



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

Paper: **NR TWG 17/07 Funding for higher unit costs associated with sparsity and rurality by the Rural Services Network**

Date: 29 September 2017

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

POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

Introduction

1. The Rural Services Network (RSN) has been asked to submit a paper to the Technical Working Group (TWG) discussing how sparsity should be addressed in the future Fair Funding formulae. RSN has been asked to comment, in particular, on the following factors relating to sparsity:
 - Whether sparsity should be considered as an addition to the Area Cost Adjustment, i.e. as a premium on unit costs driven by the effects of sparsity;
 - Whether sparsity is an appropriate measure of the effects of higher costs in rural areas, and whether it reflects the full range of additional costs in rural areas, such as those resulting from remoteness; and
 - Whether there is a simple and transparent way of measuring and funding the costs associated with sparsity, and what RSN's views are about the use of alternative indicators in a future funding formula.
2. In preparing this paper, RSN has not undertaken any new primary research but has used the findings of research papers that have been commissioned in recent years to support the case for funding for sparsity and rurality. These papers have been used to support such funding in local government and the NHS, and in England as well as other parts of the UK. We also draw on the analysis that RSN produces regularly to show the difference in funding between rural and urban areas, and the effect that this has on council tax in rural areas.

Funding gap for rural authorities

3. Despite the additional funding that rural authorities receive for their additional sparsity-related costs, there is still a funding gap between the amount that rural and urban authorities receive.
4. In 2017/18, Settlement Funding Assessment (SFA) in predominantly rural areas amounted to £215.67 per head compared to £340.01 per head in predominantly

urban areas. This gap will widen further in 2018/19 and 2019/20. The widening in funding is due to changes made in calculating SFA as part of the four-year funding settlement by the inclusion of council tax income in the formula meaning that those authorities, many of them rural, with greater reliance on council tax received steeper cuts in SFA.

5. Rural authorities have, on average, higher Band D council taxes, which supports our contention that there is a structural funding gap. If rural and urban authorities were funding on an equal footing, then we would expect average council taxes to be similar or the same.

Additional cost pressures in rural areas

6. Rural areas are faced with a range of additional cost pressures including higher unit costs. Whilst we deal with unit costs in more detail in the next section, we have included here a summary of the broader cost and spending pressures in rural areas to put our arguments in context, and to show that the current population sparsity indicators are used to fund more than higher unit costs in rural areas.
7. **Additional service demand and pressures** are incurred by rural authorities providing additional services to meet the needs of dispersed populations, such as providing transport. There is also additional volume in some services in rural areas, particularly related to higher numbers of older people. This will increase the services provided to that cohort and, whilst it is not intrinsically a rural or sparse issue, the burden of an ageing population will fall disproportionately on rural areas.
8. **Unmet need.** Rural residents will often have less access to services than their urban counterparts, and rural authorities are often able to spend less on discretionary services. Current grant funding has largely been created with reference to past expenditure patterns, and because urban authorities have historically spent more, so this is perpetuated in funding formulae. This concept is well-established in academic research.¹
9. **Rural deprivation** is often connected to a lack of access to services (including isolation and poor transport links) and low/seasonal pay rather than straightforward unemployment and benefit claimant numbers. Rural areas experience particular forms of deprivation to a greater extent than urban areas, including:²
 - Household deprivation: low incomes and lack of housing opportunities
 - Opportunity deprivation: decline in services and employment
 - Mobility deprivation: difficulties in obtaining access to jobs, services and facilities
10. As we can see, there are many causes of higher costs in rural areas, in addition to higher unit costs. Only some of these are addressed in the current funding formulae.

¹ "Review of Evidence of Additional Costs of Delivering Services to Rural Communities: Final Report", Hindle, Spollen and Dixon, 2004.

² "Healthcare in a rural setting", the BMA Board of Science, January 2005

Measuring higher unit costs in rural areas

11. The current funding formulae uses the ACA to adjust for differences in unit costs between authorities. Rural authorities do not fare well from the ACA: it is usually much lower in rural areas because private sector wages are typically lower. Cornwall is measured as having the lowest wages in the country, and many rural areas receive no uplift at all through the ACA. If they are funded at all, higher unit costs in rural areas are funded through the sparsity factors elsewhere in the formulae.
12. Higher unit costs in rural areas derive from both higher pay costs and non-pay costs. They can result from a range of causes, including diseconomies of scale; transport costs; visiting clients in the community; transporting clients to facilities; staffing difficulties and recruitment; and other market factors.
13. These costs have been documented extensively in a number of reports stretching back over the last decade and more.³ The most recent report (2014) by LG Futures for DCLG/ DEFRA undertook research with 27 councils to identify higher costs associated with providing services in rural areas. These are the services where higher unit costs were identified:
 - Regulatory Services. Less income generation, more travel downtime and higher travel claims.
 - Waste Collection. Fewer properties per round (between 2 and 7 times more on an urban round than a village/ dispersed round, distance per round (1.9 times longer in village/ dispersed), cost per round (1.64 times more expensive in village properties, 2.78 times more expensive in hamlets and isolated properties).
 - Economic Development and Community Development. Additional rural costs relating to outreach, travel, accessibility and bringing providers to locations.
 - Building Control and Development Control. More travel downtime (38% to 68% higher), and higher travel claims (25% to 46% higher).
 - Parking. Net income is up to 7.5 times higher in urban areas than town/ fringe, and up to 9 times higher in urban areas than village and dispersed areas.
 - Libraries. Premises costs higher as a proportion of total costs in rural areas. Cost per visit higher in rural areas (and note that non-rural authorities did not even have libraries in rural parts of the area).
 - Highways Maintenance. Higher costs, although more linked to topography than rurality (not always coterminous). Costs were higher, and these are usually linked to external contractors. These contractors will incur higher costs

³ "DCLG/DEFRA – Research into Drivers of Service Costs in Rural Areas – Analysis of Quantitative Survey of Local Authorities", LG Futures, November 2014. "Sparsity Partnership for Authorities – Delivering Rural Services (SPARSE-RURAL), LG Futures, August 2011. Report on higher costs in rural areas, SPARSE, Rita Hale, 2006

themselves, and also might find that the market is less competitive in rural areas.

- Adult Social Care. Significant additional cost drivers which would increase unit costs, including travel claims, travel downtime, residential care additional premia, domiciliary care rates and premia and day care.
- Children's Social Care. Travel claims, higher payments to foster carers/ agencies.

14. It should be noted that not all the additional costs identified in the report were higher in rural areas, although the bulk were, even when comparing sparse and less-sparse parts of the same authority.

15. Further data to evidence higher unit costs had previously been obtained by Rita Hale (SPARSE, 2006). Although some of the data is now possibly out-of-date, it shows the type of additional unit costs that rural authorities will still incur, and the potential scale of the uplift associated with them. The report showed the actual allowances that rural authorities were making for higher unit costs in their budgeting and contracting practices. As an example, the research showed a clear rural cost premium associated with domiciliary care, which ranged from +3-5% (Wiltshire) to +13-18% (East Sussex, Gloucestershire).

16. Other research has demonstrated higher unit costs in residential and nursing care. Additional costs are driven by rural authorities having to provide smaller nursing and residential units, with the attendant diseconomies of scale.⁴

Funding for sparsity in the current funding formulae

17. Sparsity has been used as a factor in local government funding formulae for at least 20 years (and if anyone has a longer memory, probably for longer than that). The formulae allow for both the higher unit costs that are incurred by authorities providing services in rural areas, and the additional incidence of demand in some services and of additional services. The proportion of sparsity funding that relates to higher unit costs has never been explicit, but we assume this to represent the bulk of the higher costs that are incurred by authorities in rural areas. The literature on the costs associated with sparsity focus principally on higher unit costs.

18. We have estimated the values for sparsity in the current formulae using the 2013-14 local government finance settlement, the last occasion on which full details of the construction of the RNFs was published. The weighting of sparsity in the RNFs was increased in the 2013-14 settlement, although the bulk of the increase was "damped away" which meant that the full financial benefit was not felt by rural authorities.

19. Sparsity is currently used in the following parts of the settlement:

⁴ <http://www.gov.scot/Publications/2005/10/19142752/27544>

- Local authority central education functions. Sparsity factor applies only to resident pupils. The sparsity factor accounts for some 38% of the resident pupil element before ACA and fixed costs, and some 23% of the whole block (i.e. including both resident pupils and pupils). Sparsity mainly reflects the cost of home-to-school transport, for which sparsity is a major driver of cost.
- Older people PSS. Sparsity applies to the whole block. It is one of the top-ups alongside age top-up, low income adjustment and deprivation top-up. It is not possible to estimate the proportion of funding distributed by the sparsity indicator.
- District Level EPCS. Sparsity is the largest top-up in the block, accounting for some 23% of the funding in the block.

20. Different measures of sparsity are used in the RNFs:

- Ward sparsity. This is used local authority central education functions. Proportion of the resident population living in wards with less than 0.5 residents per hectare and between 0.5 and 4 per hectare. The former is given a weighting of 3.5 and the latter a weighting of 1.
- Sparsity adjustment for people aged 65 and over. This is used in the older people PSS formula. Proportion of the population aged 65 and over living in super-output areas with 0.08 people per hectare and between 0.08 and 0.64 per hectare. The former is given a weighting of 2 and the latter a weighting of 1.
- Population sparsity. This is used in the District Level EPCS formula and in the Police formula. Proportion of the resident population living in output areas with less than 0.5 people per hectare and 0.5 to 4 people per hectare. The former has a weighting of 2. (The measure used in the Police formula is the natural logarithm of these two figures.)

21. In addition, many rural authorities also receive the Rural Services Delivery Grant, which is distributed using super-sparse population data and awards grant to those authorities with proportions of super-sparse population over an arbitrary threshold. Whilst this has the advantage of directing the additional grant to the most sparse areas, it excludes some authorities which have issues of sparsity but whose super-sparsity falls below the threshold.

22. The way that sparsity is used in the funding formulae can be adjusted using the following elements:

- Area used to measure sparsity (ward, output or super-output level). Super-output level, for instance, focuses only on those small areas that are the most sparsely populated, whereas ward sparsity is a more generalised measure of sparsity.
- Threshold used to qualify an area for sparsity. Thresholds can be used to concentrate funding on the most sparsely populated areas, although they can cause “cliff edges” and can be based on subjective judgement.

- Weighting given to the most-sparse areas. These decisions have to be combined with those on thresholds, although again they can cause “cliff edges” and are subjective.

23. The use of sparsity in the RNFs is limited and ought to be extended beyond the three RNFs in which it is currently used. RSDG is partly a compensation for sparsity changes in 2013-14 not being fully implemented. But this only strengthens the argument that the use of sparsity in the RNFs is currently too limited.

24. As an indicator, population sparsity is relatively flexible and it can be used to fund the costs associated with rurality either generally across an area, or focus funding on the most sparsely populated areas. If anything, we have concerns that the population sparsity indicator is used inconsistently, and can often have “cliff edges” and inconsistencies within it. Ideally, a resident (or potential client) living in a rural or sparsely-populated area should attract the same sparsity add-on regardless of the characteristics of the wider local authority (parts of which might be much more urban).

25. A sparsity indicator could be used to reflect the higher unit costs in rural areas, and could therefore complement the additional funding that is distributed through the ACA.

Alternative indicators for sparsity and rurality

26. We have been asked to consider whether any alternative indicators could be used other than those that are based on population sparsity. The costs incurred by rural authorities are partly linked to population sparsity, but could be driven by a wider range of factors, such as market factors, rural poverty, and isolation. It might, therefore, be beneficial to use indicators that reflect those cost pressures more accurately.

27. The benefits of using population sparsity are:

- It is a simple and readily understood methodology;
- It can be updated with each Census (although not mid-year population estimates). In practice, though, relative sparsity changes very slowly so updating data is not particularly relevant; and
- Most additional costs in rural areas are directly related to geography (i.e. distance of people from service provision, requirement on service provider to provide a greater number of service points).

28. There are some downsides to using population sparsity, however. These are:

- Sparsity is a relatively crude method: it measures average population sparsity in a given area when costs are more likely to be driven by the distribution of settlements and the road or transport networks between them; and
- The way sparsity has been applied in recent cases has been fairly arbitrary (e.g. use of thresholds).

29. These are some examples of other indicators that could be used instead of or alongside population sparsity, some of which are used in other public sector funding formulae:

- **Access to services.** The English Indices of Deprivation 2015⁵ has a sub-domain for geographical barriers to service. These include: road distance to a post office; road distance to a primary school; road distance to a general store or supermarket; and road distance to a GP surgery. *These are measures of rural deprivation or unmet needs within rural communities. They measure something different from sparsity and could be used to distribute funding for the services that rural authorities need to provide to these communities. These indicators are not appropriate for funding higher unit costs in rural areas.*
- **Road Network** (average number of road kilometres per head of population). This indicator was developed and used in the NHS funding formulae in Scotland.⁶ The main benefit of the road kms/ head indicator is that it reflects not just the population density but the way this is distributed: in other words, it reflects a range of variables relating to distance, settlement patterns, and population densities. These could be called geodemographic factors.⁷ Road data is not publicly available at district-council level. *This indicator could be used as an alternative to sparsity, especially if the formulae is measuring the additional costs associated with the transport network (e.g. travel costs, travel downtime).*
- **Peripherality.** Where supply chains are longer, where distribution is more difficult, and/ or where competition is lower resulting in higher prices for raw materials or commodities. These are likely to be parts of the country that are most remote from the main centres of population or which have poor transport links. There is little research on these factors, but there is some evidence of higher costs which would need to be verified. This factor is likely to apply to the whole authority, and not just those residents living in sparse areas. *This indicator could be used to measure the additional costs associated with the distribution network, higher prices for raw materials or commodities, or market effects. There is no current methodology for measuring peripherality, although something specific could be included within the ACA to reflect these higher costs.*

30. These indicators could be used to distribute funding for different types of rural costs, some of which are associated with higher unit costs and could be used alongside ACA. Clearly the use of any of them alongside or instead of population sparsity would be a major departure and would result in a change in the distribution of funding between rural authorities. We would want to explore the options carefully before supporting any change.

⁵ "The English Indices of Deprivation 2015, Research Report", DCLG, September 2015

⁶ <http://www.gov.scot/Publications/2005/10/19142752/27544>

⁷ For upper tier authorities, Durham would have the higher score (30-40 kms per head), followed by Herefordshire, Shropshire, Devon, Northumberland, Cumbria, Rutland, North Yorkshire, Cornwall, Somerset, Lincolnshire, Norfolk, Dorset (10-20 kms per head).

31. As a set of principles, we would want any changes in the distribution methodology to:
- To provide the same uplift in funding to each resident living in sparsely-populated areas wherever they are located in the country.
 - To use indicators that have higher uplifts for residents in more sparsely-populated places.
 - To use indicators that do not include subjective or artificial thresholds or uplifts.
 - To match the indicator – where possible – to the type of need that is attracting the funding.
32. We would expect that population sparsity continues to be the main method used to distribute funding for rural needs, including for higher unit costs. Its advantages are significant, and its effectiveness as an indicator could be improved by applying it more consistently. There are, however, other indicators that might be more suitable for specific tasks, and some of these could be used alongside a revised ACA methodology.

Conclusions

33. There is a strong evidence base showing the additional costs that are faced by local authorities in rural areas. Additional costs come in a number of forms, including additional services, rural deprivation, and access to services, as well as higher unit costs. Based on the evidence that is available, the bulk of additional costs arising in rural areas are from higher unit costs.
34. There is a strong argument that higher unit costs could be addressed alongside the ACA. The purpose of both are broadly aligned in that they are there to fund variations in geographically based unit costs. We would be very reluctant, however, for there to be a unified approach to measuring and distributing funding for higher unit costs. The methodologies used to measure ACA in the past have tended to underplay or ignore rural costs, and our view is that the higher unit costs in rural areas need to be measured and funded separately.
35. On balance, population sparsity remains the best way of distributing funding for rural areas, although there are problems with the way that the current formulae actually apply the indicators. However, we have identified other potential indicators that could be used to distribute funding for specific additional costs in rural areas. RSN would be supportive of developing these indicators with the possibility of using them alongside measures of population sparsity.

Adrian Jenkins/ Dan Bates
Pixel Financial Management
September 2017