TRL Insight

Response to *Local authority funding reform: objectives and principles*

Executive summary

1. Context and comment on consultation as a whole

Responses to the consultation could only be made through a Citizen Space online form. This required the respondent to answer each question in turn. There were 19 questions.

Three of these simply asked the respondent for their views as free text in a box (with the instruction “If you have views, please share these and any supporting explanation or evidence”).

For the rest, the respondent was asked to select between a set of options, then “provide any additional information, including any explanation or evidence for your response” as free text. In 14 cases, the options were:

- Agree
- Neither agree nor disagree
- Disagree
- No view

In the remaining two questions, the options were specific to the question.

This Executive Summary is therefore not part of TRL Insight’s formal response to the consultation – it is simply provided for the ease of reference for third parties and to set out TRL Insight’s views on the consultation as a whole.

2. Key points

For convenience, the key points in TRL Insight’s response are summarised as follows, in TRL Insight’s approximate order of priority.

- Equalise for council tax and business rates at same stage of BRR calculation;

- Introduce a fresh round of Tax Increment Financing schemes, where growth (in both business rates and council tax) would be excluded from this equalisation;

- Avoid use of taxbase projections, as this bakes in an assumed minimum level of taxbase growth – and model the use of historic/lagged taxbase data;

- Take advantage of the greater retention of council tax from these measures to refocus New Homes Bonus – providing a top-up for retained council tax from lower band properties and (if necessary) supporting affordable housing;

- Model the options of partial and rolling resets of business rate growth and rolling resets of the needs assessment;

- Start looking into broadening the local government tax base now, and how new taxes may be equalised for (so that this could be implemented not in the 2026 reset, but in the one after) – then use this in preference to New Burdens grant funding in future;

- Avoid the urge to simplify the need assessments in cases where this would significantly change the pattern of funding or would ignore important features of the funding needs for some authorities;

- Improve the assessments of differences in unit cost of providing services (the Area Cost Adjustments) – for example, acknowledging the higher spend on fuel and vehicle maintenance where rounds are longer;

- Make improvements to the Community Infrastructure Levy – provide clarity about its purpose, remove the legal restriction from borrowing against it and consult on greater local flexibility;

- Increase the financial autonomy of local government, including over sales, fees and charges policies;

- Ditch the patronising language of “rewarding” councils for growth.

Responses to individual questions

1. Summary of the government's proposed response

Question 1: Do you agree with the government's objective to allocate grant and retained business rates income in a way which accounts for differences between local authorities in demand for services, the cost of delivering them and ability to raise Council Tax locally?

- Agree

TRL Insight agrees that tariffs and top-ups should account for differences between local authorities in demand for services, the cost of delivering them and ability to raise Council Tax locally.

However, as set out in the response to the questions in Chapter 4 below and TRL Insight's forthcoming report 'Unlocking capital investment in local economic development' (which will be emailed to MHCLG shortly), council tax and business rates should be equalised for at the same stage in the calculation of tariffs and top-ups.

TRL Insight welcomes the fact that the consultation specifies that RNFs measure differences in demand and that ACAs measure differences in costs of providing services.

Question 2: In addition to the areas included in this consultation, are there elements of the local government finance system that are not fit for purpose and require improvement and reform? If so, please provide information on what reforms are required and why.

It would help to provide clarity about the purpose of the Community Infrastructure Levy and some reform of it, as will be set out in 'Unlocking capital investment in local economic development'. Specifically:

- clarity that CIL is to pay for the cumulative infrastructure needs of development, as opposed to the site-specific infrastructure covered by Section 106, and that developers need to contribute to both types of infrastructure;

- reform to remove legal restriction from borrowing against it and consult on greater flexibility for levying authorities, to help ensure it’s viable everywhere.

Question 3: Do you agree that the suggested principles should inform our approach to updating local authority funding allocations?

⊙ Agree

2. Measuring differences in demand for services

Question 4: Do you agree with our proposal to use the best available evidence and most up-to-date data in the assessment of need, including using the most recent census data?

⊙ Agree

Question 5: Do you agree with our proposal to simplify the assessment by reducing the number of Relative Needs Formulae? If you disagree, please explain why and which service areas you are concerned about.

⊙ Neither agree nor disagree

Simplification is helpful as long as it doesn’t differ significantly more from the observed pattern of spend than a more sophisticated formula would. TRL Insight urges the Government not to make changes for the sake of simplification, if they ignore important features of the funding needs for some authorities.

Question 6: For the children, young people and family services formula, do you agree that the variables set out are the right ones to consider in an assessment of relative need? If you recommend the addition or removal of variables, please provide supporting evidence and recommend a suitable dataset.

⊙ No view

Question 7: Do you agree that the government should consider updating the data in the fire and rescue services Relative Needs Formula?

- No view

3. Measuring differences in the cost of delivering services

Question 8: Do you agree we should assess differences in cost using an Area Cost Adjustment based on the structure of 2024 ACA? If not, please provide evidence for alternative approaches.

- Disagree

The consultation helpfully specifies that the ACA is where the differences in costs of providing services are accounted for in the assessment of needs. The cost per unit volume of providing a service can vary significantly across England, for many reasons. Yet in comparison to the RNFs, measuring the volume of demand, the ACAs are very simplistic. The Children's Service ACA is a substantial improvement on the ACAs used in Formula Grant and the Formula Funding components of the current baseline. However, it assumes that the only factors affecting the difference in the cost of delivering services are labour costs and property rates/rents. 32% of costs are assumed not to vary between areas.

The ACA could be more nuanced with additional factors taken into account, even if these are based on very simplistic formulae. In particular, the Children's Services ACA takes into account the higher costs of delivering to sparse areas in terms of additional hours of labour required to deliver the same volume of services. It therefore clearly accepts the principle that further distances must be travelled to deliver the same volume. But it does not take into account that vehicles must be used to deliver this volume, which will be travelling far greater distances. Consequently, the costs of fuel and maintenance for these vehicles are likely to be far greater in sparse rural areas.

The Government should examine how the cost headings that are unadjusted vary between geographies. If they are significant (for example, as proportions of total council spend), there should be one or more additional adjustments included in the ACAs. For example, if vehicle fuel and/or maintenance costs do vary significantly, there could be a Vehicle Cost Adjustment alongside the LCA and

RCA, which accounts for the greater fuel usage and/or maintenance needs of rural areas.

4. Measuring differences in locally available resources

Question 9: Do you agree that (other than locally retained business rates) we should only adjust for Council Tax when assessing local resources? If you do not agree, please include details of what other sources of income you think should be included (if any), and how the government should adjust for them.

⊙ Neither agree nor disagree

As explained in 'Unlocking capital investment in local economic development', Council Tax and Business Rates should be equalised for at the same stage in the calculation of tariffs and top-ups: either both before the transitional mechanism/damping is applied, or both after. See the responses to Chapters 5 & 7 for which is preferable under what circumstances.

The Government should start looking at additional taxes/charges that could be used to broaden authorities' tax base and take pressure of Business Rate and Council Tax bill payers now. While it would not be appropriate for these to be equalised for now, the Government should consider this in detail in advance of the next reset after 2026.

Question 10: Do you agree that we should measure Council Tax income by making uniform assumptions on the Level of Council Tax charged by local authorities and factors which determine their ability to raise Council Tax?

⊙ [No option selected]

Uniform assumptions are appropriate: it is fairer to deduct what would be raised if council tax levels were the same across the country, not what is actually raised. But use of taxbase projections should be avoided: councils would then need to exceed the growth that they describe before they receive more from tax than is deducted through equalisation. If the growth used in the projection is from an exceptional year, it may be several years before they achieve this. And there should be an exception for Tax Increment Finance schemes, as explained below.

As explained in 'Unlocking capital investment in local economic development', councils' infrastructure costs can be very substantial. The borrowing costs associated with these need to be recouped from uplifts to council tax and business rates.

The Government should investigate the implications of using council tax base data in the resource deduction from dates several years before each reset. Modelling of this should test whether this provides greater retention of tax uplifts, that could help to unlock investment in infrastructure for new developments (and whether there are any unwanted side effects).

However, investment in infrastructure tends to require a long pay-back period, of more than one decade. For example, in the Newcastle-Gateshead New Development Deal was agreed in 2012. Newcastle City Council is now, thirteen years on, finally approaching the point where business rate receipts from the new properties are matching the debt financing costs. The sums that they have borrowed to invest are still some way off being fully repaid. However, the borrowing of £50m, together with grant funding of £70m, has allowed them to provide the infrastructure and public realm improvements to unlock around £1bn of investment in three zones in the city centre.

TRL Insight welcomes the explicit statement in Chapter 5 that business rates growth generated within designated areas will be exempt from the forthcoming reset, and proposes that there should be a fresh round of TIF agreements, relating to specific geographic areas to be regenerated. These would be similar to the NDDs, but need not just be for city centre improvements - they could involve commercial or residential developments, or a mix of the two. Within these areas, councils retain all growth in business rates, council tax or both, for an agreed period, at least until an agreed level of initial borrowing is paid off. The additional receipts should be excluded from redistribution at BRR resets and from any other changes to the business rates, council tax and local government funding systems. Government should consult with councils on the details, to ensure viability, without keeping any tax receipts out of the BRR system which would occur in any case (at least, at any significant scale). There should be no national cap on the combined total of the sums borrowed.

Question 11: To what extent should we adjust for Council Tax when determining local authority allocations (i.e. what assumption should we make on Council Tax Level)?

◉ [No option selected]

It is unclear what this question means without further explanation. For example, if the Government is going to adjust for Council Tax using an assumed level of council tax for all parts of England rather than actual levels, does this mean: should we use the average (or minimum) level of council tax, or should we use a fraction of it?

Without clarification on this, I find this question impossible to answer. However, it is possible to provide some basic principles: the exact way in which council tax is adjusted for should be simple and fair, allowing local authorities to have a clear understand of the levels of uplift to council tax that they will be able to retain.

5. Resetting the business rates retention system

Question 12: Do you agree Transitional Arrangements should account for a Business Rates Reset? If not, please explain why.

◉ Agree

TRL Insight welcomes the Government's acknowledgement of the importance of balancing redistribution of growth in business rate yield with retention. It is unfortunate that the Government still refers to this as "rewarding" business rates growth, as this can seem patronising to local authorities. Local authorities in general wish to see a growth in their local businesses and do not need a "reward" for this. However, as explained elsewhere in this response, they do need to have confidence in the level of tax uplifts they will retain, in order to meet the requirements of the Prudential System when borrowing for infrastructure.

Transitional arrangements will be needed to ensure there are no sudden cuts in funding for authorities unable to cope with these - more detail is given below and in response to questions in Chapter 7.

Redistributing all business rates at each reset would not help stability and could create a financial incentive not to add hereditaments to rateable value in reset years. Conversely retention of all Business Rate growth at reset could entrench trajectories of growth and decline. It would be better to redistribute part of the growth in business rates since the previous reset. However, the Government should also carry out modelling of a ‘rolling reset’ of redistributing all business rate growth after a fixed number of years; this could turn out to be the best blend of stability, retaining uplifts resulting from growth and providing timely additional funding for disadvantaged councils.

If the Government is fixed on a full reset in 2026, it should at least consider these options for future resets.

The transitional mechanism should be a simple one, which treats all authorities in similar ways. The “blending in” mechanism described in Chapter 7 appears sensible (called “pace or change” when previously applied to Public Health Grant), but it would be prudent to carry out some modelling to determine whether there are any unforeseen flaws with it.

As stated in response to Chapter 4 above, as as explained in more detail in 'Unlocking capital investment in local economic development', Council Tax and Business Rates should be equalised for at the same stage in the calculation of tariffs and top-ups. Whether it is best to apply the transitional mechanism after this equalisation for local taxes or before it may depend on how growth is redistributed. If it is all redistributed at the same time, applying the transitional mechanism after the resource deduction could help to extend the period over which councils benefit from uplifts in the taxes and allow these uplifts to taper off gradually. However, if a ‘rolling reset’ is used, there would not be any ‘sharp edges’ that need smoothing off. In this case, it might make sense to apply the transitional mechanism after equalisation for local taxes, so that that all tax uplift is kept for the same number of years before dropping out. For council tax, this would replicate the original version of NHB, other than the extra affordable housing payment.

The Government should carry out modelling of these options to determine whether the above arguments are borne out and whether there are any unforeseen flaws in these proposals.

6. The New Homes Bonus

Question 13: Do you agree or disagree we should enable and encourage local authorities to support housebuilding in their areas through the Local Government Finance Settlement? Please provide any explanation or supporting evidence for your view.

⊙ Agree

Providing infrastructure for new developments requires considerable upfront investment. For that development to go ahead, councils need to know that they can finance the debt incurred from uplifts to local taxes. For this reason, it is important that these uplifts are transparently not completely “equalised away” in the system. This can be done with an appropriate design of the system.

If councils are able to retain sufficient uplifts in both council tax and business rates (after any deductions made in calculating the baseline), NHB funding can be used in a much more targeted way. If the Government’s additional affordable housing funding is insufficient to meet authorities’ AH costs, then NHB can continue to be used to support AH. It can also be used to pay a top-up to retained council tax for lower band properties, to reduce the differential in income from different values of property.

7. Implementing changes and keeping allocations up to date

Question 14: What measures should we use to support local authorities to move to their updated funding allocations?

⊙ [No option selected]

TRL Insight welcomes the statement that "The government will need to be considerate of the broader fiscal and economic climate in the design of any Transitional Arrangements, as well as the trade-off between Transitional Arrangements and the pace at which authorities that are receiving less funding than they need can move to their new allocations".

As stated above, the transitional mechanism should be a simple one, which treats all authorities in similar ways. The “blending in” mechanism appears sensible, but it would be prudent to carry out some modelling to determine whether there are any unforeseen flaws with it.

Question 15: Do you agree we should keep funding allocations up-to-date dynamically by using the most up-to-date data possible? If so, how?

◉ Neither agree nor disagree

As a general principle, TRL Insight agrees with this statement. However, as argued in response to one of the questions above, TRL Insight recommends against the use of taxbase projections and would like to see modelling of the use of historic/lagged taxbase data.

One of the responses above refers to use of a 'rolling reset' for distributing the proceeds of growth. A similar principle could be applied to the needs assessment. Indeed, this could be done on the same basis as the Government has adopted for capital budgets - that the next needs assessment is for a period of, say, four years, then each year (or two) after that, the Government provides a needs assessment for the following year (or two) after the end of the period. In this way, local government would always know its funding baseline for the next three or four years.

These needs assessments may need projections for drivers of demand/volume. It could be possible that using existing values for these drivers would be acceptable, if the cycle were such that the data didn't get too far out of date. The only way to tell would be to carry out some modelling. For example, 'alternative histories' could be used: what would the needs assessment have provided over the last five or ten years if it had used current data, versus what would it have provided if it were allowed to lag by the number of years envisaged (in the above example, if it were constantly four years out of date)? If the discrepancy isn't too large, use of current data from the time at which the needs assessment is done would be an alternative to projecting several years ahead. TRL welcomes the statement in Chapter 5 that the government will work with the sector to determine the most appropriate reset periods.

8. Reviewing demands on local government

Question 16: What are the most excessively burdensome activities or requirements for councils, which if changed, could significantly free up local government capacity?

[No answer given]

Question 17: Do you agree with our proposals to reduce the number of grants and New Burdens payments issued to local government?

◉ No view

For future new burdens, the Government should look at greater retention of business rates and devolution of new tax-raising powers, with appropriate equalisation in the next reset, in preference to long-term grant funding. This would reduce councils' dependence on central government for handouts and increase its ability to make spending decisions using locally raised finances.

9. Sales, fees and charges reform

Question 18: Do you agree or disagree that the government should provide local authorities with greater control over Sales, Fees and Charges? Please provide supporting evidence, considering specific fees where greater control would be of most benefit, and expected impacts on charge-payers.

◉ Agree

Local authorities are elected to take decisions in the interests of their citizens, just as central government is elected to take decisions in the best interests of the UK. Central government should not be making decisions on spending and charging policies, except:

i) where there is an overarching need for consistency across the country,

ii) where there is a particular reason that national interests outweigh local ones, or

iii) to ensure that local authorities are more accountable to their electorates and that local residents have a greater say in decision-making.

10. Equalities impacts of the proposals in this consultation paper

Question 19: Do you have any views on the potential impacts of the proposals in this consultation on persons who share a protected characteristic?

[No answer given]