



Department for
Communities and
Local Government

Fair Funding Review

Technical working group

19 July 2017

Local Government Finance



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The Fair Funding Review

- Following the General Election, the Government has confirmed its continued commitment to the Fair Funding Review as an important way to address concerns about the fairness of current funding distributions to local authorities. Our intention is therefore to continue to make progress on the Review, in collaboration with the LGA and local authority officers.
- Implementation of the Review was previously linked with the 100% business rates retention system, with a 2019/20 implementation date.
- The Government have been clear that it is important to get the Review right and will continue to seek views on the approach and the target date for implementation.



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Terms of reference

The Fair Funding Review will:

- **set new baseline funding allocations** for local authorities,
- deliver an **up-to-date assessment of the relative needs** of local authorities,
- examine the **relative resources** of local authorities,
- focus initially on the **services currently funded through the local government finance settlement**, and
- be **developed through close collaboration with local government** to seek views on the right approach



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Guiding principles

- **Simplicity** – this Review is an opportunity for bold, clear thinking to identify the most important factors that drive the ‘need to spend’ on local services,
- **Transparency** – it should be straightforward for those affected by the relative needs assessment to understand what factors have influenced the levels of funding received by a local authority,
- **Contemporary** – the new relative needs assessment will be based on the most up-to-date data that is available,
- **Sustainability** – an evidence-based approach will be deployed to identify the factors which drive costs for local authorities today and in the future,
- **Robustness** - the new funding formula should take into account the best possible objective analysis, and
- **Stability** – the funding formula should support predictable, long-term funding allocations as part of a multi-year settlement.



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The areas of focus of the Review can broadly be divided into three closely related strands of work:

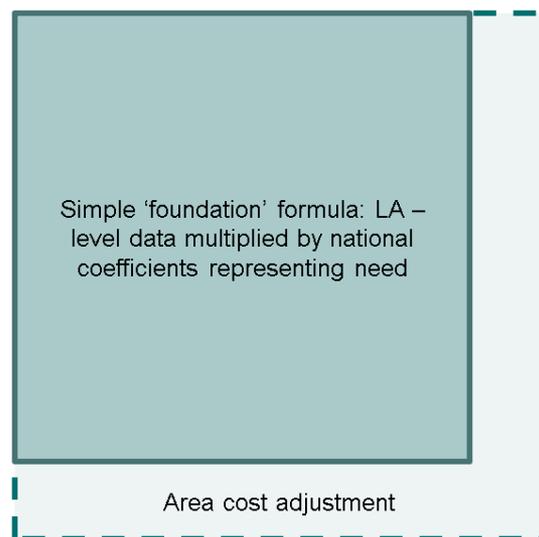
- 1) **Relative needs**
- 2) **Relative resources**
- 3) **Transitional arrangements**



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Relative needs

- A key principle of the Review is to work towards simplification of the current funding formulas. With that aim in mind, the Review is working to identify the extent to which a simple and transparent ‘**foundation**’ formula using common cost drivers can be used to allocate at least a proportion of the available funding to each type of local authority.



- Example of a foundation formula and a ‘universal’ Area Cost Adjustment (The diagram is for illustrative purposes and no inference should be drawn from the size of individual block elements)



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The Fair Funding Review Relative needs

- Whilst work has been underway to identify a **foundation formula**, the Review is also considering whether there may be a need to identify **individual service areas where a more specific approach is required**, and that a proportion of the available funding could be allocated based on the particular cost drivers for those services.
- Because the Review is progressing both approaches in tandem, an immediate priority is the completion of a high-level appraisal of the existing relative need formulas in order to develop a shortlist of analytically robust options that can be taken forward for further consideration in relation to a foundation formula or a more service specific approach.



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Relative needs

- A long-list of analytical options will be considered against the principles of the Fair Funding Review. Performance on these metrics will be taken into account, as well as practicalities such as data availability, in order to decide which options should be carried forward for further consideration.
- Although the principles cover some measures of analytical robustness, any options that would fail on a measure of analytical robustness are likely to ultimately be excluded, even where they align more generally with the other principles. Options that fulfil the above criteria will be short-listed for more detailed analysis.
- The options appraisal will be conducted in collaboration with other relevant departments where appropriate, enabling us to establish a baseline common understanding on the viable options on which we will focus.



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Relative needs

- The options appraisal will identify suitable analytical approaches, which will broadly consist of a 'do nothing' option, a 'do minimum' option (which effectively involves maintaining the current approach but with new data) and at least one other analytically robust option.
- Statistical techniques offer an evidence based approach for determining which cost drivers have a significant impact on a local authority's 'need to spend' and which, therefore, should be included in a funding formula. These techniques also enable us to quantify the relative importance of a cost driver in determining 'need to spend'. Without these techniques, judgement would necessarily play a greater role in determining funding allocations.
- One criticism of a simple expenditure based regression (EBR) approach at local authority level is that it may be seen as reinforcing existing funding decisions. The Review is therefore keeping all options open, and will consider potential improvements to EBR by using more advanced analytical techniques to address concerns relating to the influence that historic levels of funding have on levels of spending. One option being considered is multi-level modelling, which may be particularly appropriate for service areas that are high cost and where future demand is difficult to predict.



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Key criteria for including cost drivers in a formula

If a new formula is to include fewer variables that represent the key cost drivers facing local authorities, it will be even more important to ensure they are the right cost drivers. The Government is therefore proposing that the following criteria should be used to assess cost drivers before they are included in the funding formula:

- **Relevant** – there should be evidence to demonstrate that the cost driver has a significant impact on the cost of providing services,
- **Objective** – the cost driver should be measurable using robust, up-to-date data that is collected on a consistent basis across England. Local authorities should not be able to directly affect the indicator.
- **Distinct** – the cost driver should explain significant variation in the ‘need to spend’ that is not covered by another cost driver,
- **Stable** – the cost driver should not exhibit unpredictable or large changes year on year, and
- **Future proof** – the cost driver should be expected to drive the on-going costs of providing services (i.e. they should not be one-off events).



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Relative needs

Other considerations:

A potential service specific approach

- There are compelling reasons for considering social care, highways and transport, and fire as individual service block areas rather than as part of foundation formula because none of these are universal population based services.
- Both adults social care and children's services are targeted services rather than universal, and are therefore difficult to allocate on an adjusted per capita basis.
- Highways, transport and fire services are also not population based services, being based on road length and risk respectively. All of these functions are also performed at only one tier of local government.
- Legacy capital financing remains a pressure on some authorities and has very specific cost drivers.



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Relative needs

Other considerations:

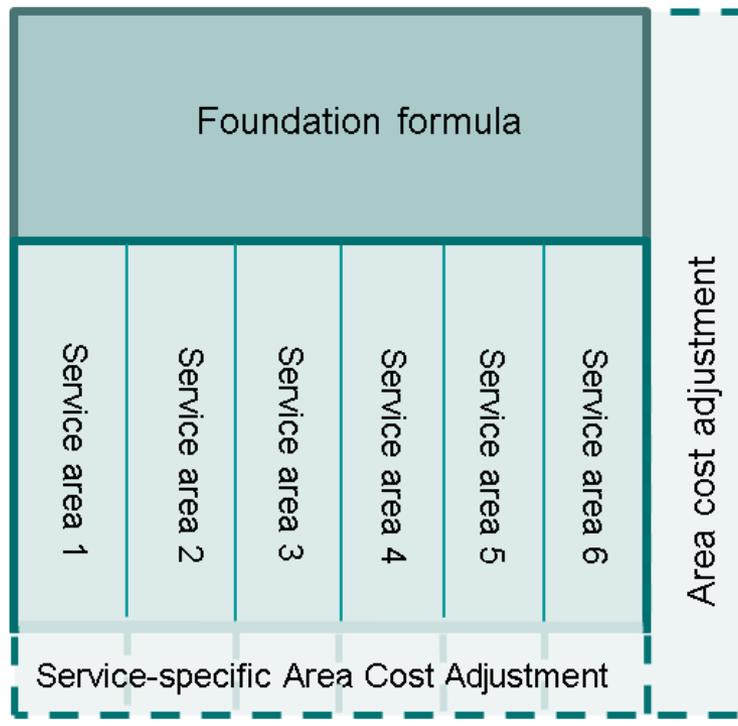
Area Cost Adjustments (ACA)

- The current approach to ACAs is based on two factors; labour costs and business rates, which are then weighted by the share of the block of services spent on each one.
- Changes in the way that local government delivers services, particularly in areas such as outsourcing and shared services, will affect the level of spending observed in some authorities, and specifically the split between employee costs and running costs currently used to weight labour costs in the ACA. This will have a knock-on effect on the estimated average used in the allocation, and careful consideration is required of how, if at all, we should identify and correct for these effects in estimation.
- Because of the significant impact that the ACA may have, this is an immediate priority area of focus for the Review and may also include within its scope considerations such as rurality, deprivation, island factors, service geographies, and the role of capital assets.



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Relative needs



- Depiction of a service-specific and cross-cutting ACA, alongside a 'foundation formula' and several potential service specific formulas within a new relative needs assessment (The diagram is for illustrative purposes and no inference should be drawn from the size of individual block elements)



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Relative needs

Other considerations:

Rurality

- Discussions with the technical working group have recognised that there are specific challenges in rural areas, which include scattered and remote populations, a lack of private sector service providers, and poor broadband or mobile phone coverage.
- The Review will consider options for measuring the impact of rurality on local authorities' 'need to spend', including the scope for alternatives to sparsity, and the evidence to support an appropriate adjustment.
- The Review will also explore whether it might be possible to incorporate measures of rurality within the area cost adjustment. It is essential that the factors and data used are reviewed in order to ensure that a new funding formula best captures the varying costs of delivering services today and in the future.



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Relative needs

Other considerations:

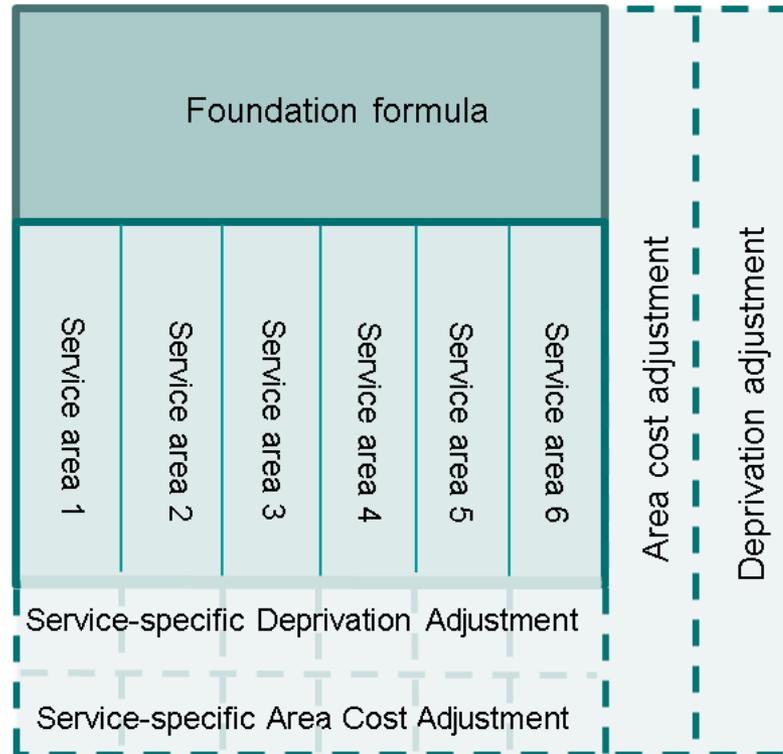
Deprivation

- Many of the current RNFs include an adjustment for deprivation. Deprivation is a cross-cutting issue across service areas; however different measures of deprivation will be relevant to specific service areas.
- Current deprivation adjustments are, for the most part, based on a relatively narrow measure of income deprivation. Specifically, they reflect the number of people in each area receiving income and employment related benefits, such as job seekers allowance, income support, tax credits and various incapacity benefits. The rollout of universal credit and discontinuation of some legacy welfare benefits mean that equivalent data derived from universal credit will not be available until it has been fully rolled-out across the entire country in 2022.
- The Review must therefore consider its approach to deprivation and a potentially suitable alternative measures to deploy.



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Relative needs



- Depiction of both service-specific and cross-cutting ACA and Deprivation adjustments, alongside a 'foundation formula' and several potential service specific formulas within a new relative needs assessment (The diagram is for illustrative purposes and no inference should be drawn from the size of individual block elements)



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Relative needs

Other considerations:

Other grants rolled into the settlement

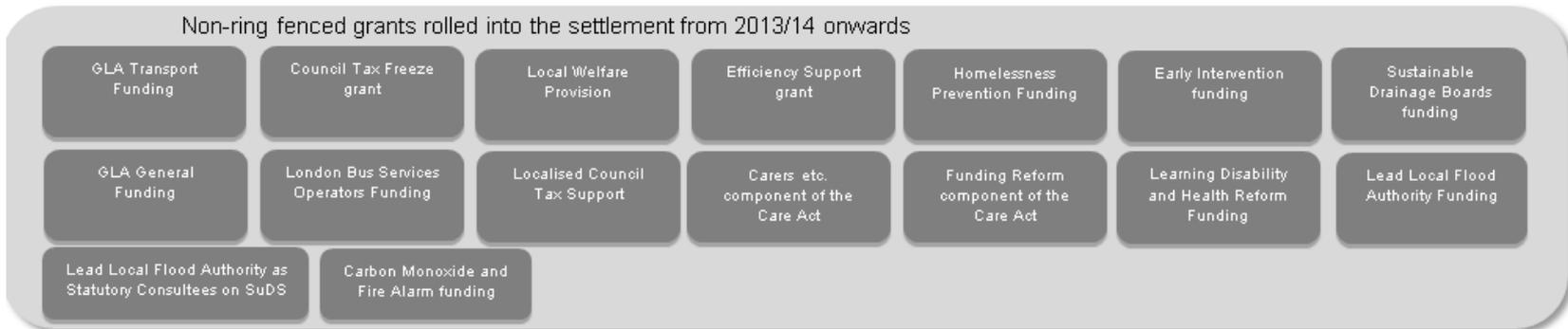
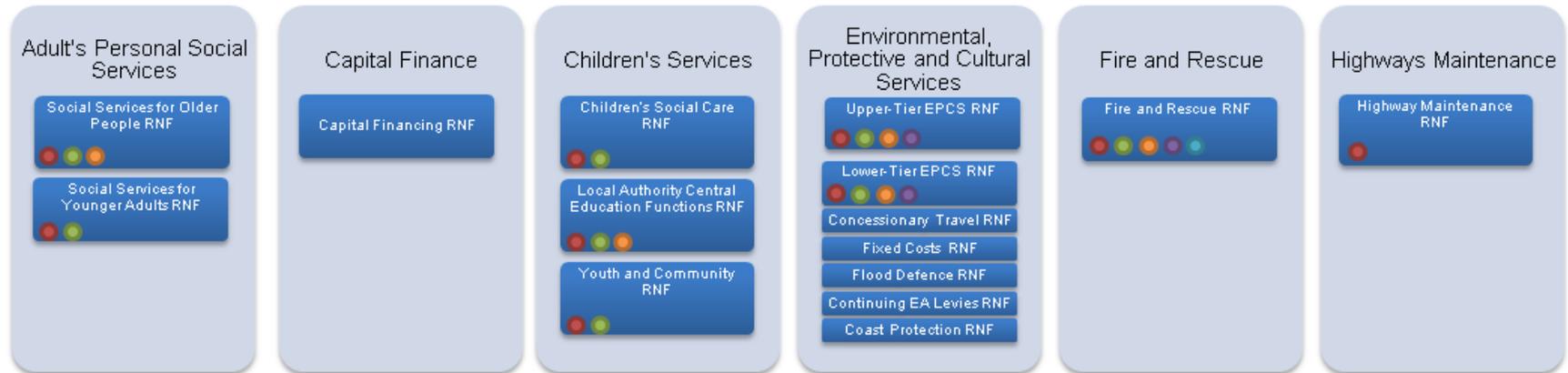
- Alongside the 15 RNFs that together make up part of the local government settlement allocations, there are several tailored distributions for services that were previously supported by non-ringfenced grants from DCLG and other Government departments (see next slide).
- Over time these have been 'rolled into' the settlement as part of a non-ringfenced allocation, retaining the original distribution formula with which they were allocated. Grants have been rolled in periodically, primarily in the 2011/12 and 2013/14 annual settlements.
- Further consideration of these grants will be required along with engagement with other departments.



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Diagram of existing RNFs and grants previously rolled into settlement





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Next steps

Workstream	Priorities
1a) Relative needs: Foundation formula	<ul style="list-style-type: none">• Development of potential approaches to foundation formula and consistent dependent variable.• Identify any other potential improvements to expenditure based regression.• Complete option appraisal.• Complete analysis and exemplification.
1b) Relative needs: Service specific formulas	<ul style="list-style-type: none">• Finalise evidence papers for potential service areas.• Formal consultation on cost drivers and structure of relative needs assessment.• Further collaboration with departments.• Analysis and exemplification of short-listed options.



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Next steps

Workstream	Priorities
1c) Relative needs: Cross-cutting areas	<ul style="list-style-type: none"> • Finalise option appraisals in relation to ACA, rurality and deprivation. • Obtain data from Annual Survey of Hours and Earnings (ASHE).
2) Relative resources	<ul style="list-style-type: none"> • Establish principles for assessing relative resources. • Finalise option appraisals in relation to council tax and sales, fees and charges. • Analysis and exemplification of short-listed options.
3) Transitional arrangements	<ul style="list-style-type: none"> • Establish principles for transitional arrangements. • Finalise option appraisal.
4) Data team	<ul style="list-style-type: none"> • Process and clean 2015/16, 2016/17, 2017/18 and 2018/19 data. • Establish dependent variable. • Develop model to replicate current formula allocations.



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Next steps

Proposed areas of focus for future technical working group meetings:

Future agenda items (with dates to be determined)

- Regular programme updates
 - Relative resources
 - ACA and rurality
 - Deprivation
 - Approach to foundation formula / service specific formula(s)
 - Transitional arrangements
- Alongside any formal consultation that takes place, our aim is to adopt an approach through which we will publish a series of **technical papers** between now and the completion of the Review related to the above priority areas.
 - These will set out options the Government is considering for the wider aspects of the Review, in collaboration with the technical working group.