Fair Funding Review

Calculation of Needs Amounts in Local Government Finance Formula

Consultation paper

- Consultation paper issued on 13 December 2018: "A review of local authorities' needs and resources"

  https://www.gov.uk/government/consultations/review-of-local-authorities-relative-needs-and-resources

- Implemented in 2020-21, with "a further formal stage of consultation before" the provisional settlement

- Consultation Closes 12th February

Overview

- Continued direction of travel towards a "flatter" distribution
- Deprivation removed from the Foundation Formula (previously alongside population and sparsity)
- Move to fund some services by population rather than usage or demand (e.g. concessionary fares, home-to-school transport)
- Options for partial council tax equalisation – and limits placed on the absolute extent of equalisation (no redistribution of council tax)
- Large gaps in adult's and children's social care formula – based on large research projects reporting later in the Summer

PIXEL
FINANCIAL MANAGEMENT

Distributional effects

✓	Rural authorities – sparsity will be recognised in ACA rather than FF
✓	Biggest winners are counties and many district councils (lower-needs, higher-taxbase) – benefit from a potentially flatter funding distribution and cut-down council tax equalisation
✕	More deprived authorities – removal of deprivation indicator from FF is a major blow especially if it is combined with partial council tax equalisation
✕	London boroughs, especially central London – will lose from removal deprivation indicator from FF and partial equalisation – plus phasing-out of damping and potential inclusion of car parking income
✓	Sparsity and density – new method of funding using travel time data within ACA

Possible outcome?

- Overall outcome will be a "package" – has to get parliamentary approval in Jan/ Feb 2020

- Outcome is a combination of Spending Review, Fair Funding Review and Business Rates reform

- Flatter distribution of funding looks more likely now – consultation paper gives ministers the "levers" to create a flatter distribution

- Constraint 1: financial viability of authorities or classes of authority

- Constraint 2: ensure change is manageable

- Constraint 3: achieve parliamentary approval

PIXEL
FINANCIAL MANAGEMENT

Structure of funding

- ***(Relative Needs minus Relative Resources) +/- Transitional Arrangements + Actual Resources***

- Baseline Funding Level (BFL) = Relative Needs and Relative Resources

- BFL funded from within Retained Rates system

- Revenue Support Grant (RSG) ceases to exist from 2020-21 – all "needs" funded through BFL

- "Damping" outside BFL – but could be funded from within BRRS

- Actual resources = council tax (but could also include retained rates)

PIXEL
FINANCIAL MANAGEMENT

Relative Needs

- Simpler formula with fewer indicators = "flatter" distribution
- Reduce the number of indicators and reduce the number of service specific formulae
- Criteria to select indicators:
  - **Complexity** – fund on population where possible, so exclude those indicators correlated with population
  - **Scale** – "proportionality", exclude where only affects small proportion of expenditure
  - **Distribution of relative need** – retain indicator where material impact on some councils (e.g. coast protection, flooding)
  - **Similarity** – amalgamate where services have a similar base (e.g. population, road length, number of children)

PIXEL
FINANCIAL MANAGEMENT

Overall funding structure

- Relative Needs Formula (RNF)

- Needs block
- Resources block
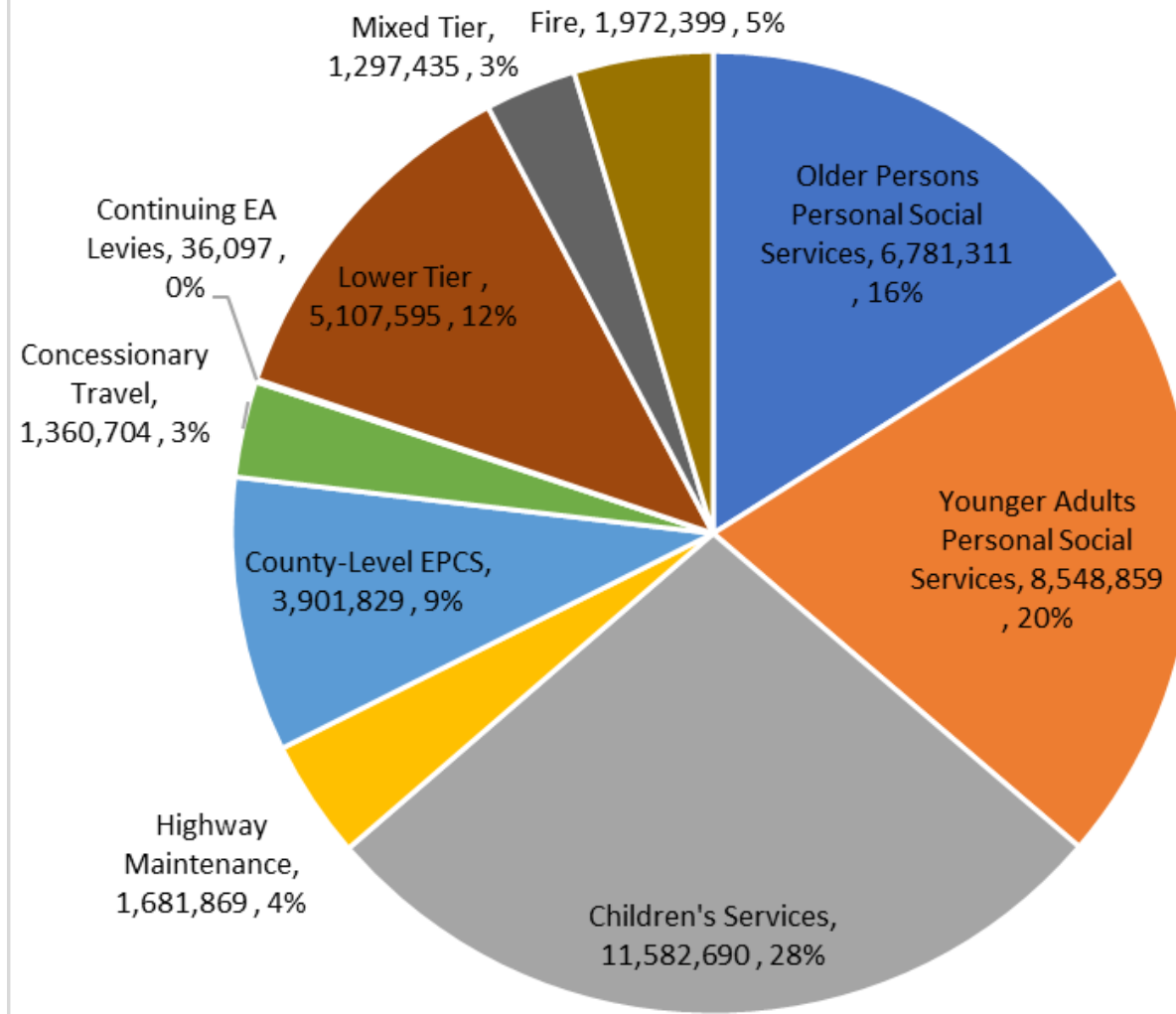- Central allocation X
- Damping
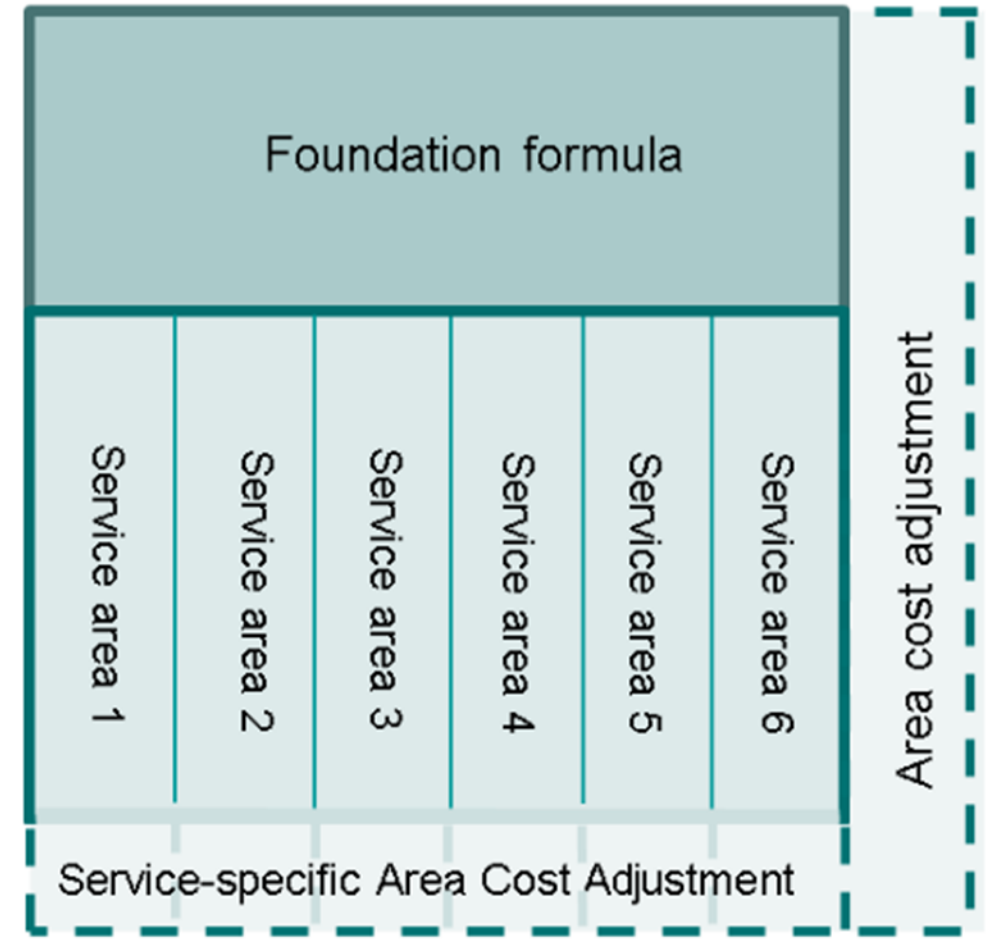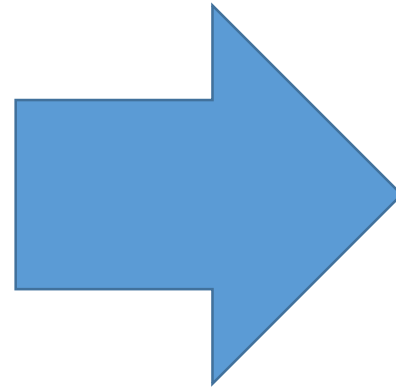
Service specific formulae

Reduction from the current 15 different service formulae plus various rolled-in grants

RELATIVE NEED FORMULAS		SHIRE AREAS			METROPOLITAN AREAS	LONDON	OTHER
		Unitaries	Counties	Districts	Metropolitan Districts	London boroughs	Fire authorities[4]
Foundation Formula	Upper tier	●	●		●	●	
	Lower tier	●		●	●	●	
1) Adult Social Care		●	●		●	●	
2) Children and Young People's Services		●	●		●	●	
3) Public Health		●	●		●	●	
4) Highways Maintenance		●	●		●	●	
5) Fire & Rescue[5]		●	●				●
6) Legacy Capital Finance		●	●	●	●	●	●
7) Flood Defence and Coastal Protection		●		●	●	●	

PIXEL
FINANCIAL MANAGEMENT

Mapping exercise - shares for major blocks

- Mixed Tier, 1,297,435 , 3%
- Fire, 1,972,399 , 5%
- Continuing EA Levies, 36,097 , 0%
- Lower Tier , 5,107,595 , 12%
- Concessionary Travel, 1,360,704 , 3%
- Older Persons Personal Social Services, 6,781,311 , 16%
- County-Level EPCS, 3,901,829 , 9%
- Younger Adults Personal Social Services, 8,548,859 , 20%
- Highway Maintenance, 1,681,869 , 4%
- Children's Services, 11,582,690 , 28%

PIXEL
FINANCIAL MANAGEMENT

Foundation Formula

- Third largest element of the new formula (after children's and adult's)
- Includes current Environmental, Protective and Cultural Services (EPCS) block plus some funding with own distribution (e.g. Concessionary Fares)
- It will be a population-based formula

- Variables:
  - Size of the FF (based on relevant spending but higher FF will result in flatter overall spending)
  - Indicators used and weighting of those indicators

Deprivation

- Historically the most important cost driver in funding formula (after population)

- MHCLG provides statistical justification for removing deprivation
  - Upper tier FF services: population explains 88.1% of the variation in past expenditure, deprivation increased explanatory power by 4.0 percentage point
  - Lower tier FF services: 84.0% and 0.4 percentage points

- Justification to reduce but not remove from upper tier FF?

- Effect on deprived authorities will be considerable ("Distribution of Relative Need")

Deprivation – arguments

- Deprived authorities have had the largest cuts in funding since 2010
- Analysis underplays real influence of deprivation on variation in spending
- MHCLG has used data from 2014-15 to 2016-17

- Is pre-2010 distribution of spending more representative than post-cuts distribution?

- MHCLG have more explaining to do but flatter distribution seems inevitable

Density and sparsity

- MHCLG decided to remove both rurality and density from FF

- Will fund through the Area Cost Adjustment (ACA)

- Proposing to use the Department for Transport's Travel Time Data

✓	ACA is multiplicative and applied to both FF and the service specific formulae Single dataset (and weighting) for both density and sparsity
✗	Weightings not yet confirmed and will determine amount of funding. Almost certainly lower than current density weightings Sparsity weighting needs to replace both current sparsity indicators and the transferred RSDG

PIXEL
FINANCIAL MANAGEMENT

Other service specific formulae – Children's and Adult's Social Care

- Detailed in-depth research for both based on small-area statistical analysis

- Adult's formula: based on 13,000 observations at 53 councils for the older people's element and 50 councils for the working-age component (the research was undertaken in 2013)

- Children's formula: research based on individual children

✓	Takes account of variations within authorities as well as between (excludes effect of past policy and funding decisions)
✗	Resulting formula is "black box" but likely to be some further ministerial discretion Indicators don't look very credible yet (based on pre-universal credit benefits which are no longer nationwide) Concern that the approach will not reflect pressures that are unrelated to resident population (e.g. learning disability) or high-cost and very unevenly distributed (e.g. children's)

Other service specific formulae – Public Health

- Grant is expected to transfer to BFL in 2020-21

- Department for Health and Social Care is developing a formula through the NHS's Advisory Committee on Resource Allocation (ACRA)

- Recent scrutiny of public-health spending in local government and the future devolution arrangements (removal of the ringfence)

✓	Should have a properly devised funding formula with external scrutiny (ACRA)
✗	Uncertainty about whether it will even be a local government service in 2020-21

PI✗EL
FINANCIAL MANAGEMENT

Other service specific formulae – Highways Maintenace

- Formula will use only road length and traffic flow

- Excludes winter services (snow-lying days, gritting days) – this is potentially an issue for authority with upland areas (Cumbria, North Yorkshire, Durham, Pennine authorities)

- Removal of the "built-up" roads indicator – gives urban twice the weighting of rural roads – based on pre-2013-14 "judgement"

✓	Simpler formula Removes the "built-up" roads indicator which was not based on any research (but might help to explain variations in highways expenditure)
✗	Removes specific funding for winter services (affected authorities should show additional costs of these services)

PIXEL
FINANCIAL MANAGEMENT

Other service specific formulae

- **Legacy capital financing** – correctly will be based on borrowing approvals pre-prudential code and not on actual debt costs – also practical problems in the latter

- **Coastal protection and flooding** – spending is low but removal of formulae would have had very significant impact on small number of authorities

- **Fire and Rescue Services**
  - Separate formula because has both risk and demand factors (not correlated with population)
  - Paper from National Fire Chiefs Council had previously suggested three indicators correlated with policy objectives: population, deprivation and residents over-65
  - MHCLG concerns: funding would be much lower for authorities with coastline and density top-ups; research was based on too narrow a sample of authorities
  - Two options for way forward: update current formula (as far as possible) or develop a multi-level model using fire incident data as a proxy for fire risk

Services not give separate formula

- **Home-to-school transport, concessionary travel (free off-peak travel for elderly and eligible disabled people) and local bus support**

- **Waste Services (collection and disposal)**

- **Homelessness (or housing services generally)**

- **Fixed-cost element (c.£100k per authority)**

- **Unaccompanied Asylum Seeking Children**

- **People with no recourse to public funds**

PIXEL
FINANCIAL MANAGEMENT

Area Cost Adjustment

- Compensates for variation in unit costs between different parts of the country

  - **Rates cost adjustment** – reflects different costs of premises (based on rateable values)
  - **Labour cost adjustment** – traditionally based on private-sector wages but will now include a further adjustment for additional downtime or travel time for staff in densely- or sparsely-populated areas
  - **Remoteness adjustment** – reflects inefficiencies in local markets (e.g. remoteness from local markets)

Travel Time data

- Additional travel time for local authority staff as a result of longer distances, poorer transport links or traffic congestion

- Measure both <u>dispersal</u> (journey time from a household – or groups of households – to a service "hub") and <u>traversal</u> (journey times between households)

- Data is available but we don't know proposed weighting within ACA

Weighting funding between services

- Support within LG to use actual expenditure to weight the size of each block (FF and service specific formula)

- MHCLG largely supports this approach but keeping options open (e.g. effect of SR 19)

- <u>Higher</u> allocation for FF means flatter funding, etc

Weighting indicators in relative needs formulae

- Prefer to use multi-level models (as would many within local government)

- Still a role for traditional regression between authorities

- Reduces the use of ministerial judgement (evidenced, fair, transparent, (more) widely accepted)

PIXEL
FINANCIAL MANAGEMENT

Population projections

- Population projections will be used in new funding formula (were used in 2013-14 formula too)

- Suggest authorities look more closely at their projected and forecast population growth (and whether growth is fully funded)

✓	Allows firm funding allocations to be announced in December 2019 for a four- or five-year allocation
	Builds-in some projected growth (and likely to give authorities with higher population more growth in funding over period)
	Combination of population projections and taxbase growth gives high-growth authorities a larger share of funding growth
✗	ONS projections and not forecasts (past not always an indicator of future change)
	Can be inaccurate, sometimes materially so (check your authority's actual Mid-Year Estimates against relevant projections
	If projection is wrong, you are stuck with it for 5+ years

PIXEL
FINANCIAL MANAGEMENT

Relative Resource Adjustment

- *(Relative Needs minus Relative Resources) +/- Transitional Arrangements + Actual Resources*

- Takes into account ability of each authority to generate council tax income

- Updating RRA is very redistributive: not updated since 2013-14, council tax now a much more important part of overall funding

- Transfer of funding from high-taxbase (lower-need) authorities to low-taxbase (higher-need) authorities (e.g. counties/ districts to Mets/ parts of London)

PIXEL
FINANCIAL MANAGEMENT

Full or partial equalisation?

- Full equalisation – RRA is set so that it is broadly equivalent to actual council tax (in say 2019-20 or 2020-21)

- Partial equalisation – RRA is set at a lower value so that only part of national council tax income is equalised

- In 2013-14, equalisation was equivalent to about 75% of actual council tax

- Consultation paper open about options: "*a higher notional council tax level supports greater equalisation of funding relative to assessed need*"

- This is a big "win" for high taxbase authorities

Notional or actual council tax

- Notional council tax: each authority's ability to generate council tax income is based on its taxbase multiplied by a notional Band D

- Partial equalisation achieved by adjusting the notional Band D

- Notional council tax has historically always been used apart from 2016-20 settlements

- Widespread support within sector for use of notional council tax (no perverse incentives, does not take into account local tax-setting decisions) but impacts very heavily on some central London boroughs

PIXEL
FINANCIAL MANAGEMENT