Review of Relative Needs and Resources

Area Cost Adjustment (ACA)

BRR Steering Group April 2019
Proposed structure of the Area Cost Adjustment (ACA)

Area Cost Adjustment

Weights determined by Subjective Analysis Return and Revenue Outturn (Slide 6)

1) Labour Cost Adjustment (LCA)
   Based on local wage data
   Slide 4

2) Rates Cost Adjustment (RCA)
   Based on local Rateable Values
   Slide 4

3) Remoteness
   Based on journey times to major cities
   Slide 5

Accessibility (within LCA)
Weights determined by National Travel Survey data or service-specific cost modelling (Slide 6)

Dispersal
   Based on journey times to "hub" towns
   Slide 5

Traversal
   Based on journey times between households
   Slide 5
What the ACA does and does not do

**The ACA does..**

- Adjust for factors that affect the costs of delivering services for authorities (holding all else constant) including: labour, premises, and 'remoteness'
  - The journey times adjustments capture additional costs that may arise due to isolation from competitive markets, as well as lower staff productivity resulting from the delivery of services to populations separated by large journey times.
- Therefore, a higher ACA compared to similar authorities will result in a greater share of funding (i.e. compared to authorities with similar values for each cost driver).

**The ACA does not...**

- Adjust for factors that affect the demand or volume of services to be delivered (for example, population.)
- However, increasing an authority’s ACA does not necessarily increase funding since the ACA is applied both before and after running the regressions:
  - A higher ACA compared to an alternative ACA (e.g. the 2013/14 methodology) for the same authority does not necessarily imply a greater share of funding. This is because when the new ACA is applied, the coefficients in any expenditure based regression will change and this affects assessed need. Although this means changes to the ACA are not exactly replicated in assessments of need, our initial analysis suggests there can be a strong link between the two. Furthermore, the ACA does have a direct impact on non-EBR formulas.
  - If we did not deflate by costs first, our coefficients in the regression would be biased since expenditure would appear higher in areas with higher costs – i.e. the coefficients would pick up a cost effect as well as a volume effect. This would be a particular concern if any cost drivers were correlated with costs, since when we re-inflate by the ACA at the end, costs may be double counted.

**Data in the ACA**

- We propose to use the best available evidence (the latest Subjective Analysis Return) to weight elements of the Area Cost Adjustment, however, the sources rely in part on Local Authorities’ interpretations of their spending.
- The measures proposed meet the criteria for inclusion we have consulted: they vary between local authorities, are independent from each other, and spending varies with journey times.
- We believe our proposed measure of remoteness is the best available proxy to measure access to competitive markets and scale.
## Description of LCA and RCA methodology

<table>
<thead>
<tr>
<th>What are we measuring?</th>
<th>Data</th>
<th>Method</th>
<th>What factors are controlled for?</th>
<th>Why do we control for these?</th>
<th>Why don't we use local authority data?</th>
</tr>
</thead>
</table>
| LCA                    | Spatial variation in the going rate for similar workers, accounting for the effects of other factors known to affect wages. | ONS Annual Survey of Hours and Earnings (ASHE) 2015, 2016 & 2017 | Mincer regression (from the human capital literature) | • Age Sex  
• Full-time vs Part-time  
• Public vs Private sector  
• Occupation (e.g. “Chief Executive” or “Dental Therapist”)  
• Industry (e.g. “Advertising” and “Youth Work”) | Averaging these effects out avoids us ascribing high costs to areas with a large number of workers in highly-paid occupations or industries such as finance. | We use a sample of all workers partly because outsourcing and other arrangements have made it more difficult to separate private and public sector profession, and partly to maintain incentives for LAs to exercise pay restraint - using LA paybills would compensate authorities which have chosen to pay above the local going rate. |
| RCA                    | Spatial variation in the going rate for similar properties, accounting for the effects of building characteristics known to affect valuation. | A detailed database of property valuations from the Valuation Office Agency (VOA) | Hedonic regression | • Property Type  
• Types of Features (e.g. air conditioning)  
• Valuation adjustments (e.g. age, variations in floor level)  
• Plant and Machinery value  
• Area of property  
• Proportion of area taken up by additional features such as car parks. | Averaging these effects out avoids us ascribing high costs to areas with higher quality buildings. | We use a sample of all buildings partly because outsourcing and other arrangements have made it more difficult to separate private and public sector buildings, and partly to maintain incentives for LAs to exercise pay restraint - using LA rent bills would compensate authorities which have chosen to pay above the local going rate. |
Description of journey times measures: *accessibility* and *remoteness*

<table>
<thead>
<tr>
<th>Measure</th>
<th>Data source</th>
<th>Purpose</th>
</tr>
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<tbody>
<tr>
<td><strong>Accessibility</strong></td>
<td></td>
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<tr>
<td>Traversal</td>
<td>• MHCLG-commissioned journey times from LSOA to the closest LSOA in an area totalling 10,000 people.</td>
<td>• Measures the additional cost – in terms of employee time and therefore paybill – of longer journeys between households when delivering services such as waste collection</td>
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<tr>
<td>Dispersal</td>
<td>• DfT Journey Times from <strong>Output Areas</strong> to the closest “hub town”.</td>
<td>• Measures the additional cost – in terms of employee time and therefore paybill – of longer journeys to reach households in order to provide services such as child protection visits</td>
</tr>
<tr>
<td><strong>Remoteness</strong></td>
<td></td>
<td>• <strong>A proxy</strong> for separation from larger concentrations of service users, since outside of larger service markets, fewer providers can sustainably operate, reducing competition and increasing the <strong>cost of procuring specialised goods and services</strong> such as social care beds for local authorities. The cost of “in house” services will also be higher due to lower <strong>economies of scale</strong>.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Geography</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td><strong>Lower Super Output Areas (LSOA)</strong></td>
<td>400 to 1,200 households</td>
</tr>
<tr>
<td><strong>Output Areas</strong></td>
<td>Average 129 households</td>
</tr>
<tr>
<td><strong>Hub Town</strong></td>
<td>Settlement of over 10,000 people</td>
</tr>
<tr>
<td><strong>Major Towns and Cities</strong></td>
<td>Areas identified by the <strong>ONS as Built Up Areas</strong> - contingent areas of high density development, also used by Defra to define Urban/Rural Classifications - with more than 75,000 residents</td>
</tr>
</tbody>
</table>
Subjective Analysis Return (SAR)

The SAR collates authorities’ break down of running costs into categories for “Social Care”, “Police”, and “All other services” and assigns categories to components of the ACA:

• “Repairs, Alterations and Maintenance of Buildings” will vary with the RCA
• “Agency Staff” will vary with local labour costs i.e. the LCA,
• “Equipment, Furniture & Materials” will reflect local market size and therefore Remoteness
• “Energy costs” are unlikely to vary between LAs given regulation and the scale of suppliers

MHCLG will publish a technical paper later this year that will outline the approach to weights using SAR in more detail.

Weights are calculated using the most recent local authority expenditure and service-specific data

Revenue Outturn (RO)

• Local Authorities record the split of their spending on each service line between “employee costs” and “running costs” in the RO
• Agency and other provider staff delivering e.g. social care are counted under "running costs" and need to be identified using the SAR (see below).
• The RCA is applied to greater proportion of “running costs” than in the previous ACA, as under the revised methodology it reflects variation in all premises costs (including costs incurred by contractors).

Weighting accessibility

• The default weight is calculated using the average number of hours per year spent travelling for work by relevant workers in the National Transport Survey as a proportion of all paid time.
• The weight for domiciliary adult social care uses travel time estimates published by the UKHCA, and the weight for waste collection estimates total travel time from WRAP’s ICP2 published model of waste collection costs.

Subjective Analysis Return (SAR)