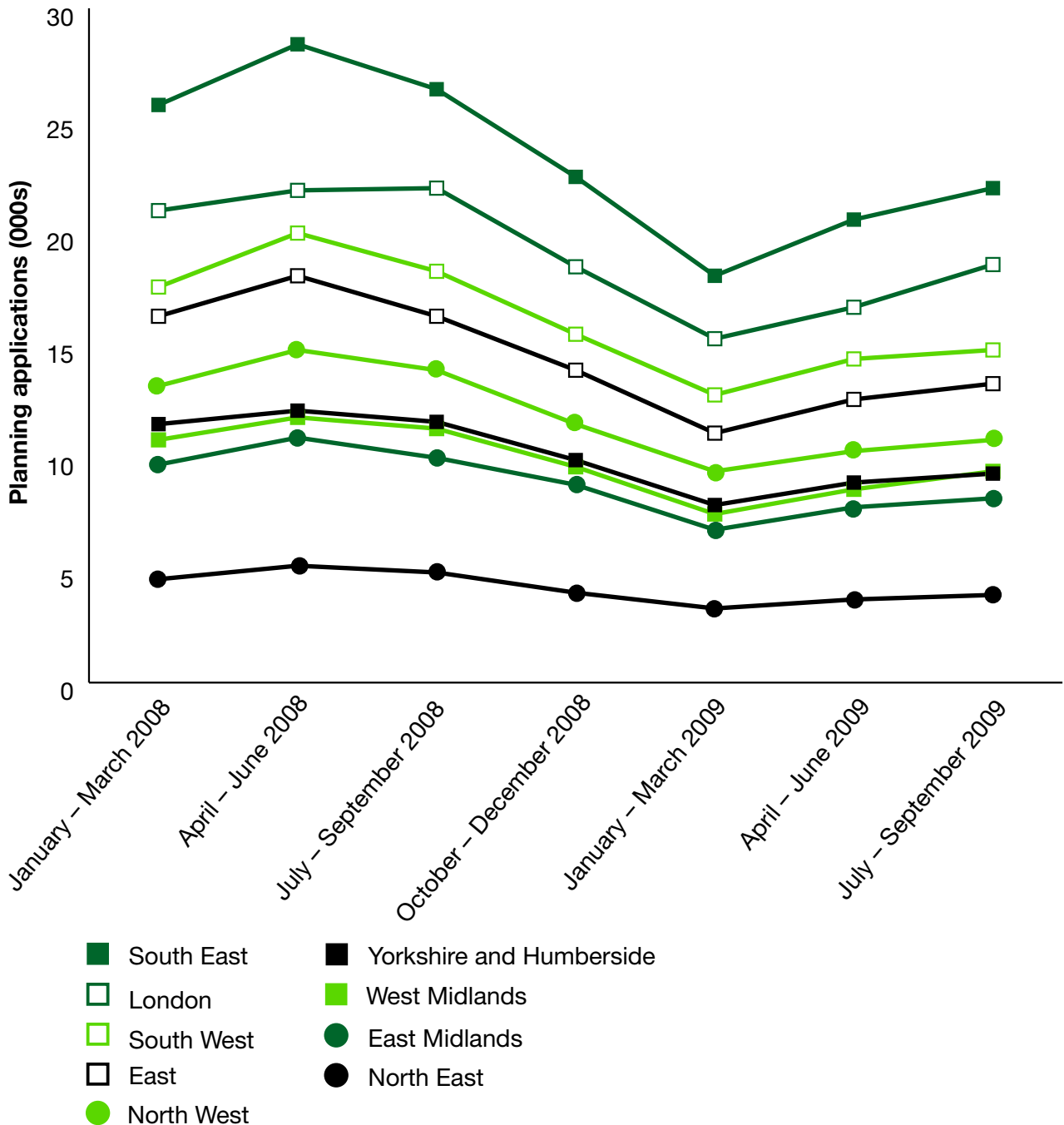
**19** Councils also report falls in income from Section 106 agreements.<sup>ii</sup> In 2007/08, Warrington Council received £2.35 million from developers in Section 106 agreements. Excluding one large development, it expects only £62,800 in 2009/10.

**20** Planning applications dropped by 22 per cent between 2007/08 and 2008/09 (Figure 4). The biggest fall was in the South East. In councils included in this research, income from land searches in 2008/09 was down 44 per cent in districts and 51 per cent in ST&CCs. Planning income was down 18 per cent in districts and 23 per cent in ST&CCs.

- i Council tax is based on properties. New builds and conversions add to the total of properties and this year-on-year increase can be an important source of income. The number of properties paying local taxes increased in 2008/09 from 18 to 18.1 million. This was less than expected.
- ii As part of the planning process, a council and a developer may enter into a legal agreement to provide infrastructure and services on or off the development site. These are known as Section 106 agreements, and there can be considerable sums involved in areas with significant development activity.

**21** There is some evidence that the situation may improve. In the first six months of 2009/10, planning applications were up 20 per cent from the lowest point. However, applications are still well below the peak in spring 2008 (Figure 4), and the future is uncertain.

Figure 4: **Planning applications fell by a third during 2008/09, but have started to increase again in 2009/10**

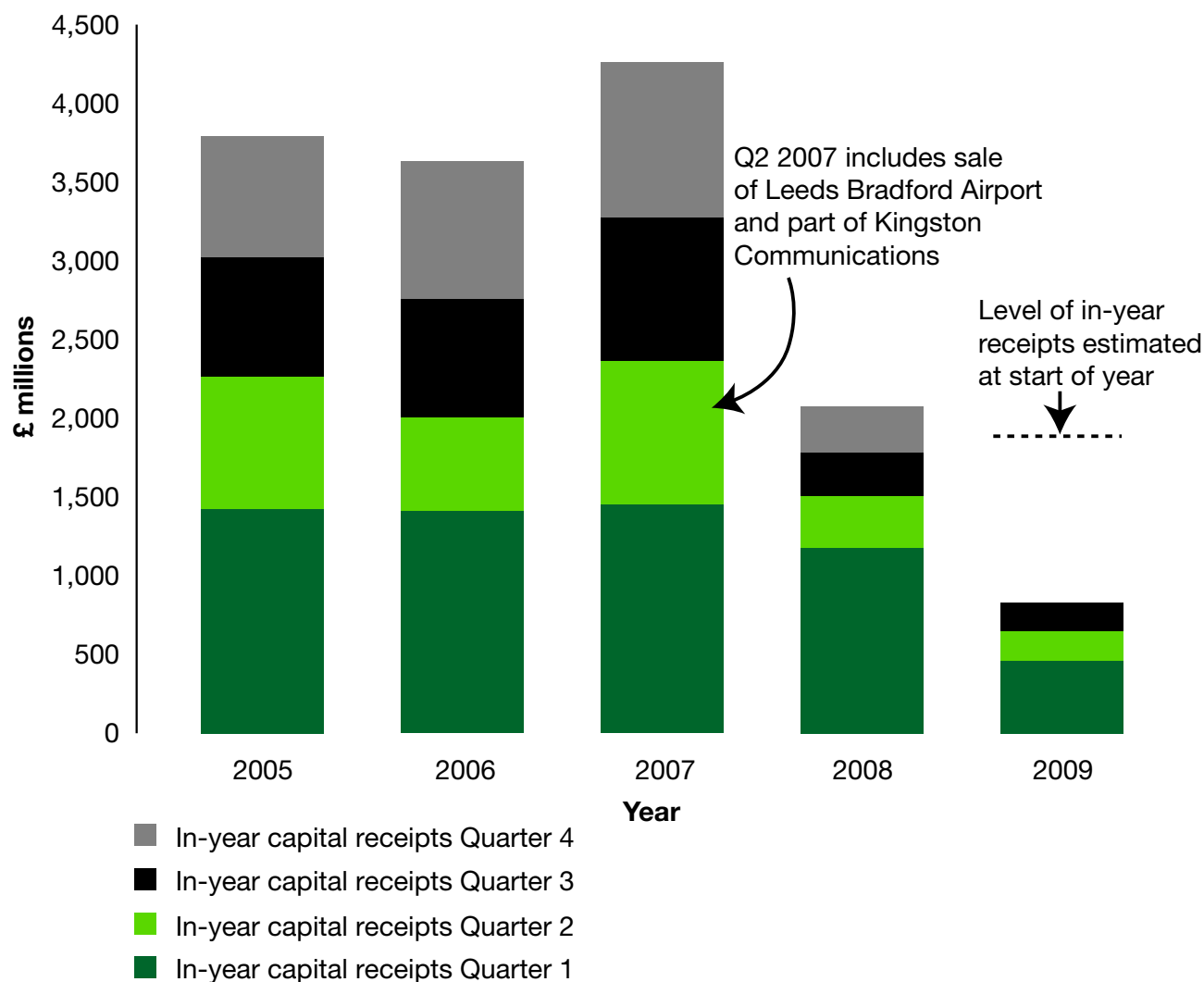


Source: CLG

## Capital receipts

**22** Capital receipts collapsed from over £3.5 billion per year in 2005, 2006 and 2007, to just £800 million in the first three quarters of 2009 (Figure 5). Property prices have fallen, making it less advantageous for councils to sell their assets, and council tenants are not exercising their right-to-buy. Receipts are unlikely to recover until there is an upturn in the property market.

Figure 5: **Capital receipts have collapsed and in 2009 are likely to be less than a third of the 2007 level**



Source: CLG

**23** Councils were committed to capital programmes in 2008/09. Some also brought forward projects to support their economies and rescue major developments. Reducing capital receipts means funding gaps for some committed schemes. These have been met by additional prudential borrowing, or using uncommitted capital reserves. These reserves dropped by £657 million (22 per cent) between 1 April 2008 and 1 April 2009.<sup>i</sup> Most councils are cutting back capital programmes from 2010.

<sup>i</sup> Figures are across all council types. Audit Commission analysis of final accounts 2008/09.

**24** A few councils are committed to higher levels of spend, using prudential borrowing, to help the local economy (see [Appendix 2](#)).

**25** The difficult development market and limited credit has also adversely affected some public-private partnerships (PPP) and private finance initiative (PFI) schemes.

### Windfall income

**26** For many councils, income losses have been partly offset by a one-off windfall. A House of Lords ruling on a longstanding VAT case in January 2008 made many councils eligible for a significant VAT refund.<sup>i</sup> Amounts range from less than £100,000 in smaller authorities to several millions in some ST&CCs; Leeds City Council received £6.3 million, Waverley Borough Council received £385,000.

**In one metropolitan borough an overspend on children's services was funded from the VAT refund**

### Spending

**27** Local government spending rose in real terms by 2.2 per cent between 2007/08 and 2008/09 (Figure 6).<sup>ii</sup> Spending on education, social services and benefits all increased by more than inflation.

**28** The balance of spending across services changed little, but two noticeable shifts are recession-related:

- the fall in development-related income led to job reductions in planning in some councils, reducing overall spending on these services by 3 per cent; and
- spending on housing and council tax benefits increased by 5.3 per cent.

**29** These changes have continued in 2009/10.

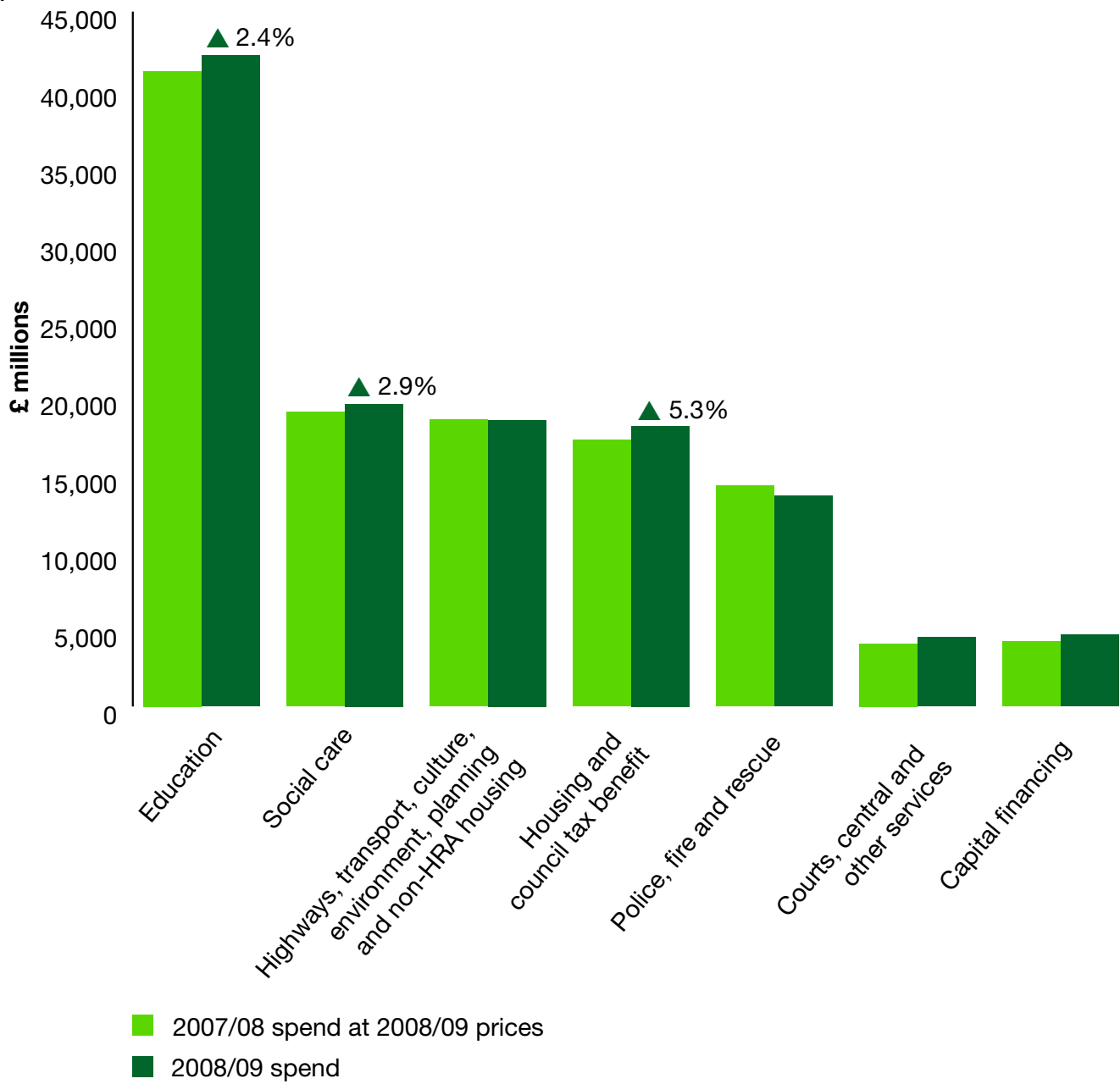
**30** Some factors are constraining the growth in spending, helping to cushion the other impacts of the recession.

- A pay deal of 1 per cent was agreed for council employees for 2009/10; a lower increase than many had budgeted for.
- Some councils negotiated better procurement deals in the recession.
- Lower interest rates made borrowing cheaper.

**Trafford received £425,000 less in interest on investments in 2009/10, but effective treasury management has reduced debt repayments by £400,000**

- i A number of councils received one-off VAT repayments in 2008/09 or 09/10 following a House of Lords decision in January 2008 known as the Fleming case. These included interest on the successful claim. In 1996, HM Customs & Excise shortened the then existing six-year time limit for under-claimed or overpaid VAT to three years. The European Court of Justice later ruled that it was illegal to introduce this new time limit without transitional arrangements. The Fleming case led to a new transitional period. Backdated claims for the period 1973 to 1997 had to be submitted by 31 March 2009. Councils claimed for items such as car park penalty charges and library charges.
- ii The rise in council net current expenditure (NCE) was 4.5 per cent before taking account of inflation. Applying the Treasury GDP deflator as of January 2010, the increase is 2 per cent. NCE does not include council tax benefit or capital financing. Including these gives a real-terms increase of 2.2 per cent.

Figure 6: **Changes in spending between 2007/8 and 2008/09 after inflation<sup>i</sup>**



Source: CLG revenue out-turn statistics and Treasury GDP deflator

<sup>i</sup> Capital financing and council tax benefit are not included in CLG net current expenditure but have been included here.

## Overall picture on council finances

**31** The recession has had a negative impact on council finances in 2008/09 and 2009/10. Broadly, the revenue effects have been manageable. Local income has fallen, but government grant has held its level and slightly increased in value. Pay rises for 2009/10 were less than many budgeted for.

**32** Capital programmes have been badly hit by the falls in capital receipts and less private sector development.

**33** But this overall picture hides significant local variations between councils, and there are further pressures looming for public finances. These issues are examined in Chapters 4 and 5.

# Pressures on council budgets, services and strategies

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## Recession-related pressures

**This chapter looks at the current and future pressures on council spending, and the sustainability of the models for funding regeneration, infrastructure in growth areas and affordable housing.**

**34** *When it Comes to the Crunch* (Ref. 2) described the progress of a recession and the subsequent recovery in three waves.

- Wave 1: Economic. A relatively short period where economic output declines, firms fail or reduce staff numbers, unemployment rises quickly and real incomes fall.
- Wave 2: Social. A longer period in which output growth returns, but job losses continue. Unemployment remains high, bringing with it homelessness, health and domestic problems.
- Wave 3: Unequal recovery. Recovery occurs when unemployment has passed its peak and the economy is expanding. But not all areas benefit; some continue to decline while others bounce back.

**35** Wave 1 ends when the contraction of the economy ends, so in early 2010 we moved into Wave 2. The model predicts impacts on the demand for local authority services in each of the waves.

### Wave 1 effects

**36** These arise from the initial downturn and include growing demand for benefits, and falling development activity.

#### Benefits

**37** Housing and council tax benefit claims have increased significantly. There is a strong correlation between increases in Job Seekers Allowance (JSA) claimants and housing and council tax benefit applications. The number of households now claiming one or both of these benefits increased by almost 9 per cent to 3.4 million in the year to October 2009.<sup>i</sup> New claimants are mainly of working age (Table 1). Government estimates put the additional cost at an extra £1.3 billion in 2009/10.<sup>ii</sup>

i Two-thirds of these claim both benefits.

ii CLG Statistical Release May 2009.

Table 1: Increases in housing and council tax benefits November 2008 to October 2009

	Additional claimants	Percentage increase	Percentage of additional claimants that are of working age (GB)
Housing benefit claims	343,800	8.9	93
Council tax benefit claims	379,610	9.8	88

Source: Department for Work and Pensions (DWP)

**38** Council tax and housing benefits are mainly funded by central government.<sup>i</sup> A grant meets around 60 per cent of council administration costs.<sup>ii</sup> Rising claimant numbers can be a cost pressure for councils, and require management attention to maintain value for money and service standards. DWP has given councils additional money to help them meet increased demand.

**39** Demand may increase further in 2010. Although the number claiming JSA fell slightly in December 2009, long-term unemployment is still rising. There is a lag between unemployment and some new benefit claims, as claimants are not eligible until their savings fall below £6,000.

#### **Development strategies in regeneration and growth areas**

**40** Falls in property values, and the credit crunch, have not just reduced development-related income. They have also undermined the model of private and public sector investment that strategies have relied on in designated growth areas,<sup>iii</sup> regeneration areas and for delivery of new affordable housing.

**41** Wave 1 of the recession, particularly the credit crunch, badly affected new developments. Some projects failed entirely, others had to be delayed or adapted. National and local council funding, and willingness to renegotiate with developers, helped save some projects.

i There are exceptions. Where there are overpayments due to council error, the funds cannot all be claimed back, and councils also may contribute to hardship funds.

ii Audit Commission value for money profile analysis.

iii The government has designated a number of growth areas to take large amounts of new housing development. The aim is to create new sustainable communities where, as well as houses, there is infrastructure such as schools, parks, health centres and transport.

**42** Renewal strategies in Housing Market Renewal Areas (HMRA) are also based on the assumption that public spending can be used to bring in private investment, so master plans include a mix of private and social housing. But private investment has almost dried up in HMRA areas and new house completions have fallen (Ref. 3). A stagnating or falling market, more limited access to mortgages and personal economic uncertainty means fewer buyers for completed homes.

**43** HMRA pathfinders have responded by switching public funding from building to buying properties intended for demolition, and have amended the tenure mix of developments finished in 2008 to 2010 to include more social renting. This has often been paid for by the government's Kickstart scheme, introduced in the 2009 budget to support stalled housing developments.

**44** Focus and funding has shifted from new-build to identifying alternative short-term uses for development sites. Pathfinders are exploring alternative ways of supporting home purchase, so far with limited success.

## Wave 2 effects: Social

**45** While the main impact on service demand has so far been restricted to benefit services, evidence from previous recessions suggests that other pressures will increase over time. These were referred to as Wave 2: social effects in *When it Comes to the Crunch* (Ref. 2) and could put considerable further pressure on council budgets.

**46** Early indications of social change can already be seen.

- Child poverty is increasing; demand for free school meals among primary pupils increased by 3.7 per cent in the year to January 2009, the first increase in four years.
- More young people are staying in education after 16. A rise in youth unemployment among those seeking work means that there are more young people not in employment, education or training (NEETs).<sup>i</sup>
- There are longer-term concerns in housing (see Paragraph 48 onwards).
- Long-term unemployment and workless households<sup>ii</sup> have increased. Both can lead to other social problems, such as depression.
  - In the quarter ending December 2009, the number of people unemployed for more than 12 months rose by 37,000 to 663,000, the highest figure since 1997.
  - The number of working-age people living in workless households in the three months to June 2009 was 4.8 million, up 500,000 from a year earlier.

i The proportion of 16-18 year olds who were NEET in 2004 was 9.6 per cent; by the end of 2008 it was 10.3 per cent. This was because, while 56 per cent of those not in education or training were employed at the end of 2007, this fell to 49 per cent a year later.

ii A workless household is a household containing one or more adults of working age in which none of these adults work.

**47** Pressures will not be evenly spread. Increases in long-term unemployment and workless households are geographically concentrated (Ref. 4). The percentage of NEETs is greatest in the North East, as is the relative level of house repossessions, despite the lower value of properties. Future homelessness may cost councils more in the more housing-stressed areas of the South East and London.

#### **Future housing concerns: homelessness**

**48** Statutory homelessness has fallen during the recession.<sup>i</sup> There is more local and national work to prevent homelessness and repossessions (Ref. 5). But housing charities report increases in demand from other groups that are not considered vulnerable, particularly single homeless people. Two-thirds of charities reported increases in demand in 2009, compared with one-third in 2008.<sup>ii</sup>

**49** The number of homeowners at risk of repossession could increase.

- Repossessions in the last quarter of 2009 were lower than predicted, at 46,000, although nearly double the level in the last quarter of 2007.<sup>iii</sup>
- Mortgage arrears had stopped rising by October 2009, but were 16 per cent higher than in October 2008.<sup>iv</sup>

**50** This, combined with falls in new affordable homes, suggests that demand will increase for housing advice, homelessness services and social housing.

#### **Future housing concerns: affordable homes**

**51** The number of affordable homes completed in 2008/09 held up well, as government funding under the Kickstart programme converted some faltering private sector developments into affordable homes. But overall, new dwelling starts collapsed between January 2007 and January 2009 (Figure 7). There has been some improvement during 2009, but starts are still 40 per cent below the January 2007 level.

**52** Overall numbers of affordable homes depend on negotiated contributions from private developers. With less overall building and a weaker property market these contributions will fall. Section 106 funds, which contribute towards developing sustainable neighbourhoods, are harder to come by.

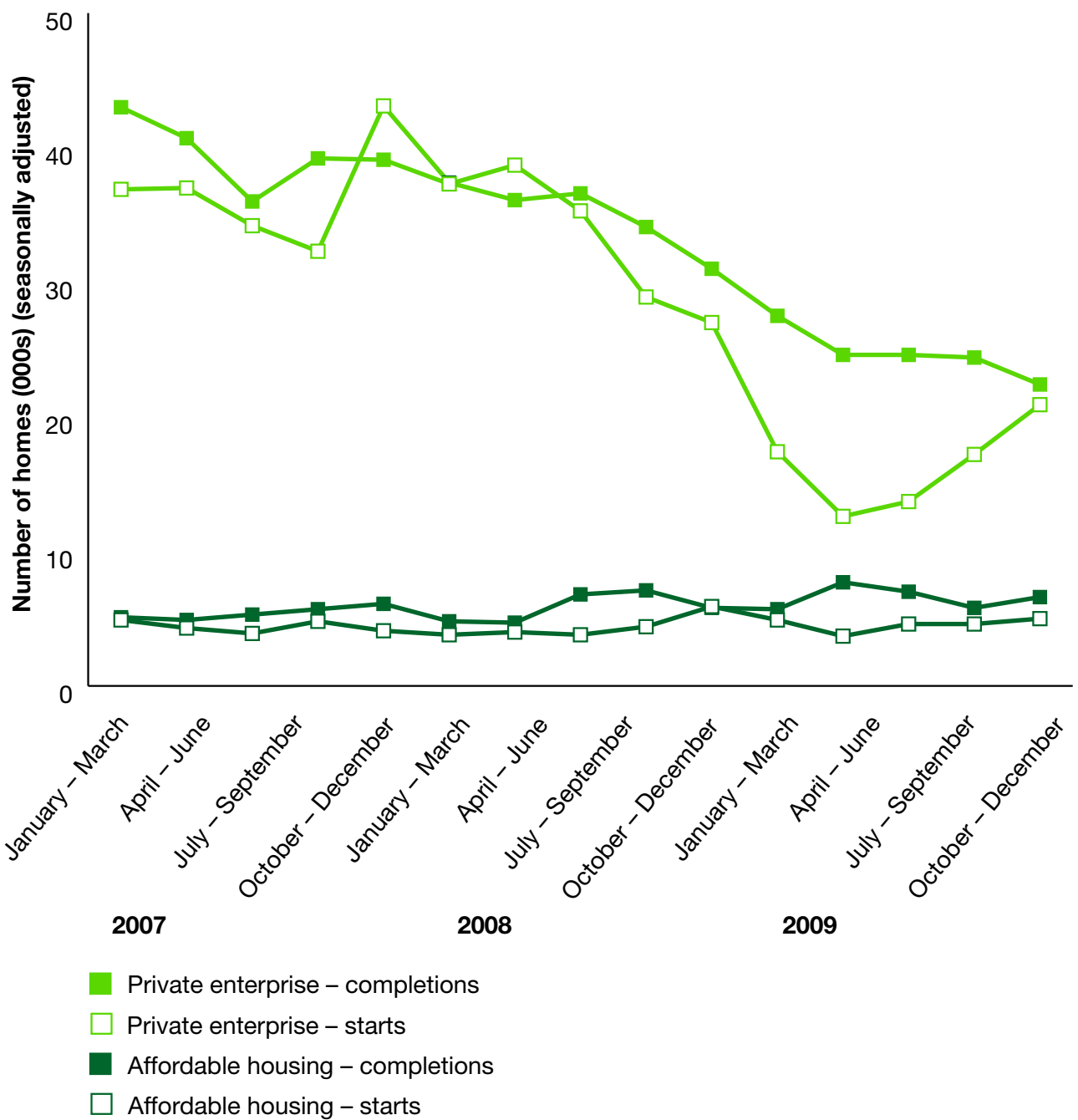
i This group covers those considered vulnerable in the legislation, including families with children or people with particular mental or physical health needs.

ii Homeless Link survey in 2009.

iii Council for Mortgage Lenders quarterly statistics.

iv Financial Services Authority mortgage arrears statistics.

Figure 7: Private house-building starts and completions collapsed between January 2007 and January 2009



Source: Audit Commission based on data from CLG

**53** Other funds are also falling.

- Capital receipts, used to fund social housing developments, have fallen significantly.
- Housing associations will sell fewer new properties to subsidise social rented developments.<sup>i</sup>
  - Those who previously bought starter homes or Homebuy products<sup>ii</sup> are now struggling to get mortgages. They often cannot raise large deposits and are considered high risk by lenders.
  - Social landlords must buy back equity shares if buyers wish this, converting the homes into full rented properties. More requests are diverting capital away from new development.

### **Wave 3: Recovery and the model for future sustainable communities**

**54** Regeneration and growth area strategies, both key to local recovery from the recession, assume that public spending can bring in private investment at an individual and company level. Some of that private sector investment is also expected to subsidise the infrastructure needed to make new developments work as communities.

**55** The credit crunch has restricted access to credit. Lenders and borrowers are less willing to take risks. There is less public sector capital available to directly fund development. The funding model is not working. This could affect recovery from the recession.

**56** A rethink of current funding strategies for regeneration and growth area infrastructure may be needed (Ref. 6).

### **Financial pressures linked to demography and policy changes**

**57** The benefits, regeneration and housing issues linked to the recession are an immediate concern to councils, especially districts. But there are other demographic, economic and policy-related financial pressures. Many are more worried about the future than the present, due to:

- social care costs linked to an ageing population;
- the increasing need for support for people with learning difficulties;
- the increasing birth rate;
- policy-driven changes, particularly to child protection and (for districts) concessionary fares;
- potential increases in employer costs for equal pay or pensions;
- higher inflation, especially in energy; and
- environmental pressures including waste disposal costs.

i Sales may be of the whole property or may be equity share arrangements, where individuals initially buy a share of a home and rent the rest.

ii These are a range of schemes to help those with lower incomes to get onto the homeownership ladder.

## Demography

**58** Changing demography is a significant cost pressure for ST&CCs. In February 2010, we published *Under Pressure*, (Ref. 7), on the costs of an ageing population. Less widely discussed but also rising are the costs of supporting adults with severe learning disabilities.

**59** The rising birth rate is beginning to affect schools. Between 2006 and 2008, the numbers of pupils aged five and under increased by 1.6 per cent nationally, and by 4.6 per cent in Outer London.

**60** There is no reliable data on numbers that have switched from private to state schools. Some councils identified this as a concern in previous surveys (Ref. 2), and in risk registers. This has not had an impact on councils we talked to but may increase pressures on school places in some areas.

## Policy changes

**61** Policy changes following the Baby Peter case have increased costs for almost all ST&CCs. Placement costs for looked-after children are rising. See [Appendix 2](#).

**62** District councils' main policy-related cost concern is concessionary fares. Demand, and costs, rose for some in 2008/09. There are worries about how much funding some may lose when responsibility moves to counties from April 2011.<sup>i</sup>

## Employer costs: Pensions and equal pay

**63** Some councils will need to increase employer's pension contributions following the triennial valuation of the Local Government Pension scheme due in March 2010. This was a major concern for 40 per cent of the councils we talked to. One district expects to have to find an additional £3 million per year.

**64** Negotiations on equal pay and (or) single status are not finalised in all councils. Some have designated reserves and others plans to fund back-pay through capitalisation,<sup>ii</sup> but where staff move to higher grades, long-term pay costs will rise.

**In one metropolitan council the numbers of looked-after children have increased by 35 per cent since March 2008**

<sup>i</sup> An England-wide concessionary bus travel scheme was introduced in April 2008. The pre-budget report of December 2009 proposed some changes, including transferring responsibility for the scheme from district to county councils from April 2011. Proposed revisions to the current scheme from April 2010 onwards will redistribute the existing grant. This will mean late changes to some 2010/11 budgets.

<sup>ii</sup> A capital direction allows revenue expenditure to be treated as capital. CLG Annual Report July 2009 shows that directives for more than £1 billion have been granted between 2006/07 and 2009/10.

# Variation in impact on individual council finances

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**Reliance on particular income sources, levels of reserves, the types of services provided and the local impact of the recession all vary between councils. Some have been relatively unaffected by the downturn; others have been harder hit.**

**65** This chapter explores these variations and summarises key features affecting the resilience of a council's finances.

### **Income profiles: the relative importance of grant, council tax and other income**

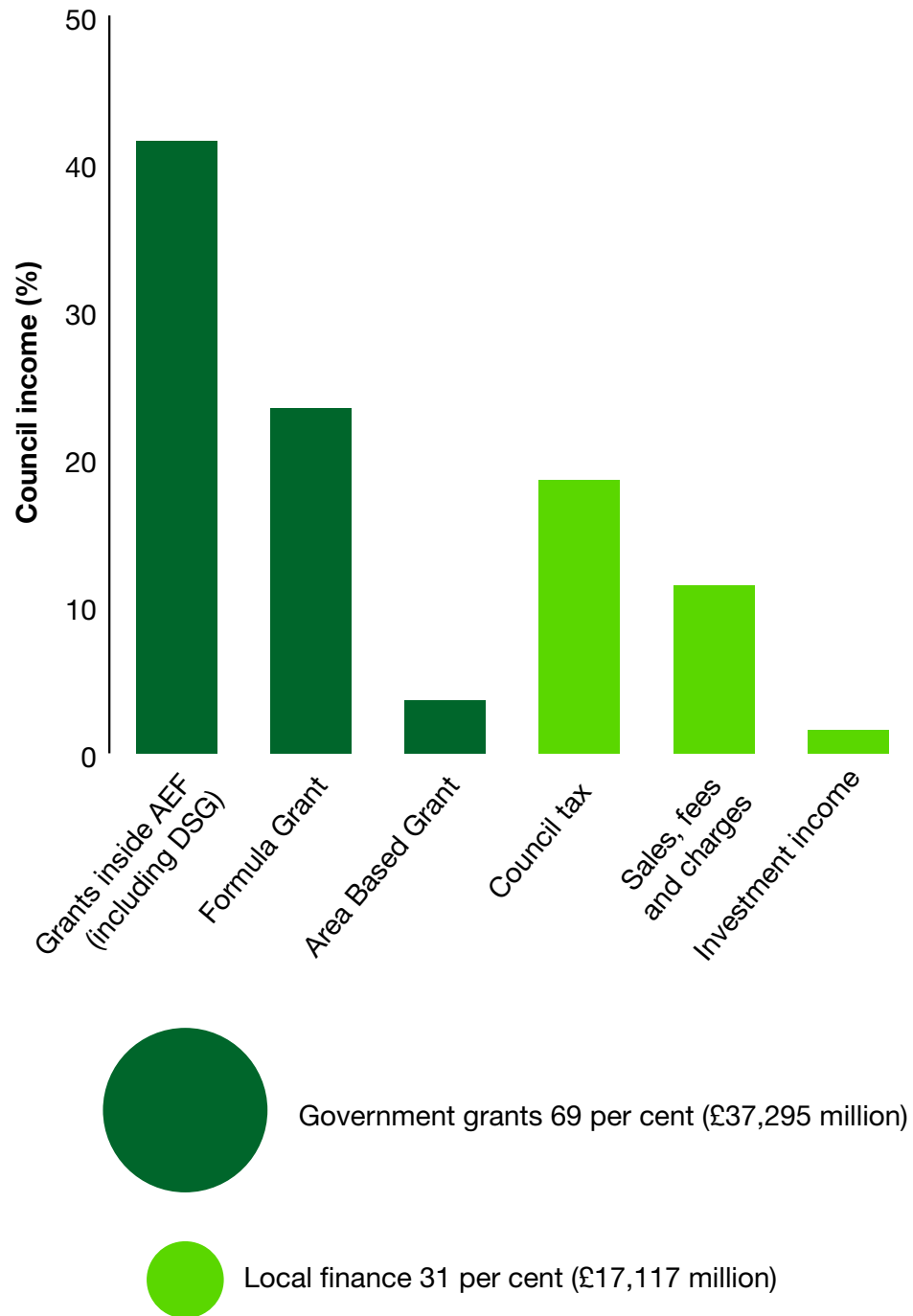
**66** We have analysed, at council level, the balance between the different sources of income previously shown for all councils in Figure 2.<sup>i</sup> The profiles vary significantly.

**67** Broadly, district councils are more reliant on local fees and charges, while single-tier councils get more of their income from government grant (Figures 8 and 9). County councils are similar to single-tier with a slightly higher reliance on council tax. Districts provide a narrower range of services – many government grants relate to education or social care, which are not provided by districts.

<sup>i</sup> The analysis is based on data from the Revenue Outturn forms for English local authorities excluding the Corporation of London, the Isles of Scilly and the Greater London Authority, as well as single-purpose bodies such as police authorities and national parks. See details in Footnote i, Page 13.

**Figure 8: Income profile of single-tier councils<sup>i</sup>**

Government grant makes up 69 per cent of the income of single-tier councils. Sales, fees and charges are 11 per cent.



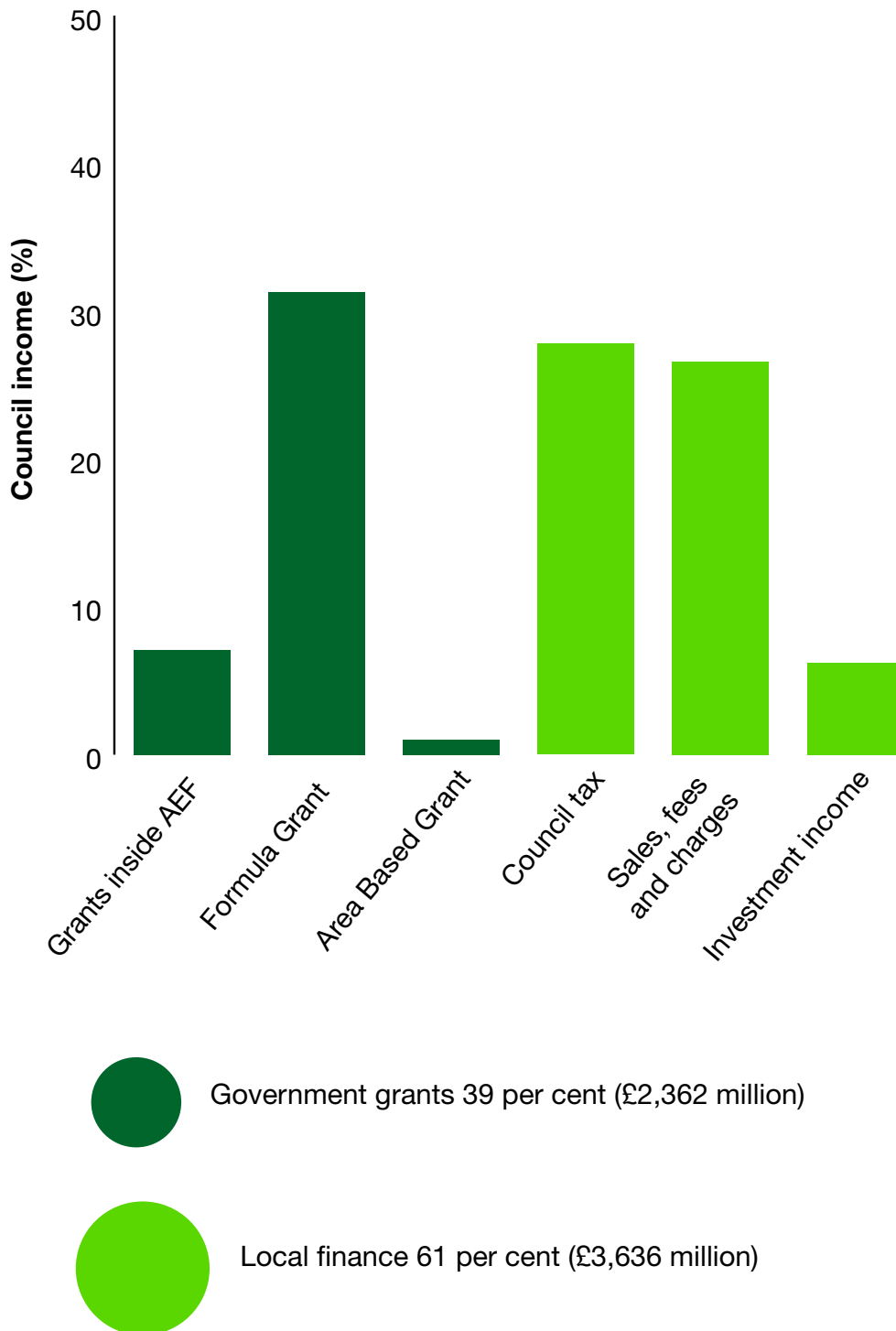
Source: Audit Commission analysis of revenue outturn statistics

<sup>i</sup> See Footnote i, Page 13

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**Figure 9: Income profile of district councils**

Over 60 per cent of district funding is locally generated, and 39 per cent comes from government grant.



Source: Audit Commission analysis of revenue out-turn statistics

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**68** Councils face different risks depending on their key sources of funding.

### **Reliant on income from sales, fees, charges and investments**

**69** The drop in income from sales, fees, charges and investment income has been a problem for districts. One-third of district funding comes from these sources, compared with just 13 per cent for single-tier councils (Figures 8 and 9).

**70** Some districts are particularly heavily reliant on local income. For example, in 18 districts, investment interest was 10 to 20 per cent of total income in the three years to 2008/09.<sup>i</sup> Lower interest rates have hit these areas particularly hard. Some have a limited range of income-generating assets – for example, one multi-storey car park or leisure centre – and so cannot spread their risks.

### **Reliant on government grant**

**71** Government grant is a key source of funding for councils. There is considerable uncertainty about grant levels after 2010/11. Councils that rely more on grant have been less affected so far but could be badly affected by future reductions. These tend to be single-tier councils (Figure 8).

**72** Deprived areas receive more of their income in government grant, as funds are partly distributed on the basis of need. These areas may be more affected by future cuts, particularly if a uniform reduction in government support is applied.

### **Reliant on council tax**

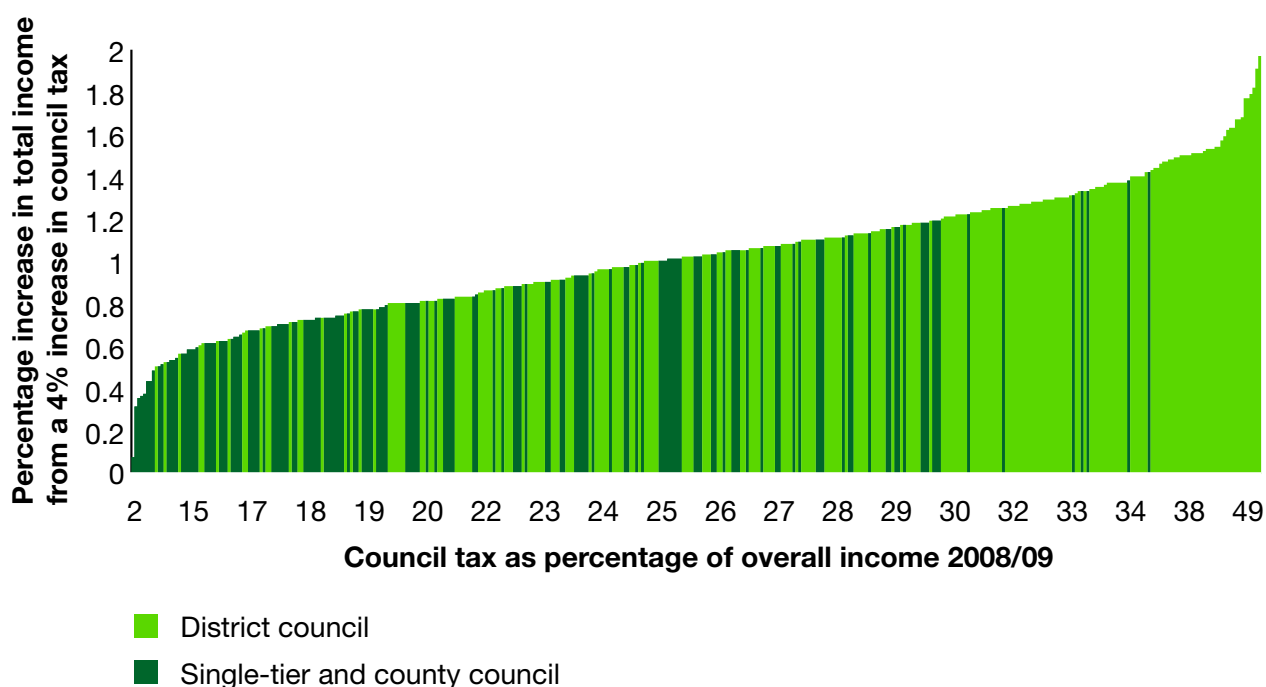
**73** Districts get 13 to 49 per cent of their income from council tax, and ST&CCs 2 to 36 per cent. Areas with the highest reliance on council tax tend to be more prosperous.

**74** While a, say, 4 per cent<sup>ii</sup> increase in council tax might feel the same to a resident in any area, the effect on each council's finances is very different. A 4 per cent increase will add between 0.1 and 2 per cent to total income, depending on how reliant each council is on council tax income (Figure 10).

i Source: individual RO returns for three years; 2006/07, 2007/08, 2008/09.

ii Used for illustration here, as it was the average increase in 2008/09.

Figure 10: Increasing council tax by, say, 4 per cent has a variable impact on total income



Source: Audit Commission analysis of Communities and Local Government revenue out-turn statistics

**75** As a result of this variation, national decisions on capping, or local decisions on council tax levels, have different local impacts. Where the proportion of income from council tax is low, a decision to freeze council tax will not cost much in lost income. A freeze is a far more expensive option for a council that gets almost half of its income from council tax.

## Types of services provided

**76** Services where funding has not yet fallen, such as education, health and adult social care, are subject to demographic pressures that will increase future demand.

**77** This means a key difference between those, mainly districts, facing short to medium-term falls in local income caused by the recession, and the longer-term increases in demand and costs faced by ST&CCs.

## The use of reserves to support spending

**78** District councils are smaller, with less financial flexibility, so found it harder to re-profile budgets when income fell unexpectedly in 2008/09. Many used reserves to make up the shortfall. ST&CC general revenue reserves increased in real terms by 2.7 per cent. District general revenue reserves fell by 6.3 per cent (Table 2).

Table 2: **Revenue reserves have increased in ST&CCs, and fallen in districts between 2007/08 and 2008/09**

	Total general reserve 2008/09 (£000)	Percentage change since 2007/08 <sup>i</sup>	Total earmarked reserve 2008/09 (£000)	Percentage change since 2007/08 <sup>i</sup>	Total uncommitted capital 2008/09 (£000)	Percentage change since 2007/08 <sup>i</sup>
District councils	711,426	-6.3	1,092,261	-3.3	1,762,631	-23.6
All ST&CC	2,080,377	2.7	5,507,554	-3.9	1,222,754	-19.8
All councils <sup>ii</sup>	2,791,803	0.3	6,599,815	-3.8	2,985,385	-22.0

Source: Audit Commission, figures taken from audited accounts 2008/09

**79** Uncommitted capital reserves fell across all councils by 22 per cent. These were used to bridge the funding gap left by the collapse of capital receipts, or to finance decisions to bring forward capital programmes to help local economies.

**80** Districts generally have higher relative reserves than other councils; their median level is 8 per cent of expenditure,<sup>iii</sup> compared with 5.4 per cent for ST&CCs. One-quarter of districts have revenue reserves of over 14 per cent of annual expenditure. Only three ST&CCs (around 2 per cent) have reserves at this level.<sup>iv</sup> Many districts could use their reserves to support a level of expenditure that slightly exceeded income for several years, giving them time for planned cost reductions (Figure 11).

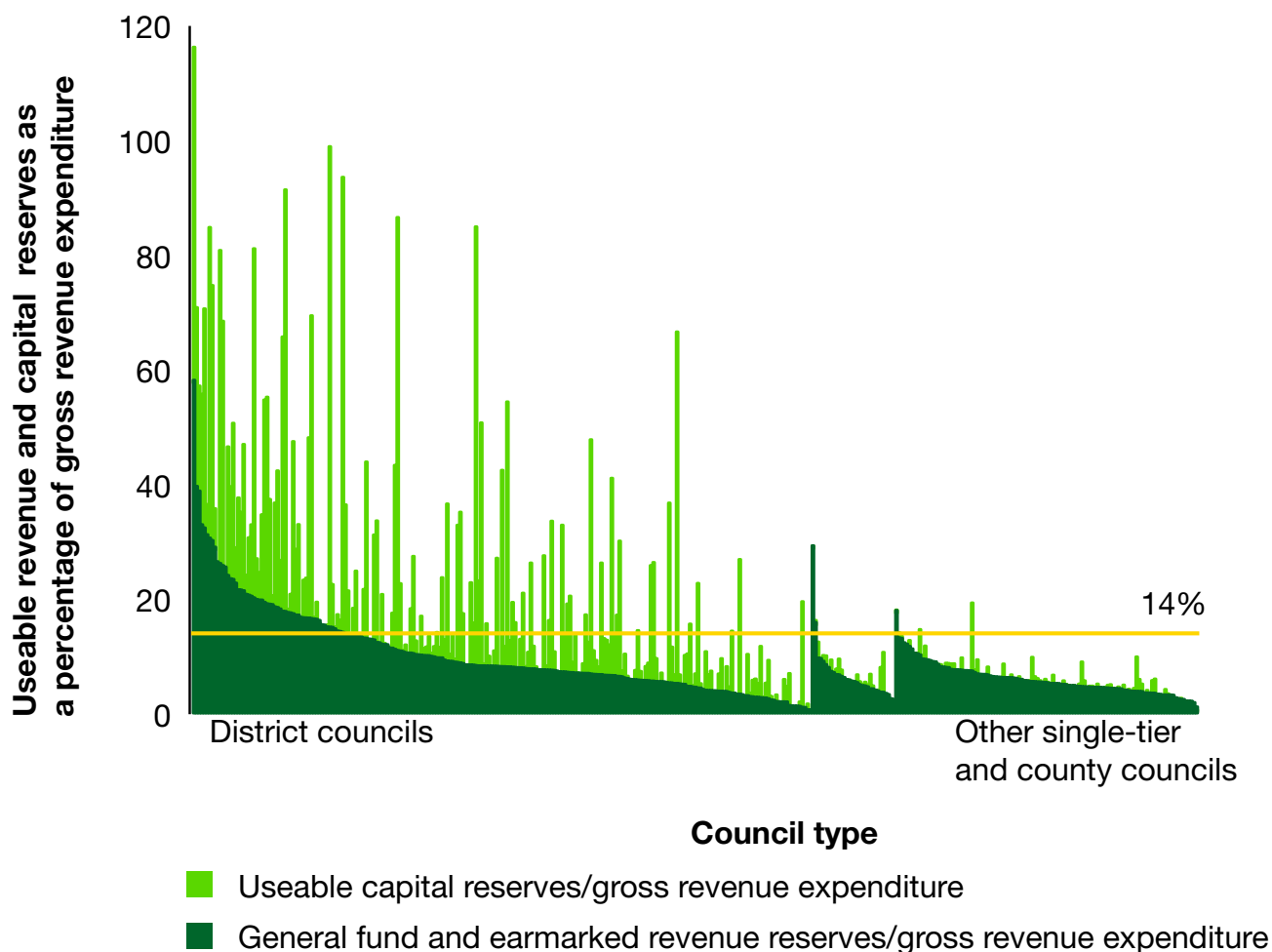
i Adjusted for inflation to 2008/09 prices.

ii Excluding City of London, the Isles of Scilly and new authorities that came into existence on 1 April 2009.

iii Median useable revenue reserves as a percentage of Gross Revenue Expenditure.

iv There is no required, or ideal level of reserves. This is a matter for each council.

Figure 11: Reserves as a percentage of gross revenue expenditure, 31 March 2009



Source: Audit Commission, from audited accounts 2008/09

**81** Reserves continue to be used in 2009/10 to replace lost income or cover overspends (Table 3). Some underestimated the ongoing falls in income and had to amend their budgets in year. Others have still not found the savings needed to replace lost income.

Table 3: Use of reserves in 2009/10

	Expected change in revenue reserve levels April 2009 to April 2010		
	Total general reserves %	Total earmarked reserves excluding schools %	Total %
DCs	-23.2	-38.5	-31.0
ST&CC	-13.7	-34.3	-27.5

Source: Audit Commission, based on data from 28 councils

**82** Councils with higher reserves have used these to provide some breathing space. For example, Chichester District Council used £900,000 of reserves to balance the 2009/10 budget, which gave the council time to find efficiencies (see [Appendix 2](#)).

## **The geographical impact of the recession on service demand and income**

**83** Different rates of economic recovery affect council finances. Income is still falling for some, while more prosperous parts of London and the South report that economic recovery has started and income is recovering. Demand also varies, especially for housing and council tax benefit.

### **Same income source, different local economies**

**84** Car park usage generally fell in 2008/09. In some areas income fell, even where usage remained high, because councils reduced charges to maintain or increase the numbers of visitors to help local businesses.

- In Stafford Borough Council, car parking income was £672,000 (23 per cent) below budget in 2008/09. It has remained at this lower level in 2009/10.
- Parking income from on-street and CCTV enforcement in the London Borough of Camden fell by £6.2 million to £20.2 million in 2008/09.

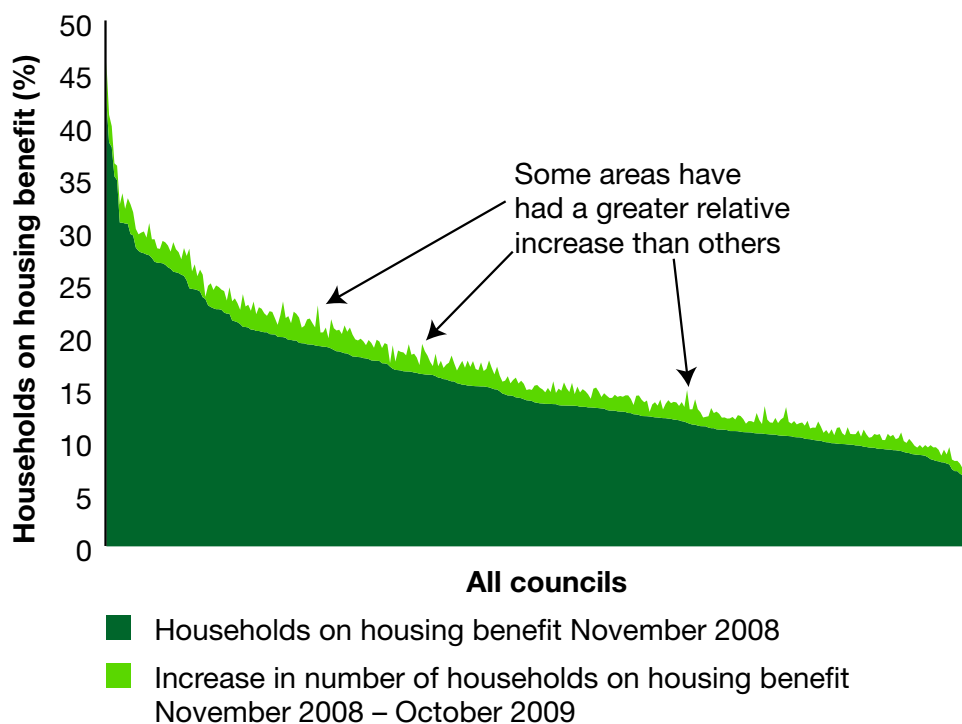
**85** In some tourist areas, or where new attractions have opened, car parking income has held up well.

- St Edmundsbury saw a major growth in car park income when a new shopping complex opened, the only one to open in the UK in 2009.
- One council benefited from increases in domestic tourism, with higher car park usage in summer 2009. The council received £2 million in 2008/09, an increase of 7 per cent. Income for 2009/10 is expected to rise to £2.2 million. This increase is partly due to the council changing its fee structure.

### **Council tax and housing benefit – variations in impact and response**

**86** All councils have seen an increase in successful applications for council tax and housing benefits, but the increase has not been uniform. Some have had to manage more rapid increases than others (Ref. 8). The fastest increases are not always in areas with a high percentage of households already on benefit. Some smaller benefits teams have had to react quickly (Figure 12). Responses to this challenge are summarised in [Appendix 1](#).

Figure 12: **Relative increases in housing benefit**



Source: *DWP housing and council tax benefit statistics*

## Resilience of council finances

**87** This chapter has discussed a number of features that affect how well placed each council is to cope with the impact of the recession, or any financial shock. Key factors are summarised in Figure 13.

**88** It is risky to be heavily reliant on one source of income, but the councils that are at risk will change as the economy recovers. Grant dependence – an advantage while national settlements have been protected – will become a challenge when public spending is squeezed. Councils that depend on local income have fared badly in the recession but, as the economy improves, these income streams should start to recover, partly compensating for constraints on central grants.

Figure 13: Features affecting financial resilience



Source: Audit Commission

**89** Councils with a balanced portfolio of income, a wide range of services and healthy reserves will cope best, as they can respond flexibly to changes. Some districts have struggled. They are smaller organisations, providing a narrower range of services, so are less able to spread risks. However, many have higher levels of reserves.

**90** By analysing its finances, and testing different scenarios, a council can assess the vulnerability of its financial position now and in the future. This requires an understanding of its income profile, the types of services it provides, the risks to each and the state of its reserves. This, combined with knowledge of the local economy, can be used to support strategic financial management. Not all councils analyse and plan in this way. The Commission is planning a study on strategic financial management that will examine some of these issues.

# A challenging future: responses to financial pressures

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**This chapter looks at how councils are responding to the financial challenges they face. It considers why some councils are moving faster and are more confident about the future than others. It is based on information about the financial position and future plans of over 40 councils covering all types and regions.**

### **An uncertain future for public spending**

**91** The recession and banking crisis have left a large deficit in public finances. The government plans to reduce this budget deficit by real reductions in public spending, and tax increases.

**92** The current three-year spending plan ends in March 2011. The level of government support for councils thereafter will be determined against this wider backdrop of real reductions in public expenditure. Councils are unlikely to escape cuts. Large cuts could be a challenge for councils in their delivery of frontline services. But there is no clarity on the size of public spending reductions, over how many years cuts will be spread, or whether any services or geographical areas will be protected.

**93** In early 2010, all councils set their budgets and council tax levels for 2010/11 based on the current grant settlement figures. While the situation may change during the year, initially government grant will be at pre-recession levels, potentially giving councils some breathing space.

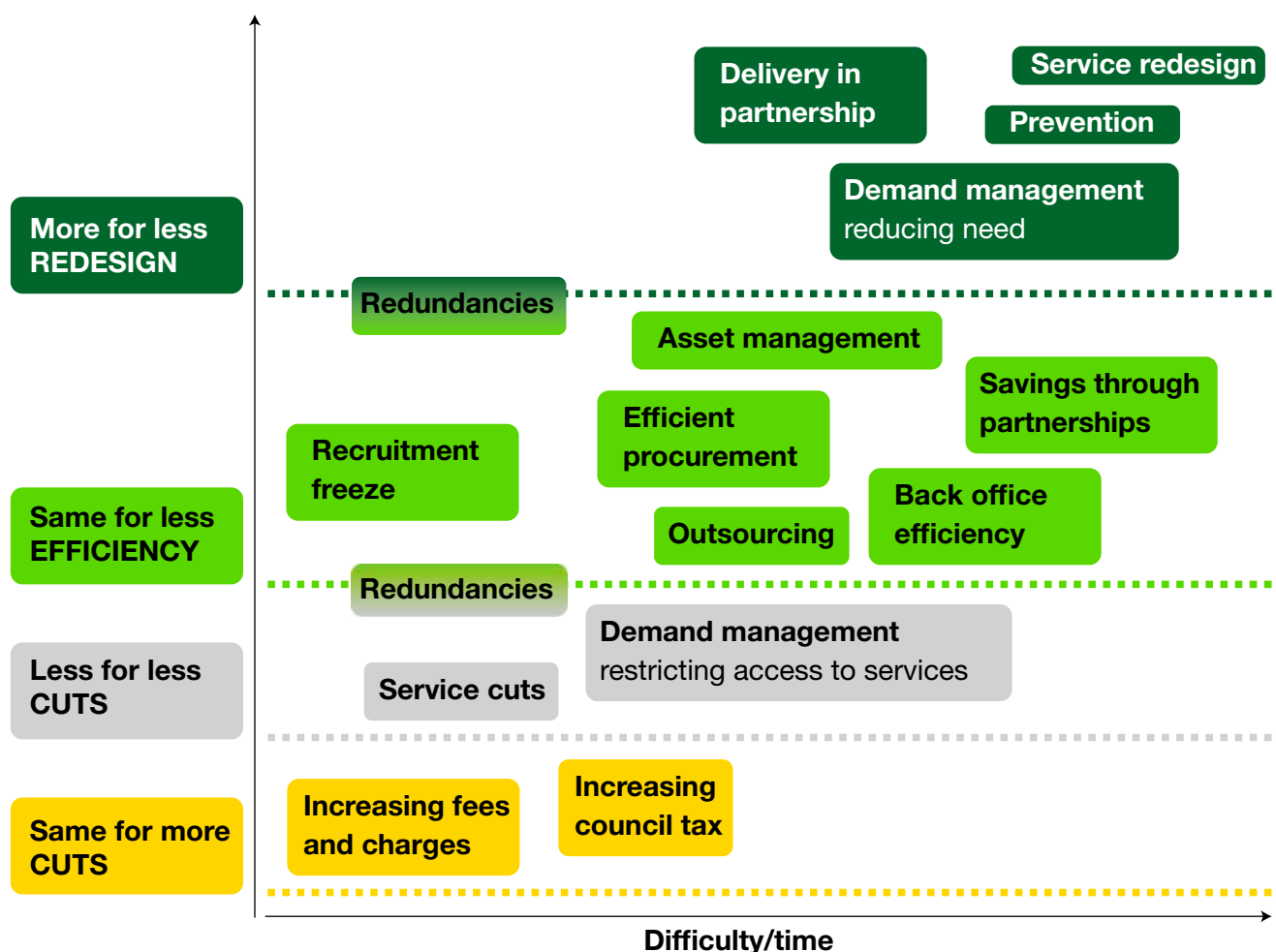
### **The challenge: delivering more for less**

**94** There are a range of actions councils can take to bridge funding gaps, from cuts to major service redesigns (Figure 14). Councils are planning for savings of between 1 and 15 per cent over the next three to five years, but progress towards these targets is very variable.<sup>i</sup>

**95** Standard actions to improve efficiency are important and, if implemented successfully, will deliver the same level of service at lower cost. However, with demand rising and income falling, these may not be enough. More creative solutions such as demand management, prevention, and rethinking service delivery, could be needed if frontline services are to be protected. This may have to involve a shift towards individuals taking responsibility for services currently provided by the state. But significant changes often take time, investment and political will.

<sup>i</sup> Based on the 40 councils that took part in this research.

Figure 14: **Cuts can be made quickly. Delivering more for less is harder and takes longer**  
 Improving front line services while reducing costs requires a radical rethink of how services are delivered. This takes time.



Source: Audit Commission

## How councils are responding

**96** The extent of local planning for the future is very variable. Almost all councils are taking standard actions to cut costs. Many are going further. They fall into three broad groups:

- taking basic efficiency measures, with limited plans for the future;
- recognising the scale of the issue, but response not yet developed; and
- thinking bigger, looking further ahead, often with a track record of change.

**97** There is a further small group of councils that had major financial problems, and savings plans to address them, before the crunch. Like councils in the third group above, they have made major savings. Unlike these councils, their plans were a reaction to internal financial problems, rather than a proactive response to future demand. Some of the councils in this group still do not have adequate long-term plans.

**One metropolitan council predicted that, after 2011, savings of 5 to 12 per cent per year may be needed, but had no plans for achieving this**

**From 2011/12, savings of £1 million a year will be needed. The district council is 'still considering the areas to be targeted'**

#### **Basic efficiency measures, limited future plans**

- 98** Immediate income losses caused by the recession have been met in most councils by a range of standard belt-tightening measures including:
- recruitment freezes, maintenance cut backs and putting new projects on hold;
  - targeted cut backs in planning and development to offset falls in income. A heavy reliance on contractors has kept down direct staff redundancies;
  - action to prevent council tax arrears and minimise losses from commercial rents; and
  - reviews of fees and charges.

**99** This may suffice for those with large reserves, but some councils appear over-optimistic about the future, or are waiting for more clarity and (or) the elections before acting. Some members have not yet fully engaged with the issues.

**100** All councils should have a medium-term financial strategy, but some in this group have avoided planning beyond 2011, despite recognising the issues they face. They may miss the opportunity to act early.

#### **Recognise the scale of the issues they face, but plans not fully developed**

**101** Most councils recognise the scale of the issues they face, and are taking action. But elements of their plans are poorly defined, over-optimistic or too reliant on one high-risk and (or) long-term initiative.

**102** Shared services is a key element of many savings plans. Some initiatives are delivering on time; others have failed or estimated savings appear unrealistic (see [Appendix 2](#)).

### Case study 1

One county was working with district and fire authority partners on a major shared support services project covering finance, human resources, IT and property services. Potential savings were more than £80 million across the partners, with £45 million savings over ten years for the county. However, one district pulled out because of incompatible finance systems and another because of fears of outsourcing jobs from the local area. The project was wound up in December 2009 without delivering any savings.

**Lichfield council is working with Tamworth on a joint waste service that should save £750,000 per year**

**103** A number of plans rely on partnerships for future savings but, as with shared services, these plans can be vague or timings optimistic. Savings generated through working with others take time, and may not deliver the scale, and speed, of savings needed (Refs. 9, 10). This risk is recognised by some.

**104** Some councils in this group are carrying out more fundamental reviews of structures and service delivery, often supported by external consultants. As of early 2010, few have been implemented.

#### **Thinking bigger, looking further ahead, with a track record of change**

**105** Some councils were planning efficiencies, to fund predicted future demands, before the credit crunch added urgency. They are ahead of most in terms of delivery, although the level of savings in their plans may need increasing.

**106** Savings initiatives include outsourcing, service reviews, de-layering management structures and reducing the size of senior management teams. They have often involved joint work with others. These savings have been long planned, illustrating the significant lead-in times that can be needed for big cost reductions to be achieved. But these councils are well placed to generate further savings by building on their experience and solid relationships.

### Case study 2

Procurement efficiencies in Sunderland City Council saved £1.5 million in 2009/10. The target for 2010/11 is £3 million. This is part of a wider Sunderland way of working efficiency programme with a target of £50 million savings over four years. The council invested in new managers to help deliver the change. The targets increase over a four-year period. This recognises the need to scale up the programme and gives time for the new way of working to become embedded throughout the council. This planned approach should mean redundancies are minimised. The programme includes staff retraining and service redesign.

### Case study 3

The City of Westminster has an ongoing efficiency drive that delivered £6 million savings in 2008/09. It is continuing its efficiency programme and Council restructuring. It works closely with the PCT. For example, 60 of its 140 adult commissioning staff are paid for by the PCT. The two bodies are looking at further joint contracts.

**107** Some have tried to reduce demand, or redesign service delivery, including:

- minimising unnecessary customer contact by delivering right first time services as some have done in reorganising housing benefit sections (see [Appendix 1](#));
- encouraging self service, through better electronic forms and information; and
- working to prevent children from needing care or reducing hospital admissions for older people by preventing trips and falls. Often this requires partnership working.

## Overall picture on responses

**108** Some responses are proportionate to the issues faced, but some are not doing or planning enough.

**109** Most initiatives are aimed at delivering the same for less. More radical actions – to constrain demand or to provide more for less through prevention and rethinking service delivery – will be needed to keep ahead of rising demand, particularly for ST&CCs. Cuts may also be needed, but few councils are acknowledging this in current plans.

**110** The tight financial situation is focusing minds. Previous work by the Commission on innovation and value for money (Ref. 11) identified financial

pressure as a driver of major innovation. Many officers think the same will be true of the current situation. Already more districts are looking seriously at joint working. In some cases this includes joint chief executives and joint management teams.

#### Case study 4

In 2007, Adur District Council and Worthing Borough Council entered into a partnership for the delivery of their local services. The councils created a joint senior management structure. Through a programme of service reviews the two councils expect to save £860,000 in 2009/10, rising to over £1.2m by 2011/12.

## What gets in the way of better planning?

**111** Councils recognise that income will fall and demands rise, but this has not always been translated into planning for future change. Barriers to sound planning include:

- financial uncertainty about the future, in particular the extent and nature of cuts in public spending;
- inadequate political engagement, weak consultation on real choices;
- a lack of capacity; and
- unrealistic expectations about the financial benefits of joint work and the speed with which partnerships can deliver savings.

### Financial uncertainty

**112** Simply knowing that grant will be less generous does not give councils a clear steer on the level of change needed. Change will be challenging and may involve service cuts. Some members are not happy to start this difficult work without a clearer understanding of how far they have to go.

### Inadequate political leadership and poor public involvement

**113** The scale of change needed in many councils requires strong leadership. Some local members have been more focused on the national and local elections. Those councils with clear plans reported effective links with, and support from, executive members. Some reported wider discussions with members; for example, through overview and scrutiny committees. One council commented that the recession has helped to improve relationships with cabinet, with weekly meetings in 2008/09 to discuss finances. The management team was able to get rapid member buy-in to changes. However, another council noted that members were not engaged in the financial debate or in looking at reprioritising: 'they won't consider significant changes until after the election'.

**'Members won't consider significant changes until after the election'**

**114** Public consultation has not had to tackle serious budget reductions for many years. Councils are unsure how to deal with this.

**115** In some areas the chances of achieving savings through working with partners and shared services are hampered by a legacy of mistrust, poor relationships with partners and (or) neighbours, or uncertainty surrounding local government reorganisation. It is hard to overcome these barriers without members' support and leadership.

#### **Lack of capacity**

**116** Few managers in local government have experience of managing through a recession with contracting finances. Change and financial management skills are particularly stretched in some districts.

**117** Every year, Commission-appointed auditors report their views on council strengths and areas where they need to improve their use of resources.<sup>i</sup> These assessments suggest that councils are relatively strong at short-term budget control and making efficiencies.

**118** But auditors were concerned about 38 councils (11 per cent) that lacked the capacity for effective service redesign, and 46 (14 per cent) that were not good at reviews of service competitiveness. These are the skills needed to deliver major savings while minimising the impact on services.

#### **Unrealistic expectations about the savings from joint work**

**119** Joint working can deliver significant savings but they are not automatic. Previous work by the Commission confirms that partnerships and joint work without the right approach do not necessarily deliver savings (Refs. 9, 10). Partnerships require work. (Refs. 12, 13). There has been much emphasis on Total Place,<sup>ii</sup> which is identifying ways to improve joint working to address complex and cross-cutting issues at the local level. It is also highlighting medium to longer-term solutions, recognising that some will take longer to deliver significant change.

- i Auditors only report on major concerns or particular strengths and do not give comment for most councils.
- ii Total Place is a new initiative that looks at a 'whole area' approach to public services. It identifies duplication between organisations to save costs and improve services at the local level.

# Impact on local employment

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**This chapter looks at the significance of local public services as employers. It identifies different approaches to reducing pay bills and reviews councils' plans.**

**120** As Chapter 6 illustrated, councils are making efficiencies and planning more in anticipation of public spending cuts. Staff costs make up half of expenditure, so efficiencies frequently involve cuts in the pay bill; often delivered through job losses. However, councils and their partners can be major employers in local labour markets and decisions on staffing have wider consequences.

**Public sector employment**

**121** There was a small increase of 14,000 (0.8 per cent) in council, schools, police and fire service employment in 2008/09 – Table 4. NHS employment increased by 38,000 (2.8 per cent) in the same period.<sup>i</sup>

Table 4: **Total full-time equivalent (FTE) employment in councils, schools, police and fire services increased slightly in 2008/09**

Service area	2007/08 employees	2008/09 employees	Percentage increase
Police	224,800	230,700	2.66
Fire	51,600	51,700	0.15
Local councils (including education staff)	1,460,200	1,468,300	0.55
Total police, fire, local authority and education employment	1,736,600	1,750,700	0.81

Source: Government departments and Local Government Association

**122** There is variation within this overall picture. The number of school support staff and teaching assistants has risen by 4.5 per cent, while council employment excluding school staff has fallen by an estimated 2 per cent.<sup>ii</sup>

- i Based on headcount rather than full-time equivalents.
- ii A split of education and council staff is not readily available. The percentage change in numbers employed by councils has been estimated based on DCSF information on changes to schools staffing, and an analysis of the pay bill by service. The calculation assumes that average pay per FTE is similar across services, so is a broad estimate only. However, total employment in councils and schools increased by around 8,000 and, per DCSF information, schools employment has risen by 20,000. This confirms a small fall in council employment excluding schools.

**123** The growth in local public sector employment is coming to an end. Every council in our research group reported some staff reductions and almost all have at least partial recruitment freezes. The majority expect to make more major reductions in future. This is consistent with a BBC survey in March 2009 covering 49 ST&CCs,<sup>i</sup> suggesting workforce reductions of 10 per cent over the next three to five years.

**124** As a lot of council spending is on pay, the efficiencies underway, or planned, inevitably involve savings on staffing. Overwhelmingly, these efforts have focused on reducing the numbers employed. Examples include:

- recruitment freezes;
- abolishing vacant posts;
- not renewing short-term contracts and (or) reducing agency staff;
- restructuring to strip out layers of management; and
- redundancies.

**125** The rate of job losses in councils has accelerated in 2009/10. We compared the reasons for staff leaving councils in 2008/09 with the first six months of 2009/10.<sup>ii</sup> There has been a fall in turnover and a rise in the proportion of leavers that were ‘enforced’. They were either made redundant, had to retire early or did not have their short-term contract renewed (Table 5).

Table 5: **Percentage of enforced leavers in councils – 2008/09 and 2009/10**<sup>iii</sup>  
More people are losing their jobs in councils in 2009/10, particularly in districts.

	District councils			ST&CC		
	Numbers of ‘enforced’ leavers	‘Enforced’ leavers as % of total staff	‘Enforced’ leavers as a % of all leavers	Numbers of ‘enforced’ leavers	‘Enforced’ leavers as % of total staff	‘Enforced’ leavers as a % of all leavers
2008/09	461	6.1	28	4,890	2.8	19
First 6 months 2009/10	615	8.3	60	3,045	1.7	23

Source: Audit Commission based on returns from 12 districts and 14 ST&CCs

## Employee costs

**126** Half of all local government service<sup>iv</sup> expenditure goes on directly employed staff (Table 6).

i Accessed from [news.bbc.co.uk/1/hi/england/8528836.stm](http://news.bbc.co.uk/1/hi/england/8528836.stm) 1 March 2009.

ii For 26 councils in our group that provided this detailed information.

iii These councils may still be recruiting to some posts, so this does not necessarily mean that the total employed has fallen by this percentage.

iv Councils, schools, police and fire.

Table 6: **Direct employee costs as a percentage of total local government expenditure**

Service	Total expenditure in £ thousand	Spend on direct employees as a % total expenditure
Education	47,368,279	66
Social care	24,499,804	28
Environment, planning, non-HRA housing, culture	18,126,561	30
Police and fire	14,918,906	81
Central and other	14,044,406	45
Highways and transport	8,575,214	15
Total local government expenditure	127,533,1705	49

Source: CLG from Revenue Out-turn Service Expenditure Summary (RSX) 2008/09.

**127** Much of the non-employee spend also pays for staff providing frontline services who work in the private and third sector; for example, through contracts with street cleaning firms or providers of social care. This explains the low percentage of social care spend on direct council employees. Some councils contract out more services than others. Where outsourcing is more limited, the proportion of spend that goes on salaries will be higher.

### Factors affecting the amount spent on pay

**128** Annual changes in the pay bill are driven by:

- changes in the numbers employed;
- the annual pay rise for staff;
- salary increments;
- changes in grade mix;
- changes in levels of flexible working including the balance between full and part-time;
- transfers of staff to contractors following outsourcing;
- the impact of equal pay and single status;<sup>i</sup>
- changes in employers costs such as pensions;
- changes in overtime levels; and
- expenses and other pay-related costs.

**129** The changes between 2007/08 and 2008/09 are set out in Table 7 below for council staff. This estimates that factors other than the pay rise

<sup>i</sup> All council staff moved over to the same terms and conditions of service in the 1997 Single Status agreement. This involved changes to working hours and pay rises for some staff. Resulting financial changes have been implemented in most councils, but not all.

and the numbers of full-time equivalent employees added around 2 per cent to the total pay bill. One of the main factors is likely to be the cost of salary increments, known as pay drift. This has been estimated as 1.22 per cent (2.5 per cent for full time staff) by Local Government Employers (Ref. 14).

**Table 7: Changes in the pay bill – council staff excluding education**

The pay bill for council staff increased by more than the national pay settlement despite an estimated 2 per cent fall in FTEs employed.

Pay deal 2008/09	2.79%
Estimated change in numbers employed (excluding education)	-2.0% <sup>i</sup> (estimated)
=> <b>Expected increase</b> if the only changes were in basic pay and numbers employed	0.8%
<b>Actual increase</b> in pay bill 2007/08 to 2008/09	3.0% <sup>ii</sup>
Difference	2.2% (estimated)

*Audit Commission, based on a number of sources; see Footnotes*

**130** The national pay rise of 1 per cent has helped to contain staff costs for 2009/10, and many councils are making redundancies, but the other factors such as pay drift are still an upward pressure.

## The public sector is an important employer

**131** A decision by a major local public sector employer, such as the council or hospital, to cut jobs can affect the wider economy in the area. In some parts of the country where there are few private sector jobs, local public services are key employers. This is particularly true for women and part-time workers (Table 8).

<sup>i</sup> See reference to Paragraph 122.

<sup>ii</sup> From the RO forms, excluding back pay for equal pay claims. This was 0.7% of pay bill in 2007/08 and 0.2% in 2008/09.

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Table 8: **Employment profiles in the public and private sectors**<sup>i</sup>

Almost three-quarters of public sector staff are women.

	Percentage male	Percentage female	Full-time	Part-time
Public sector	27	73	58	42
Private sector	59	41	73	27
Total workforce	51	49	69	31

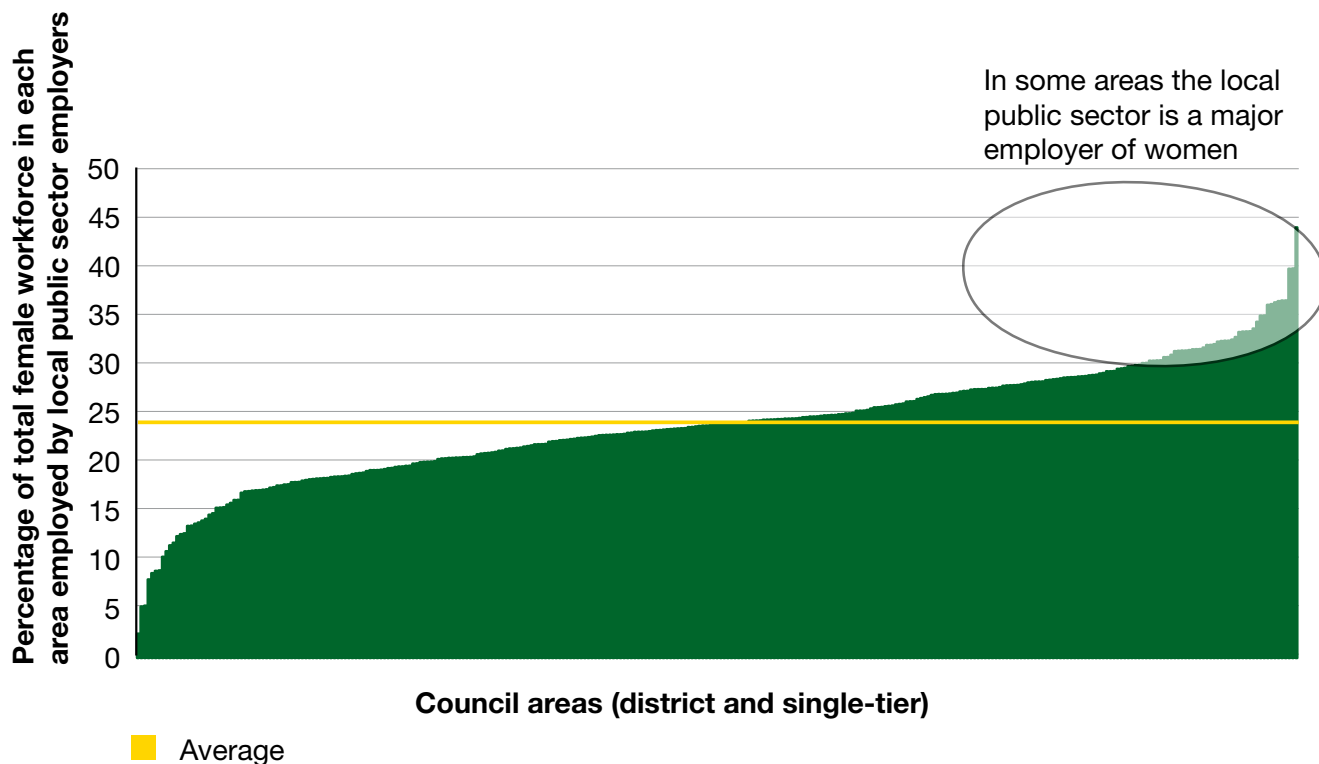
Source: ABI data from NOMIS 2008

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**132** We have carried out a sensitivity analysis of local public service employment – see [Appendix 3](#) for methodology and additional maps.<sup>ii</sup> On average, 16 per cent of the employment in an area is in police and fire services, councils, schools or the NHS, but this varies from 4 to 30 per cent. Women are more dependent on the public sector with, on average, a quarter of the women employed in each area working in local public services.<sup>iii</sup> In around 50 areas, this rises to more than 30 per cent (Figure 15).

- i All definitions are from the 2003 Standard Industrial Classification. Public Sector Definition – Sections L, M, N. Private Sector Definition – Sections A, B, C, D, E, F, G, H, I, J, K, O, P, Q.
- ii This analysis looks at the numbers of people employed in each area by the council, police, fire, education and health. This is calculated as a percentage of the total number of jobs in that area. It is not a percentage of the resident population or workforce, but of jobs located within the area boundaries. A high percentage would be found in an area where there are limited private sector jobs, making public sector employment a higher proportion of all jobs.
- iii This includes police, fire, councils, education and the NHS.

Figure 15: **Women employed in councils, education, police, fire and the NHS as a proportion of the total female workforce by council area**



Source: Audit Commission based on quarterly public service returns, NHS information centre, Communities and Local Government Fire and Police statistical bulletins, Annual Business Inquiry. See [Appendix 3](#)

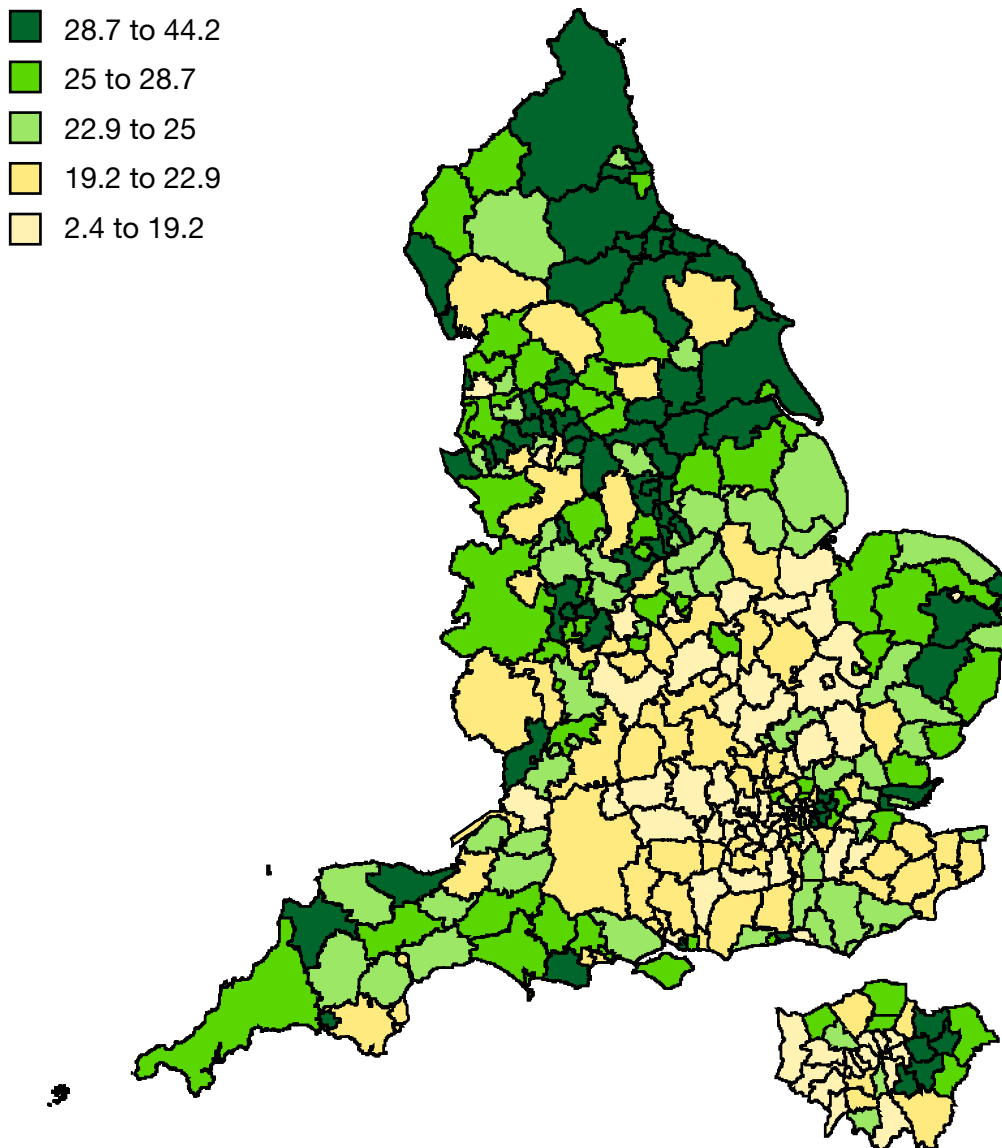
**133** The map at Figure 16 shows the areas where women are most dependent on local public service jobs. Public sector job losses here may have a significant impact on the economy of the areas. At worst, they might contribute to lowering consumer confidence, further accelerating localised downward economic spirals.

**134** The areas with the highest levels of sensitivity are often already deprived because a weak local private sector is a key reason for greater reliance on public sector jobs. They also include rural areas, including some with high retirement populations. Here, long-distance commuters may have reasonable incomes but there are limited jobs in the council area, and choice is restricted by poor transport links.

**135** The greatest economic impact of job cuts will be in those areas where a high percentage of employment is in the public sector (as shown for women in Figure 16) and there are already high unemployment rates. There is a risk that public sector staff who are made redundant and cannot find other work will become clients for housing benefit and debt advice, and potentially long-term unemployed.

**Figure 16: Female employment in local public services as a percentage of all female employment in the area**

All females in local public sector employment – councils, schools, fire, police and health – as a percentage of total employment in the area.



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[Appendix 3](#) provides a number of other maps.

Source: *Audit Commission*

## Reducing the pay bill; taking a wider view

**136** Reducing the pay bill while maintaining employee numbers can have advantages for councils and their staff, as well as constraining the rise in unemployment and associated social tensions. Councils will avoid redundancy costs and retain skills and knowledge that may be difficult to replace. For example, some councils did not want to lose planning skills where there is a shortage of qualified people so have redeployed some of these staff. They will also retain capacity; important in maintaining frontline services.

**137** Councils can look at ways of reducing staff costs without, or in addition to, cutting the numbers employed.

### Case study 5

Solihull Metropolitan Borough Council is asking staff to work more flexibly and will offer voluntary reductions in hours or additional unpaid annual leave. This will reduce workforce costs but retain the skills base and improve work-life balance for employees.

### Case study 6

St Edmundsbury District Council is reviewing all aspects of the pay bill as part of its overall savings work. It expects to reduce overtime, travel and subsistence and essential car-user allowances (through more use of pool cars).

**138** Private firms used pay freezes or even pay cuts in the recession to preserve jobs, skills, improve competitiveness and ultimately to ensure the survival of the business. This is rare in the public sector, as pay increases are nationally negotiated, but councils could explore options with their staff and unions to minimise redundancies. For example, The Royal Borough of Kensington and Chelsea agreed on a pay freeze for 800 of its most senior staff and councillors in 2010/11.

**The Royal Borough of Kensington and Chelsea agreed on a pay freeze for 800 of its most senior staff and councillors in 2010/11**

## Minimising the impact of job cuts

**139** If job cuts are needed, councils and LSP partners should be aware of the impact these will have in their areas, particularly where alternative jobs are in short supply.

**140** A number of councils have worked with external employers and colleges. For example, a lot was done to soften the impact of the Rover plant closure in the West Midlands (Ref. 15). Councils with a legacy of coalfields and older manufacturing industry have also worked on training and sometimes on transport links between communities with high unemployment and employment areas. This approach was discussed in a Commission report, *A Mine of Opportunities* (November 2008, Ref. 16).

# Conclusions

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## Conclusions

**141** The impact of the downturn on council revenue finances has been manageable so far as government grant, the main source of funding, has maintained its level and value, and the national pay rise was less than many had budgeted for. Capital programmes have been hit by the falls in capital receipts. Many councils used revenue and capital reserves to cover short-term losses.

**142** But impacts vary and some councils, particularly districts, have been harder hit. Falls in local income due to the recession have been a bigger problem for districts as they rely on this source more heavily.

**143** The future for local government finances is challenging. Service pressures linked to the recession may increase further. Issues such as the ageing population, rising birth rate and the response to the Baby Peter case mean financial pressures, particularly for ST&CCs. Cuts in public spending are likely, but there is no clarity on the size or whether any services will be protected.

**144** Overall, short-term income losses are the major concern for districts. The medium-term issue of funding rising demand for services with shrinking resources is the main worry for most ST&CCs.

**145** The balance of different income sources within a council has a big impact on financial resilience. The kinds of services provided, and the state of the local economy, also influence a council's ability to withstand financial shocks. Scenario testing can help councils prepare and plan financially.

**146** The model of public-private funding for regeneration, growth areas and affordable housing depends on accessible credit for private developers and house buyers, and rising land and property values. The recession has undermined this model, threatening the recovery in some areas, and the delivery of sustainable future communities.

**147** Councils should be responding now to potential funding cuts if they are to minimise the impact on frontline services. Major efficiency projects take time and investment. Quick savings are more likely to involve cuts. The last year of pre-recession levels of funding, 2010/11, should be used to prepare for operating at a lower cost base.

**148** The level of preparedness for the leaner times ahead is variable. Most councils are making some savings and planning more, but some do not have detailed financial plans beyond 2010/11.

**149** Good leadership from members is important. Not all have been engaging in debates on how to respond to the changing financial climate. Some are unwilling to take radical steps without clarity on future funding.

**150** Some councils are trying to constrain demand or deliver more services at lower cost. This is challenging. Joint work is often key to success here. Innovation, planning, investment and political leadership will be crucial. Some councils, particularly districts, lack the capacity to make this kind of change.

**151** Almost half of local government spending goes on paying staff. Efficiencies will mean reducing the pay bill. Most councils have focused on cutting jobs and posts as the means to achieve this. But local public services are major employers,<sup>i</sup> particularly of women, and in areas where the private economy is weak. Reducing the number of people employed can damage the local economy, and the council, as skills and capacity are lost and redundancies are costly.

**152** The pay bill can also be reduced by offering more flexible working, changing entitlements to annual increments, reducing expenses and overtime, and introducing pay freezes or even pay cuts. Few councils are exploring all of these options as a way of minimising negative impacts of their decisions on the local jobs market.

<sup>i</sup> Including councils, education, police and fire and the NHS.

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