



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

Paper: NR TWG 18-13: Discussion paper on transitional arrangements for the review of relative needs and resources by the Ministry of Housing, Communities and Local Government

Date: 10 July 2018

Venue: MHCLG, 2 Marsham St, London

POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

Introduction

- 1) Calculating local authorities' relative needs and resources using updated data and based on new formulas identified through the review of relative needs and resources is likely to result in changes to the level of funding individual councils receive.
- 2) Transitional arrangements are processes that may be used to mitigate any change in funding in order to ensure either authorities receive funding at a particular level or changes are gradually introduced.
- 3) This paper proposes for discussion principles to guide transitional arrangements to support the implementation of the review of relative needs and resources.
- 4) In 2013-14, banded 'floor damping' was implemented, which guaranteed that no authority would be allocated less than their floor percentage change in formula funding. (Annex 1 details these transitional arrangements).
- 5) These damped allocations were fixed in 2013-14 as part of the introduction of the 50% business rates retention scheme as a means to ensure a continued growth incentive. As a consequence, relative 'winners' did not receive their full allocation over time, whereas other authorities benefitted as a result of damping grant forming part of their baseline funding.

Background to transition

- 6) The premise of this paper is that transition will be fiscally neutral. Any alternate decision will be a matter for the 2019 Spending Review and is out of scope for this paper.
- 7) There are multiple precedents for transitional funding arrangements in central government, including:
 - a. The Public Health Grant, transferred from the NHS to local authorities in April 2013, had a “pace-of-change” mechanism to iterate local authorities’ funding closer to their target allocations in 2013-14 and 2014-15
 - b. The assessment of local authority relative needs in 2013-14 saw Damping Grant allocated as one block of the four-block Formula Funding model
 - c. Transition Grant was allocated at the 2016-17 and 2017-18 local government finance settlements to ease the change as increased retention of locally raised taxation replaced a system based on central government grants
 - d. The implementation of the national funding formula for schools in England included transitional arrangements with caps on gains in respect of schools considered under-funded as well as minimum per-pupil cash increases in respect of all schools.

Principles for Transition

- 8) Local authorities’ long-term financial planning and service delivery will be assisted by temporary transitional arrangements to their new relative needs baseline to ensure there are no undue year-on-year changes in funding.
- 9) There are multiple options for the design of transitional arrangements. One key trade-off is between efficiency and stability, across local authority and system-wide levels; between the length of time taken to reach target allocations and the pace of change required of those authorities facing the largest reductions.



- 10) The most efficient transition arrangement might be to move everyone to their newly assessed level of funding from day one. However, this would likely result in costs at the individual authority level for those with the longest journeys to new funding allocations, and significant short term movements in funding levels might prove more difficult to plan for and sustain.

- 11) Following a new assessment of relative need, it is inevitable in a net neutral cost transition arrangement that there will be a set of relative 'winners' and 'losers' across local authorities. Transition arrangements, which unwind over time, could help relative 'winners' move to their new allocations as efficiently as possible and support relative 'losers' to transition in a sustainable way to their new funding allocations. There is a tension between these objectives. The approach to transition could be determined depending on the relative size of the changes.

- 12) Resources to support relative 'losers' might be secured through relative 'winners' having deferred gains. Transition could be implemented according to a percentage change in funding, by an absolute level of change, or through a combination of both.

- 13) Establishing principles will support the design of transition arrangements. The following principles for discussion have been designed following representations made to the Call for Evidence in 2016:

Principles	Description
Stability	The transition from existing funding allocations to new target allocations must be manageable and sustainable for both the sector and individual local authorities, in the context of wider changes to the local government finance system.
Transparency	The process must be clear and understandable to support both financial planning and explaining the nature of transition to a wider audience.
Time-limited	Support for relative losers using deferred gains for winners should be provided over a fixed period of time to enable target allocations to be reached.
Flexibility	The speed of change could vary across the sector to achieve greater efficiency. Considerations might include local revenue raising capacity, distances from target allocations and/or relative funding pressures, for example, to deliver statutory services.

- Question 1): Does the group agree with the proposed principles? Are there any missing?**
- Question 2): Does the group have views on whether any principles should be given a higher priority, and if so how these should be prioritised?**
- Question 3): Does the group have any views on how we should balance securing the gains for relative winners against supporting**

relative losers in reaching their target allocation, for a fixed quantum of funding?

Establishing the baseline

- 14) The needs and resources elements on the review will determine new baseline allocations for individual local authorities. Transitional arrangements will resolve the method of reaching these target allocations over time, in order to provide stability in delivering services.
- 15) However, the scale of transition will depend on the baseline it is measured from. It may be necessary to 'adjust' the start (baseline) and end (position from 2020-21 onwards) to ensure an appropriate measure for comparison in terms of funding.
- 16) One potential starting assumption is for the baseline to be cash available in 2019-20. However, this position may require an 'adjustment' to reflect the value of grants that will be rolled in to achieve 75% business rates retention, such as Public Health Grant. Similarly, the baseline may also be affected by decisions on the treatment of business rates growth, business rates retention pilots and negative Revenue Support Grant. Transitional arrangements will also be discussed at the July Business Rates Retention Systems Design Working Group. There are a number of alternatives for the baseline, including Settlement Funding Assessment, Core Spending Power (CSP) or some other measure of income.
- 17) The 'end' position (target allocations) for individual local authorities may also include predicted change over more than one year, for example, through the inclusion of population projects in the relative needs assessment.

Question 4): Does the group have any views on how we should establish the baseline and what factors we should take into account?

Next Steps

- 18) Following feedback at this working group, these principles will be tested with the sector in the next consultation, which we aim to publish in autumn 2018.

Annex 1 – Previous transitional arrangements

- 1) This annex was previously shared with the Technical Working Group in February 2017 and is included again for reference.
- 2) It sets out the transitional support methodology that has been used historically in local government finance to ease the implementation of new funding allocations.
- 3) Firstly, the responses to the call for evidence (summer 2016) are summarised to provide background to the reasoning behind the changes.
- 4) A review of the main types of transitional support is given, with emphasis on banded floor damping in the 2013-14 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” (summer 2016)

- 5) Whilst some respondents stated that there should not be any transitional funding, the majority (61 %) of respondents agreed that there should be some form of transitional arrangements.
- 6) 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.
- 7) 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.
- 8) 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.
- 9) 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.

Banded Floor Damping

- 10) 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 receive less than their floor percentage change in formula funding.

- 11) 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.
- 12) 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.
- 13) 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.
- 14) 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:

Band assignment	EDUPSS 2010/11 FG divided by 2010/11 budget requirement
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

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

Band	EDUPSS	SD	POLICE	FIRE
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

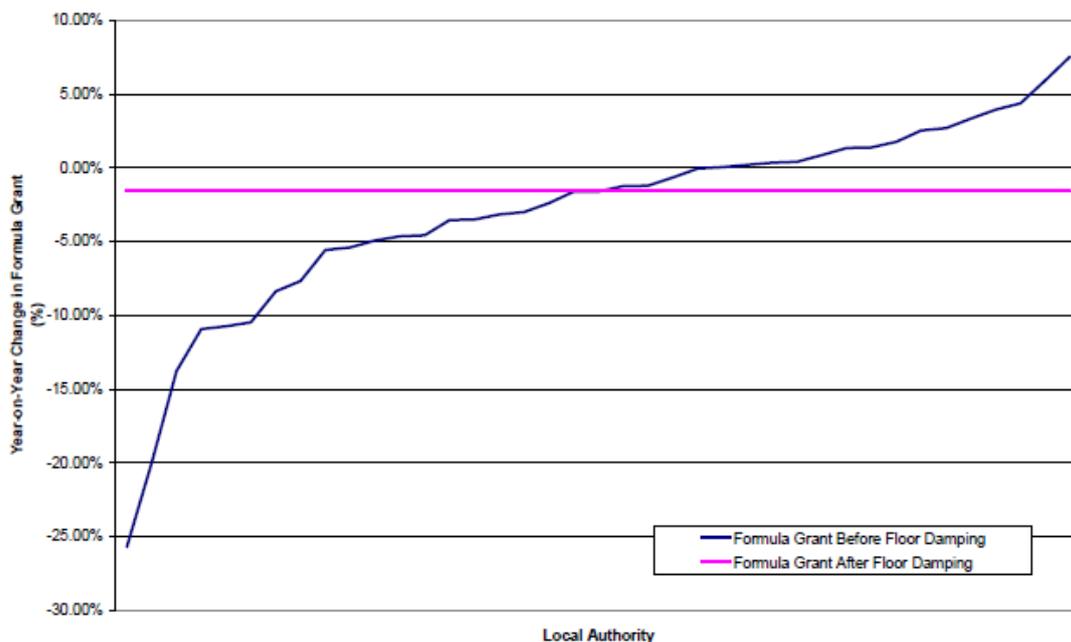
Table 2 – Floor damping thresholds in 2013/14 for all authorities and bands

16) 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.

17) 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.

18) 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



19) 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.

20) 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

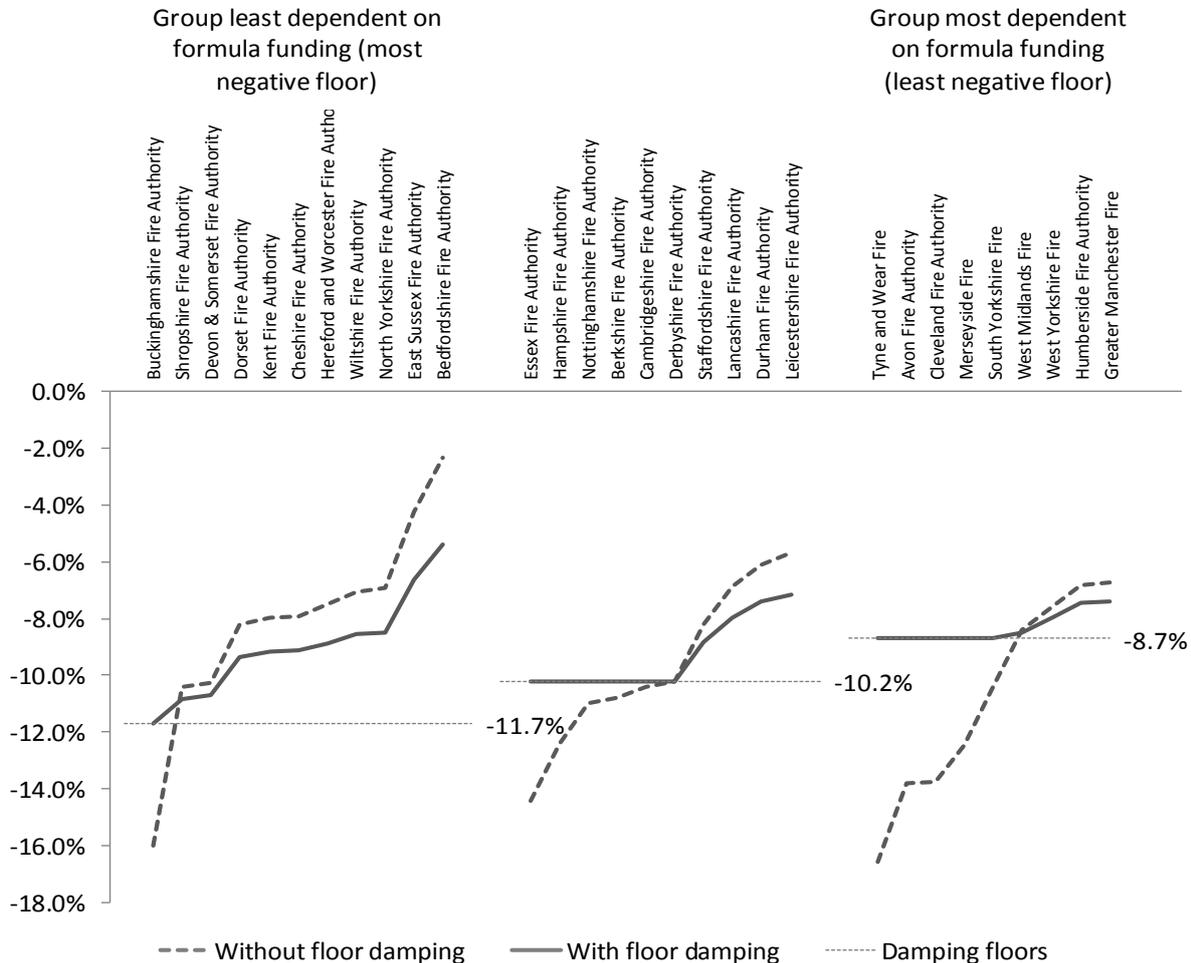
below their respective floors. In 2013-14 this was calculated to be a 32% proportion of fire authorities' funding needed to bring all authorities up to their respective floor threshold.

21) 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.

22) 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)

23) The maximum losses and gains in funding had floor damping not been implemented in the 2013-14 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 %).

24) 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).

25) A comparison of the damped funding allocations for 2013-14 with the target funding for 2013-14 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.

Fig. 3

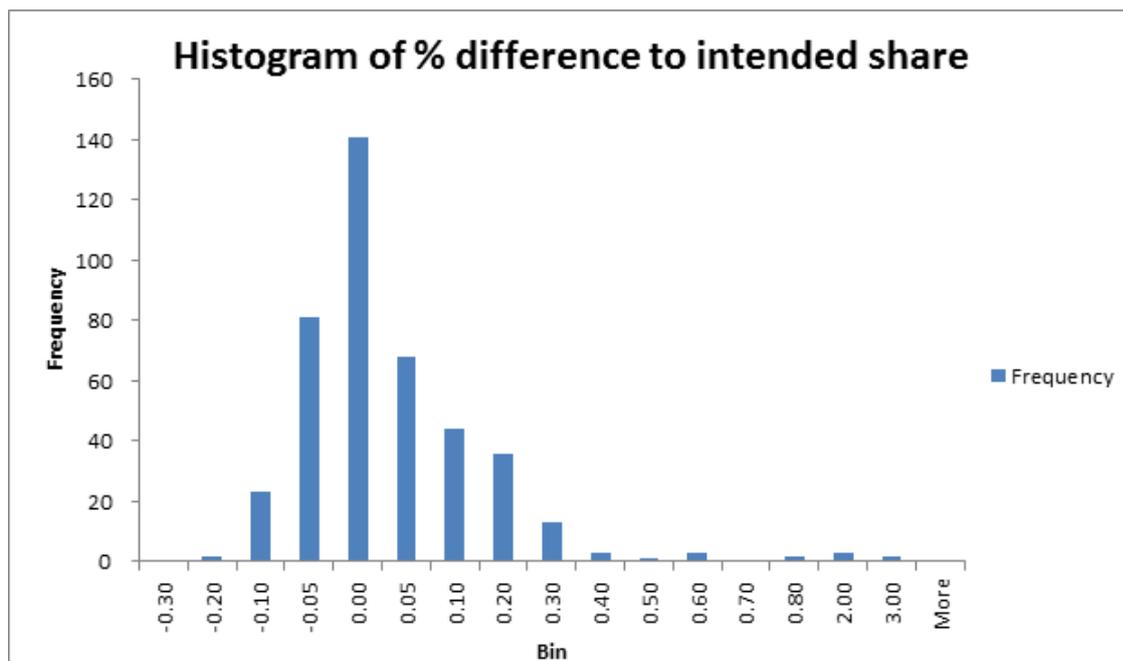


Table 3 – Maximum un-damped and damped changes in funding 2013/14

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

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

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

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)

26) 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.

27) 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.