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**Research Report**

## COVID-19 and English council funding: What is the medium-term outlook?

IFS Report, No. R179

**Provided in Cooperation with:**

Institute for Fiscal Studies (IFS), London

*Suggested Citation:* Ogden, Kate; Phillips, David; Spiliotis, Jean-Christophe (2020) : COVID-19 and English council funding: What is the medium-term outlook?, IFS Report, No. R179, ISBN 978-1-80103-004-5, Institute for Fiscal Studies (IFS), London, <https://doi.org/10.1920/re.ifs.2020.0179>

This Version is available at:

<https://hdl.handle.net/10419/235065>

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**Institute for Fiscal Studies**

**IFS Report R179**

Kate Ogden  
David Phillips  
Jean-Christophe Spiliotis

# **COVID-19 and English council funding: what is the medium-term outlook?**



**Economic  
and Social  
Research Council**

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Published by **The Institute for Fiscal Studies**

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ISBN 978-1-80103-004-5

# Preface

The authors would like to thank Naomi Cooke, Mike Heiser, Jeff Houston, Bevis Ingram, Ian Leete, Kamal Panchal, Liam Robson, Aivaras Statkevicius and Jon Sutcliffe from the Local Government Association and Caroline Newman from CIPFA for help in relation to the data used in this report, as well as the funding available to councils to address the COVID-19 crisis. The authors would also like to thank Paul Johnson for comments on an earlier draft. In addition, they gratefully acknowledge funding from the Local Government Association and co-funding from the UKRI/ESRC COVID-19 Rapid Response funding programme (Je-s grant reference ES/V005073/1) and the ESRC-funded Centre for the Microeconomic Analysis of Public Policy (ES/M010147/1). However, all opinions and any errors or omissions in terms of analysis are the responsibility of the authors only.

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# Executive summary

The COVID-19 crisis is having immediate effects on councils' budgets as a result of increases in spending on local services and reductions in income from sales, fees and charges (SFCs) and commercial activities. However, the crisis will cast a longer shadow on councils' finances. First, reductions in council tax and business rates revenues collected this year will feed through to budgets over the next three years. Second, some COVID-19-related spending pressures and reductions in revenues are likely to persist, and indeed could grow in a few cases. This report considers how councils' revenues and spending needs may evolve over the period to 2024–25, accounting for both the impact of COVID-19 and the pre-COVID funding outlook.

It is important to note up front that the next few years are particularly uncertain economically and fiscally. How high will unemployment rise, how quickly and fully will the economy recover, and what will this mean for councils' revenues? To what extent will changes in service provision made in an effort to control the COVID-19 epidemic continue, and what will this imply for service delivery costs? Definitive answers to these key questions are lacking. And even putting the COVID-19 crisis to one side, changes in service demands and costs would be uncertain, given the range of factors that influence them, including trends in ill health, income, wages and productivity. We therefore look at a number of scenarios for the financial pressures councils could face (lower, middle and upper), drawing on councils' own forecasts, scenarios from the Office for Budget Responsibility (OBR) and other sources. We also highlight a number of issues we feel unable to analyse quantitatively that local and national government may wish to consider when developing plans for the next few years.

## A £3bn+ shortfall arising in 2020–21 ...

Our first report utilising councils' forecasts of the impact of the COVID-19 crisis on their non-tax income and spending in 2020–21 estimated that there was a £2 billion gap between the funding provided and the pressures councils forecast. Updated forecasts from councils lead to a very similar estimate. This figure remains highly uncertain though and depends on the extent to which costs fall and income

recovers during the remainder of the year: councils' forecasts imply overall monthly pressures between August 2020 and March 2021 are around 46% of those faced between April and July 2020, but they could be higher or lower.

Our view is that risks are skewed to the upside though, for several reasons. First, councils made these forecasts before local lockdowns (with the exception of Leicester) and the new more stringent national restrictions were introduced and before the recent upsurge in COVID-19 cases, which may put further upwards pressure on spending and downwards pressure on income. Second, councils have increased their forecasts of full-year pressures as time has gone by. And third, as of July at least, there is little sign of abatement in the monthly pressures councils report facing. If monthly pressures average two-thirds of those faced between April and July (rather than 46%), the in-year shortfall in funding for spending and non-tax income pressures would be £3.1 billion (rather than £2.0 billion) if no further funding were forthcoming. A fourth less easily quantifiable upside risk relates to outsourced services such as leisure centres, where evidence suggests councils are unlikely to be including the full income losses and cost increases being experienced by service providers.

In addition to the pressures we have previously examined, councils are also forecasting that they will collect £12.0 billion less in business rates and £1.5 billion less in council tax this year than they were initially planning. However, over 80% of the reduction in business rates reflects the impact of central-government-funded waivers for the retail, hospitality and leisure sectors, and councils only generally keep half of business rates revenues anyway. After accounting for this and the fact that councils are likely to recoup some of the missed business rates and council tax payments later on, falls in business rates and council tax revenues this year are forecast to actually cost councils £0.6 billion and £0.7 billion respectively. Temporary changes to accounting rules will allow councils to spread these impacts over three financial years: 2021–22, 2022–23 and 2023–24.

Central government is providing extra funding to help pay for reductions in council tax bills for low-income households. However, we estimate that this still leaves a net £1.1 billion cut in funding over the next three years as a result of falls in local tax collections this year. Together with the £2 billion shortfall in relation to spending and non-tax income pressures, councils' forecasts for COVID-19-related financial pressures arising this year exceed available funding by around £3.1 billion. The final figure could be higher or lower – although, as highlighted

above, our view is that there is more risk of it being higher. As discussed in our previous report, this uncertainty, together with the highly variable impact across councils, makes addressing this shortfall via up-front grant funding difficult.

## ... and a growing underlying funding gap

The outlook for local government revenues and spending needs in subsequent years is also highly uncertain. However, without additional funding and/or flexibility over council tax rates, it is highly likely that councils will have insufficient revenues to keep pace with rising spending needs.

This was true even before the COVID-19 crisis. Increases in the demand and cost of key services, most notably adult social care services, were always likely to outpace increases in local tax revenues if council tax increases are effectively capped by the default 2% referendum limit in future. This reflects the impacts of a growing and ageing population, the (welcome) survival of people with more complex social care needs for longer, increases in the number of children requiring protection or care, and increases in the costs of service provision driven by the combination of substantial planned increases in the National Living Wage and low productivity growth.

The COVID-19 crisis is likely to worsen some pressures but may lessen others. Higher unemployment is likely to push up the number of households entitled to council tax support, reducing the amount of tax collected by councils. An increase in business rate appeals and higher rates of business failure are likely to reduce the yield from business rates. Other income and spending pressures could also persist to some extent. On the other hand, lower inflation and slower growth in average earnings (and hence the National Living Wage) could dampen some cost pressures.

Our medium-term analysis makes use of three scenarios – lower pressures, middle pressures and upper pressures – where we vary assumptions on revenue growth, demand growth and cost (and productivity) growth.

Our middle scenario suggests that the spending needed to maintain services at their pre-COVID-19-crisis level could exceed available revenues by £3.2 billion in real terms (£3.4 billion in cash terms) in 2024–25 if council tax is increased by 2% a year and grant funding is increased in line with inflation. Slower productivity growth, bigger increases in demand for children’s services, and larger and longer-



lasting impacts of COVID-19 on incomes and costs result in a gap of £7.3 billion in real terms (£7.7 billion in cash terms) in our upper scenario. Councils may also have to find an additional £0.3–£1.2 billion in funding for higher pension contributions from April 2023 onwards given the latest OBR scenarios for the stock and commercial property markets. And benchmark prices used previously in analysis by the Competition and Markets Authority and the Local Government Association suggest councils were underpaying social care providers by £1.2–£1.4 billion in 2018–19, potentially growing to £1.4–£1.7 billion in real terms by 2024–25. Such underpayments might eventually pose problems for sustainability.

How to tackle this funding gap?

One option would clearly be not to. But that would lead to further cutbacks to service provision, on top of those driven by a 17% reduction in net spending on services between 2009–10 and 2019–20. Outside of social care, spending on many services has fallen by more than 40%, and an increased fraction of spending is concentrated on those with the most acute needs, such as children in care, adults with severe disabilities and the homeless.

If central government did want to provide further funding, a range of options are available, either separately or in combination. First, the referendum limit on council tax could be raised or scrapped, with each additional 1 percentage point increase every year for the next four years raising approximately £1.2 billion by 2024–25. However, councils serving more affluent areas can raise more from council tax than those serving more deprived communities (especially outside London). This means that unless there were redistribution of existing funding, reliance on council tax increases to meet rising spending needs would see increasing inequalities between more affluent and more deprived areas.

The second approach – increasing grant funding – would allow central government to target funding at more affluent or more deprived areas as it saw fit by varying the formula used to allocate the grants. However, such an approach would mean less discretion over tax and spend levels by councils, and require higher taxes, lower spending or more borrowing by the national government.

Third, the government could give councils additional tax-reform and/or tax-raising powers. This could include additional powers over council tax and business rate

exemptions, discounts and reliefs, but also new local taxes. Such an approach makes more sense, the greater the weight placed on giving councils incentives to grow local economies and tax bases and discretion to vary tax and spending levels. But as with reliance on council tax increases, it is less sensible the greater the weight placed on redistribution and consistency of funding and service provision across the country.

## Key findings

- 1 Council tax is the largest source of revenues for local government, funding approximately half of council spending. Councils will raise less in council tax this year than the £27.9 billion they had budgeted, due to failed payments and the cost of providing discounts on bills to residents with low income. Accounting for the likelihood councils will recover some lost income, and for an additional £500 million provided by government to fund council tax discounts, we project councils to lose out on £493 million in council tax revenues in our central scenario. This loss will be spread across the next three years, affecting councils' main budgets from 2021–22.
- 2 Councils also forecast they will collect £12.0 billion less in business rates from local businesses this year. The vast majority of this is due to additional reliefs this year which have reduced the bills for many in the retail, leisure and hospitality sectors to zero. Central government is compensating councils for the cost of these reliefs. Councils have also deferred some payments and faced other losses. Accounting for the likely recovery of some of these losses and that, like business rate revenues, these will be shared between local and central government, we project councils to lose out on £602 million in retained business rates revenues in our central scenario. As with council tax, this loss will affect their main budgets in the three years from 2021–22.
- 3 Councils also forecast spending pressures of £5.0 billion and non-tax income pressures of £2.9 billion this year. We estimate that government has provided £4.2 billion in grant funding and a further £1.6 billion in other non-grant support to help councils manage these pressures. Taken together, this implies an in-year funding shortfall of

approximately £2 billion in council budgets this year, although uncertainty about pressures and funding availability over the remainder of the year means there is scope for the gap to be much bigger or smaller.

- 4 Turning to the medium-term outlook, our middle scenario implies that councils' revenues will increase by 16% in cash terms and 4% in real terms between 2019–20 and 2024–25. This is under the assumption that council tax rates are increased by 2% a year and grant funding is increased in line with inflation from 2021–22 onwards. It also accounts for an increase in the cost of council tax support and downgrades to business rates revenue forecasts in line with the central scenario in the OBR's July 2020 Fiscal Sustainability Report.
- 5 Our middle scenario implies that councils' spending needs will increase substantially faster: by 23% in cash terms and 11% in real terms between 2019–20 and 2024–25. This assumes demand for adults' and children's social services increases by 2.2% and 2.0% respectively, with demand for other services increased in line with population growth. Unit costs are assumed to grow largely in line with earnings, implicitly assuming zero productivity growth, in line with post-2010 trends. Changes in working and shopping patterns are assumed to lead to income from transport services falling by 10% permanently, increasing net expenditure. But other COVID-related costs are assumed to have fully abated by 2024–25.
- 6 These projections for revenues and spending imply a notable funding gap. They suggest that councils would need an extra £3.2 billion in real terms in 2024–25 to maintain services at their 2019–20 level. They would also need an extra £2.4 billion, £2.1 billion and £2.8 billion in 2021–22, 2022–23 and 2023–24. The fact that the gap initially falls is because our scenario assumes more of the revenue falls and spending increases associated with the COVID-19 crisis persist in the shorter than longer term.

- 7 These figures are highly uncertain though and will depend on how revenues, and service demands and costs, evolve. Our upper scenario incorporates the effects of a slower economic recovery, faster demand growth, bigger wage increases to maintain headroom above the National Living Wage, falls in productivity of 0.5% a year, and larger and longer-lasting increases in costs as a result of the COVID-19 crisis. It implies a funding gap of £7.3 billion in 2024–25. However, even with a stronger economic recovery, slower demand growth, productivity increases of 0.5% a year, and no lasting effects of COVID-19 on costs – a concurrence of good outcomes that we consider unlikely – we estimate a funding gap of £0.4 billion in 2024–25 in our lower scenario. We therefore consider it very highly likely that councils will be unable to maintain pre-crisis service standards without additional funding.
- 8 Two further spending pressures may also be worth considering. Based on the prices councils pay for adult social care services and benchmark prices needed to meet costs and provide a suitable return on capital for suppliers, councils underpaid by £1.2–£1.4 billion in 2018–19. This could increase to £1.4–£1.7 billion in real terms by 2024–25. Councils may also need to increase their pension contributions as a result of the COVID-19 crisis. Falls in asset prices alone could increase costs by £0.3–£1.2 billion in real terms for 2023–24 onwards.

# 1. Introduction

The COVID-19 crisis is having immediate impacts on councils' budgets. Increases in spending and falls in income raised from sales, fees and charges (SFCs) and commercial activities are being only partially compensated for by increases in central government funding (Ogden and Phillips, 2020a).

However, further pressures loom in 2021–22 and beyond. First, falls in council tax revenues and business rates collected this year will have to be reflected in councils' main accounts from next year. Second, tax collections and potentially income from SFCs and commercial activities could remain depressed looking forward, as higher unemployment pushes up the cost of council tax support (CTS) schemes and changed consumer behaviour impacts the viability of high streets. And third, a range of spending pressures could persist (or arise) as some services – such as social care services – see increased costs and demands, and councils' pension schemes are revalued in April 2023.

These pressures will arise in a context in which councils' funding was already set to be insufficient to meet increasing spending pressures (Harris, Hodge and Phillips, 2019). In particular, even pre-COVID-19, business rates and council tax revenues were unlikely to keep pace with the rising costs of adult social care services. This means that to avoid further cuts to at least some services, additional grant funding or devolved revenues would need to be provided to councils.

This report therefore updates the medium-term outlook to account for the additional pressures resulting from the COVID-19 crisis. It proceeds as follows. Chapter 2 looks at the impact of falls in council tax and business rates revenues this year on councils' main budgets over the next three years, updating analysis in LG Futures (2020). It also provides an updated assessment of the spending and non-tax income pressures councils forecast for 2020–21, although the forecasts by councils that this is based on were made before the recent upsurge in COVID-19 cases and the associated local lockdowns and more stringent rules. Chapter 3 then looks at the potential income losses and spending pressures arising over the next few years, highlighting how these come on top of an already challenging funding outlook.

Chapter 4 discusses potential policy responses and concludes. Finally, Appendix A provides details on the data and methods employed in this report, while a separate spreadsheet appendix (Appendix B) provides further results.

It is important to note up front that the next few years are particularly uncertain economically and fiscally. How high will unemployment rise, how quickly and fully will the economy recover, and what will this mean for councils' revenues? To what extent will changes in service provision made in an effort to control the COVID-19 epidemic continue, and what will this imply for service delivery costs? Definitive answers to these key questions are lacking. And even putting the COVID-19 crisis to one side, changes in service demands and costs would be uncertain, given the range of factors that influence them, including trends in ill health, income, wages and productivity. We therefore look at three main scenarios for revenues and spending pressures, drawing on councils' own forecasts, scenarios from the Office for Budget Responsibility (OBR) and other sources. These are our 'lower', 'middle' and 'upper' scenarios, which have the lowest, middle and highest estimate of the funding gap in 2024–25, respectively.

We also highlight a number of specific issues and areas of uncertainty that local and national government may wish to consider when developing plans for the next few years. This includes an analysis of what falls in asset prices could mean for the Local Government Pension Scheme (LGPS) and pension contribution costs – although it is beyond the scope of this report to attempt a full revaluation of the LGPS. We also discuss how the COVID-19 crisis could affect the demand for services such as social care and housing services going forwards. Unfortunately, available data do not allow us to model these effects quantitatively as part of our scenarios, but our review of academic and policy research suggests COVID-related increases in demand do represent a very real risk of further upwards pressure on spending – and the funding gap.

## 2. The impact of this year's falls in local tax revenues

Councils have raised less through local taxes – council tax and business rates – this year than they had previously expected. Local government accounting rules mean these differences do not affect councils' main budgets, and so their ability to spend on local services, until next financial year. We look at these two important taxes in turn, and then update the estimates of in-year spending pressures and losses of non-tax income in Ogden and Phillips (2020a) using a more recent survey of councils conducted by the Ministry of Housing, Communities and Local Government (MHCLG) in July (MHCLG, 2020a). We then look briefly at the financial support and burden-sharing mechanisms the government has put in place to support councils to manage this pressure in 2020–21, and whether they are likely to be sufficient.

### 2.1 Council tax

Councils budgeted to raise £27.9 billion in council tax in 2020–21 (with a further £5.2 billion raised for police, fire and combined authorities).<sup>1</sup> This is enough to cover around half (50.3%) of councils' spending,<sup>2</sup> and forms the largest single source of revenues for councils.

<sup>1</sup> Council tax is collected by billing authorities on behalf of all the different types of authority in a local area. In 2020–21, around 16% of revenues would have been allocated to police forces, fire services, combined authorities and the Greater London Authority (GLA). The following analysis is restricted to the losses faced by authorities included in the monthly MHCLG surveys – unitary authorities, London boroughs, metropolitan districts, shire districts and shire counties – as we have some understanding of the likely spending pressures and support provided only for these types of authority. A further 1.8% of revenues are collected on behalf of parish councils; these are included in the above figures as billing authorities bear the share of any losses attributable to parish councils.

<sup>2</sup> By spending, we here mean a measure of adjusted revenue expenditure in 2020–21, as described in the appendix to Ogden and Phillips (2020a).

Many households have faced financial difficulties as a result of COVID-19 and the disruption to work since March. Research using real-time data on households' finances from Money Dashboard, a budgeting app, found the fraction of users of the app making council tax payments was 9% lower in May 2020 than predicted based on pre-crisis trends (Bourquin et al., 2020). Further research suggests non-payment of council tax in recent months has risen amongst furloughed workers, those receiving money from the Self-Employed Income Support Scheme (SEISS) and those in receipt of universal credit (Delestre et al., 2020).

Consistent with this, in the four months between April and July, councils raised £707 million less in council tax than expected. In total, councils report that they expect to collect £1,410 million less from council tax payers in 2020–21 than they had budgeted at the start of the year – their 'cash losses'. These losses can be broken down into:

- **Payment failures** of £812 million. Many councils have reported council tax payers who have fallen into arrears during the first few months of the year, ceasing to pay bills without arranging new payment schedules.
- **Increase in local council tax support (LCTS)** of £475 million. Households that have seen their incomes fall may have become newly eligible for discounts on their bills. Councils operate their own discount schemes, known as local council tax support, with different criteria for eligibility and levels of discount. In total, their existing local council tax support schemes cost councils approximately £1.6 billion in forgone revenue in 2019–20.<sup>3</sup> The number of working-age claimants of LCTS had been trending steadily downwards over the past four years as unemployment rates fell and as councils have reduced the generosity of their schemes (Adam, Joyce and Pope, 2019). This was sharply reversed in the first quarter of 2020–21, when claimant numbers increased by 9.3% compared with the same quarter (April–June) of 2019.<sup>4</sup> This increase from 2.32 million to 2.53 million claimants came despite the furlough scheme and SEISS. Councils estimate that claimant numbers will increase to

<sup>3</sup> Forecast of forgone revenue due to working-age local council tax support in 2019–20, excluding amounts relating to police forces, fire services, combined authorities and the GLA. Authors' calculations based on MHCLG (2019a).

<sup>4</sup> Authors' calculations based on MHCLG (2020d).



2.66 million over the course of the year, although it is not known what expectations about the economy these estimates are based on.

- **Other losses** of £123 million. It is not clear what these losses relate to, and councils may have included different pressures in this line, although some mention delayed construction projects meaning the tax base in 2020–21 will be smaller than they had forecast. This may also include payment failures or the rescheduling of some payments from 2020–21 to 2021–22.<sup>5</sup>

Of course, councils may collect some of this lost income in future years. Only the amount that they do not expect to be able to collect – that they expect to eventually ‘write off’ – should be considered as a loss that affects their ability to spend on council services.

Councils are typically very successful at collecting council tax from residents, collecting 98% of amounts due within the financial year and a further 0.7% the following year.<sup>6</sup> They have significant legal powers to pursue individuals for council tax arrears, including the use of bailiffs. Enforcement action was paused for several months this year to support social distancing,<sup>7</sup> and the closure of courts meant councils were not able to apply for new liability orders which need to be issued before they can attempt to recover unpaid council tax. Many councils reported that they would restart sending reminder letters after missed payments from August.

In our ‘middle’ scenario, we assume that 12.8% of income lost through payment failures will eventually be written off by councils; this is around double the proportion of total arrears at year-end that were written off by councils in 2019–20 and reflects the likelihood that some of those who have failed to pay their bills will be found to have been eligible for council tax support. We also include ‘upper’ and ‘lower’ scenarios, where this figure is simply doubled or halved to 25.6% or 6.4%, to show the sensitivity of our estimates to this assumption.

<sup>5</sup> The vast majority of councils have agreed to case-by-case changes in payment schedules, allowing households to pay council tax bills between June and March (council tax is typically paid in 10 instalments between April and January). Very few councils report rescheduling payments into the next financial year (MHCLG, 2020a), so we assume that these are a small proportion of losses reported across the whole financial year.

<sup>6</sup> Authors’ calculations based on MHCLG (2020b).

<sup>7</sup> See <https://www.civea.co.uk/news-and-media/civea-confirms-suspension-of-enforcement-action>.

In line with LG Futures (2020), we assume in our middle and upper scenarios that losses attributable to reasons other than payment failures or LCTS are all written off by councils. In our lower scenario, we assume that only 6.4% of these losses are eventually written off, again to test the sensitivity of our estimates.

On 24 March, the government confirmed £500 million in funding for councils to reduce the bills of those receiving council tax support by a further £150, and to fund additional discounts at the councils' discretion (MHCLG, 2020c). Many households are likely to have seen their bills reduced to zero as a result. Many councils report that they expect to exhaust this funding on the mandatory £150 discounts, especially if LCTS claimant numbers rise through the year after the scheduled end of the furlough scheme in October. It is unclear how much of this additional discount councils have included when reporting their losses from the increase in local council tax support, and so how much of the loss relates to increased eligibility for LCTS (for new or existing claimants) as opposed to the temporary increase in generosity of support. In our middle scenario, we include half of the available council tax hardship funding, and assume that the remaining half has been netted off councils' reported cost pressures already. In our upper scenario, we assume that councils have already netted off this funding, and in our lower, that they have netted none of it off already.<sup>8</sup> We consider how the cost of council tax support may evolve in future years in Chapter 3.

As mentioned in the introduction to this report, losses in relation to council tax this year will not affect councils' main budgets until the next financial year. Any money collected by billing authorities is paid into a separate account – the Collection Fund – while councils are paid an amount from the Collection Fund equal to the amount they expected to raise at the start of the year (plus or minus an adjustment for any deficit or surplus on collections in previous years). This protects councils' main budgets from some of the volatility of local tax receipts, and means lower collections in 2020–21 do not affect councils' main budgets (or their ability to

<sup>8</sup> Instead of including the council tax hardship funding in our estimate of grant funding this year, we treat it as reducing the deficit created on the Collection Fund in subsequent years. We only include the proportion of the hardship funding relating to the main council types. This means the maximum value of funding we include is £419 million, rather than £500 million. See Appendix A for discussion of the impact of the timing of hardship fund payment to councils.

spend on services) until 2021–22, when payments from the Collection Fund will need to be lower to close the deficit created by the reduced collections.<sup>9</sup>

In addition, government has announced a scheme to allow deficits on the Collection Fund arising in 2020–21 to be spread across three years (MHCLG, 2020e). It has not yet confirmed details of how this deficit spreading will operate, such as the specific percentage of deficits apportioned to each of the three years or whether councils will have discretion over this. These, as well as any apportionment of losses between central and local government, will be confirmed as part of the Spending Review this autumn. For ease, and without further detail on any sharing of losses, we assume that payments of council tax revenues into councils' main budgets are lower in each of the three subsequent financial years by one-third of the deficit created in 2020–21.

**Table 2.1. Estimated council tax losses and impact on revenues in subsequent years, under different assumptions (£ million)**

Scenario	Losses arising in 2020–21 that will not be recovered	Council tax hardship funding	Deficit created on Collection Fund	Loss each year, 2021–22 to 2023–24
Middle	702	209	493	164
Upper	806	0	806	269
Lower	535	419	116	39

Note: Deficit created on the Collection Fund is the proportion of losses (payment failures or others) that councils may expect to eventually write off, as well as the cost of the increase in local council tax support in 2020–21, less any council tax hardship funding that we assume councils have not yet included. For detailed calculation steps, see Appendix A.

Source: Authors' calculations using MHCLG (2020a).

<sup>9</sup> These losses may, however, mean cash-flow issues for billing authorities in 2020–21. Government has taken steps to mitigate these issues, as described in Appendix A.

In summary, councils report losses of council tax arising in 2020–21 of £1,410 million. In our middle scenario, we expect £702 million of these losses will not be recovered in future years. Assuming that councils have already accounted for half of the council tax hardship funding they were allocated, this suggests a deficit will be created on the Collection Fund of £493 million. This will impact council budgets in the subsequent three years, reducing council tax revenues each year by £164 million. The equivalent figures in our upper and lower scenarios are £269 million and £39 million, as shown in Table 2.1.

## 2.2 Business rates

As well as council tax, councils collect business rates from the occupiers of local non-domestic properties, based on the rateable values of these properties – their notional annual rent as determined by the Valuation Office Agency (VOA). Councils were expecting to collect £25.6 billion in total for ratepayers in 2020–21. Like council tax, this is shared with other types of local authorities, such as fire and police services and combined authorities.

Unlike council tax, around 50% of this revenue is allocated to central government, the ‘central share’, although some authorities retain a higher proportion of this local tax revenue under a business rates retention pilot.<sup>10</sup> In total in 2020–21, councils expected to retain £12.5 billion in revenue from business rates (the ‘local share’). They also expected to receive a further £1.6 billion in grants from central government to compensate them for reliefs on some properties, and to pay £93 million in aggregate to central government in net tariffs and top-ups. Councils’ income from retained business rates in 2020–21 was therefore expected to be £14.0 billion in total, enough to fund 25.2% of their spending in 2020–21.<sup>11</sup>

<sup>10</sup> Formally, this ‘central share’ is returned to local government. For instance, in 2018–19, it was used to finance Revenue Support Grant (RSG) and other grant funding. However, this link is notional and there is no direct link between the amount of business rates revenues the government receives as its ‘central share’ and the size of the grants it provides to local government – which far exceed the ‘central share’. Therefore, when discussing the impact of reduced business rates revenues on councils, we consider only retained business rates, and ignore any losses affecting the central share. Any grant funding financed through the ‘central share’ of business rates is included as grant funding when we turn to the medium-term outlook in Chapter 3.

<sup>11</sup> By spending, we here mean a measure of adjusted revenue expenditure in 2020–21, as described in the appendix to Ogden and Phillips (2020a).

In the four months between April and July, councils raised £5.3 billion less in business rates than expected. In total, councils report that they expect to collect £12.0 billion less from ratepayers in 2020–21 than they had budgeted at the start of the year. These losses can be broken down into:

- **Additional reliefs** of £10.4 billion. The vast majority of this reduction reflects business rates relief provided by government, especially the expanded retail discount to businesses in the retail, hospitality and leisure sectors.
- **Deferred payments** of £130 million, of which approximately £65 million would have formed the ‘local share’. The majority of these are likely to be collected by councils with some delay.
- **Other losses** of £1,510 million, of which the ‘local share’ would have been approximately £704 million. It is unclear what councils have included within this line, but this may include payment failures, as well as the additional costs of empty properties relief where businesses have failed and left properties unoccupied.

Crucially, councils will be provided with grant funding from central government to meet the cost of additional reliefs in full, as discussed in Appendix A. We can therefore ignore these losses for the purposes of our analysis, as they ultimately impact central rather than local government finances. Of the remaining losses, only the portion that councils do not expect to be able to collect in future years – that they expect to eventually ‘write off’ – should be considered as a loss that affects their ability to spend on council services. We consider the potential recovery of these losses below.

There are several other factors potentially impacting 2020–21 collections which we do not consider fully here – although councils may have taken them into account to some extent when forecasting their ‘other losses’. First, enforcement action was paused during the lockdown, and COVID-19 has increased the likelihood that some businesses already in arrears may fail. This is likely to reduce councils’ ability to collect arrears relating to previous years. To give a sense of scale, the latest out-turn data available suggest the sum outstanding from ratepayers at 31 March 2019 was

£1.268 billion,<sup>12</sup> of which councils still expected to be able to collect approximately half.

Second, businesses may be able to appeal successfully to have their rates bills reduced due to the COVID-19 crisis, as discussed further in Box 2.1. Significant uncertainty around these further potential losses means they are not included in the scenarios below.

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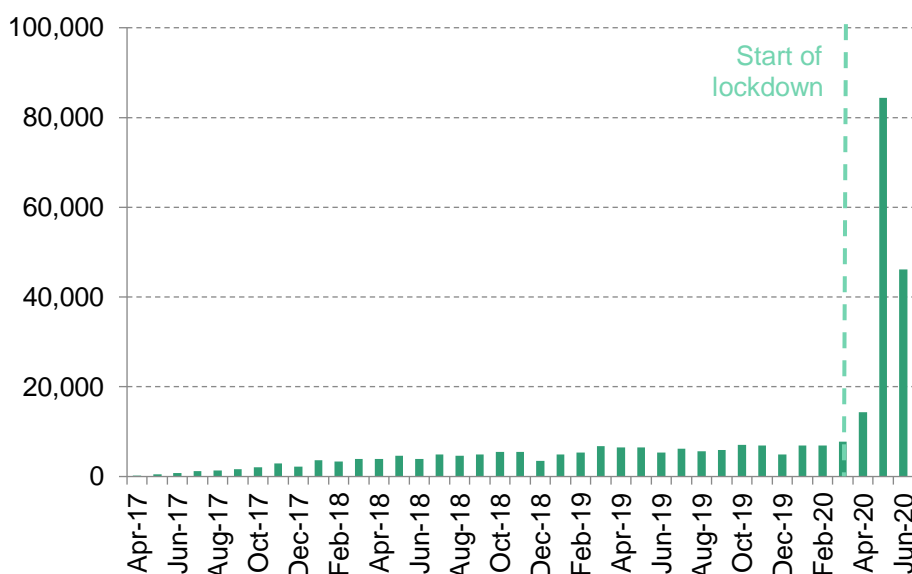
### Box 2.1. Potential costs of successful appeals

Ratepayers are able to appeal to the Valuation Office Agency (VOA) if there has been a ‘material change of circumstance’ which has affected the rateable value of their property. For instance, high-street shops can appeal to have their business rate bills lowered if roadworks affected their shopfront and reduced turnover.

Many businesses are likely to apply to the VOA for a rate reduction on the basis that COVID-19 has affected their profitability. The first stage of the ‘check, challenge, appeal’ process involves submitting a ‘check’ to the VOA which, if the change is temporary, must be during the period when the change occurred. In the months April to June 2020, there were 145,000 checks submitted, compared with fewer than 20,000 over the same months in 2019. This suggests the rateable values of around 7% of all eligible properties may already have been queried.

It is so far unclear whether the VOA is likely to consider COVID-19 to be a ‘material change of circumstance’. The VOA Rating Manual suggests that changes in the ‘propensity to spend within the economy as a whole’ would not qualify as a relevant change, whereas matters that affect ‘the ability of the tenant to enjoy the premises by being physically present in them’ would do so (VOA, 2017, part 2, sections 7 and 8). We also do not know the rateable values of those properties that have been checked, or what percentage reduction in their rates bills may result from a successful challenge.

<sup>12</sup> Authors’ calculations based on MHCLG (2019b and 2019c).

**Figure 2.1. Number of checks registered with the VOA each month**

Source: VOA, 2020.

To give a sense of the potential scale of losses, if all of these checks were to result in a 10% reduction in rates due for a period of six months, and the rateable value of these properties was representative of all rateable properties on the valuation list as of March 2020, this may reduce the local share of business rates revenues in 2020–21 by a further £86 million.

In our middle scenario, we assume that 5% of losses associated with deferred payments of business rates are never collected. This is in line with the OBR's assumption in its July Fiscal Sustainability Report, that 5% of VAT payments deferred by businesses to March 2021 will never be paid because some firms will fail between now and the end of the financial year (OBR, 2020a, p.71). Like LG Futures (2020), we are less optimistic about the potential for councils to recover their 'other' losses. Our middle scenario assumes 85% of 'other' losses reported by councils are eventually written off. We also consider the losses arising in upper and lower variants, where councils write off more or less of this lost income than our central scenario: 100% and 70%, respectively.

Like council tax, business rates are paid into a Collection Fund, which means these losses will not affect councils' main budgets until 2021–22. These are also covered by the scheme to spread the deficit over three years, details of which are yet to be confirmed, so we make the same assumptions about the operation of this scheme as described in Section 2.1.

**Table 2.2. Estimated business rate losses and impact on revenues in subsequent years, under different assumptions**

Scenario	Assumptions about proportion of losses eventually written off		Deficit created on Collection Fund (£ million)	Loss each year, 2021–22 to 2023–24 (£ million)
	Deferred payments	Other losses		
Middle	5%	85%	602	201
Upper	10%	100%	711	237
Lower	0%	70%	493	164

Note: Deficit created on the Collection Fund is the proportion of losses (deferred payments or others) that councils may expect to eventually write off. For detailed calculation steps, see Appendix A.

Source: Authors' calculations using MHCLG (2020a).

In summary, councils report losses of business rates (excluding reliefs) arising in 2020–21 of £770 million. In our middle scenario, we expect £602 million of these losses will not be recovered in future years, creating a deficit on the Collection Fund. This will impact council budgets in the subsequent three years, reducing retained business rates revenues each year by £201 million. The equivalent figures in our upper and lower scenarios are £237 million and £164 million, as shown in Table 2.2. None of these figures includes any potential impact from reduced collection of arrears or successful appeals (beyond those that councils have already built into their forecasts of 'other losses').

## 2.3 Non-tax income and spending pressures arising in 2020–21

While councils' main budgets this year are protected from losses in local tax revenues, there are spending pressures and other (non-tax) income losses which are impacting their finances immediately. We estimated the total value of these losses in Ogden and Phillips (2020a). We replicate that analysis here, updating our estimates to reflect more recent (July) survey returns from councils. These suggest council finances are under greater pressure in 2020–21 than was previously thought



– and even before the recent upsurge in cases and associated local lockdowns and more stringent national measures.

Table 2.3 shows councils' own estimates of the impact of COVID-19 on spending by service and on non-tax income by source for the first four months of 2020–21 and the full year.<sup>13</sup> Figures for April, May and June are, where possible, based on provisional out-turns data, while figures for July and the full year are forecasts. The table also shows the forecast full-year pressure measured as a percentage of estimated baseline spending/income for each item, to give a sense of the scale of these pressures.

In total, councils now estimate they will spend £5.0 billion more in 2020–21 than they had budgeted to before the COVID-19 crisis. They expect to have lost £2.1 billion in income from sales, fees and charges (SFCs) relative to expectations, with the biggest proportionate loss relating to culture and leisure. This is likely to include, among other things, fees relating to local visitor attractions and management fees received from contractors operating council-owned leisure centres. Losses of transport SFCs will reflect reduced income from public transport, as well as from high-street parking. Councils also expect to lose £0.8 billion from commercial and other income sources.

Together, this additional spending and loss of non-tax income implies a total pressure this year of £7.9 billion, which is equivalent to 14.1% of what councils expected to spend this year.

Councils have been asked to submit returns to MHCLG each month since April, and the returns for May, June and July ask for a broadly comparable set of information on spending and income pressures. This allows us to consider how councils' expectations changed over these three months as more information, including about the easing of the national lockdown, became available. Table 2.4 shows, for each spending area and each income source, the forecast full-year pressure according to each set of survey returns.

<sup>13</sup> We do not consider any pressures arising in March 2020, which affected councils in financial year 2019–20. Councils estimated they spent £78 million more than expected, and lost non-tax income of £123 million, in March as a result of COVID-19 (MHCLG, 2020f).

**Table 2.3. Estimated increases in expenditure and losses in non-tax income as a result of the COVID-19 crisis: £ million and as % of item**

Pressures	April	May	June	July	2020–21	% of item
<b>Spending pressures</b>						
Adults' social care	248	275	367	289	2,174	12.3%
Children's social care	32	33	34	33	318	3.2%
Education	15	16	14	16	230	0.7%
Transport	9	9	10	9	72	3.4%
Public health	3	3	9	24	237	7.2%
Housing and homelessness	29	31	34	29	254	14.7%
Culture and leisure	20	22	26	30	242	11.4%
Environment and regulation	56	40	38	35	239	4.9%
Planning and development	2	2	3	2	18	1.9%
Police and fire	1	1	0	0	2	0.5%
Finance and corporate	43	30	39	31	252	9.1%
Other (incl. unachieved savings)	144	121	102	87	960	n/a
<b>Total spending pressures</b>	<b>603</b>	<b>583</b>	<b>676</b>	<b>587</b>	<b>4,998</b>	<b>n/a</b>
<b>Income pressures</b>						
Transport SFCs	135	140	118	97	810	32.6%
Culture and leisure SFCs	65	66	65	64	529	59.5%
Planning SFCs	23	22	18	17	148	13.6%
Other SFCs	107	93	91	77	575	6.4%
Commercial	97	64	52	96	564	n/a
Other	31	38	35	25	230	n/a
<b>Total non-tax income losses</b>	<b>457</b>	<b>422</b>	<b>378</b>	<b>375</b>	<b>2,855</b>	<b>n/a</b>

Note: Final column shows the full-year pressure as a percentage of the estimated baseline for each item pre-COVID. See the appendix to Ogden and Phillips (2020a) for detail of the baseline used for each spending and income line. Figures have been updated to account for a very small number of missing returns (one in April, two in July).

Source: Authors' calculations using MHCLG (2020a, 2020g and 2020h).

**Table 2.4. Councils' estimates of full-year increases in expenditure and losses in non-tax income as a result of the COVID-19 crisis based on survey returns submitted each month**

Pressures	May	June	July
<b>Spending pressures</b>			
Adults' social care	1,466	1,788	2,174
Children's social care	296	305	318
Education	142	254	230
Transport	57	62	72
Public health	21	96	237
Housing and homelessness	181	205	254
Culture and leisure	125	192	242
Environment and regulation	202	220	239
Planning and development	15	15	18
Police and fire	3	3	2
Finance and corporate	190	274	252
Other (incl. unachieved savings)	926	987	960
<b>Total spending pressures</b>	<b>3,627</b>	<b>4,400</b>	<b>4,998</b>
<b>Income pressures</b>			
Transport SFCs	743	785	810
Culture and leisure SFCs	377	484	529
Planning SFCs	147	151	148
Other SFCs	540	537	575
Commercial	624	626	564
Other	230	237	230
<b>Non-tax income losses</b>	<b>2,661</b>	<b>2,821</b>	<b>2,855</b>

Note: Figures have been uprated to account for a very small number of missing returns (one in April, two in July).

Source: Authors' calculations using MHCLG (2020a, 2020g and 2020h).

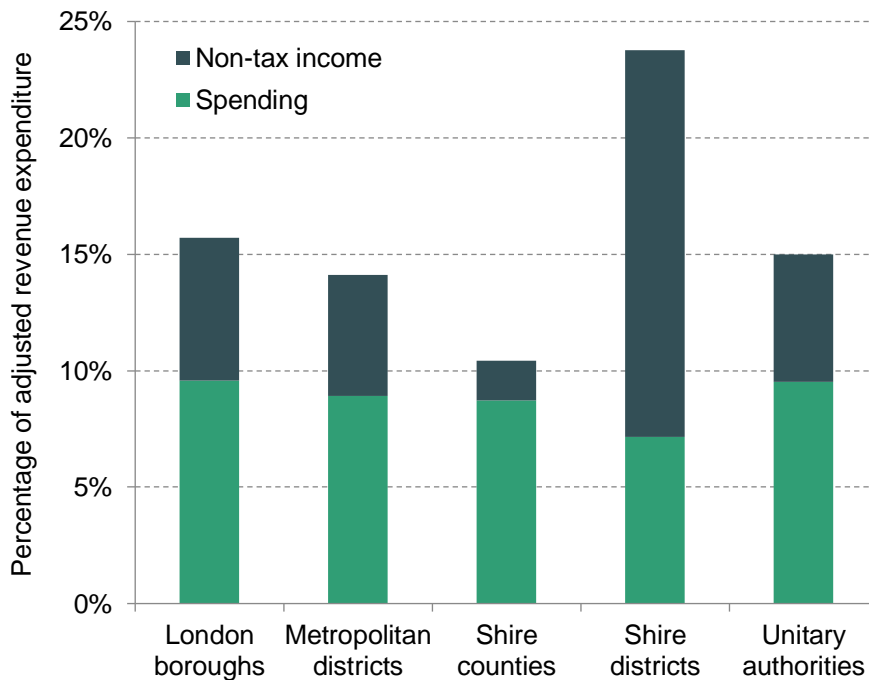
Compared with their estimates a month previously, councils have again revised upwards their expected spending on adult social care, housing and homelessness, and culture and leisure services. It seems likely that this reflects their revised expectations about the length of time local populations will be affected by the crisis, and the severity of the impacts on demand for council services (such as support for those threatened with homelessness). The significant upward revision in estimates of councils' additional spending on public health, which have more than doubled, likely reflects that more councils have included pressures stemming from their new responsibilities relating to the management of local outbreaks. These had only recently been announced when councils completed the prior survey. There has also been a slight increase in council expectations of losses of non-tax income pressures, mainly driven by a £45 million increase in losses of SFCs income from culture and leisure.

Importantly, these estimates pre-date many of the additional restrictions affecting local areas ('local lockdowns'). While some restrictions affecting Leicestershire were in force during July, the restrictions affecting Manchester, Lancashire and West Yorkshire throughout August were not announced until 30 July 2020 (DHSC, 2020a), and further restrictions have been introduced since then (DHSC, 2020b). These are likely to have affected councils' services and income streams directly, closing council leisure facilities and requiring additional publicity to residents, as well as indirectly by depressing local transport revenues or worsening the social and economic impacts of the crisis on residents, driving up longer-term spending pressures. Given councils generally did not modify their survey responses after 31 July, none of these pressures is likely to have been included in the estimates in Table 2.4. This means the figures from councils that we are using are more likely to be *underestimating* than overestimating the pressure on council finances this year.

As discussed in Ogden and Phillips (2020b), individual councils have been affected by the crisis in different ways, depending on the structure of their local economies and the characteristics of their local populations. Councils also rely on different at-risk income sources to varying degrees. Some patterns in the pressures affecting different types of council can be identified, and are confirmed by the July survey data. In particular, in areas with two tiers of local government, shire districts appear to be facing greater non-tax income losses relative to their spending, as shown in Figure 2.2. This reflects their greater reliance on income from SFCs, while their relatively lower spending pressures reflect that shire county councils have

responsibility for some key services (such as adult social care and public health) in these areas.

**Figure 2.2. Forecast pressures by council type (% of adjusted revenue expenditure)**



Source: Authors' calculations using MHCLG (2020a).

## 2.4 The financial support provided to councils in 2020–21

The government has announced a range of additional grants to help councils address the spending and income pressures arising from the COVID-19 crisis. In working out whether councils have sufficient resources to meet the spending and non-tax income pressures discussed in the previous section, we need to include only the additional funding that is available to meet these pressures. If part of this funding is to be used instead to pay for other activities – such as new responsibilities councils have not taken account of when filling in their returns to MHCLG – we do not want to offset it against the spending and non-tax income pressures they have identified.

Our baseline measure of relevant grant funding includes:

- £3.6 billion of extra **general-purpose grant funding**, across three tranches (A);
- £150 million of the total £600 million funding for **infection control** in adult social care services, reflecting the fact that councils have had to pay over at least 75% of the funding to care homes, including those that only provide care to private customers (B);
- £300 million in **Test and Trace service support grant**, as the significant upward revisions in councils' estimates of public health spending between the June and July survey returns suggest many have now included their new public health responsibilities in their returns (D);
- £20 million from the **active travel fund** which has been provided directly to councils to support temporary changes to cycling and walking facilities due to COVID-19 (E);
- £63 million for **emergency assistance**, to allow councils to provide support to households struggling to afford food and other essentials (F);
- £50 million to help with **reopening high streets safely** (G);
- £3.2 million to cover the costs of providing **emergency accommodation** to rough sleepers (H).

Our baseline measure therefore includes approximately £4.2 billion of grant funding. As in our earlier report (Ogden and Phillips, 2020a), we exclude around £200 million of active travel funding (E) that has been allocated to other types of authority or is designed to fund projects with somewhat longer horizons, and the latest £92 million of rough sleeping funding (I). We also exclude £44 million for home-to-school transport which was allocated to authorities after they submitted their latest survey returns.<sup>14</sup>

In addition to extra grant funding, we estimate that central government has provided the following support to address spending and non-tax income pressures this year:

- Councils are able to **furlough staff** whose salaries are usually funded by income from SFCs or commercial sources, with the government paying affected individuals up to 80% of their usual earnings under the Coronavirus Job Retention Scheme. The level of support is scheduled to decrease each month

<sup>14</sup> Details of each source of grant funding, and any differences between this and our earlier report, are given in Appendix A.

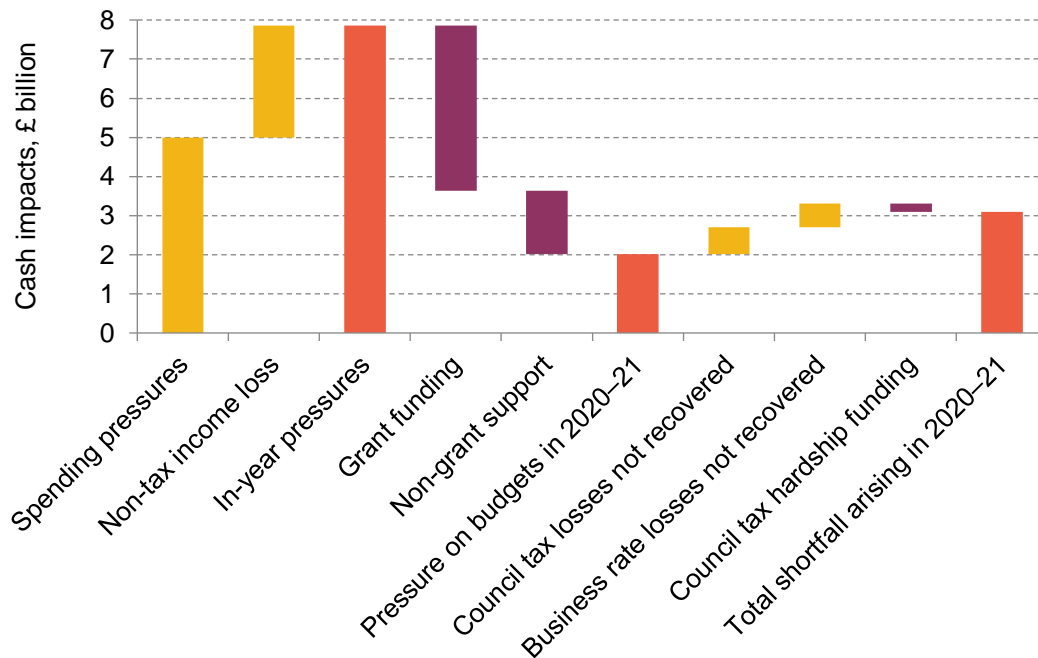
after August, with the scheme due to end after October. 88 councils report that they are using this scheme, up from 81 a month earlier, offsetting around £35 million of losses in SFCs income.

- **NHS clinical commissioning groups (CCGs)** are part-funding adult social care spending pressures. 131 out of 151 councils with responsibility for adult social care reported in July that they had reached agreements with the CCGs in their areas already, up from 103 in June. Among these, CCGs will pay for an average of 26% of adult social care pressures, which sums to £486 million in total.
- A **‘safety net’ for SFCs income** will provide compensatory payments of 75p for every £1 by which SFCs income falls below 95% of what councils planned to raise prior to the COVID-19 crisis. This scheme is discussed more fully in our previous report, where we estimated that it could be worth £985 million to councils in 2020–21. Since then, councils have increased their forecast full-year losses from SFCs income by around 5%, so that we now estimate this support may be worth £1,059 million.
- Councils expect to be able to recover some costs through the **welfare system**. Some of the costs councils have incurred relating to homelessness and rough sleeping, such as providing temporary accommodation to residents, will ultimately be met by central government through successful claims for housing benefit and universal credit made on behalf of those residents. Councils expect to recover £46 million this way.

In total, we estimate this **non-grant support** will be worth £1.6 billion in 2020–21. Taken together with the additional grant funding, the total financial support for councils to address COVID-related spending and non-tax income pressures this year amounts to £5.8 billion.

As shown in Figure 2.3, the in-year pressures from additional spending and lost non-tax income exceed this support, leaving a shortfall in council budgets this year of £2.0 billion. As discussed above, some further pressures relating to the loss of income from local taxes due in 2020–21 will not impact councils’ main budgets until later years. If these pressures are included, the total unmet pressure arising in 2020–21 in our middle scenario increases to £3.1 billion, although with risks weighted to the upside (meaning this unmet pressure is more likely to be higher than £3.1 billion than it is to be lower).

**Figure 2.3. Baseline forecast of unmet pressures arising in 2020–21 (£ billion)**



Note: 'Pressure on budgets in 2020–21' includes the spending and non-tax income losses and the support provided that will impact on councils' main budgets this year. 'Total shortfall arising in 2020–21' includes any council tax and business rate losses we do not expect to be recovered, less a portion of the council tax hardship funding received by councils. This shortfall reflects all pressures arising in relation to 2020–21, although some will only affect councils' main budgets in future years.

Source: Authors' calculations.

## 2.5 Summary

Our middle scenario is for councils to lose council tax revenue of £0.7 billion and retained business rate revenues of £0.6 billion in 2020–21 that will not be recovered. Taking into account council tax hardship funding, this suggests a net loss of £1.1 billion. This could be higher – £1.5 billion in our upper scenario, for example – and does not include in full some other potential losses, such as from business rate appeals, which are too uncertain for us to include. While this pressure arises in 2020–21, it will impact councils' main budgets over the next three years (2021–22, 2022–23 and 2023–24).



This comes on top of in-year pressures from additional spending and non-tax income losses of £7.9 billion. We estimate government has provided £5.8 billion in support to councils, leaving a remaining shortfall which will hit council budgets this year of £2.0 billion.

This is based on forecasts councils made in July of what pressures they would face across the whole year. Our estimate of this shortfall in support is therefore uncertain. More than half of the pressures (52%) councils forecast for the year as a whole relate to costs already incurred in the first four months of the year, and some significant future pressures (such as ‘local lockdowns’ and the recent national surge in cases and associated more stringent measures) will not have been reflected. This means we expect that the eventual pressures on councils are more likely to be higher than this estimate than lower. For instance, if pressures in each of the months after July remain at two-thirds of the levels reported by councils in the first four months (rather than the 46% they currently estimate), the unmet pressure would increase to £3.1 billion.<sup>15</sup>

<sup>15</sup> In this scenario, we assume total spending and non-tax income pressures persist at £680 million per month for the months between August and March, rather than the £471 million implied by councils’ July survey returns. This would increase the total pressure on councils to £9.5 billion, but some of the higher SFCs losses would be compensated by government. This would leave councils with a remaining shortfall of £3,139 million which would impact their main budgets in 2020–21.

## 3. The outlook from 2021–22 to 2024–25

In this chapter, we look at the prospects for revenues and spending pressures over the period to 2024–25. We update and extend our previous analysis of the funding outlook (Harris, Hodge and Phillips, 2019) to account for updated projections for demand and cost pressures, and a number of potential pressures linked to the COVID-19 crisis, including reductions in local tax revenues and other income sources, and increases in the costs of service provision. Given the uncertainty about both the underlying funding outlook and the impact of the COVID-19 crisis, we look at three main scenarios: lower, middle and upper. However, it is important to note that the lower and upper scenarios do not provide bounds on the potential funding gap that may arise over the next four years. And there are several factors (such as the impact of the COVID-19 crisis on demand for children’s and adult’s mental health social care services) where we feel evidence is too limited to incorporate them into our quantitative modelling, but which clearly represent a risk of further upwards pressure on spending.

The chapter begins by setting out the different revenue streams and spending pressures we account for, as well as an overview of the assumptions we make. We then look at the path for revenues, spending needs and any funding gap over the period to 2024–25 under our middle, upper and lower scenarios. Appendix A provides further detail of our modelling.

### 3.1 Revenues outlook

Councils’ revenue comes from three main sources: revenues from local taxes (council tax and business rates); central government grant funding; and other locally-raised income such as from sales, fees and charges (SFCs). Each of these is subject to rules which, in effect, limit their yield, and each could be affected by the COVID-19 crisis.

## Council tax

Council tax is the largest single source of revenues for councils and, as discussed in Chapter 2, was budgeted to raise £27.9 billion in 2020–21 (with a further £5.2 billion raised for police, fire and combined authorities). The amount raised in future years will depend both on how the *tax base* evolves and on the scale of any increases in the *tax rate*.

Legislation currently makes council tax increases above a certain percentage subject to a referendum of local voters. Between 2011–12 and 2015–16, this limit was 2% per year. Since 2016–17, upper-tier and single-tier councils with responsibility for social care responsibilities have been able to increase council tax rates by an additional amount – an extra 2 percentage points in 2020–21 – provided that they certify that this is used to fund adult social care services. Powers to further increase this ‘social care precept’ may not continue,<sup>16</sup> however, and therefore in our main funding scenarios we assume council tax rates are increased by the standard limit of 2% a year. We discuss how much would be raised by additional increases in council tax when discussing options to raise additional revenue in Chapter 4.

Growth in the council tax base will depend on several factors:

- *The change in the number of properties on which council tax is payable*, which in turn depends on the number of new properties built and converted for residential use, as well as the number of demolitions. For our scenarios, we use Office for Budget Responsibility (OBR, 2020c) forecasts for the housing stock from March 2020, but make an adjustment for the slowdown in residential completions during the period of national lockdown restrictions, which means that roughly 39,000 fewer properties had been completed between March and the end of August than in the same period in 2019.<sup>17</sup>
- *Changes in the number of properties subject to exemptions, discounts and premiums*. This includes exemptions for households consisting solely of students, discounts for households with only one adult, and discounts or premiums for empty and second homes. For simplicity, we assume that the

<sup>16</sup> It was initially planned that these ‘social care precept’ powers would last for four years (2016–17 to 2019–20), but they were extended for a fifth year (2020–21).

<sup>17</sup> Based on the number of new dwellings for which Energy Performance Certificates had been lodged each week (MHCLG, 2020i), a leading indicator of house completions.

same proportion of properties are subject to these as was initially forecast for 2020–21.

- *Changes in the number of properties whose residents are eligible for local council tax support (LCTS).* We assume that the increase in the generosity of LCTS schemes (the additional discounts funded by the council tax hardship funding) this year does not continue, and assume in our middle scenario that part of the increase in LCTS reported by councils this year was due to this generosity.<sup>18</sup> We assume that the remaining portion of the full-year cost of the increase in LCTS for working-age residents that councils reported for 2020–21 is associated with falls in incomes and rising unemployment increasing the value of claims. We assume this additional cost persists in future years, and base this profile on the OBR’s (2020a) scenarios for the unemployment rate, using its central scenario in our middle scenario and its ‘downside’ and ‘upside’ scenarios in our upper and lower scenarios, respectively.<sup>19</sup>
- *Changes in the collection rate for those still eligible to pay council tax.* As discussed in Chapter 2, there has been an increase in non-payment this year, although based on past experience most of this is expected to be recouped in future years. Collection rates remained broadly stable during the last recession (in fact, increasing slightly) (MHCLG, 2011), and we therefore assume the collection rate in 2021–22 and beyond is equal to the collection rate that was forecast for 2020–21 before the COVID-19 crisis.

## Business rates

As with council tax, growth in business rates revenues will be affected by changes in the tax rate and in the tax base.

Increases in the tax rate (the ‘multiplier’) are now capped at the rate of Consumer Prices Index (CPI) inflation, and legislation requires that the tax rate is adjusted to ensure revaluations of properties are revenue-neutral across England as a whole.

<sup>18</sup> In our middle scenario, we assume that up to 50% of the council tax hardship funding provided to councils relates only to the additional generosity of the schemes this year, so the remainder (which we constrain to be at least zero for each council) is attributable to the worsening economic situation for households. In our upper and lower scenarios, we net off 0% and 100% of the funding respectively.

<sup>19</sup> See Appendix A for detail.

Our use of the OBR's scenarios for overall growth in business rates revenue (discussed below) means we implicitly use its scenarios for CPI inflation as well.<sup>20</sup>

The business rates tax base is affected by several factors, including: the change in the quantity of non-domestic property (weighted by value); the change in the number of properties subject to different tax reliefs, such as the 100% reduction in tax bill available for the first 3–6 months a property is empty; changes in the value of existing properties as a result of the 'check, challenge, appeal' process; and changes in the collection rate.

Each of these is uncertain and could have been affected by the COVID-19 crisis.

- The number of empty properties is likely to increase as recession and the decline of visits to high streets and other retail venues cause businesses to collapse or close branches. Figures from the British Retail Consortium suggest the vacancy rate for retail units increased from 12.2% to 12.6% between the end of March and the third week of July, an acceleration of previous trends, for example (Local Data Company, 2020). How much higher vacancy rates will go, and the extent to which these feed into medium-term increases in the cost of empty property relief is unclear though.
- Businesses could argue that there has been a 'material change in circumstances' as a result of the COVID-19 crisis that means existing values used in the calculation of their business rates bills are too high. As discussed in Chapter 2, 145,000 business rates 'checks' were initiated in the second quarter of 2020, which is equivalent to 7% of all non-domestic properties in England and around half of all checks initiated over the last three years (Valuation Office Agency, 2020). Of the nearly 84,000 checks that were resolved during the quarter, the VOA agreed in part or in full with the 'facts' presented by the claimant or their agent in 86% of cases. What this implies for assessed values and bills going forwards is unclear, however, as even when the VOA agrees with the facts presented (as it has in 74% of all checks so far) it does not always reduce the rateable value assigned to a property (which has happened in just 24% of checks so far). It is also not clear to what extent these will affect bills in 2020–21 only or whether any changes would apply in subsequent years as well.

<sup>20</sup> We also increase the redistributive 'tariffs' and 'top-ups' each year in line with the OBR forecast in its central scenario for CPI the previous year.

- Businesses that are struggling financially may be unable to pay their business rates bill (or may prioritise more immediate bills). The collection rate for business rates fell from 98.8% to 97.8% during the last recession, and then slowly increased to 98.4% by 2017–18 (MHCLG, 2012 and 2019b). Some of this fall may have reflected a change to rules, which meant empty properties were liable to full business rates after 3–6 months, though.

We do not try to model each of these effects from the bottom up, but instead use the OBR’s ‘central’, ‘upside’ and ‘downside’ scenarios for business rates revenue growth (in our middle, lower and upper scenarios respectively), which build in these factors to various extents.<sup>21</sup>

Another important factor is the proportion of business rates retained by local government (as opposed to being transferred to central government). Currently, for most parts of the country this is 50%, although it is 67% in London and 100% in a few pilot areas (there were previously many more of these). The government had planned to move to 75% retention across England as a whole from April 2021, at the same time as abolishing a number of grants in order to ensure the change was revenue-neutral (MHCLG, 2018). On 28 April 2020, however, the government confirmed that this would no longer take place next year, and offered no date as to when it would take place. In our analysis, we therefore assume that current retention rates remain in place until at least 2024–25. As the concurrent abolition of grants would have ensured this policy was close to revenue-neutral at the point of delivery, the only effect this has is to reduce the share of any change in business rates revenues, from say 2022–23 onwards, that accrues to local government from 75% to 50%.

## Grant income

Councils receive a range of grants from central government departments to help pay for their expenditure. In our scenarios, we focus on those general and specific grants that help pay for non-school expenditures. This includes the Revenue Support Grant, Public Health Grant, social care grants such as the Improved Better Care Fund, New Homes Bonus and a range of smaller grants (a full list is provided in Appendix A).

<sup>21</sup> Information based on discussions with the OBR.

The future value of these grants is a policy choice for central government. In each of our scenarios, we assume that they are held constant in real terms, in order to provide a sense of the real-terms increases that would be needed in order to close the funding gap we identify.

We also assume that the emergency increases in grant funding for COVID-19-related pressures in 2020–21 are one-off increases which are not repeated.

## SFCs and commercial income

The extent to which SFCs and commercial income recover from the big falls expected in 2020–21 is unclear and will depend on the pace and extent to which people’s behaviour returns to pre-crisis norms. This includes the use of council parking, culture and leisure facilities, as well as profits or losses generated from the properties, airports and businesses councils own.

In our lower scenario, we assume SFCs and commercial income all return to pre-COVID-19-crisis levels in 2021–22, with no impacts on these income streams from April 2021 onwards. However, our middle and upper scenarios assume that there are ongoing reductions to income from parking, culture and leisure facilities, and commercial activities.<sup>22</sup>

A range of evidence suggests parking income may be slow to recover and may not recover in full. For example, online retail sales have increased significantly as a share of overall retail sales, which is expected to persist to at least some extent, which may reduce trips to physical retail outlets.<sup>23</sup> Big increases in homeworking – from 6% before the lockdown to a peak of 43% in April – are also expected to only partially reverse over the coming years. 88% of employees who worked at home during lockdown would like to continue working at home at least some of the time, with around 47% wanting to do so often or all of the time (Felstead and Reuschke,

<sup>22</sup> In all scenarios, we assume there are no losses of SFCs from planning and development from 2021–22 onwards, given that the rate of completion of new dwellings appears to have now recovered the level seen in 2019–20. We also assume there are no losses of SFCs from other services, or of ‘other income’, from 2021–22 onwards.

<sup>23</sup> For instance, Alvarez & Marsal (2020), quoting Retail Economics, report that consumers in the UK plan to reduce the frequency of trips to physical stores by 35% and increase the frequency of online shopping by 34% in the long run. In a survey for Waitrose (2020), 40% of people expected to shop more often for groceries online after the lockdown.

2020). And a number of major employers have made their intentions to have more people working from home clear, including Legal & General, PwC and Aon (Financial Times, 2020). Our upper scenario is that losses in transport and parking income persist in future years at the same level as the losses councils expect on average over the last eight months of 2020–21 (August – March).<sup>24</sup> This is equivalent to assuming income from transport remains depressed by around 20% permanently. Our middle scenario is for losses to persist at half this level, so SFCs income from transport services remains around 10% below its pre-crisis level.

There is less analysis of the factors that will drive future leisure and culture services. Discussions with Local Government Association (LGA) advisors suggest councils expect that income from leisure and culture facilities will not recover until 2022–23. Councils' estimated monthly losses of around £65 million in each month between April and July, suggesting that revenues did not recover even as some restrictions were eased. There is also evidence from shire district councils that suggests the losses reported to MHCLG for 2020–21 may not capture the full income losses incurred by outsourced providers.<sup>25</sup> If these providers fail, councils could see significant increases in costs in future years if they are to maintain leisure services. In our middle scenario, we therefore assume income from this service is reduced by half of the reduction councils expect for the remaining eight months of the year in 2021–22, and then recovers to pre-crisis levels from 2022–23. This is equivalent to revenues being 23% lower next year than pre-crisis, compared with the 45% forecast for the remainder of this year. Our upper scenario assumes that SFCs from this service area are reduced in line with councils' forecasts for the last eight months of 2020–21 (45%) and by half that amount in 2022–23 (23%), and that they then remain permanently depressed by a quarter of that amount (11%).

<sup>24</sup> Councils expect full-year losses of £810 million, of which £490 million had been incurred between April and July. This implies they expect an average monthly loss in the remaining eight months of the year of £40 million. Our middle estimate is for annual losses in 2021–22 and future years of £240 million (equivalent to half of this £40 million monthly pressure persisting) and our upper estimate is twice this.

<sup>25</sup> Based on a survey of its members, the District Councils' Network (2020) estimates that total losses for leisure services and providers for all district councils may be £306 million in 2020–21. This is significantly higher than the £130 million in total losses of culture and leisure SFCs the same councils reported in the July survey (MHCLG, 2020a), suggesting councils may have included lost management fees rather than the entire losses of private providers where services have been contracted out. This means they are fairly representing councils' own losses in 2020–21, but raises concerns about the viability of these providers, with the risk that councils may need to take services back in-house in future years, and face significant running costs.



Changes in commercial property income will reflect trends in occupancy, rents and payment rates. Forecasts for occupancy and payment rates are unavailable, but have been published for rents. For instance, a survey of property advisors and fund managers found that they expected commercial property rents to fall by 0.8%, on average, between 2020 and 2024, with a fall of 4.2% for shopping centres and a rise of 1.1% for industrial properties (Statista, 2020). A larger survey, which focused on the 12 months from June 2020, forecast bigger falls in the shorter term, with a decline in retail rents of between 10% and 14% and in office rents of between 4% and 7% (RICS, 2020). While income from airports is small for the sector as a whole, it matters for a number of councils, including Luton and Manchester, and IATA (2020) forecasts that air passenger volumes will not recover to 2019 levels until 2024. Given these factors, in our middle scenario, we assume that losses persist into 2021–22 at half of the level of losses councils reported expecting for the remainder of 2020–21, and then decline to zero by the end of the period. Our upper scenario assumes bigger losses in 2021–22, with income returning more slowly.<sup>26</sup>

## 3.2 Spending pressures outlook

Changes in spending needs can reflect changes in demand for services (for example, the number of people in care homes funded by councils) and changes in the ‘unit costs’ of delivering services (for example, the cost per care home resident). In turn, both can be affected by the policies of central and local government, such as eligibility rules and service and labour standards.

In this report, we put to one side most potential policy changes, including to eligibility for publicly funded social care or to the level of spare capacity in the system. But we do account for increases in the National Living Wage, which will increase labour costs for a range of services, most notably adult social care services.

### Demand pressures

Demand for councils’ services can be affected by a range of demographic and socio-economic factors, as well as changes in expectations among potential service users and wider society.

<sup>26</sup> For full details of the profile of losses assumed for each line of revenues in each scenario, see Appendix A.

At the most basic level, a growing population is likely to lead to an increase in demand for services. As a starting point, we therefore assume that demand for most council services rises in line with the Office for National Statistics (ONS) principal projection for population growth from 2018, which averages 0.52% between mid 2019 and mid 2024.

However, demand is likely to grow more quickly for adult social care services. A widely used model developed by the Personal Social Services Research Unit (PSSRU) projects demand will increase by about 2.2% a year, around four times the rate of overall population growth. This is based on differences in service usage and population growth by age group, trends in the prevalence of learning disabilities, and projected changes in the share of people living with a partner and with assets and income low enough to qualify for state support (Wittenberg, Hu and Hancock, 2018).

The only major service area on which council spending has increased since 2009–10 is children’s social care services (although spending on more universal services such as Sure Start and youth centres and services has declined by over 60%) (Harris, Hodge and Phillips, 2019). This has been driven by an increase in the number of children in foster or residential care and increasing numbers of children subject to safeguarding enquiries and plans (Institute for Government, 2019).

Whether this will continue to the same extent is unclear. In our lower scenario, we assume that demand growth returns to longer-run trends. In particular, we use the Institute for Government’s (2019) projection, which is for demand to increase by 1.44% a year, based on a continuation of trends in fostering and residential care since 2007–08 and other social care services since 2012–13. Our upper scenario assumes a continuation of more recent (2013–14 to 2018–19) trends in foster and residential care and the number of children placed on child protection plans: an approach used by the LGA. This leads to demand growth of 2.6% per year. Our middle scenario assumes some slowdown in recent especially rapid growth and is a simple average of the Institute for Government and LGA figures: 2.02%.

### Additional demands as a result of the COVID-19 crisis

The impact of the COVID-19 crisis on demand is likely to be complex and vary across services and over time.

In some ways, the crisis could reduce demand.

An increase in deaths among those making use of adult social care services may reduce caseloads for a period of time, for instance. A large fraction of COVID-19 deaths have been among the elderly (89% are over 65 and 42% over 85) and those with pre-existing health issues (95% among those dying in hospitals) (ONS, 2020a; NHS England, 2020). Even more starkly, the number of deaths of care home residents increased by 87% compared with 2019 between 6 March (when the first COVID death was reported) and 6 June (when death rates first fell below 2019 levels), equivalent to an extra 29,100 deaths (ONS, 2020b).

The number of children referred to social services fell by 18% between April and June and the number of children entering foster or residential care fell by a third (Local Government Association, 2020). All else equal, this would reduce the number of service users going forwards. And lockdown and other policies in response to the COVID-19 crisis, such as limits on evictions, are likely to have reduced demand for some public health and housing services.

However, these effects may prove to be temporary, and other effects of the COVID-19 crisis may be expected to lead to an increase in demand, especially in the medium term.

There is emerging evidence that a proportion of people who have had COVID-19 suffer long-term health effects (Public Health England, 2020). In addition, evidence from past recessions suggests that ill health and especially mental ill health increase significantly following economic downturns, with each 1% fall in employment leading to a 2% increase in the prevalence of chronic illness after two years (Janke et al., 2020). Unfortunately, survey evidence suggests a significant worsening of mental health, especially among young adults, during the first two months of lockdown (Banks and Xu, 2020), although the extent to which this will be sustained, and the longer-run implications for health and service usage, are unclear.<sup>27</sup> It is also possible that falls in asset values and incomes could lead to an increase in the proportion of people entitled to council-funded care (which is means

<sup>27</sup> It is possible that impacts could be very long lasting. Research finds an important relationship between having depression earlier in life and dementia in later life. For example, Ownby et al. (2006) find dementia is twice as likely among those who previously experienced depression, while Kessing and Andersen (2004) find each in-patient admission for depression increases the likelihood of dementia by 13%. However, the extent to which this represents a causal as opposed to correlatory relationship is unclear.

tested), although so far residential property values (households' main asset) have performed relatively well.<sup>28</sup>

If the fall in referrals and safeguarding actions during lockdown has meant children remaining in risky and/or abusive situations for longer, more difficult and costly interventions may be required. A review of evidence suggests that mistreatment of children increases when families face increased economic insecurity and additional burdens (Romanou and Belton, 2020). And evidence from the US suggests that child abuse increased as a consequence of the Great Recession (Schneider, Waldfogel and Brooks-Gunn, 2017).

Children's health may also be affected. Parents may not be able to fulfil the increased attention needs in their children, with adverse mental-health outcomes in the short and long term (Miller and Commons, 2010). Extended episodes of isolation, together with reduced interactions with their peers, might also take a toll on children's social and cognitive development. Isolation has documented effects on factors associated with dependence later in life (such as educational performance, inflammation, coronary heart disease, psychological distress and obesity) (Lacey, Kumari and Bartley, 2014).

Historically, recessions and income falls have been associated with reductions in drinking, smoking and unhealthy eating (Banks, Karjalainen and Proper, 2020). However, there is evidence that the COVID-19 crisis may be associated with an increase in drinking and unhealthy eating, increasing the demand for some public health services. For instance, the Royal College of Psychiatrists (2020) estimates that in June, 8.4 million people in England were drinking at higher-risk levels, up from 4.8 million in February. Moreover, the number of people seeking support for opiates increased by 20% in April 2020 compared with April 2019, despite difficulties in accessing services as a result of lockdown.

There are also concerns that the moratorium on evictions could be followed by a spike in evictions, increasing pressures on housing services. A survey by YouGov commissioned by Shelter (2020), for instance, suggests that the number of private

<sup>28</sup> Nationwide (2020) and Halifax (2020) report annual house price growth of 3.7% and 5.2%, respectively, for the year to August.

renters in arrears had increased from 215,000 (2%) to 442,000 (5%) since the start of the pandemic, with 174,000 (2%) having already been threatened with eviction.

It therefore seems likely that demand for a range of services could increase in the medium term as a result of the COVID-19 crisis. The scale and persistence of these increases are uncertain though, so we do not feel able to build them into our quantitative scenarios. However, government and councils should bear in mind the potential for increases in demand as they plan funding and budgets for the next few years.

### Cost pressures

As well as increases in demand, the unit cost of delivering services is likely to increase over the next few years. This was true even before the COVID-19 crisis, reflecting two main factors: slow growth in productivity and increases in the National Living Wage.

In its projections for the long-term outlook for adult social care spending, the OBR (2018) assumes zero productivity growth. Increases in wages and other input costs (such as property costs) therefore feed through in full into increases in the cost of service delivery. This is based on the ONS (2020c) analysis of the productivity of publicly funded adult social care services, which suggests that productivity was effectively unchanged between 2010–11 and 2019–20, after falling by an average of around 1% a year during the 2000s. ONS (2020d) analysis suggests that the productivity of children’s social care services was effectively unchanged between 2003 and 2017, after falling during the late 1990s and early 2000s.

Given this, our middle scenario assumes zero productivity growth for council services, while our upper scenario has productivity falling by 0.5% a year and our lower scenario has productivity increasing by 0.5% a year. Unit costs are therefore projected to increase in line with the price of inputs (in our middle scenario), plus 0.5% (upper) or minus 0.5% (lower). The increase in the price of inputs is estimated to be a weighted average of inflation as measured by the GDP deflator and our assumed increase in earnings. The weight applied to earnings is 85% in our middle scenario, 100% in our upper scenario and 70% in our lower scenario. These weights are higher than councils’ own labour costs and are designed to capture changes in labour provided by suppliers and the cost of land and property.

We assume earnings grow in line with the OBR's post-COVID-19 central scenario for average earnings, plus estimates of the impact of planned increases in the National Living Wage (NLW) to two-thirds of median hourly earnings by April 2024 (which we assume to be £10.30 in cash terms). This increase will affect councils' own labour costs, and the costs of providers providing outsourced services, most notably in the adult social care sector.

Our estimates of the costs for councils' own workers have been produced using the LGA's model of local government pay. In our lower scenario, we assume that councils' pay scales are set so that each 'spine' on the scale is equal to the maximum of the NLW or the current spine point increased in line with average earnings. This is the bare legal minimum required to ensure compliance with the NLW. In our upper scenario, we assume that the spines on councils' pay scales are increased in line with the percentage increase in the NLW. This would ensure that 'headroom' over the NLW and pay differentials between spine points are maintained in full. Our middle scenario is closer to our lower scenario than our upper scenario, reflecting the fact that research suggests that increases in minimum wages lead to significant but not complete squeezing of differentials.<sup>29</sup> In particular, we assume the cost is a weighted average of our lower and upper scenarios, with a weight of 80% on the former and 20% on the latter.

Our estimates of the impact of increases in the NLW on wages in the adult social care sector are based on figures reported by Skills for Care (2019). It estimates that 28% of adult social care workers were paid the NLW and 60% were paid within 50p of the NLW in March 2019 (when the NLW was £7.83). In addition, it estimates that the 6.2% increase in the NLW in April 2020 would increase the wage bills of care providers by £375–£400 million.<sup>30</sup> We use this figure, together with an assumption that two-thirds of the work of care providers consists of council-funded care, to estimate that each 1% increase in the NLW will increase the labour costs that need to be passed on to councils by £50 million in each of our scenarios.<sup>31</sup> We do this because we have no estimates of what maintaining differentials could cost,

<sup>29</sup> See, for instance, Denvir and Loukas (2007).

<sup>30</sup> <https://www.skillsforcare.org.uk/adult-social-care-workforce-data/Workforce-intelligence/publications/Topics/Pay-rates.aspx>.

<sup>31</sup> This figure incorporates an allowance for additional employer costs such as National Insurance and pension contributions at a rate of 20%, and for increases in the NLW level over time.

but note that if care providers felt they needed to (partially or fully) maintain differentials, costs could rise further.

It is also worth noting that there is evidence that councils have been paying social care providers less than the full economic costs incurred including an allowance for an appropriate return on capital (i.e. profit rate). However, Box 3.1 provides estimates of the potential scale of this issue, based on figures used previously by the Competition and Markets Authority and the LGA.

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### **Box 3.1. An estimate of the pre-existing adult social care funding shortfall**

As discussed in Section 3.3, this report projects spending needs from a 2019–20 baseline so as to examine how future revenues may compare with the amount needed to maintain services at their level in that year. However, a number of studies express concern that existing levels of spending on adult social care are below what is required to ensure sustainable provision.<sup>a</sup> A range of issues are identified including losses (or low profits) among providers, recruitment difficulties (which may be exacerbated by Brexit) and the need to cross-subsidise low payments by councils with higher charges on private clients.

A number of organisations produce estimates of the minimum price providers would need to be paid in order to cover their costs and generate a modest profit, including LaingBuisson (2019) for residential care and the UK Homecare Association (2018) for home care. The Competition and Markets Authority (2017) and the Local Government Association (2018) have previously used these to assess the extent to which councils are underpaying for adult social care, with the latter also estimating the amount needed to ensure all councils paid at least the benchmark prices calculated by LaingBuisson and the UK Homecare Association. Updating the LGA’s estimates to account for differences in costs across the country (using the Area Cost Adjustment Factors that will be used in the new adult social care spending needs formulas), we estimate that it would have cost £1.34 billion in 2018–19 for all councils to meet these benchmarks, very similar to the figure the LGA has used (which does not account for differences in costs across the country). We estimate the cost would be £1.16 billion if councils paying more than the benchmark were to reduce the prices they paid to the benchmark level.

a. See, for instance, Institute for Government (2019), Shembavnekar (2020) and Age UK (2020).

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We have been unable to find data on the number of workers in other contracted-out services that could be affected by the NLW. We therefore do not incorporate any additional increase in costs as a result of increases in the NLW for outsourced services.

### Increases in unit costs as a result of the COVID-19 crisis

As with service demand, the COVID-19 crisis could also have medium-term impacts on the unit costs of providing services. And it is clearly having short-term impacts. For example, approximately £1.3 billion of the additional £2.2 billion councils forecast to spend this year on adult social care is due to cost factors, with:

- £0.27 billion being spent on personal protective equipment (PPE);
- £0.85 billion being spent on ‘supporting the market’, including higher payment rates for suppliers;
- £0.14 billion being spent on ‘workforce pressures’.

Given planned spending of approximately £17.5 billion prior to the crisis, this suggests an increase in unit costs of 7.3%. The extent to which these increases will persist is unclear though. However, it is worth noting that there are different types of costs being incurred. Mitigation costs relate to the direct additional labour and non-labour costs, including PPE, extra cleaning, and the extra time to administer and deliver services in a way that complies with social distancing requirements. Non-mitigation impacts include losses in productivity as a result of changes to staff routines, increases in anxiety and reduced scope for collaboration between co-workers. These latter costs are likely to abate as people adapt to changes in working arrangements – especially in an industry where workers are already used to dealing with stress and pressure (Skills for Care, 2017). Assuming non-mitigation costs abate in full by the end of this year, and that these account for half of ‘workforce pressure’ costs and ‘supporting the market’ costs, we assume the remaining ‘mitigation’ costs evolve as follows:

- in our lower scenario, they are zero by 2021–22;
- in our middle scenario, they decline linearly during 2021–22 and 2022–23;
- in our upper scenario, they decline by 20% per year and in 2024–25 are equal to approximately a quarter of the overall additional unit costs incurred in 2020–21.

The fact that other spending increases are not broken down into cost and demand factors means we are unable to apply this approach to other service areas. There is



therefore an unmodelled risk of additional increases in unit costs for other services – such as children’s social care services and leisure and culture services.

In our middle and upper scenarios, we do though assume that additional public health expenditure associated with the COVID-19 crisis persists beyond 2020–21. In our middle scenario, the monthly costs in 2021–22 are equal to half the monthly cost incurred between August 2020 and March 2021 implied by councils’ forecasts, with no additional costs incurred in 2022–23 and beyond. In our upper scenario, we assume that monthly costs in 2021–22 and 2022–23 are three-quarters and one-quarter of their August 2020 to March 2021 levels, respectively.

One notable factor that may increase unit costs, but not until after April 2023, is the impact of the COVID-19 crisis on local government pension schemes. It is beyond the scope of this report to try to model this in full – and the data to do so are not publicly available – but Box 3.2 looks at one of the ways the crisis could increase pension contributions costs: a decline in the value of pension funds’ assets.

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### **Box 3.2. How might COVID-19-related falls in asset prices affect local government pension costs?**

The COVID-19 crisis could impact on local government pension schemes in several ways. Lower inflation will reduce the cost of future pension obligations, but lower future growth rates could reduce the extent to which investment returns help pay for them. Most obviously, a fall in the value of assets held by pension funds (such as shares and properties) would lead to an increased pensions deficit, necessitating higher contributions by councils from April 2023, if that fall is sustained.

Available data do not allow us to estimate how councils’ pensions liabilities may have changed as a result of the COVID-19 crisis, but data on their assets and pre- and post-COVID forecasts for asset prices are available. We can therefore look at how one particular aspect of the COVID-19 crisis – the fall in asset values – might affect councils’ pension costs.

In particular, making use of the OBR’s July scenarios for the FTSE All-Share Index and commercial property prices (and comparing them with previous forecasts from March), and information on the asset holdings of local government pension schemes, we estimate an increase in councils’ share of the pension deficit of £12.3 billion in our middle scenario.<sup>a</sup> This figure is subject to significant uncertainty though, as reflected in our lower and upper

scenarios of £5.4 billion and £22.7 billion (which themselves are not bounds on the potential effect).

The implications of a given increase in deficit for councils' pension costs are also uncertain, as a range of different responses are possible. These include recouping the deficit over different periods of time and, in extreme cases, sharing costs with employees by increasing their contribution rates (although this would be subject to collective bargaining arrangements). Assuming that councils bear the cost in full and choose to close the deficit over 25 years, we estimate the increase in councils' pension contributions would be £0.63 billion per year in real terms from April 2023 in our middle scenario. It would be £0.28 billion per year in our lower scenario and £1.17 billion in our upper scenario. This compares with contributions of approximately £4–£5 billion by English councils in 2018–19 (the rest is from employees and from other employers that are members of the schemes, such as schools and some universities).

Changes in liabilities (for example, due to changes in assumptions about future investment returns as well as existing asset values) could have big effects too though, and a full valuation would also take account of such effects.

a. See Appendix A for further details of the calculations underlying this and the following figures.

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### 3.3 The overall outlook for funding

We now turn to examine what the assumptions outlined above imply for our estimates of councils' spending needs and revenues for the years 2021–22 to 2024–25. To aid interpretation of the estimates, Table 3.1 provides an overview of the factors that we account for and of the key differences between scenarios (further detail is provided in Sections 3.1 and 3.2 and in Appendix A).

Table 3.1. Overview of our assumptions and scenarios

Item	Overview of assumptions
<b>Revenues</b>	
Council tax	<p>Tax rates increase by 2% in all scenarios</p> <p>Tax base increases in line with forecast increase in the housing stock, with an allowance for construction slowdown in 2020–21, except in lower scenario where growth of 1% is assumed</p> <p>Increases in the cost of LCTS in line with OBR unemployment scenarios, using the upside in our lower scenario, central in our middle scenario and downside in our upper scenario</p> <p>Deficit incurred in 2020–21 spread over three years</p>
Business rates	<p>50% business rates retention remains in place</p> <p>Tax revenues increase in line with OBR scenarios for business rates growth, using the upside in our lower scenario, central in our middle scenario and downside in our upper scenario</p> <p>Deficit incurred in 2020–21 spread over three years</p>
Grant funding	Grants increased in line with inflation (GDP deflator) in all scenarios
<b>Spending</b>	
Demand	<p>Adult social care demand increases by 2.2% a year in all scenarios</p> <p>Children's social care demand increases by 1.44% in our lower scenario, 2.02% in our middle scenario and 2.6% in our upper scenario</p> <p>Demand for other services and spending increases in line with population projections</p>
Unit costs	<p>Productivity increases by 0.5% a year, is unchanged and falls by 0.5% a year, respectively, in our lower, middle and upper scenarios</p> <p>Cost of inputs increases in line with a weighted average of average earnings growth and inflation (GDP deflator), with weights applied to average earnings of 70%, 85% and 100%, respectively, in our lower, middle and upper scenarios</p>

Item	Overview of assumptions
NLW	<p>For adult social care, each 1 percentage point increase above average earnings is assumed to cost £50 million.</p> <p>For directly employed staff, our lower scenario assumes workers are paid the maximum of their wage increased in line with average earnings or the NLW. Our upper scenario increases all wages in line with the NLW from 2024–25 to maintain headroom and pay differentials in full. Our middle scenario is an 80/20 weighting of these scenarios.</p>
COVID-related costs	<p>Assumed to fully abate by 2021–22 in our lower scenario. Our middle and upper scenarios account for ongoing falls from income from transport, culture and leisure services and commercial activities, as well as increases in costs for adults' social care and public health. All except the fall in income from transport are assumed to fully abate by 2024–25 in our middle scenario. Abatement is slower and only partial in our upper scenario.</p> <p>Income losses and additional costs for other services (such as children's social care, planning, and housing and homelessness) are not accounted for in our middle or upper scenarios.</p>
COVID-related demand	Not accounted for in any of our scenarios

Source: See Sections 3.1 and 3.2 and Appendix A.

What do these assumptions imply for the outlook for revenues and spending? Table 3.2 shows our projections for revenues and spending needs for the period 2021–22 to 2024–25 under our middle scenario. It shows that:

- Spending needs are projected to increase by almost 11% in real terms between 2019–20 and 2024–25 (23% in cash terms). This is driven by a 16% real-terms increase for adult social care services (29% in cash terms). Spending needs for other services – which in this table incorporate children's social care services – are projected to increase by 7% in real terms (19% in cash terms).
- Revenues are projected to increase by just 4% in real terms between 2019–20 and 2024–25 (16% in cash terms). Projected increases in council tax revenue of 6% in real terms are higher than this, in part reflecting large increases in council tax this year. The figures for business rates and Revenue Support Grant are distorted by the ending of most business rates pilots in 2019–20 and, taken together, these two sources of revenue are projected to fall 0.7% in real terms.

Table 3.2. Funding outlook up to 2024–25, middle scenario

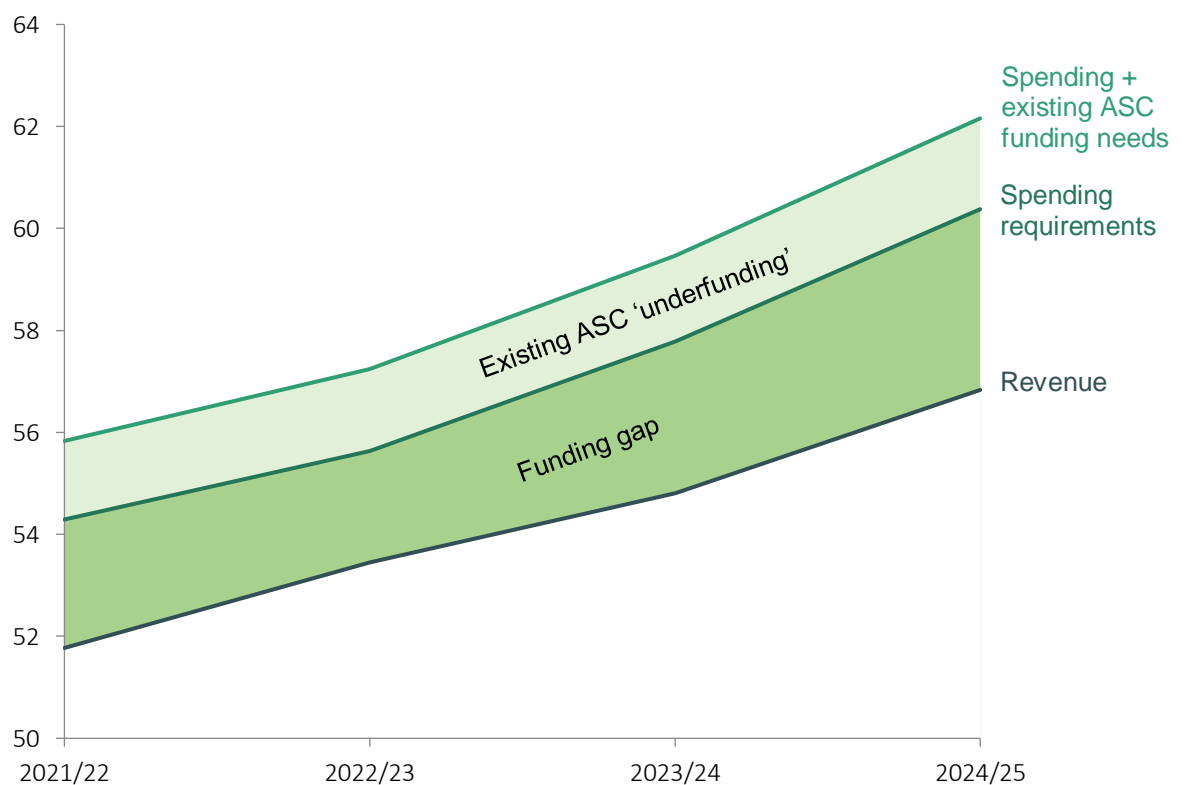
£ million	2021–22	2022–23	2023–24	2024–25	Real-terms change since 2019–20
<b>Spending requirements</b>	<b>54,291</b>	<b>55,633</b>	<b>57,780</b>	<b>60,377</b>	<b>10.6%</b>
Adult social care – excl. additional COVID-related cost pressures	18,490	19,389	20,473	21,634	15.9%
Other services – excl. additional COVID-related cost pressures	34,486	35,588	37,002	38,503	7.2%
Additional COVID-related cost pressures	681	287	0	0	n/a
COVID-related losses in non-tax income	634	368	304	240	n/a
<b>Revenue streams</b>	<b>51,849</b>	<b>53,528</b>	<b>54,887</b>	<b>56,991</b>	<b>4.4%</b>
Council tax	28,073	29,076	29,968	31,095	5.5%
Retained business rates	13,910	14,377	14,640	15,408	–6.6%
Revenue Support Grant	1,446	1,477	1,507	1,537	170.4%
Social care grants	3,492	3,566	3,638	3,712	34.2%
Public Health Grant	3,283	3,353	3,421	3,491	0.1%
Other grants	1,644	1,679	1,713	1,748	–2.9%
<b>Difference</b>	<b>2,443</b>	<b>2,105</b>	<b>2,893</b>	<b>3,386</b>	<b>n/a</b>
Existing adult social care ‘underfunding’	1,328–1,540	1,383–1,605	1,457–1,690	1,536–1,782	n/a
Difference incl. existing adult social care ‘underfunding’	3,770–3,983	3,489–3,710	4,350–4,583	4,922–5,168	n/a
<b>After adjusting for inflation:</b>					
Difference	2,439	2,059	2,773	3,181	n/a
Difference incl. existing adult social care ‘underfunding’	3,765–3,978	3,412–3,629	4,169–4,393	4,624–4,855	n/a

Source: Authors’ calculations using data and assumptions described in Sections 3.1 and 3.2 and Appendix A.

- Spending needs are projected to exceed revenues available in each year between 2021–22 and 2024–25, with a gap of £3.2 billion in real terms in 2024–25. The gap falls between 2021–22 and 2022–23, reflecting the abatement of additional COVID-19-related cost pressures and non-tax income losses. But the underlying trend is upwards, and the gap would continue to grow beyond the end of the projection horizon.

The table also shows our estimates of the pre-existing gap between what councils pay for adult social care services and what benchmark prices imply providers need. Addressing this difference too would increase the amount of extra funding councils need in 2024–25 to £4.6–£4.9 billion in real terms (or £4.9–£5.2 billion in cash terms).

**Figure 3.1. The funding gap and pre-existing adult social care (ASC) gross ‘underfunding’ (middle scenario, £ billion)**



Source: Authors' calculations using data and assumptions described in Sections 3.1 and 3.2 and Appendix A.

These trends in revenues and spending needs (both excluding and including existing social care ‘underfunding’), and the implied gap between them, are shown graphically in Figure 3.1.

Full projections for revenues and spending in our lower and upper pressures scenarios can be found at the end of Appendix A.

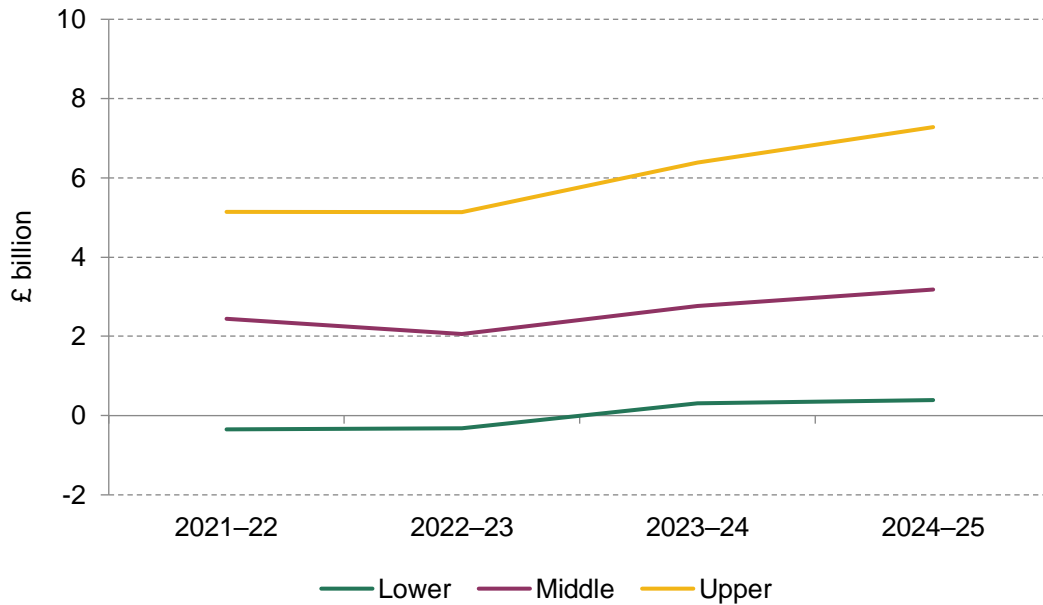
Under the lower scenario, there is a smaller divergence between growth in revenues (5% in real terms between 2019–20 and 2024–25) and spending needs (6%), largely driven by the latter being slower than under the middle scenario. This reflects increases in productivity, slower growth in pay (doing the bare legal minimum to meet NLW requirements), slower growth in demand for children’s social care services, and the complete abatement of any impacts of COVID-19 on unit costs and non-tax incomes.

Under the upper scenario, there is a bigger divergence between growth in revenues (4% in real terms between 2019–20 and 2024–25) and spending needs (17%). This is largely driven by the latter being faster than under the middle scenario. This reflects falls in productivity, faster growth in pay (to maintain headroom above the NLW and pay differentials), faster growth in demand for children’s social care services, and longer-term and larger increases in unit costs and reductions in non-tax income as a result of the COVID-19 crisis.

The paths for the real-terms differences between revenues and spending needs (excluding pre-existing adult social care pressures) for the lower and upper scenarios (as well as the middle scenario) are shown in Figure 3.2. It shows that under our upper scenario, the funding gap would increase from around £5.1 billion in 2021–22 and 2022–23 to £7.3 billion in 2024–25. Under our lower scenario, revenues would exceed spending needs in 2021–22 and 2022–23, but a gap of £0.4 billion and growing would emerge by 2024–25, and would continue to grow over time.

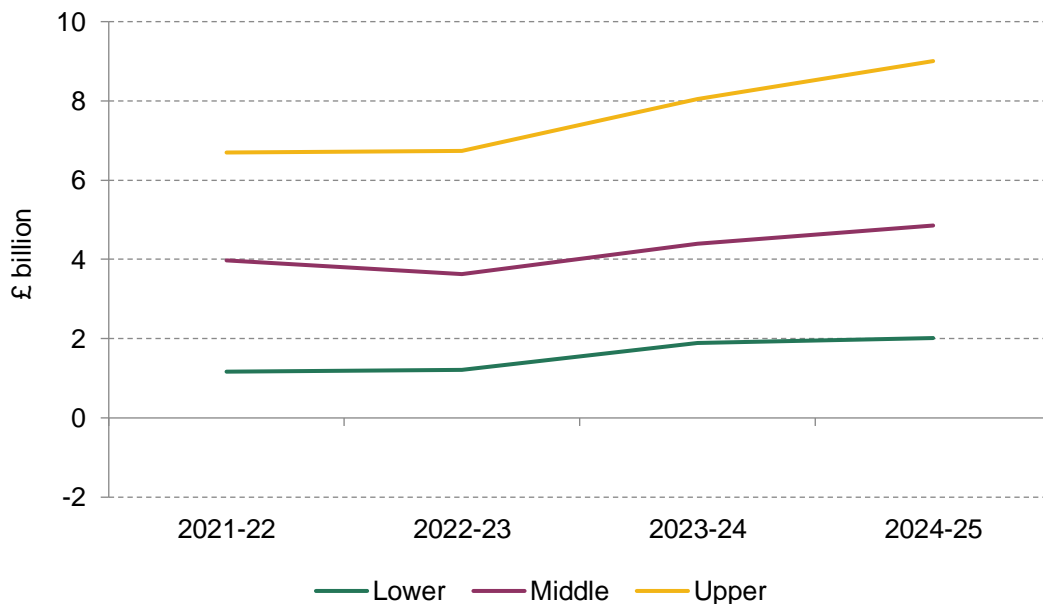
Figure 3.3 adds the additional costs it would take to address pre-existing shortfalls between the prices councils pay for social care and benchmark minimum prices. It shows a gap of £6.7 billion in 2021–22, increasing to £9.0 billion by 2024–25 under our upper scenario. Under our lower scenario, a gap of £1.2 billion would increase to £2.0 billion by 2024–25.

**Figure 3.2. The projected gap between revenues and spending needs under our three scenarios**



Source: Authors' calculations using data discussed in Sections 3.1 and 3.2 and Appendix A.

**Figure 3.3. The projected gap between revenues and spending needs under our three scenarios, including pre-existing adult social care 'underfunding'**



Source: Authors' calculations using data discussed in Sections 3.1 and 3.2 and Appendix A.



Recall also that these projections exclude any effects of the COVID-19 crisis on service demand. They also exclude the impact of the crisis on pension contribution costs which, taking account of changes in assets only, could be £0.3–£1.2 billion for councils in real terms from April 2023 onwards.

### 3.4 Summary

This chapter has examined the medium-term outlook for local government revenues and spending needs. To do this, we have utilised three scenarios with varying assumptions about service demands, productivity, wage cost growth and the impact of the COVID-19 crisis on both tax and non-tax incomes and unit costs. We also reviewed the evidence on the potential effect of the COVID-19 crisis on service demands, but did not incorporate any impact in our scenarios: this clearly represents a risk of further upwards pressures on spending needs.

Most of the differences between our scenarios are driven by differences in spending needs – with demand growth, productivity growth, wage growth and COVID-19 impacts all playing an important role. However, even in our lower, most optimistic scenario for spending pressures, a growing gap would emerge by 2023–24. It is therefore very highly likely that councils will need additional grant or devolved funding if they are to avoid further cutbacks to services, even when the pressures caused by the COVID-19 crisis have largely abated. As discussed more in the final chapter of the report, uncertainty about the scale of the duration and scale of ongoing impacts of the COVID-19 crisis and uncertainty more generally about underlying demand and cost pressures mean flexibility on funding is likely to be needed over the next few years.

## 4. Conclusion and discussion

This report has updated and extended our previous analysis of the short-term COVID-19-related revenue and spending pressures councils are facing. This confirms that there is likely to be a shortfall between the extra spending and reductions in income councils are incurring this year and the extra funding councils are being provided with. While many councils may be able to draw down reserves to make up the difference, many may have insufficient useable reserves to do so. This report has also looked at the medium-term outlook to 2024–25. While the degree of uncertainty is high, it has found that it is likely that without additional funding, councils will have to cut back service provision. This reflects increases in service demands and costs that are likely to outpace increases in local tax revenues.

The options and issues for providing more support for councils to address spending and non-tax income pressures in 2020–21 were discussed in our last report (Ogden and Phillips, 2020a). LG Futures (2020) discusses options for helping address losses in local tax revenue collections, one of which – the spreading of collection shortfalls in 2020–21 over three years (2021–22 to 2023–24) rather than just one – has already been adopted.

But what about addressing the medium-term gap between the increasing demands for and costs of local services, and increases in the amount of council tax and business rates councils are likely to receive under default policy?

One option would clearly be not to. However, that would lead to further cutbacks to service provision, on top of those driven by a 17% reduction in net spending on services between 2009–10 and 2019–20 (Harris, Hodge and Phillips, 2019). Outside of social care, spending on many services has fallen by more than 40%, and an increased fraction of spending is concentrated on those with the most acute needs, such as children in care, adults with severe disabilities and the homeless. Indeed, despite a more-than-20% rise in the numbers of people aged 65 or over, social care

spending for this age group is estimated to have fallen by 18%, as councils withdrew support from those with more modest needs.

If central government did want to provide further funding, a range of options are available, either separately or in combination.

First, the referendum limit on council tax could be raised or scrapped, with each additional 1 percentage point increase every year for the next four years raising approximately £1.2 billion by 2024–25.

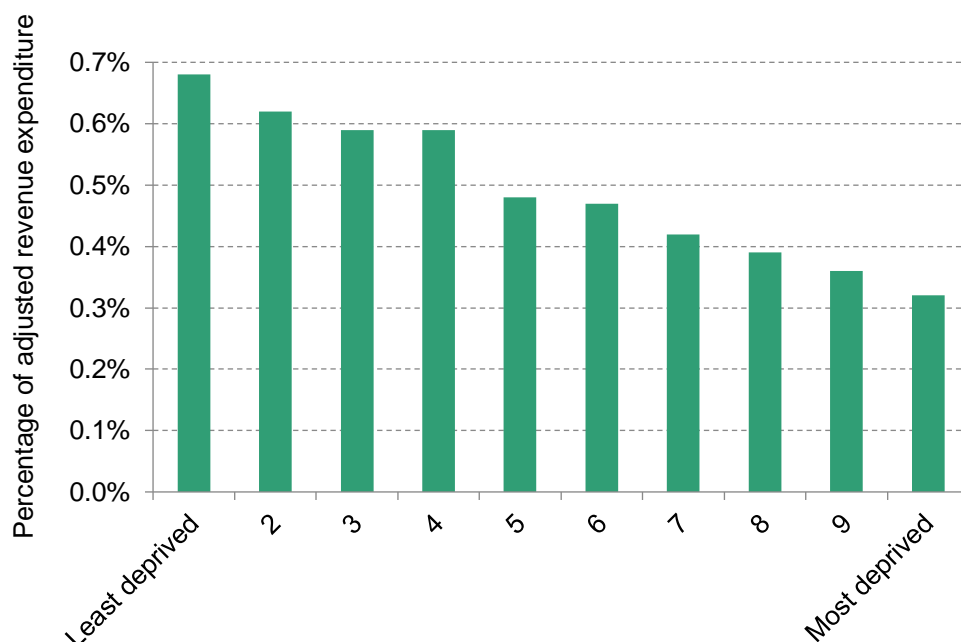
To fully close the real-terms funding gap in our middle scenario through council tax alone would require council tax increases of 4.6% each year. This would increase the average Band D council tax bill by £354 (19%), from £1,818 in 2020–21 to £2,171 in 2024–25. Annual increases of 2.3% would be needed in our lower scenario, and 7.8% in our upper scenario. The latter would see average council tax bills rising by 35% to £2,450 by 2024–25, a rise of £632.

However, councils serving more affluent areas can raise more from council tax than those serving more deprived communities (especially outside London), as illustrated in Figure 4.1. For example, each additional 1 percentage point increase in council tax currently raises the equivalent of 0.7% of adjusted non-schools revenue expenditure in the most affluent tenth of councils, compared with just 0.3% in the least affluent. This means that unless there were redistribution of existing funding, reliance on council tax increases to meet rising spending needs would see increasing inequalities between more affluent and more deprived areas.

This highlights a key point that must be considered when deciding how to provide additional funding to councils: the chosen approach(es) must be consistent with wider objectives for local government – in particular, the extent to which priority is placed on redistribution and consistency of tax and spending policies across the country, versus the provision of incentives to councils to boost local tax bases and discretion to vary tax and spending levels.

The greater the weight placed on the former objectives, the stronger the case for using increased grant funding to help meet rising demands and costs. This approach would allow central government to target funding at more affluent or more deprived areas as it saw fit by varying the formula used to allocate the grants.

**Figure 4.1. Additional council tax revenue raised by an additional 1% increase in council tax levels (% of adjusted revenue expenditure)**



Note: Figures for lower-tier districts and upper-tier counties are combined to the upper-tier county level in shire areas. Deprivation is measured by the average score of upper-/single-tier councils according to the English Index of Multiple Deprivation 2019. Adjusted revenue expenditure is a measure of forecast pre-COVID spending needs in 2020–21.

The greater the weight placed on the latter objectives, the stronger the case for devolving additional tax-reform and/or tax-raising powers to councils. This could include additional powers over council tax and business rate exemptions, discounts and reliefs, but also new local taxes.

If further tax devolution is seen as at least part of the solution, it is important to realise that some taxes make better candidates for devolution than others, and the amounts that can be raised vary substantially between taxes. Amin-Smith, Harris and Phillips (2019) considered these issues in depth and concluded that:

- Councils could be given more discretion over currently mandatory discounts and exemptions from council tax. However, giving councils more significant powers – such as the ability to revalue properties in their own areas – could pose significant problems for the redistribution of funding between councils. It would be better to revalue and reform council tax at a national level, which is overdue.

- While tourist accommodation taxes would be administratively feasible and would raise useful amounts in a few well-visited areas, a £1 per night charge (the level often discussed) would raise little more than £0.4 billion across England.
- A local income tax would be the most sensible option for devolution of significant new revenue-raising powers. Concerns about tax competition between councils, and inequality in the revenues that different councils could raise, could be mitigated by restricting powers to a flat-rate local income tax. Each 1% on all tax bands would raise around £6 billion per year across England.

Devolving local income tax powers would not be without its challenges though. For instance, because there is currently no statutory duty for people to tell HM Revenue and Customs (HMRC) where they live, HMRC does not have up-to-date address details for all taxpayers. This (and people with multiple homes) has caused difficulties with devolution of income tax to Scotland and Wales and may need reform if a local income tax were to be introduced in England.

It is also the case that even if powers were restricted to a flat rate, revenues would still vary quite substantially between areas. Revenues per person in richer parts of West London and Surrey, for instance, would be more than twice the national average, while in places such as Blackpool, Blackburn, Hull and Sandwell, they would likely be less than half the average. A system to redistribute revenues between richer and poorer council areas would therefore be needed – akin to what has historically existed for council tax and business rates – to avoid big differences in service provision, although redistribution need not be complete.

The plans set out in the Spending Review will also need to integrate with or be adapted to account for four other major reviews, none of which has yet concluded.

First is a review of devolution to English local government, with the government's plans due to be published in a White Paper – which may be published before the Spending Review. This could lead to changes in the structure of local government (such as the creation of new single-tier councils in areas with two-tier local government), as well as the devolution of additional powers and responsibilities to local government in at least some parts of the country. This could have implications for the outlook for both spending needs and revenues.

Second is the so-called Fair Funding Review, which aims to provide updated formulas for assessing councils' spending needs and the first rational system for redistributing between councils since the mid 2000s (Amin-Smith, Harris and Phillips, 2018). The implementation of this review has been delayed from April 2021 to at least April 2022 but should not be shelved if we want to avoid funding into the mid 2020s and beyond being based on circumstances over 20 years prior. Careful consideration of the extent to which the COVID-19 crisis may change the relative spending needs of different councils will be needed when the review resumes though.

Third is the 'fundamental' review of business rates that HM Treasury is currently consulting on (HM Treasury, 2020). This could lead to big changes in the design and yield of the tax, which would matter greatly for local government given that it currently contributes around 30% of non-schools revenues. There is scope to significantly improve the design of business rates, but policymakers should also recognise that it is because of changes in technology and consumer behaviour rather than the business rates system that we are seeing high-street retail struggle and online retail grow (Adam, 2019).

Fourth are plans for the future funding and organisation of adult social care services. Amin-Smith, Phillips and Simpson (2018) argue that there is a tension between increased reliance on local revenue sources and greater emphasis on national standards for social care. Reconciling these different goals will be difficult, and ultimately the government needs to decide whether it places primacy on national standards and consistent provision or local responsibility and discretion. The funding system should then be made consistent with the policy goal, with an emphasis on national standards suggesting more of a role for needs-based funding paid for by national taxes, and emphasis on local responsibility and discretion implying more of a role for local revenue sources.

Ideally, these policy reviews would have been undertaken on a timescale so as to feed into the Spending Review – and the Fair Funding and Social Care Reviews have been ongoing for over three years. The fact that they have not been, combined with the uncertain outlook for the public finances at both a national and a local level, means that it would be unwise to expect the Spending Review to set firm and fixed funding allocations for councils. Instead, it may be better to consider the Spending Review as a chance to set baseline allocations and a direction for travel in relation to reliance on local versus national revenue sources. Those allocations

could then be varied as more evidence on councils' revenues and spending needs and on central government's public finances becomes available over the next few years.

# Appendix. Data and methods

This appendix lists and describes the data, methodological approach and assumptions we use in this report.

## A.1 Description of data

This report uses the following main data sets on COVID-related spending and income pressures and councils' overall spending and income. These are described more fully in Ogden and Phillips (2020a, appendix).

- **COVID-19: Local Authority Financial Management Information.** These data contain information on the expected spending and income impacts on councils in 2020–21 of the COVID-19 crisis. As well as their May and June returns, this report uses their July returns in the first instance to estimate the full-year pressures facing councils. The deadline for councils to submit this return was 31 July 2020. There has since been another round of the survey, but data from this are not yet available.
- **Revenue budget (RA) and revenue out-turn (RO) returns.** These data contain budgets and out-turns for councils' spending on services for each financial year. The RA data contain information on expenditure net of income from sales, fees and charges (SFCs) only, whereas RO data contain information on SFCs from different service areas.
- The source of data on the **allocations of COVID grant funding** to each council are mostly detailed in Ogden and Phillips (2020a, table A.1). Any additional sources are described in Table A.1 below.

In modelling councils' losses of council tax and business rates arising in 2020–21, and the medium-term outlook for council finances, we also use the following:

- **Council tax levels set by local authorities.** These data include the levels of council tax set by each local authority (including the shares of bills which relate



to different types of authority in an area) in 2019–20 and 2020–21 (MHCLG, 2019d; MHCLG, 2020j). They also include their council tax requirement and the size of the council tax base.

- **National non-domestic rates collected by councils.** These data are forecasts of the business rates revenues councils expected to collect from local ratepayers in 2019–20 and 2020–21 (MHCLG, 2019e; MHCLG, 2020k), as well as the expected value of Section 31 grants to compensate them for reliefs.
- **Key information for local authorities** (MHCLG, 2020l). This includes details of the final local government finance settlement 2020 to 2021, and is used to model the business rates retention system, including the payment of tariffs and top-ups. It also contains figures for Revenue Support Grant paid to local authorities.
- **Core spending power supporting information** (MHCLG, 2020m). This includes figures for the following sources of grant funding: New Homes Bonus, Social Care Grants and Rural Services Delivery Grant.
- **Public Health grant allocation papers.** These detail the public health grants paid to local authorities in 2019–20 and 2020–21 (DHSC, 2018; DHSC, 2020c).
- **OBR forecasts of various economic indicators.** These include forecasts for inflation, unemployment, additions to the housing stock and business rates cash receipts. These are taken from either the Economic and Fiscal Outlook published in March 2020 (OBR, 2020b) or the July 2020 Fiscal Sustainability Report (OBR, 2020a). The latter includes the impact of the COVID-19 crisis, and details three scenarios for its economic impact: central (which we use in our middle scenario), upside (lower) and downside (upper).

Analysis underlying Chapter 3 of the report also makes use of data on population age structures from the Office for National Statistics (ONS, 2020e).

## A.2 Methods and assumptions

### Pressures and support affecting councils' main budgets in 2020–21

Missing data and differences in the assumptions different councils have made when filling in their returns (including what look like mistakes or misinterpretations in some instances) have necessitated several imputations and robustness checks. In

general, the same approach has been taken in the analysis underlying Chapter 2 as in the baseline scenario for pressures described in Ogden and Phillips (2020a).

This report does not include an alternative or pessimistic scenario for spending and non-tax income pressures in 2020–21, but takes authorities' estimates at face value. It uses the July survey returns where possible, and relies on earlier months' returns only for the two councils that did not submit a return in July and when discussing how councils' estimates have changed between the different returns. Any differences between the income and spending pressures reflect changes to councils' estimates of the pressures, rather than methodological changes between the two reports.

In estimating the value of government support provided to councils in 2020–21, our approach is very similar to the baseline for funding pressures described in Ogden and Phillips (2020a). Below, we highlight the key differences between our final figures for grant support in that report and this.

Our approach to estimating the value of non-grant support has also not changed between the two reports, and is described in detail in the appendix to our earlier report. Our estimate of the total value of this support has increased, as the July survey suggests greater losses of SFCs income (implying higher compensation), agreements on cost-sharing between local authorities and CCGs have been reached in more areas, and there has been greater use of the furlough scheme. The recovery of costs through housing benefit or universal credit was first asked about in the July survey round, allowing us to quantify this potential revenue for the first time.

We continue to make the following important assumptions in relation to the impact of COVID-19 on local government finances in 2020–21:

- None of the non-tax income lost by councils in 2020–21 is subsequently recovered.
- We do not take any account of additional pressures that councils may face in relation to local lockdowns.
- We do not include any impacts on councils' housing revenue accounts (HRAs), which are ring-fenced from the rest of a council's activities and managed using separate HRA reserves.

Table A.1. Details of grant funding provided to councils in 2020–21, comparing this and our earlier report

	Description	Total value (£ million)	Included in this report	Included in Ogden and Phillips (2020a)
A	<b>General-purpose grant funding</b> , to allow councils to respond to spending and income pressures, which is not ring-fenced. In both reports, we exclude any funding allocated to fire authorities or the Greater London Authority (GLA).	3,688	3,634	3,634
B	<p><b>Infection Control Fund</b> to support measures to reduce COVID-19 transmission and support workforce resilience in the adult social care sector, with £600 million in funding announced in May. At least 75% of the funding must be used to support care homes, with up to 25% available to support domiciliary care and ‘wider workforce resilience’. We include 25% of this funding.</p> <p>An additional £546 million in funding was announced by DHSC on 17 September 2020 (DHSC, 2020d) and this has not been included.</p>	600	150	150

C	<b>Local authority council tax hardship fund</b> , which councils must use to provide top-ups to council tax support (i.e. reductions in council tax bills to low-income households) and may also use to provide other support to households. This was not included in the previous report, which did not consider losses relating to council tax and business rates. As described in Chapter 2, it is unclear how much of the cost of these discounts councils have reported as lost income, so we include half of this in our central scenario, and only the funding relating to councils in scope of this report. We treat this as reducing the deficit created on the Collection Fund in subsequent years, rather than in our estimate of grant funding this year.	500	0	0
D	<b>Local authority Test and Trace service support grant</b> , to cover the public health responsibilities of councils in mitigating against and managing local outbreaks. Part of this funding was included in our last report, for the 27 councils that appear to have included these extra pressures when submitting their June returns. The entirety of this funding is now included, as councils have had sufficient time to incorporate the new responsibilities into their estimates of spending pressures.	300	300	53

E	<p><b>Active travel fund</b> to support improvements to cycling and walking facilities, including:</p> <ul style="list-style-type: none"> <li>£42 million in emergency funding for the installation of temporary projects for the COVID-19 pandemic. We include the portion of this allocated to local authorities (i.e. in areas where these are also the local transport authorities);</li> <li>£180 million for the creation of longer-term projects. This is not included as councils only know their indicative allocations from this funding, not the final amounts.</li> </ul>	222	20	20
F	<p><b>Local Authority Emergency Assistance Grant for Food and Essential Supplies</b>, which is to allow councils to provide support to households struggling to afford food and other essentials. This was allocated to specific councils in mid July, and so is now included.</p>	63	63	0
G	<p><b>Reopening High Streets Safely Fund</b>, to fund measures that establish a safe trading environment for businesses and customers, particularly in high streets, to the end of March 2021.</p>	50	50	50
H	<p><b>Emergency rough sleeping funding</b>, to reimburse councils for the cost of providing accommodation and services to rough sleepers, and others at risk of homelessness, to help them successfully self-isolate.</p>	3	3	3

I	<p><b>Interim accommodation and immediate support</b> to end rough sleeping.</p> <p>Revenue funding of £92 million in 2020–21 has been allocated to authorities as part of the Next Steps Accommodation Programme (MHCLG, 2020n). This is to fund interim accommodation, or help support rough sleepers and those at risk of homelessness to secure tenancies. As councils were not aware when submitting their July survey returns whether any bids into the fund would be successful, we do not include any of this funding.</p>	92	0	0
J	<p><b>Home-to-school transport funding</b>, to support additional dedicated school and college transport up to the October 2020 half term due to current social distancing requirements on public transport. Of total funding of £44 million, £18 million has been allocated to combined authorities or Transport for London (in areas where these are the local transport authority) and we would anyway have excluded this sum. Allocations of this funding were only confirmed in August, so we do not include this funding in our analysis (DfE, 2020).</p>	44	0	0
<b>Total value of grant support included:</b>			4,221	3,911

Table A.2. Details of non-grant funding provided to councils in 2020–21, comparing this and our earlier report (£ million)

	This report	Ogden and Phillips, 2020a
SFC compensation	1,059	985
CCG reimbursement	486	293
Coronavirus Job Retention Scheme	35	27
Recovery of costs through housing benefit / universal credit	46	0
<b>Total value of non-grant support included</b>	<b>1,625</b>	<b>1,305</b>

Table A.3. Details of remaining shortfall affecting council budgets in 2020–21, comparing this and our earlier report (£ million)

	This report	Ogden and Phillips, 2020a
Spending pressures	4,998	4,400
Non-tax income loss	2,855	2,821
Grant funding	(4,221)	(3,911)
Non-grant support	(1,625)	(1,305)
<b>Remaining shortfall affecting budgets in 2020–21</b>	<b>2,007</b>	<b>2,005</b>

Our final estimate of the remaining shortfall affecting councils' budgets in 2020–21 is very similar to that in Ogden and Phillips (2020a), as detailed in Table A.3. This small difference – less than £3 million – conceals large revisions in the underlying components. Despite this apparent stability, these estimates remain highly uncertain.

## Local taxation in 2020–21

Several key features of local government accounting are important to the way losses of council tax and business rates in 2020–21 feed through to affect councils' main budgets.

- **Billing and precepting authorities.** Billing authorities collect council tax and business rates on behalf of all authorities in a local area. This means each taxpayer receives a single bill from their billing authority. These revenues are then shared out between their local council (or their shire district and shire county councils in areas with two tiers of local government), and any separate fire authority or combined authority in that area, and the Greater London Authority for London boroughs. We only have information on spending pressures and funding for some types of authorities, which we term 'councils' in this report – unitary authorities, London boroughs, metropolitan districts, shire districts and shire counties. We therefore exclude the shares of council tax and business rates revenues which would be allocated to other types of authorities from all figures in this report, unless stated otherwise. For business rates, this also means ignoring the 'central share' of any falls in revenues. Any revenues or losses attributable to parish councils are included, as billing authorities meet these losses on their behalf.
- **Collection Fund.** Local authority accounting rules mean falls in local tax revenues – from council tax and business rates – do not affect councils' main budgets until later years. This is because they are collected by billing authorities and paid into a Collection Fund. This is separate from councils' main budgets, their 'General Fund', from which they spend on services. Each year, councils receive payments from the Collection Fund into their main funds based on the value of council tax and business rates they *expect* to raise in that year. If less than this expected amount is actually collected during the year, this creates a deficit on the Collection Fund. Usually, this would then be reconciled the following year, with authorities receiving lower amounts out of the Collection



Fund. This delayed impact of falls on councils' main budgets makes their revenues more predictable.

- **Cash-flow effects.** These falls do, however, have cash-flow implications for billing authorities, which must ensure that the Collection Fund has sufficient resources to make payments out as scheduled. The government has adjusted the timings of payments of some business rate revenues from the Collection Fund to central government in 2020–21 in order to manage these cash-flow effects, as described by the Chartered Institute of Public Finance and Accountancy (CIPFA, 2020). We do not consider these cash-flow effects in our report.
- **Section 31 grants for business rate reliefs.** In March 2020, government announced a significant increase in business rate reliefs in response to COVID-19. In particular, the expanded retail discount for businesses in the retail, hospitality and leisure sectors is expected to reduce revenues by over £10 billion and result in Section 31 grants of approximately £6.0 billion to compensate councils for their share of this. We assume that councils will be compensated for the full amount of their share of the eventual cost of these reliefs, so that they can be considered revenue-neutral for local government. In fact, differences in the timing of the grants and reliefs mean this expansion will appear to have a very large impact on councils' main budgets in 2020–21 and 2021–22. The Section 31 grants paid by government to compensate councils for business rate reliefs will accrue immediately to billing authorities' General Fund accounts. They will receive 100% of this grant in the first instance, rather than just their proportionate share, to aid cash flow. There will be reconciliation when final revenue out-turns data become available, to ensure all councils end up with their share of the final Section 31 grant. This may mean councils' reserves appear to increase in-year, but this effect is somewhat artificial as this funding will be needed to address the concomitant reductions in business rates revenues when they are transferred to the General Fund next year. We exclude these effects, which would give a misleading impression of the level of funding actually available to councils to spend this year and next.
- **Hardship funding grants.** Council tax hardship funding of £500 million has been credited to the General Funds of billing authorities. When this is applied to the accounts of individual council tax payers (when they are 're-billed') it will reduce the total amount to be collected – in effect, this funding will be transferred to the Collection Fund and will reduce any potential deficit. As described in Section 2.2, we include only some proportion of the £500 million council tax hardship funding – that which relates to the councils we are

interested in – and we only include half this amount in our middle scenario, to reflect the likelihood that some councils will already have netted this funding off their reported pressures (so that to include the full amount would be to double-count this support). We treat this funding as if it were paid straight into the Collection Fund and reduces the deficit, and so the losses felt in later years.

This means that for 2020–21, councils' expected revenues from local taxation are not impacted by COVID-19. For council tax, we simply use their council tax requirement in 2020–21, and ignore any existing surplus/deficits on the Collection Fund in relation to earlier years.

For business rates, we use forecast revenues from NNDR1 ('retained business rates'), and share this between authorities based on the planned operation of the business rates retention scheme this year. We then add on the Section 31 grants that authorities expected to receive from central government to compensate them for existing business rate reliefs, and any tariffs and top-ups due to councils (again, excluding any amounts due to fire authorities or combined authorities). We adjust these tariffs and top-ups for under-indexation historically but not going forwards. As we are only interested in aggregate figures, we do not model the operation of the safety net / levy system, as these should be revenue-neutral from the perspective of local government as a whole, with surpluses or deficits on the levy account being distributed via increases or decreases in grant funding. This also means we ignore any arrangements between councils to pool business rate revenues.

We base estimates of reduced collections of local tax revenues in 2020–21 on councils' estimates from the July survey. We assume that some of these losses relating to deferred payments or payment failures, or described as 'other losses', are likely to be recovered in future years, with the rest being eventually 'written off' by councils. We do not estimate the profile of any potential recovery (see LG Futures (2020)) but instead assume that councils will estimate the proportion likely to be written off. Only this proportion is considered to create a deficit on the Collection Fund which then affects councils' main budgets in future years.

Our estimates of the impact on councils' finances of council tax and business rate losses arising in 2020–21 are calculated as described in Tables A.4 and A.5. In our medium-term outlook in Chapter 3, we assume that this deficit is spread evenly over the subsequent three years, reducing revenues by a total of £365 million in each of these three years.

**Table A.4. Calculation of estimated council tax losses and impact on revenues in subsequent years, under different assumptions**

(£ million)	Middle	Upper	Lower
Council tax losses – payment failure	812		
<i>Proportion of payment failure assumed to be eventually written off</i>	12.8%	25.6%	6.4%
Payment failures eventually written off	104	208	52
Council tax losses – other	123		
<i>Proportion of other losses assumed to be eventually written off</i>	100%	100%	6.4%
Other losses eventually written off	123	123	8
Council tax losses – increase in LCTS	475		
<b>Losses arising in 2020–21 that will not be recovered</b>	<b>702</b>	<b>806</b>	<b>535</b>
<i>Proportion of council tax hardship funding we assume councils have not included</i>	50%	0%	100%
Council tax hardship funding (to net off)	209	0	419
<b>Deficit created on the Collection Fund</b>	<b>493</b>	<b>806</b>	<b>116</b>
<b>Reduction in revenues in each year (2021–22, 2022–23, 2023–24)</b>	<b>164</b>	<b>269</b>	<b>39</b>

Note: Assumptions that differ between scenarios are in italics.

Source: Authors' calculations using MHCLG (2020a).

**Table A.5. Calculation of estimated business rate losses and impact on revenues in subsequent years, under different assumptions**

(£ million)	Middle	Upper	Lower
Business rate losses – deferred payments	65		
<i>Proportion of deferred payments assumed to be eventually written off</i>	5%	10%	0%
Payment failures eventually written off	3	6	0
Business rate losses – other	704		
<i>Proportion of other losses assumed to be eventually written off</i>	85%	100%	70%
Other losses eventually written off	599	704	493
<b>Deficit created on the Collection Fund</b>	<b>602</b>	<b>711</b>	<b>493</b>
<b>Reduction in revenues in each year (2021–22, 2022–23, 2023–24)</b>	<b>201</b>	<b>237</b>	<b>164</b>

Note: Assumptions that differ between scenarios are in italics.

Source: Authors' calculations using MHCLG (2020a).

## Methods and assumptions used in future projections

### Council tax projections

As discussed in the main body of the report, we assume that council tax *rates* increase by 2% each year from 2021–22 onwards in each of our scenarios.

In our middle and upper scenarios, we assume that in the absence of the COVID-19 crisis, the tax *base* for council tax-setting purposes would have grown in line with the OBR's March 2020 forecast for growth in the UK housing stock (OBR, 2020c). Historically, changes in the size of the UK housing stock have been strongly correlated with changes in the number of properties potentially subject to council tax in England, as recorded by the VOA. In our lower scenario, we instead assume this tax base grows by 1% each year. Together, this growth in tax levels and the tax

base gives us an estimate of how council tax revenues may have grown in the absence of the COVID-19 crisis.

We then make several further adjustments to these revenue figures to reflect impacts relating to the COVID-19 crisis, and these differ between the scenarios:

- **Construction slowdown.** In our middle and upper scenarios, we reduce the tax base in each subsequent year by approximately 39,000 dwellings. This is an estimate of the impact of the slowdown in residential completions between March and the end of August 2020. This is based on weekly statistics on the number of Energy Performance Certificates for new dwellings lodged on the register in England (MHCLG, 2020i), which suggest this many fewer certificates were lodged in total over this period relative to the same weeks in 2019. In our lower scenario, we assume that construction activity not only recovers, but that the number of completions by the end of 2020–21 is as forecast in March, which would require a significant increase in completions over the rest of the year. Together, our assumptions about increases in the tax base in the absence of the COVID-19 crisis, and the hit to construction, mean the tax base by 2024–25 is assumed to be 3.22% larger than the tax base was forecast to be in 2020–21 in our middle and upper scenarios, compared with 4.06% in our lower scenario.
- **Local council tax support.** Some of the increase in the total value of LCTS in 2020–21 will be explained by the additional discounts of up to £150 that councils have been required to offer to all claimants. As many councils link eligibility for LCTS to eligibility for other benefits, such as universal credit, temporary increases in the generosity of these other benefits will also have increased eligibility for LCTS this year. In recognition of the former of these costs, government has provided some funding this year to meet the cost of these additional discounts. However, the economic downturn and likely increase in unemployment mean that even if councils' pre-crisis LCTS schemes were reinstated, higher claimant numbers would mean additional costs over the next few years.
- We base our estimate of the increase in the cost of LCTS in future years on the full-year cost estimated by councils for 2020–21. In our middle and lower scenarios, we assume some portion of this cost relates to the additional discounts. In our middle scenario, we reduce the cost of LCTS for each council by an amount equal to 50% of the hardship funding it was provided. In our lower scenario, we reduce it by 100% of this funding. If this would imply a

negative cost for any council, we assume the cost of LCTS attributable to additional claimants is zero. In our upper scenario, we use the whole cost reported by councils.

- To project this estimate into future years, we adjust this cost based on the OBR's (2020a) scenarios for the unemployment rate, using its central scenario in our middle scenario and its 'downside' and 'upside' scenarios in our upper and lower scenarios, respectively.
- For instance, we assume that £288 million of the additional cost of LCTS in 2020–21 is due to the underlying increase in unemployment and falls in income that year in our central scenario. The OBR's central forecast was for the unemployment rate to be 4.95 percentage points higher on average in 2020–21 than in 2019–20. The OBR's central scenario sees unemployment increase by a further 1.28 percentage points in 2021–22, and so we assume the additional cost of LCTS to councils will show the same relative increase, to £363 million that year, before beginning to fall as the unemployment rate decreases.
- **Collection Fund deficit arising in 2020–21.** Losses arising in 2020–21 create a deficit on the Collection Fund, as described in Chapter 2. In each scenario, we reduce revenues in each of the three years affected (2021–22, 2022–23 and 2023–24) by a third of the total deficit arising in relation to council tax losses in 2020–21. The size of this deficit varies between the three scenarios as described.

In addition:

- We do not consider any impact on the collection of arrears relating to previous years, or any additional costs associated with enforcement action.
- We only include the share of council tax revenues allocated to general-purpose councils, and exclude any due to fire authorities, police authorities, combined authorities or the GLA.

A breakdown of our council tax projections is available in our online spreadsheet appendix.

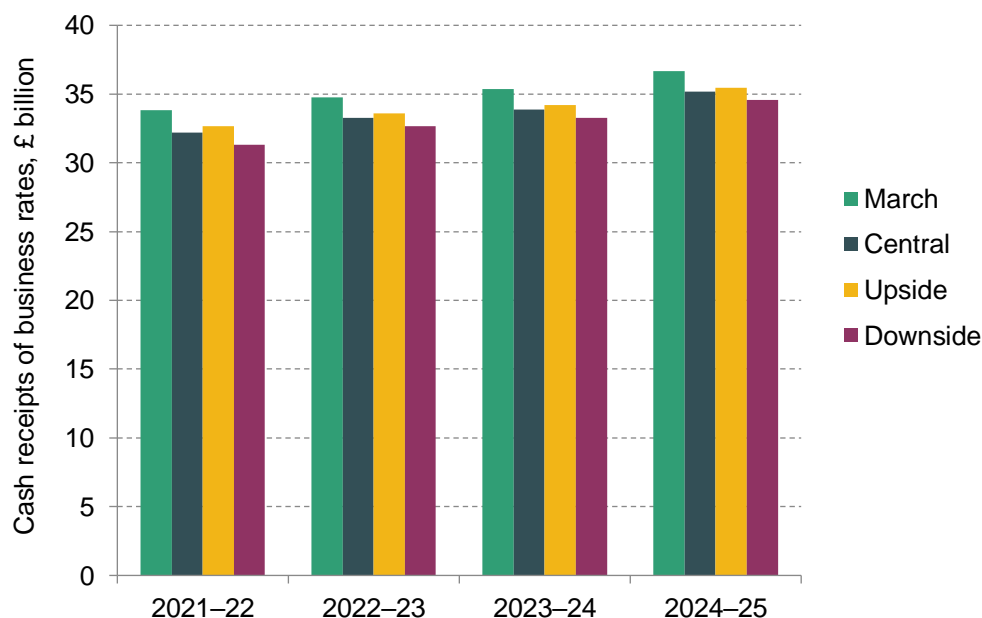
## Business rates

- **Retained business rates revenues in 2020–21.** We calculate the revenues councils expected to receive in 2020–21, before the COVID-19 crisis. As

described in Chapter 2, this includes the ‘local share’ of revenues, plus Section 31 grants.

- **Business rates growth.** In future years, we assume this figure for total retained business rates grows in line with the OBR’s (2020a) scenarios for overall growth in cash receipts of business rates in the UK. Our middle, lower and upper scenarios are based respectively on the OBR’s ‘central’, ‘upside’ and ‘downside’ scenarios. In doing this, we avoid modelling the complex interaction of increasing vacancies and eligibilities for reliefs, changes to inflation forecasts, and changes to property valuations. The OBR’s forecasts in each scenario are lower for the duration of the period that the OBR forecasted in March, as can be seen in Figure A.1. This is due to a combination of an increase in eligibility for empty property relief, lower rateable values over time and the impact of a lower forecast for CPI on the multiplier. Receipts as measured and forecast by the OBR include those outside of England, and any ‘central share’ of revenues. We therefore use the year-to-year percentage changes in these receipts as the basis of our modelling.

**Figure A.1. Forecast current receipts of UK business rates (on a cash basis) in each financial year, under different OBR forecasts**



Note: March figures are from the OBR’s March Economic and Fiscal Outlook. ‘Central’, ‘upside’ and ‘downside’ are the specific scenarios in the OBR’s July forecasts.

Source: OBR, 2020a and 2020c.

- **Business rates reliefs and appeals.** We make no other explicit assumptions about eligibility for different business rates reliefs, or how these might change. This effectively assumes the same level of discretionary reliefs are applied as were forecast in March 2020–21, apart from any impacts included in the OBR’s forecasts.
- **Tariffs and top-ups.** We also add on each year the tariffs and top-ups due to councils, which reflect differences in the tax-raising capacity of councils and their ‘baseline funding need’, and are fixed in real terms until the next business rates revaluation. We assume tariffs and top-ups increase in line with CPI inflation (2% a year), and that the tariff/top-up adjustment factor remains the same as it was in 2020–21.
- **Collection Fund deficit arising in 2020–21.** Losses arising in 2020–21 create a deficit on the Collection Fund, as described in Chapter 2. In each scenario, we reduce revenues in each of the three years affected (2021–22, 2022–23 and 2023–24) by a third of the total deficit arising in relation to business rates losses in 2020–21. The size of this deficit varies between the three scenarios as described.

A breakdown of our business rates forecasts is available in our online spreadsheet appendix.

### Non-tax income in future years

We do not explicitly project the total revenues councils may raise through SFCs, commercial or other income. This would be especially difficult for commercial and other income, where we do not have a clear understanding of the revenues councils expected to raise in 2020–21, only of the losses they report. This means we implicitly assume the revenues from these sources grow in line with councils’ net expenditure on the services in question, which avoids making a judgement about whether councils may seek to raise more or less revenue from these sources as a matter of policy.

We assume that losses from planning SFCs, other SFCs, and other non-tax income do not persist into future years, but these revenue streams recover immediately to pre-crisis levels from April 2021. We assume the same for all other non-tax income losses in our lower scenario. As described in Section 3.1, in our middle and upper scenarios, we assume that there are ongoing reductions to income from parking, culture and leisure facilities, and commercial activities.



### Grant funding in future years

As discussed in the main text, we assume grant funding is increased in line with the GDP deflator and is therefore held fixed in real terms. We take account of the following grant funding:

- Revenue Support Grant
- social care grants
- Public Health Grant
- Rural Services Delivery Grant
- New Homes Bonus (assuming it is replaced with funding of equal value if it is abolished in its current form)
- former Independent Living Fund recipients grant
- flexible homelessness support grant
- homelessness reduction grant
- housing benefit administration subsidy
- localised council tax support administration subsidy grant

Figures for these grants in 2020–21 are taken from either the Local Government Finance Settlement (Revenue Support Grant, social care grants, Rural Services Delivery Grant and New Homes Bonus) or from the relevant grant confirmation documentation.

### Future demand and unit cost drivers – non-COVID

The main body of this report describes our sources and assumptions for future demand growth and unit cost growth for adult social care services, children’s social care services and ‘other services and spending’. It is worth noting, however, that our assumptions for average earnings growth takes account of the 2.75% pay award given to council staff in 2020–21 and assumes wages revert to the path of average earnings growth smoothly by 2023–24. We therefore assume the following rates of earnings growth (excluding the impact of the National Living Wage):

- 2020–21: 2.75%
- 2021–22: 1.96%
- 2022–23: 1.96%
- 2023–24: 3.03%
- 2024–25: 3.17%

**Table A.6. Spending increases implied by our demand and cost assumptions (excluding COVID-19 pressures)**

	2020–21	2021–22	2022–23	2023–24	2024–25
<b>Lower</b>					
ASC	4.5%	3.7%	3.7%	4.8%	4.9%
CSC	3.7%	2.4%	3.0%	3.7%	3.8%
Other	2.8%	1.5%	2.0%	2.7%	2.8%
ASC NLW	n/a	£122m	£249m	£319m	£384m
Other NLW	n/a	£0.03m	£0.2m	£0.6m	£2.6m
<b>Middle</b>					
ASC	5.5%	4.7%	4.7%	5.8%	6.0%
CSC	5.9%	5.1%	5.1%	6.2%	6.4%
Other	3.9%	3.0%	3.0%	4.0%	4.1%
ASC NLW	n/a	£122m	£249m	£319m	£384m
Other NLW	n/a	£80m	£165m	£218m	£268m
<b>Upper</b>					
ASC	5.5%	4.7%	4.7%	5.8%	6.0%
CSC	5.9%	5.1%	5.1%	6.2%	6.4%
Other	3.9%	3.0%	3.0%	4.0%	4.1%
ASC NLW	n/a	£122m	£249m	£319m	£384m
Other NLW	n/a	£400m	£826m	£1,088m	£1,331m

Note: ASC = adult social care; CSC = children's social care.

Source: Authors' calculations using various sources listed in Section 3.2.

Taking account of demand and cost pressures, Table A.6 shows the percentage increase in costs for adults' and children's social care and other services and spending excluding the impact of the NLW under each of our scenarios. It also shows the additional cash-terms increase in expenditure as a result of increases in the NLW under each of our scenarios, separately for adult social care and other services.

We project forward adult social care net expenditure as reported in councils' budgets for 2019–20 (MHCLG, 2019f). We project forward children's social care services net expenditure as reported in 2019–20 budgets too but make two adjustments. First, we subtract spending on Sure Start and services for young people, as we do not feel the demand drivers we use for the rest of children's social

care spending are suitable for these more universal services. Second, we inflate budgeted spending by 11.3%, the degree to which councils overspent their budgets for children's social care services (excluding Sure Start and services for young people) in 2018–19. The 'other services and spending' we project forward from 2019–20 is a residual item and is calculated as revenues minus spending on adults' and children's social care services. This implicitly assumes that revenues equal overall spending needs in 2019–20 and means that our main projections are projections of what would be needed to be spent to maintain services at their 2019–20 level. In addition, by projecting forward net expenditure rather than gross expenditure and sales, fees and charges and other income separately, we implicitly assume that these income sources increase in line with service demands and costs (except where explicit adjustments are made, as discussed below).

### Pre-existing adult social care underfunding

Our analysis of the potential pre-existing social care funding gap makes use of data on service volumes, prices paid and benchmark prices.

- NHS Digital (2019) provides information on the volume of social care services and their annual cost to councils. This allows the calculation of prices paid per unit of residential and nursing home care (segmented by type of need, such as physical or cognitive impairment) and domiciliary care by each of the 151 councils with adult social care responsibility in 2018–19.
- These are then compared with benchmark prices for the operation of care homes catering to each type of need, as well as the hourly cost of domiciliary care, also from 2018–19. National provider cost benchmarks, obtained from LaingBuisson by the LGA, measure the weekly cost base, topped up by a 9–10% profit margin (to reflect an appropriate return on capital), for two types of residential care needs (elderly care and dementia) and for nursing care (LaingBuisson, 2019). For domiciliary care, the Minimum Price for Home Care is constructed in a similar fashion by the UK Homecare Association (2018).
  - We then adjust these national benchmark prices to account for heterogeneity in the costs of social care services across the country. To do this, we use MHCLG's (2019g) Area Cost Adjustment for social care services, which incorporates differences in labour costs, commercial rents and travel times across council areas.

### The effects of falls in asset prices on local government pension costs

At any given time, a pension fund's financial position is determined by comparing the cost of providing benefits to its current members, known as total pension liability, and the assets available to fund those benefits at that time. Formally, total pension liability is the present value of the cost of accrued benefits. Net assets are composed primarily of investment assets in the fund's portfolio, as well as short-term cash-flow assets and liabilities.

At 31 March 2019, the Local Government Pension Scheme's total pension liability was £296 billion. It held £291 billion of net assets, out of which £290 billion were investment assets. They were allocated into equities (55%), bonds (19%), property (9%), cash (2.4%) and other asset classes. Since the LGPS serves council and non-council employers across England and Wales, assets and liability need to be adjusted to include only English councils:

- Councils account for approximately three-quarters of the LGPS's worth.
- We only keep those 93.9% of net assets and 93.8% of total pension liability held by English funds.

In scaling down assets and liability in this way, we assume that the allocation of English councils' investment assets is the same as for the LGPS as a whole.

The first stage is to estimate the increase in the pension deficit:

- We estimate the long-run decrease in the value of LGPS domestic equity and commercial property that can be attributed to COVID-19. We compare forecasts for the 2024–25 value of assets from the OBR's Economic and Fiscal Outlook, published in March 2020, with the updated forecast in the Fiscal Sustainability Report from July 2020. This allows us to calculate the change in value that results only from new information about the extent of the COVID-19 financial crisis, and minimise contamination by other factors. This is carried out using central, upside and downside forecasts for UK equity and commercial property value in our middle, lower and upper scenarios respectively.
- Another source of uncertainty is the allocation of equities across domestic and overseas companies. Whilst this allocation is not reported at the level of the LGPS, individual fund valuation reports for 2019 suggest that about two-thirds of the scheme's equities are from overseas companies. Since overseas equities have seen their values recover, a higher share of overseas equity investments

dampens the scheme assets' long-term depreciation. We therefore allow the overseas equity share to be higher in our lower scenario (75%) and lower in our upper scenario (50%), compared with 66% in our middle scenario.

- We assume that COVID-19 has no long-run effect on overseas equity, cash balances and non-investment assets. Those are allowed to increase annually by the nominal discount rate, which is a measure of pension funds' expectations for long-run market returns. This yields an annual increase of 4.2%.
- At the 2019 valuation, the LGPS's ratio of net assets to total pension liability was 98.5% in England. Taking this funding ratio as a reasonable long-run target for the scheme, we project the value of total pension liability to grow in line with our projections for total assets in the absence of COVID-19 disruption.

The next stage is to assess the implications of this estimated deficit for local government's pension contributions. Rates are set every three years through actuarial valuations which take into account employer- and fund-specific circumstances.<sup>32</sup> The additional deficit will not be passed on to employers until the next valuation in April 2022, with effect on contributions from April 2023 onwards.

Employer contributions have two components with separate objectives:

- Primary contributions are the cost of benefits accruing over the three years following the valuation. They will be adjusted in response to long-term demographic changes caused by COVID-19, which are uncertain at the time of this report and therefore omitted from our analysis.
- Secondary contributions are set as the amount needed to recover deficits or offset surpluses attributable to the employer. At each revaluation, funds and employers agree on a recovery plan, which consists of:
  - a recovery period at the end of which deficits (or surpluses) must be eliminated;
  - the secondary contributions to be paid every year of the recovery period – which are only binding until the next revaluation.

In our analysis, we calculate contributions under the assumption that the recovery period is 25 years and contributions increase each year in line with the rate of inflation assumed in the 2019 valuation. In both cases, we use the following

<sup>32</sup> Figures estimated at the level of the LGPS are therefore subject to considerable variability across councils.

formula to calculate the constant real-terms additional contribution  $X$  required to bring the additional deficit  $D$  to zero at the end of the  $T$ -year recovery period (starting contributions after three years to reflect the fact that new contribution rates would not apply until April 2023):

$$X = \frac{D(1+i)^{T+3}}{\sum_{t=3}^{T+3} (1+\pi)^t (1+i)^{T+3-t}}$$

where both  $i$  (the nominal discount rate) and  $\pi$  (the long-run rate of inflation) are the average value reported by LGPS funds at the 2019 revaluation: 4.2% and 2.4%, respectively.

### Future demand and unit cost drivers – COVID-related

As discussed in Chapter 3, we do not account for any impacts of the Covid-19 crisis on demand for services. We do, however, account for a continuation of additional public health spending associated with the Test and Trace programme, and ongoing impacts on the unit costs of adult social care services.

Our methodology for projecting additional costs for Test and Trace capabilities are discussed in Chapter 3.

Our projections for higher unit costs for adult social care are based on figures reported in the July financial monitoring returns to MHCLG (2020a). These show that increases in unit costs for adult social care amount to 7.2%, with 4.9 percentage points due to ‘supporting the market’ (i.e. increasing payments to suppliers), 1.6 percentage points due to personal protective equipment (PPE) and 0.8 percentage points due to ‘workforce pressures’. While some of these pressures are the result of mitigation measures (purchasing and gearing up with PPE, additional cleaning and administrative tasks), other factors are not directly attributable to mitigation. These include logistical issues (demobilisations, disrupted deliveries of equipment) and work fatigue (from excess absenteeism, social distancing, off-shift work, altered delivery, inspection and cleaning requirements).

Our scenarios allow mitigation and non-mitigation effects to persist differently after 2020–21. Apart from PPE, it is not possible to infer what share of the pressures reported in the returns to MHCLG corresponds to mitigation. There are currently no data on the effect of those factors on the productivity of social care workers. However, a report by the New Horizons Foundation (2020) estimates that mitigation measures account for 48.6% of the loss of productivity experienced by

workers in the sheet metal, heating, ventilation and air conditioning installation industries in the United States – with requirements for PPE and social distancing when conducting client visits. The disruptions, constraints and public health restrictions faced by this sector have some similarities to those incurred by social care workers in England. We therefore impute 48.6% of the additional spend on supporting the market and workforce pressures to mitigation measures.

In our middle scenario, we assume that COVID-19 mitigation measures are phased out progressively until they completely disappear. We therefore assume that their additional cost in 2021–22 is two-thirds of the impact measured in 2020–21, one-third in 2022–23 and zero from 2023–24 onwards. In our upper scenario, mitigation measures are more persistent; they decrease geometrically by 20% every year. Finally, our lower scenario sees their impact disappear in 2021–22. Throughout, non-mitigation measures are assumed to dissipate entirely after 2020–21, as logistical and psychological disruptions abate.

This yields the following index for the real unit cost of adult social care, measured relative to what unit costs would be in the absence of COVID-19 (and which we multiply our pre-COVID-19 expenditure projections by to obtain post-COVID-19 projections):

Real unit cost (1 = 2019–20)	2021–22	2022–23	2023–24	2024–25
Middle	1.029	1.015	1	1
Upper	1.035	1.028	1.023	1.018
Lower	1	1	1	1

### Additional breakdowns of the lower and upper scenarios

Tables A.7 and A.8 provide a breakdown of spending requirements and available revenues under our lower and upper scenarios, respectively. The baseline figures for 2019–20 are:

- Revenues of £49,081 million, consisting of £26,497 million in council tax, £14,835 million in retained business rates and £7,750 million of grant funding.
- Spending needs are set to £49,081 million, with adult social care accounting for £16,787 million of this, and other services and spending accounting for £32,294 million. As discussed above, these figures are based on net expenditures, after incomes from sales, fees and charges and other organisations (such as the NHS) have been accounted for.



Table A.7. Funding outlook up to 2024–25, lower scenario

£ million	2021–22	2022–23	2023–24	2024–25
<b>Spending requirements</b>	<b>52,159</b>	<b>53,731</b>	<b>55,738</b>	<b>57,870</b>
Adult social care – excl. additional COVID-related cost pressures	18,307	19,103	20,073	21,108
Other services – excl. additional COVID-related cost pressures	33,852	34,628	35,665	36,762
Additional COVID-related cost pressures	0	0	0	0
COVID-related losses in non-tax income	0	0	0	0
<b>Revenue streams</b>	<b>52,508</b>	<b>54,057</b>	55,417	57,453
Council tax	28,498	29,437	30,330	31,425
Retained business rates	14,145	14,546	14,808	15,540
Revenue Support Grant	1,446	1,477	1,507	1,537
Social care grants	3,492	3,566	3,638	3,712
Public Health Grant	3,283	3,353	3,421	3,491
Other grants	1,644	1,679	1,713	1,748
<b>Difference</b>	<b>–348</b>	<b>–326</b>	321	417
Existing adult social care ‘underfunding’	1,308–1,517	1,356–1,573	1,421–1,648	1,490–1,729
Difference incl. existing adult social care ‘underfunding’	960–1,169	1,030–1,247	1,741–1,969	1,907–2,146
<b>After adjusting for inflation:</b>				
Difference	–348	–319	307	392
Difference incl. existing adult social care ‘underfunding’	958–1,168	1,007–1,220	1,669–1,887	1,792–2,016

Table A.8. Funding outlook up to 2024–25, upper scenario

£ million	2021–22	2022–23	2023–24	2024–25
<b>Spending requirements</b>	<b>56,181</b>	<b>58,231</b>	<b>61,055</b>	<b>64,340</b>
Adult social care – excl. additional COVID-related cost pressures	18,675	19,678	20,879	22,170
Other services – excl. additional COVID-related cost pressures	35,368	37,062	39,026	41,100
Additional COVID-related cost pressures	872	618	473	392
COVID-related losses in non-tax income	1,267	874	677	677
<b>Revenue streams</b>	<b>51,039</b>	<b>52,982</b>	<b>54,392</b>	<b>56,591</b>
Council tax	27,679	28,831	29,774	30,959
Retained business rates	13,477	14,076	14,339	15,144
Revenue Support Grant	1,446	1,477	1,507	1,537
Social care grants	3,492	3,566	3,638	3,712
Public Health Grant	3,283	3,353	3,421	3,491
Other grants	1,644	1,679	1,713	1,748
<b>Difference</b>	<b>5,142</b>	<b>5,250</b>	<b>6,663</b>	<b>7,749</b>
Existing adult social care ‘underfunding’	1,348–1,564	1,411–1,637	1,493–1,733	1,583–1,836
Difference incl. existing adult social care ‘underfunding’	6,490–6,706	6,661–6,887	8,157–8,396	9,331–9,585
<b>After adjusting for inflation:</b>				
Difference	5,136	5,134	6,387	7,279
Difference incl. existing adult social care ‘underfunding’	6,482–6,697	6,514–6,735	7,818–8,047	8,766–9,004

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