



Title: **Steering Group**

Paper: Structure of the relative needs assessment and next steps for the review by the Ministry of Housing, Communities and Local Government

Date: 23 July 2018

Venue: Local Government Association, 18 Smith Square, London

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## **POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY**

### **Introduction**

1. The previous Steering Group agenda included an update on the responses received to the Government's December 2017 consultation on relative needs,<sup>1</sup> including the key messages that were received through the consultation and outstanding areas of the relative needs assessment.
2. The aim of this paper is to inform the Steering Group of current thinking on how the structure of the needs assessment will take shape, including its approach to the Foundation Formula and service specific formulas.
3. This paper should be read alongside the papers on resources and transition. These three topics will be the subject of further engagement with the sector through a formal consultation later this year.

### **Recent Technical Working Group papers on relative need**

4. The Working Group has recently considered the following papers on relative need:
  - **September 2017:** MHCLG - Discussion paper regarding the approach to Area Cost Adjustment and rurality in the Fair Funding Review
  - **September 2017:** MHCLG - Discussion paper regarding the approach to Deprivation in the Fair Funding Review

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<sup>1</sup> <https://www.gov.uk/government/consultations/fair-funding-review-a-review-of-relative-needs-and-resources>

- **September 2017:** Society of County Treasurers (SCT) - Deprivation in the Needs Allocation Formula: Discussion paper on evidence and weightings for deprivation in service funding formulae
- **September 2017:** Rural Services Network (RSN) - Funding for higher unit costs associated with sparsity and rurality
- **November 2017:** MHCLG - Potential approaches to developing a Foundation Formula
- **January 2018:** MHCLG - Overview of statistical techniques
- **January 2018:** Society of County Treasurers (SCT) - Discussion paper on an alternative to regressions
- **January 2018:** MHCLG - Summary of potential analytical options
- **March 2018:** Department for Health and Social Care (DHSC) - Discussion paper regarding the approach to Adult Social Care in the review of relative needs and resources
- **May 2018:** MHCLG - Summary of the responses to the consultation on relative needs and next steps for the review
- **May 2018:** DHSC - Discussion paper regarding the Public Health Grant allocation formula
- **May 2018:** National Fire Chiefs' Council (NFCC) - Discussion paper on the Fire funding formula
- **May 2018:** LGA/University of Essex - Discussion paper regarding the divergence of relative needs over time
- **May 2018:** LGA - Criteria for evaluating Fair Funding Review proposals
- **July 2018:** - MHCLG - Discussion paper on Legacy Capital Finance
- **July 2018:** - MHCLG - Discussion paper on transitional arrangements
- **July 2018:** - MHCLG - Discussion paper regarding the area cost adjustment

## **Structure of the relative needs assessment**

### **Foundation Formula**

5. Following the consultation on relative needs and internal analysis, we are building consensus for the likely structure for the needs assessment. There was strong support on the need to simplify the formula, hence the new methodology will focus on a simplified approach. This will be based on a Foundation Formula for upper and for lower tier authorities, each including a reduced set of proposed common cost drivers, with service specific formulas for upper and for lower tier services where these areas require a bespoke approach.
6. A bespoke approach has been identified for the following service areas due to scale, distribution or significance:
  - Adult Social Care
  - Children's Social Care
  - Highways Maintenance
  - Fire and Rescue Services
  - Legacy Capital Finance

- Public Health
- Flood Defence
- Coastal Protection

7. The proposed approach to the Foundation Formula and to those services requiring a bespoke approach is outlined below. Some areas require further exploration and this analysis is ongoing.
8. The Foundation Formulas will be based on a reduced set of cost drivers such as population and will account for all of the universal services LAs are responsible for, where it would not be proportionate or credible to develop a standalone funding formula.

#### Lower Tier Foundation Formula

9. Due to the nature of the services provided at lower tier, it is likely to be the case that the majority of lower tier funding is distributed through the Foundation Formula. A formula based on a reduced set of common cost drivers such as population would fit well with the majority of services which are population driven (e.g. environment, planning control and implementation, revenues and benefits, licensing, sports and recreation, registration of electors). An Area Cost Adjustment (ACA) would be also applied to the formula.

#### Upper Tier Foundation Formula

10. For upper tier authorities, the most significant service areas of spend (e.g. social care) are driven by distinct cost drivers, which cannot robustly be included in a simple Foundation Formula. It is likely that a service-specific approach at upper tier (or Fire Authority) level will be needed for Adult Social Care, Children's Services, Highways and Transport, Fire and Rescue Services and Legacy Capital Finance Formulae.
11. However, with a large number of service areas which are not likely to require a bespoke approach, the Foundation Formula may potentially be the third largest area for these authorities. The Foundation Formula for upper tier authorities will also be based on a reduced set of common cost drivers such as population. An Area Cost Adjustment (ACA) would be also applied to the formula.
12. Work continues on assessing the basis for population as a common cost driver for both upper and lower tier Foundation Formulas. This could include addition of further common cost drivers (upper and or lower tier), if supported by analytical evidence.

13. The Working Group recognised the correlation with population as a driver of overall spend, but acknowledged this alone doesn't tell the full story. They recognised that there is likely a strong argument for developing specific formulas for a limited number of service areas.
14. There was a degree of optimism that once those service areas are tackled, the Foundation Formula offered a simple and transparent approach for residual funding, pending the outcome of further analysis. This approach meets the principles of simplicity and transparency.

**Question 1: What are the Steering Group's views on the proposed approach to the Foundation Formulae?**

**Specific Service areas**

Upper tier

**Adult Social Care**

15. There is strong support for having an Adult Social Care (ASC) formula. The Department of Health and Social Care (DHSC) recently published research<sup>2</sup> on a new relative needs formula to account for the factors that drive costs in adult social care. This new formula offers a more robust and up-to-date formula than the current ASC formula.
16. The Working Group has considered the new DHSC formula as a leading option for the review. An alternative approach would be a simple LA-level expenditure based regression (EBR); this would offer limited advantages in using some more recent data, however the new DHSC formula provides a better proxy for ASC need and uses multi-level modelling, a more robust analytical technique.
17. The Working Group were supportive of using the new DHSC formula to measure ASC need, subject to testing the robustness of the formula.

**Children's Services**

18. Children's Services has been identified as a service area where a more sophisticated approach is likely to be required. No respondents to the consultation mentioned this as an area which did not require a bespoke formula. It is a complex area of need and the second largest area of spend, and has its own specific cost drivers.
19. The current Children's Service formula was introduced in 2006/07 however some parts of the formula date back much further. The Department recently

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<sup>2</sup> <https://www.pssru.ac.uk/project-pages/adult-social-care-rnf-review/>

commissioned a data research project on children's services in partnership with DfE. As well as gathering important evidence on cost and demand pressures in the sector, the project will also develop a robust, service specific formula. This will be based around a multi-level model, constructed from individual-level data (person-based resource allocation, PBRA). This is seen as the leading option in the review.

20. The Working Group has welcomed the research commissioned by MHCLG and DfE. They pointed out that children may be placed outside of the authority, and this may require mapping of out-of-area placements. They also noted that there could be a non-linear unit cost pattern for authorities, as once a saturation point is reached within the home authority, additional placements can be more expensive.
21. Other factors to consider include treatment of Home to School Transport. This could be included in the new, broader, Children's Service formula that is being developed. However, it is a significant area of national expenditure and its cost drivers may be distinct from 'mainstream' Children's Services. Subject to further analysis, a specific Home to School Transport funding formula may be investigated to account for this.

### **Highways Maintenance**

22. There has been strong support for a Highways Maintenance formula, as a service which is driven by specific, non-population factors. A leading option for Highways maintenance would be an LA-based Expenditure Based Regression formula based upon:
  - Road length
  - All traffic flow

### **Fire and Rescue**

23. There is broad support for a specific Fire and Rescue Services (FRS) formula, including from the National Fire Chiefs' Council (NFCC). Due to the nature of the risk-based service, FRS is based on a measure of population with top ups for various risk factors, rather than demand.
24. We propose a formula based on population, with the inclusion of evidence-based additional cost drivers where appropriate. We are therefore continuing to test cost drivers, including those in the current formula, and those suggested by the NFCC's paper on this service area.
25. The current FRS formula is based on an Expenditure Based Regression methodology and this is a leading option for the FRS formula. However, a multi-level modelling (MLM) option that analyses spend at both LA-level and FRA-level is currently being investigated by MHCLG and the Home Office.

## **Legacy Capital Finance**

26. A formula for Legacy Capital Finance is proposed for both upper and lower tier authorities. This would be based on an LA-level calculation using the following cost drivers, for which there was broad support:

- Notional outstanding debt
- Assumed rate of interest

27. The Working Group were in general agreement with the approach suggested by the Department, and voiced concerns over taking any approach that was based on actual legacy capital debt.

## **Public Health**

28. There is strong support for a specific Public Health formula. DHSC consulted on an updated Public Health formula in 2015/16, and DHSC and Public Health England are continuing to work with the Advisory Committee on Resource Allocation to ensure this formula is up to date.

29. This formula is a leading option for the review, if agreement to devolve the Public Health Grant is reached with the DHSC.

30. The Working Group agreed with the importance of considering public health within the wider framework of the review, however required further time to consider the issue.

## **Other service areas**

31. In addition to the service specific formulas outlined, there are upper tier service areas which are being further explored. These include:

- **Local bus support and concessionary travel:** There was less consensus from the consultation regarding the approach to Local Bus Support and Concessionary Travel. Possible options for these service areas include incorporation within the Foundation Formula or an alternative approach. This will be informed by analysis and responses to the consultation going forward.
- **Waste Disposal:** Due to its high correlation with population, waste could be a candidate for inclusion within the Foundation Formula. Analysis is ongoing on whether waste requires a specific approach, and the Government will set out its proposal in the consultation later this year.

## Lower Tier

32. The majority of lower tier funding is likely to be distributed via the Foundation Formula, the exception being **Legacy Capital Finance**, which would be

incorporated within the lower tier as in the upper tier (above). However, there are service areas which are being explored further. These include:

- **Flood defence and coastal protection:** These services are relatively small in budget at an England level but may be significant for a small number of authorities. There was mixed support for a service specific formula. Alternative approaches could be to include these services within the Foundation Formula, or to address these outside of the relative needs assessment.
- **Non-HRA Housing and Homelessness:** There was broad support through the consultation for a specific funding formula. This service area could be also captured within the Foundation Formula. We will explore the potential for a specific housing formula, any correlation with the Foundation Formula, and consider the most appropriate cost drivers. The Working Group raised homelessness and housing support as areas that may require specific treatment under the review

**Question 2: What are the Steering Group's views on the issues discussed regarding the service specific needs formulae?**

#### Area Cost Adjustment (ACA)

33. Area characteristics, such as numbers of children or cumulative length of road, which determine the number of interventions required are 'additive' cost drivers and are accounted for in RNFs. ACAs account for factors which affect the cost of making the same intervention, they do this via a 'multiplicative' adjustment (the RNFs are multiplied by ACAs in order to assess need). Where the current RNFs were constructed using analysis of past spending, this spending is divided by the ACAs beforehand in order to give equal influence to the response of each local authority to cost drivers. The current ACA makes an adjustment for differences in labour costs (Labour Cost Adjustment, LCA) and costs of operating premises (Rates Cost Adjustment, RCA).
34. There is strong support for the inclusion of an Area Cost Adjustment (ACA) in the new methodology.
35. We are proposing to consult on continuing to adjust for the LCA and RCA (including a measure of the differences in building costs), and also adjusting for accessibility and remoteness (outlined below). We will also consult on leading options for implementing the ACA, including how to weight different factors in the ACA.

36. We are proposing to calculate an ACA that reflects the relative costs of providing services in each authority. In line with the current ACA, we are proposing that this continues to include:

- **an LCA:** work is on-going to consider potential alternatives to a broad lower limit on the national pay agreement floor. These might include: keeping the existing approach; seeking sources of evidence to inform a revised 'floor'; treating direct and indirect expenditure on labour separately within the ACAs; or removing the lower limit.
- **an RCA:** We propose to maintain the current methodology (index of average VOA rateable values per square metre of office space) and also control for variation in characteristics (such as car parking, building floor) between areas to improve accuracy. Work is on-going to consider adjusting for differences in all building and premises costs relating to service delivery, using the RCA index.

37. We are also proposing to develop the ACA to take account of two further impacts on the cost of providing services:

- **accessibility** - costs associated with longer journey times and therefore 'down time' of service providers (e.g. down time of a social worker travelling between clients). This is typically associated with rural sparse areas but also highly dense and therefore congested areas.
- **remoteness** – the additional costs associated with being at a greater distance from major markets. Additional costs may arise as a result of reduced competition for services tendered or the need to provide services on a smaller and therefore less economical scale.

38. As accessibility – the impact of sparsity and density on journey times – and remoteness include a treatment of rurality, it is proposed that a separate 'additive' (cost driver) approach is not taken to include rurality within the Foundation Formula for upper or lower tiers in order to avoid 'double counting.' The review is also proposing that service-specific ACAs may be required for all, or some, services.

39. In addition, we propose that in the new methodology the ACA should be made at a district-level geography. This will make the adjustment more accurate and will allow a more robust weighting of cost drivers.

40. There was consensus amongst the Working Group that an ACA should be included within a needs assessment. Some members noted that service specific ACAs may mean that sparsity or density factors may not be required in individual RNFs as it was important not to 'double count' these factors. The Working Group was supportive of an adjustment for accessibility, noting that this could provide a

sophisticated consideration of the effects of both sparse and dense areas on the costs of delivering services.

**Question 3): Do the Steering Group have any comments on the approach to the ACA?**

**Next steps**

41. The next stage for the needs assessment element of the review will involve further consultation with the sector later this year on a proposed overall structure for the needs assessment (e.g. the number and type of formulas), set out the leading cost drivers for each formula for consideration, and describe a proposed analytical technique for weighting these cost drivers in each formula. This will be carried out alongside material on the proposed approach to resources and transition.