



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

Paper: NR TWG 16/32 Discussion paper regarding transitional arrangements under 100% business rate retention by the Department for Communities and Local Government

Date: 15 February 2017

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

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

- 1) This paper examines the possible measures which may be implemented as local authorities manage the transition to 100% business rates retention in 2019/20 and any changes in funding that result directly from the introduction of a new funding formula.
- 2) Calculating local authorities' relative needs and resources based on new formulae and using updated data (potentially including forward calculations of need) is likely to result in changes in the level of funding individual councils receive. We may need to consider which features we wish transitional arrangements for this system to have.
- 3) A call for evidence was performed in the summer of 2016, in which the question of transitional funding was posed; the response is also summarised in this paper.
- 4) To help support today's discussion and by way of background information the annex to this paper provides further information regarding previous transitional funding arrangements, responses received to the fair funding review call for evidence from summer 2016.
- 5) As an initial step today, we would like to encourage a discussion across the group on this policy area and in the process begin to define a programme of work and/or analysis that will be progressed in the coming months with input from the technical working group.

6) In particular, we would welcome the group’s feedback on proposed future direction (set out below), which suggests specific areas of focus and that may form the basis of future technical working group meetings. In particular, we would like to establish:

- Whether these are the most appropriate areas of focus,
- Whether any of these areas are of a higher priority, and if so how these should be prioritised with relevant input from the working group,
- Which group members may be best placed to provide relevant input to each area.
- Any other points you deem relevant to transitional funding.
- Timescales
- Our next steps
- Others?

<b>Proposed areas of priority focus for considering transitional support</b>	
1	Develop realistic policy options for transitional arrangements that may be used
2	Determine the parameters of a transition scheme
3	Identify any further modelling that would support consideration of the most appropriate approach
4	Examine the approach and impact of transition arrangements used elsewhere in Government funding settlements
5	Explore any potentially new or radical approaches (e.g. forms of transition grant, Intra-local government loaning etc.)
6	Identify behaviours that may potentially be incentivised or encouraged through transitional arrangements

- 1) This annex sets out the transitional support methodology that has been used in the past in order to ease the implementation of new funding allocations.
- 2) Firstly, the responses collected from the recent call for evidence are summarised, in order to provide background to the reasoning behind the changes.
- 3) A review of the main types of transition support is given, with emphasis on banded floor damping in the 13/14 Settlement. Examples of the scale of changes before and after damping are presented.

### **Views on transitional funding from the “call for evidence on needs and distribution” (CfE)**

- 4) Whilst there were some respondents who stated that there should not be any transitional funding, the majority (61 %) of respondents agreed that there should be some form of transitional arrangements.
- 5) Many respondents discussed the importance of transitional arrangements upon implementation of the new distribution methodology to avoid significant step-changes, shocks or disruption to stable financial planning and service delivery.
- 6) Where the respondents disagreed with transitional funding, this was along the lines of authorities not receiving the correct funding or realising their full needs baseline allocation of funding due to damping.
- 7) The preference for a rapid transition to full allocation over a period of three to five years was proposed in order to avoid some authorities suddenly losing out, but to allow authorities to reach their full allocation before any resets.
- 8) Alternative methods to aid transition in the event of step-changes suggested by authorities included greater flexibility over council tax and fee setting, or individual councils setting funding volatility reserves to manage the transition with their own resources.

### **Background to Transitional Arrangements**

- 1) Transitional arrangements or damping are processes which may be used to mitigate any change in funding in order to ensure all authorities recipients receive funding at a particular level or phased in over a given period. This can be achieved for example by scaling the funding of recipients who have surpassed a higher or less negative percentage change, the 'ceiling,' or may also include those recipients whose funding sits between floor and ceiling.
- 2) Scaling down of funding is usually carried out on the share of a recipient's funding above floor level; a scaling factor is calculated and multiplied against funding value above the floor threshold. This ensures that no recipients are brought down to the floor. There is a cost to the system as authorities do not receive their total funding allocation, or will not until damping reaches its final level.
- 3) Another approach is to take a top-slice of funding before redistribution, which may be redistributed to bring authorities up to the floor value. *It should be noted that in the case of the FFR, as BRR is to be a fiscally neutral process, there will be no extra funding allocated for this purpose.*

### **Banded Floor Damping**

- 4) In the period 2013/14, banded floor damping was used to bring all authorities in the Local Government Finance Settlement (excluding the Isles of Scilly) up to a designated 'floor' for the Settlement year. This guaranteed that no authority would get less than their floor percentage change in formula funding.
- 5) Authorities were allocated to floor categories based on their type and therefore responsibilities. This resulted in four groups; authorities with a responsibility for education and personal social services (EDUPSS - excluding police authorities), police authorities, fire authorities, and shire districts (SD) in two shire areas.
- 6) Since the 2011/12 Settlement, these floor categories were sub divided into bands based on formula grant dependence of authorities. Upper and lower tier authorities were divided into 4 bands; 1 being most dependent on formula grant, and 4 least. This 'banded floor damping' methodology has been used in LGF Settlements since 2011/12.
- 7) Each band was designated an individual annual calculated floor value. Police authorities were not separated into banded floors (Fig. 1), having just one floor threshold, and fire authorities divided into three floor levels (Fig. 2). Authorities where their 2010/11 Formula grant had formed a larger proportion of their 2010/11 Budget Requirement were defined as more dependent.
- 8) The placement of authorities in bands 1 to 4 was allocated based on pre-defined values between 0 to 1, separating authorities into similar sized groups based on grant dependence; these values were calculated as the proportion of an authority's 2010/11 Budget Requirement that was funded through the 2010/11 Formula Grant (FG). For EDUPSS these values were:

<b>Band assignment</b>	<b>EDUPSS 2010/11 FG divided by 2010/11 budget requirement</b>
1 (most dependant)	1.000 – 0.587
2	0.596 – 0.498
3	0.497 – 0.378
4 (least dependent)	0.377 - 0

**Table 1**

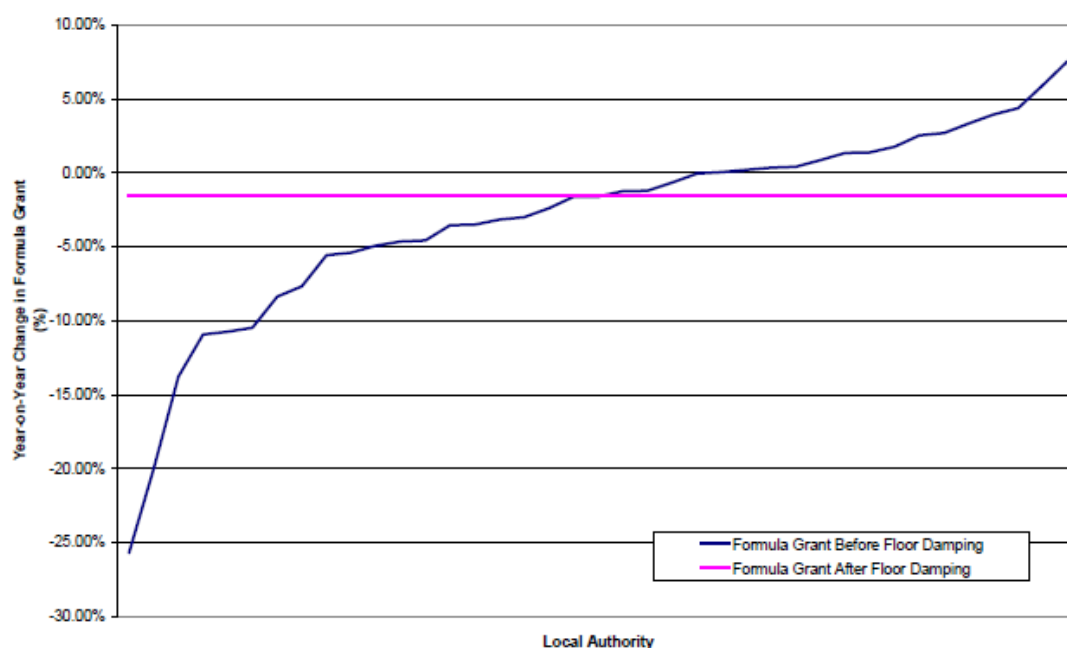
- 9) The band values for all authority types in 2013/14 is given in Table 2. These values were assigned based on Ministerial judgement.

<b>Band</b>	<b>EDUPSS</b>	<b>SD</b>	<b>POLICE</b>	<b>FIRE</b>
1 (most dependant)	-2.7%	-5.4%	-1.57%	-8.7%
2	-4.7%	-7.4%	N/A	-10.2%
3	-6.7%	-9.4%	N/A	-11.7%
4 (least dependent)	-8.7%	-11.4%	N/A	N/A

**Table 2 – Floor damping thresholds in 2013/14 for all authorities and bands**

- 10) Prior to the use of bands, a non-banded ‘floor damping’ mechanism was in place from 2005/06. From 2001/02 until this point, ‘floors and ceilings’ methodology was used, in which funding required to bring authorities to the floor threshold was taken from authorities above a ceiling amount, and partial funding from between these cut off points; both with differing re-scaling factors.
- 11) An authority’s formula funding was then not allowed to drop below a “floor” defined as the percentage change compared to the 2013/14 formula funding adjusted to reflect changes in funding and responsibility. The authorities most dependent on formula funding had a larger floor: their funding was more protected than authorities less dependent on formula funding.
- 12) For example, the use of a constant re-scaling factor of 0.277 (for Band 1, EDUPSS) brought 46 band 1 authorities up to the - 2.7 % floor threshold by redistributing funding from the 105 authorities above the floors. In total floor damping in the EDUPSS category redistributed £523.6m in 2013/14.

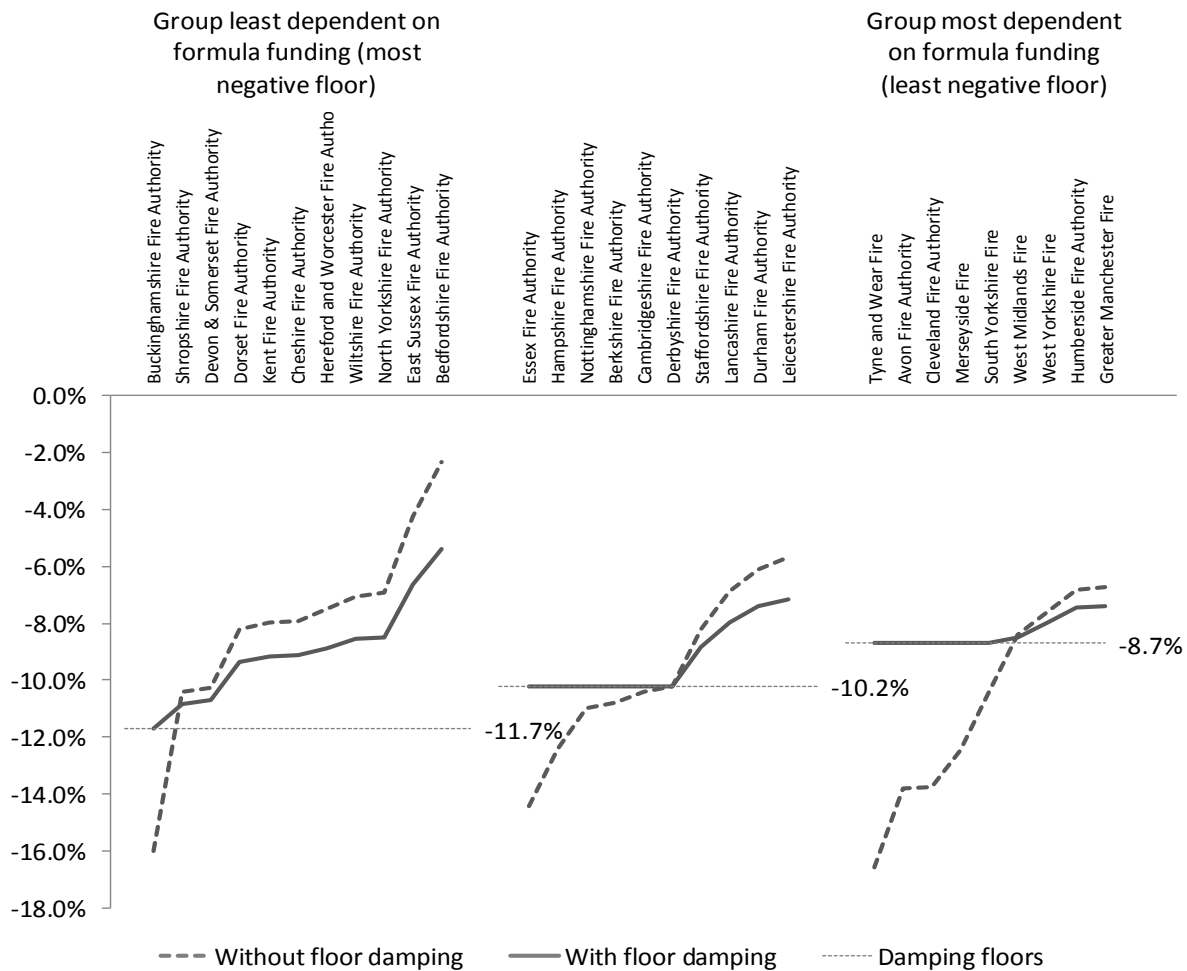
**Fig.1 Police formula grant floor damping 2013-14**



- 13) As shown in Fig. 1, only one floor was implemented in the group of police authorities. This led to all authorities being brought to the floor threshold of -1.57%, and resulted in large contributions from some authorities to finance this floor. The largest percentage contribution to the floor was 8%, from West Midlands Police, with the largest percentage received by Cumbria Police (32%) to bring the authority up to the floor.
- 14) Within the group of fire authorities, all fire authorities above their floor paid an equal proportion of their funding *above their floor* to finance those fire authorities below their respective floors. In 2013/14 this was calculated to be a 32% proportion of fire authorities' funding needed to bring all authorities up to their respective floor threshold.
- 15) This means that authorities on the cusp of dependency groups would face quite different damping grants were they the other side of the threshold. Avon Fire was just in the most dependent group, and being below the floor of -8.7% received a damping grant of £1.14m. Had their grant dependency been slightly lower, their floor would have been -10.2% and their damping grant only £0.80m. This would mean total formula funding 1.6% lower.
- 16) Cheshire Fire was in the least dependent group, and paid 32% of their amount above their relevant floor. Had their grant dependency been slightly higher, they would have faced a more generous floor and paid 32% of a smaller amount, and their total formula funding would have been 0.5% higher.

**Fig. 2**

**Percentage change in 2013-14 formula funding (with and without floor damping) from 2012-13 formula funding adjusted for changes in funding and responsibility, by group**



GLA Fire excluded for exposition

**Scale of funding changes with and without damping, 2013/14 (all authorities)**

17) The maximum losses and gains in funding had floor damping not been implemented in the 13/14 settlement can be seen in Table 3. These changes were significant, ranging from a monetary loss/gain of -£71.7m/£36.3m, with a range of £108m, to extremes of percentage change of -76.6 % to + 29.2 % (a range of 106 %).

18) However with the implementation of floor damping, the maximum monetary loss was reduced to -£31.2m. The maximum percentage change in funding was reduced from the large -76.6 % to -11.7 % (loss) and from +29.2 % to + 0.34 % (gain).

19) A comparison of the damped funding allocations for 13/14 with the target funding for 13/14 showed that 209 of 442 (47 %) authorities were *within 5%* of their target share in 2013-14 and that 334 of 442 (76 %) authorities were *within 10%* of their target share in 2013-14 (see Fig. 3), however there were some major outliers.

Authority	Actual Change in funding yoy /£m		% Change in funding yoy	
	Un-damped	Damped	Un-damped	Damped
Max loss	-71.7 (52 %)	-31.2 (1.6 %)	-76.6 (£14.5m)	-11.7 (£1.2m)
Max gain	36.3 (8 %)	0 (-0.03 %)	29.2 (£0.95m)	0.34 (£0.39m)
Median	-1	-1	-4.6	-5.4
Range	108	31	106	12

Yoy = year-on-year, from adjusted 12/13 value to 13/14 value

**Table 3 – Maximum undamped and damped changes in funding 2013/14**

Authority	Actual value /£m	% value
Max Gained (to <i>move to floor</i> )	59.6 (89 %)	289 (£12.8m)
Max Contributed ( <i>paid to floor</i> )	43.8 (8 %)	22.6 (£0.95m)

**Table 4 – Maximum values gained or contributed via the damping methodology**

20) Compared to the adjusted 2012-13 formula funding, 305 of 423 authorities would have been worse off. 131 of these authorities would have seen a formula funding decrease of more than 10%; 25 a decrease of more than 25%. Post-damping, by definition no authority faced a reduction exceeding the floor of their group.

21) There is a downside to damping though. As the cost of increasing the funding for those authorities was financed by other authorities, the number of authorities who would have received more than their adjusted 2012-13 figure decreased from 117 to 2. Overall 175 authorities benefitted from damping while the remaining 247 paid for it.

**Fig. 3**

