



Title: **Needs & Redistribution Technical Working Group**

Paper: NR TWG 17/01 Discussion paper regarding the approach to resources in the Fair Funding Review by the Department for Communities and Local Government

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Venue: **Southwark Council - 160 Tooley Street, London, SE1 2QH**

POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

Introduction

- 1) The focus of the Fair Funding Review ('the Review') can broadly be divided into three closely related strands of work
 - I. relative needs,
 - II. relative resources, and
 - III. transitional arrangements.
- 2) The resources work stream is examining the relative resources of local authorities. The Review will take a fresh look at how council tax income should be taken into account when redistributing business rates at local government finance settlements, and will also consider other potential sources of income available to councils.
- 3) This subject was discussed at the last technical working group (TWG) meeting in February 2017. The main points raised by various TWG members included:
 - the varying capability of local authorities to raise council tax
 - the effects of council tax discounts, from nationally set student exemptions to those with local discretion such as Local Council Tax Support (LCTS)
 - the use of tax base data which is influenced by local policy decisions
 - how net expenditure is used, which takes into account sales, fees and charges (SFC) and other local authority income such as inter-authority transfers.
 - it was suggested by one member that parking income should be considered, but other SFC revenue streams were thought less significant; issues with data were also raised.

- it was expressed that there should be a balanced approach toward discretionary income - incentivisation without penalisation.
- 4) In response to these points, this paper will:
- I. provide a short summary of the council tax and SFC landscapes including data availability,
 - II. discuss approaches to factoring these into a needs assessment and
 - III. ask how the Review should consider income sources over which councils have discretion.
- 5) The treatment of discretionary sources of revenue in a settlement methodology has the potential to create incentive effects on local behaviours and finances which the Review will consider carefully.
- 6) This paper invites suggestions for how to approach some of these issues, with the aim of confirming a set of principles for consideration by DCLG ministers and for presentation at a future TWG meeting.
- 7) The reform or redesign of council tax itself is not within the scope of the Review.

Council tax

- 8) Councils' capability to raise council tax varies widely due to the differing size of tax bases, as well as differing council tax levels set each year. Both of these are impacted by some factors which authorities cannot control. There are a range of options, in a settlement methodology, for how to make an adjustment for different council tax incomes across England.
- 9) The Review could not take council tax into account at all – this would mean the same amount of settlement funding would be distributed to areas which it assessed as having the same 'relative need', even if there is discrepancy in how much council tax they can raise each year. This could lead to an uneven spread of spending power for local services across the country
- 10) Alternatively taking actual Council Tax Requirements (CTR) into account in a fully proportional adjustment may benefit areas which do not raise as much council tax income. This could lead to a discrepancy in the amount of council tax paid by residents for the same level of public service. There are multiple possible other more 'middle ground' which the Review will explore.

Council tax landscape

- 11) At the last TWG meeting it was suggested that it would be helpful to provide an overview of the data available to measure council tax bases and council tax levels, including the impact of LCTS on the former.
- 12) In 2017-18 council tax in England will be £24.6bn, including the adult social care and parish precepts, excluding that which is raised by Police Crime Commissioners. This will comprise over 50% of local government core spending power.
- 13) DCLG annually publishes statistical releases on council tax levels, council tax bases and council tax requirements¹. Data on the number of council tax discounts, exemptions and disregards are available via the published Council Tax Base Statistics². Data are shown at a national and local authority level.
- 14) By comparing council tax data with published Revenue Outturn statistics it is possible to work out the proportion of revenue expenditure council tax makes up, analysis of which shows that this varies widely across England.

Council tax base

- 15) For tax setting purposes, and in published official statistics, a 'tax base' is officially measured by calculating the number of Band D equivalent dwellings in a local authority area: other tax bands are set as proportions of Band D.
- 16) This measure adjusts the total number of dwellings to take account of any discounts, exceptions, premiums or local support offered as well as for collection rates.
- 17) The total number of dwellings in England in 2016 was 23.9 million which equate to 21.5 million Band D equivalents before discounts etc. are accounted for. England's tax base after the above process is applied was 17.6 million Band D equivalents. There are multiple categories of discount and exemptions for which data is readily available. Excluding LCTS, these are all set nationally with two exceptions: the second homes discount and the empty homes discount and premium.

¹ <https://www.gov.uk/government/collections/council-tax-statistics#council-tax-levels-set-by-local-authorities>

² <https://www.gov.uk/government/collections/council-taxbase-statistics>

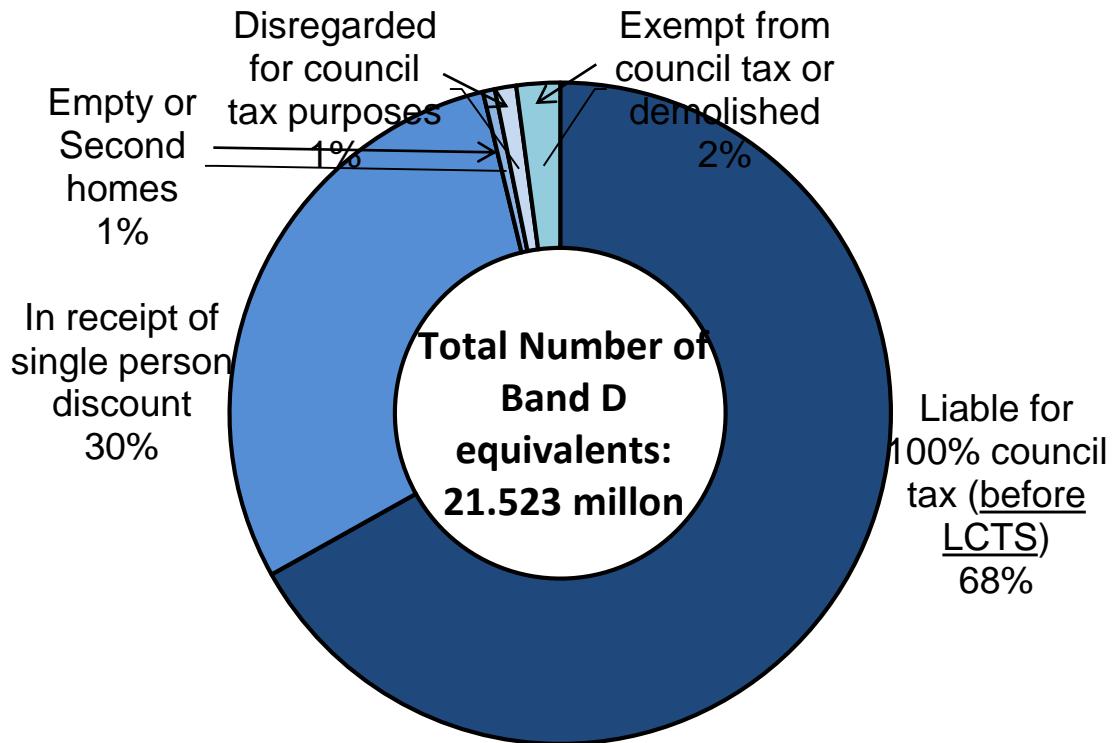


Figure 1: Breakdown of the number of Band D equivalents

18) With regard to LCTS, DCLG collects aggregate financial data on what is forgone by each authority, and on the number of pensioners and working age people in receipt of a reduced bill – providing the adjusted measure of tax base (17.6 million) as above³. In 2016-17 there were 2.8 million Band D equivalent dwellings in receipt of LCTS and over £3.3bn forgone in council tax across England specifically because of these reduction schemes⁴.

Council tax levels

19) As well as size of tax base, the amount of income raised through council tax will depend on the Band D level set by individual authorities every year. DCLG publishes details of the level of council tax set by local authorities in England⁵. There are policies and bodies which affect this, including:

- levying bodies, which contribute to the limit to which council tax can be raised by a billing authority before triggering a referendum. That which is levied is not available to the authority

³ <https://www.gov.uk/government/statistical-data-sets/live-tables-on-local-government-finance#local-council-tax-support>

⁴ This figure is not yet subject to full data coverage.

⁵ <https://www.gov.uk/government/statistics/council-tax-levels-set-by-local-authorities-in-england-2017-to-2018>

- historic capping policies, current referendum principles and local decision making
- precepts, which certain types of council can charge as additional income for certain purposes, collected by the billing authority.

20) In 2017-18, the average area Band D council tax is £1,350 in London (an increase of £44 when compared to 2016-17), £1,575 in metropolitan areas (+£69), £1,641 (+£69) in unitary areas and £1,662 (+£61) in shire areas.

Measuring and factoring council tax in a relative needs assessment

21) A settlement methodology, when making an adjustment for resources, may choose a specific measure of council tax base and council tax level to adjust for the widely differing capabilities to raise council tax income across England.

Factoring discounts and exemptions

22) The current needs assessment methodology did include nationally-set non-discretionary discounts and exemptions in its measure of different councils' tax base when the Government last set baseline business rate allocations in 2013-14, and when it introduced settlement core funding in 2016-17.

23) The Government therefore recognised that areas with a higher number of residents eligible for national schemes are less able to generate income through council tax, setting baseline funding allocations accordingly.

Q: Should the Government continue with the current approach to nationally set council tax discounts and exemptions in a resources adjustment?

24) The current methodology's approach to discretionary discounts is different. Regarding the discretionary empty homes discount and premium it assumes that every council charges a 100% discount on every empty home regardless of whether they do or not, adjusting a measure of tax base lower⁶. The methodology makes no assumption on any premiums applied after two years. The current approach therefore enables local authorities to benefit from offering less of a discount and from charging empty home premiums, should they wish, as the additional council tax income is not 'netted off' from their need – it does not affect the amount being allocated at the settlement.

25) The example above highlights the flexibility available in a needs assessment when measuring tax bases, particularly toward discretionary discounts.

⁶ In 2016, there were 443 thousand dwellings classed as empty, of which 93 thousand were subject to a discount and 59 thousand were subject to a premium.

Local Council Tax Support

- 26) The Review will have to decide how to measure tax bases adjusted for Local Council Tax Support, a discount for low income residents over which authorities have a greater degree of discretion. There is no precedent for this as the current methodology set new baselines before Council Tax Benefit was localised.
- 27) As per para 18, it is possible for the Review to use aggregate financial data and factor, in some way, LCTS in its measurement of council tax. By doing so, authorities with more eligible low income residents and which forgo more council tax would be assessed as having lower tax bases and receive more redistributed funding.
- 28) However the number of eligible residents, particularly low income working age residents, is influenced by a number of factors - including local circumstances and political choice.
- 29) The Review will carefully consider how best to approach LCTS in a measure of resources for the purposes of redistributing funding at settlements. By way of illustration, two options at opposite ends of the spectrum would be:
- a. **LCTS is factored:** *council tax base measures are adjusted for the total amount forgone due to LCTS.* This means that areas with higher council tax forgone would likely receive more funding. An advantage is that this could be considered to be fairer for areas with higher numbers of low income residents for whom it offers support.
- However, the Review's measure of a tax base adjusted for LCTS is shaped by local political choice or other circumstances affecting a council's overall wealth, which may influence local eligibility for support and the amount of council tax forgone. It would be necessary to understand potential incentive effects on local support schemes through this option.
- b. **LCTS is not factored:** *council tax base data are used as if there was no income forgone by any authority.* An advantage would be that this takes a consistent approach across councils and does not engage with a measure of tax base which is arguably not objective or consistent.

However, this approach may disadvantage areas offering proportionally more support to low income pensioners and low income wage earners (though it is possible to disaggregate and adjust for just one of these groups): it assumes such areas are receiving more income through council tax than is actually the case and distributes less funding. It would be necessary to understand potential incentive effects on local support schemes.

30) However, alternative approaches may exist and will continue to be explored.

Q: What views do working group members have on how the Review should approach discretionary council tax discounts, exemptions and premiums as well as Local Council Tax Support?

Factoring council tax levels

31) There are policies and bodies which affect what level of council tax authorities can set. The Government could explore whether to factor council tax levels before or after these effects.

32) An example might be levying bodies, which contribute to the limit to which council tax can be raised by a billing authority before triggering a referendum, constraining the amount of income it can raise through council tax. That which is levied is not available to the authority. Measuring tax levels as if levies had not been applied, or only partially applied, may provide more settlement funding to those affected.

Q: Should a measure of council tax be adjusted for levying bodies?

33) Different funding methodologies deployed by the Government over the last few years (the Improved Better Care Fund, the 4-block model, Settlement Core Funding) have taken different approaches to factoring council tax levels. The Review may choose whether to factor actual levels or take an averaged approach.

'Actual' approach

34) Were the Government to consider 'actual' Band D council tax levels when assessing the relative resources available to authorities, such an approach would recognise what each authority sets individually and multiply that by their council tax base, thereby calculating a figure akin to actual Council Tax Requirements – depending on the measure of tax base and level adopted (as discussed above).

35) This figure would then be set against their 'relative need' and funding would be distributed accordingly. It would mean authorities which have the highest Band D levels in the country would receive proportionally less settlement funding than authorities with similar tax bases (and similar assessments of 'need') but lower levels.

36) It could be argued that this approach ensures that the distribution of the bulk of overall spending power (settlement baseline funding plus Council Tax Requirement) is more aligned with the same distribution of relative need. It would enable areas

which cannot raise as much income from council tax due to historically low council tax levels to receive a larger proportion of settlement funding to meet their need.

- 37) On the other hand, by distributing proportionally less settlement funding to areas with higher council tax levels, this approach could sustain a discrepancy in the amount of council tax paid by residents in England for roughly the same level of public service.

'Averaged' approach

- 38) Alternatively, it would be possible, as under previous needs assessments, to work out an average or notional Band D council tax level, apply it to every council and in effect adjust the distribution of settlement funding according to the size of each council's tax base.

- 39) This would mean authorities with similar tax bases and similar assessments of relative need would receive broadly the same amount of settlement funding, regardless of historic council tax levels and what they actually raise through council tax.

- 40) Advantages of this approach might be that it could be seen as a way of addressing the pressure on residents in areas with historically high council tax levels, as outlined above. Putting more emphasis on relative sizes of council tax base rather than actual levels could also be seen as more impartial, controlling for local decision making.

- 41) However, a decision to use a different measure of Council Tax Requirement than is actually the case has a consequence of distorting the distribution of the bulk of overall spending power (baseline funding plus Council tax Requirement) away from the same distribution of need. There would be an uneven level of funding available to councils with the same 'need' to spend, particularly if gaps in council tax levels in England continue to remain far apart.

Q: What are the group's views on different approaches to factoring council tax levels?

Sales, Fees and Charges

- 42) In 2015-16, authorities were able to raise £11.7bn of gross income from SFC, with an additional £18.8bn of 'other' income.⁷

- 43) The highest income generating area of SFC is parking. Combined on- and off-street parking surplus in 2015-16 exceeded £750m,⁸ with the next highest surplus area,

⁷ Revenue outturn service expenditure summary (RSX) 2015 to 2016, Line 699

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/569789/RSX_2015-16_data_by_LA.xlsx

cemeteries and mortuary services, £75m.⁹ Other services generating a large surplus include trade waste (£30m)⁹ and local land charges (£28m).¹⁰

44) In 2015-16 there were service areas at authority level where SFC surplus formed a significant proportion of, or exceeded, some authorities' council tax requirements (CTR).^{11,12}

45) In 2015-16, 96 authorities generated the equivalent of >10% CTR, and 30 generated >25%, from their parking surpluses. Parking surplus was >50% for 7 LAs, > 75% for 4 LAs, and for one authority this reached the equivalent of 114% of 2016-17 CTR⁸ from on-street parking alone.¹³

Q: Do you think SFC should be considered within the scope of a relative resources adjustment?

46) The main issues for how to build a resources adjustment into a settlement allocation methodology which incorporates SFC have been identified as follows:

- this is a multi-faceted source of income over which councils have discretion
- the income and data sources which map it must be stable and robust
- there are different ways to factor SFC income in a settlement methodology

47) These issues overlap with those concerning how to adjust settlement funding allocations for relative ability to raise council tax.

Discretionary income

⁸ (1) Revenue outturn highways and transport services (RO2) 2015 to 2016, Lines 61 to 62
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/569805/RO2_2015-16_data_by_LA.xlsx

⁹ (2) Revenue outturn cultural, environmental, regulatory and planning services (RO5) 2015 to 2016, Lines 210 and 283
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/569818/RO5_2015-16_data_by_LA.xlsx

¹⁰ (3) Revenue outturn central, protective and other services (RO6) 2015 to 2016, Line 460
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/569824/RO6_2015-16_data_by_LA.xlsx

¹¹ As an indicator of whether a surplus is large, it is compared to a local authority's council tax requirement.

¹² Council Tax Requirement for billing authority including special expenses, local precepts and Adult Social Care Precept for 2016-17

¹³ Source:
Revenue outturn highways and transport services (RO2) 2015 to 2016 (with Copeland and Reading excluded),
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/569805/RO2_2015-16_data_by_LA.xlsx

Table 9: 2016 to 2017 Council Tax requirement and chargeable dwelling figures - all authorities,
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/532640/Table_9.xlsx

48) SFC are a more service-specific means of generating local revenue for authorities than council tax, and are subject to local priorities and decision making. At a local level, authorities manage local service outcomes using SFC by making strategic charging decisions.

49) SFC are not currently taken into account in the assessment of local authority resources. They are, however, netted off from the variable used to proxy authority need – net revenue expenditure. The Review may consider the effects of treating SFC differently and the potential behaviours that might be incentivised through different approaches.

Data availability, current trends and levels of volatility

50) In order to have an effective measure of SFC, and to fully understand issues such as incentive effects, the data used must be robust and accurate. The data DCLG currently hold on SFC are the aggregated revenue outturn (RO) form data. There is some overlap between SFC and ‘other income’ RO form data. SFC income from trading activities is not easily identifiable across the RO forms.

51) Data on RO forms is obtained at an aggregated level, meaning a more granular measure of this income is not available. It is thus difficult to assess the efficiency and sustainability of SFC usage at a local level.

Q: What are the group’s views on the use of RO data as a measure of SFC?

52) An accurate measure of SFC income is important in order to understand any potential volatility and whether there are risks from placing greater weight of such income in the overall assessment of local authority need.

53) A preliminary analysis of SFC aggregate data, and individual service areas (including at local level where possible), suggests that SFC income at England level is relatively stable. It has remained relatively flat in cash terms since 2007-08 [Fig 3], with an increase of 4.47% over the total period. The highest positive change of +4.00% and a highest negative change of -5.31% year on year, were observed for the periods to 2013-14 and to 2011-12 respectively. Over the period 2011-12 to 2015-16, SFC income as a % total expenditure increased, from 8.91% to 9.64%.

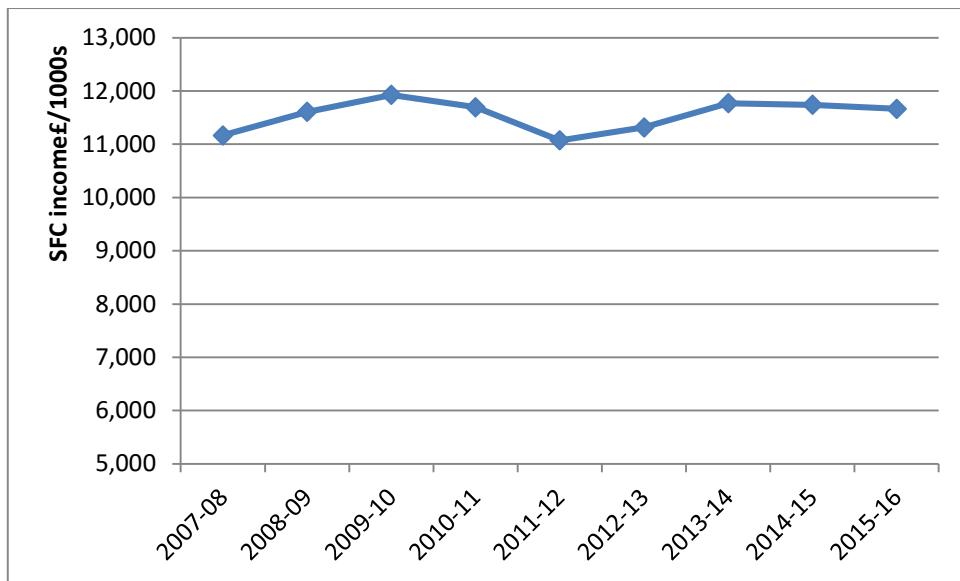


Figure 2: England-level SFC income from 2007-8 to 2015-16

54) At an England level, the sum of income for off-street and on-street parking increased by 14% at the England level over the period 2010-11 to 2015-16 year on year, the highest positive change was +4.98% and the highest negative change -2.48% [Fig 4]. For some local authorities, the income from on- and off-street parking is comparable in size to their council tax requirement. For example, there are seven LAs for which parking income exceeded 90% of their council tax requirement in 2017-18.

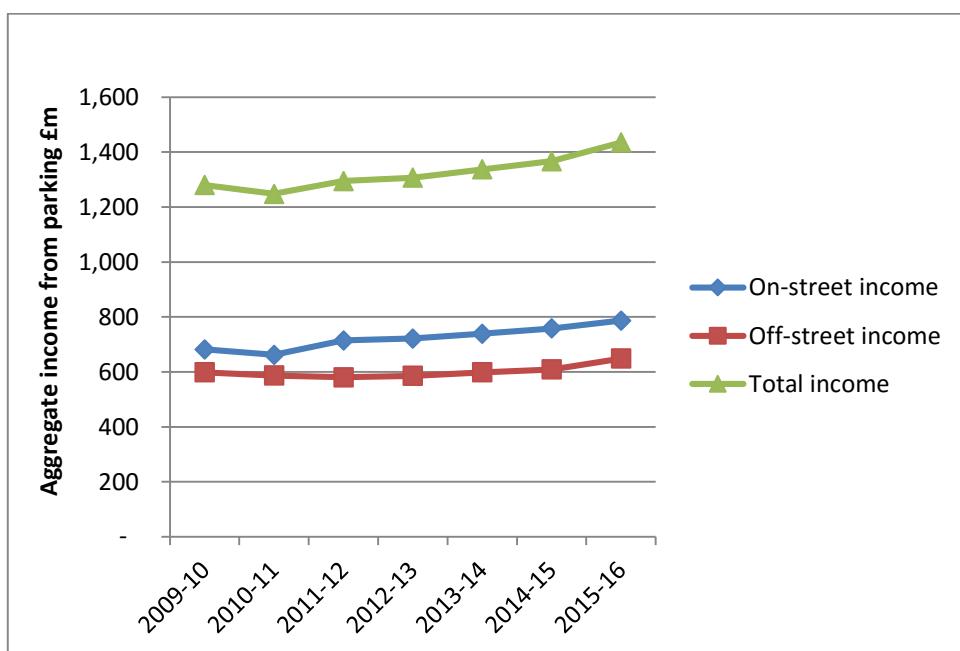


Figure 4: Volatility of parking income at England level 2009-10 to 2015-16

- 55) Parking income, however, is not stable. It is not uncommon for parking income for a local authority to change by more than 15% year-on-year. Even for those authorities with the parking income the highest proportion of their 2017-18 CTR, year-on-year changes are unpredictable.
- 56) Far bigger year-on-year changes are observed in some cases, for example an increase in parking income of +140% in Norwich between 2014-15 and 2015-16. For another authority percentage changes from 2009-10 to 2015-16 read as +13%, -5%, -43%, +141%, +2%, +27%. Over the period 2009-10 to 2015-16, a minimum of 58 authorities saw a positive or negative change in parking income of more than 15% each year [Table 1].

| Year | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|------------------|---------|---------|---------|---------|---------|---------|
| <i>Threshold</i> | 15% | 15% | 15% | 15% | 15% | 15% |
| Negative | 32 | 37 | 35 | 24 | 37 | 41 |
| Positive | 36 | 41 | 29 | 34 | 42 | 37 |

Table 1 – Number of authorities seeing a change of more than +/- 15% year-on-year from 2009-10 to 2015-16

Q: What are the group's views on accounting for SFC income streams which display a certain degree of volatility when setting baseline funding allocations over a multi-year reset?

How SFC may be factored in a needs assessment

- 57) SFC income is currently taken into account in the settlement methodology through the relative needs formulas, via the dependent variable (revenue expenditure) in regressions against past expenditure. Using net revenue expenditure as the dependent variable with SFC netted off effectively means an LA's estimated level of need is unaffected by SFC income.
- 58) The review will carefully consider whether and how best to incorporate SFC in a settlement methodology. SFC is a complex area of resources, with large variation. This centres on multiple sources of income, each with underlying regulations.

- 59) By way of illustration, some potential options on the spectrum may include:

- A. No change – SFC income taken into account only via the dependent variable in a needs formula using regressions against past expenditure.
- B. SFC not taken into account in any way – using gross rather than net spend as the dependent variable in a needs formula using regressions against past expenditure. This would mean that funding formulas reflected patterns between local authority characteristics and the gross amount spent on services. This is desirable if it is thought that an authority's ability or willingness to raise a SFC surplus did not follow the same pattern as its need to spend.
- C. Use of gross spend in the regression as in (b), but making an adjustment for SFC income in the resources block. Rather than affecting the funding formula common to all authorities (by choosing gross or net expenditure), this would reduce allocations for LAs with large surpluses.
- D. Using a double measure of SFC income (using net spend as the dependent variable and also reducing a need-based allocation by an amount proportionate to size of the SFC surplus)

60) Should 'option c' be adopted, there are further considerations for what, exactly, to include in a separate resources adjustment. These may include:

1. Which service areas income to include (all or specific service areas)
2. Use of net or gross SFC revenue (i.e. should we take into account surpluses only?)
3. How far to take that income into account (fully, above a threshold, or a percentage 'tariff'?), and
4. Whether to use 'ring-fenced' income

61) In all of the above options, there should be consideration against objectives for the resources adjustment overall.

Q: What are the TWGs views on what and how SFC should be included in a resources adjustment?

Other income sources

62) There are additional sources of local income in addition to SFC and Council Tax.

Q: Should any other sources of local income available to LAs be explored by the Fair Funding Review?

Incentive effects, other common issues and principles

- 63) This paper has outlined some of the principal constituent elements of local council financial resources, as well as the main issues facing the Review when factoring these into a settlement allocative methodology.
- 64) The Resources work stream's next steps are to confirm a set of principles and policy objectives, for agreement with ministers. DCLG welcomes the group's input into these. Whilst certain elements or mechanics of making a resources adjustment for council tax and SFC will need to be resolved through further work, some of the fundamental or cross cutting questions for which some early principles could be of benefit include:
- To what degree should overall spending power be distributed across the local government sector according to the same pattern of need?
 - How should the Review view the possible incentive effects of factoring discretionary sources of income in a needs assessment methodology? Are 'good' incentive effects something which should be explored?
 - Data sources should be robust and acceptable
 - How should outliers be treated – i.e. areas which might have extraordinary SFC surpluses, or a very high number of residents receiving discounts?
- A preliminary set of principles are suggested below for discussion within the group:
- **Stability** – Income measured should be continual, not one-off or time limited. It should also exhibit low volatility at both national and LA-level; consistent or with consistent growth.
 - **Sustainability** – Incorporation of a particular element or the adoption of a specific approach should not undermine local authorities' financial planning or their flexibility to meet their own local priorities. It also should not conflict with other aspects of a relative needs assessment.
 - **Robustness** – Data should be objective, clear, consistently and universally available across all LAs.
 - **Good Incentivisation** – Both financial and behavioural. A resources adjustment should not disincentivise good practises, and should encourage growth.
 - **Meaningful** – A resources adjustment should only account for factors which have a significant impact on finances or a broader needs assessment, and are a comparable source of income to other factors.

Q: What are the group's views on these principles?

Next steps

65) We would like to initiate a discussion on the issues above and in particular welcome the group's views on:

- **What should be included in a resources adjustment**

For Council Tax:

- **Whether the Government should continue with the current approach to nationally set council tax discounts and exemptions in a resources adjustment?**
- **How the Review should approach discretionary council tax discounts, exemptions and premiums as well as Local Council Tax Support?**
- **Should a measure of council tax be adjusted for levying bodies?**
- **Different approaches to factoring council tax levels?**

For Sales, Fees and Charges:

- **Should SFC be considered within the scope of a resources adjustment?**
- **The use of RO data as a measure of SFC**
- **Accounting for SFC income streams which display a certain degree of volatility when setting baseline funding allocations over a multi-year reset**
- **What and how SFC should be included in a resources adjustment**

More widely:

- **Should any other sources of local income available to LAs be explored by the Fair Funding Review?**
- **What are the group's views on the suggested principles?**
- **Are these the most appropriate areas and issues of focus? Are there any particular issue that the group feel should be covered in upcoming meetings?**
- **ALATs' feedback from their recent work into resources**

- **Which group members may be best placed to provide relevant input to each area (CT, SFC, other income)?**