

---

**BUSINESS INTEREST GROUP: NEEDS AND DISTRIBUTION WORKING GROUP  
PROGRESS UPDATE**

---

**Introduction**

1. The Fair Funding Review is an essential element of the reforms we are making to the Local Government Finance system with the introduction of 100% Business Rates Retention.
2. The Fair Funding Review was announced to Parliament in February this year alongside the 2016/17 local government finance settlement. It will be a thorough review of what the needs assessment formula should be in a world in which all local government spending is funded by local resources and not central grant. We will use it to determine the transition to 100% business rates retention.
3. Ultimately this Review will determine the initial funding allocations for all councils under the new business rates system.

**Structure and scope of the Fair Funding Review**

4. It is 15 years since the current methodology for assessing the relative needs of local councils was last comprehensively examined and there is good reason to believe that demographic changes and the cost of providing services will have affected areas in different ways.
5. Local government has universally welcomed the announcement of this and we are developing our work in close partnership with councils.
6. The Review is being informed by a Technical Working Group on Needs and Redistribution comprised largely of Chief Finance Officers from different parts of the Local Government Sector. The group is co-chaired by DCLG and the Local Government Association (LGA), and the material it considers falls broadly into 3 areas:
  - 1) 'Defining need' – agreeing what statistical technique we are going to use to model allocations, what factors and data go into those, and how we prioritise and weight those factors.
  - 2) 'Interaction with the wider LGF system' – technical issues concerning how to combine the new needs assessment with the wider LGF system, including transitional arrangements and options for resetting the assessment periodically.
  - 3) 'Treatment of resources' – local authorities have access to sources of income other than business rates. This stream of work will need to consider whether, and how, we should take these into account as part of the needs assessment and redistribution of business rates.

**Progress to date**

7. Since May, a significant number of papers have been presented to the technical working group. One of the initial papers the Technical Working Group discussed was the key questions that the Review needed to address. This discussion played a key role in influencing the contents of the Fair Funding Review: Call for evidence which was published in July.

## POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

8. The group have also arrived at agreed positions on a number of important issues that have helped shape the direction of the Review.

### *Defining Need*

9. This is the largest, most significant and therefore, the most challenging area that the Review needs to address. It is therefore the area that DCLG and the technical working group have dedicated the most time to so far.
10. The group has been presented with a series of papers which have outlined different options for measuring need. Having considered these papers the group have agreed the following:
  - Population, while a key driver, does not capture enough alone of the factors that drive local authorities' need to spend. Other drivers should be included
  - While we should not discard all of the current approach to measuring need the reliance on historic patterns of spending does not incentivise efficiency and alternative statistical approaches should therefore be considered
  - Instead of thinking about potential outcome measures the Review should focus on cost drivers that are likely to drive future need.

### *Features of the system*

11. One of the key issues for the Review is how the needs assessment interacts with the wider reforms to business rates and in particular how we find the balance between incentivising growth and ensuring funding is fairly distributed according to the needs of local authorities.
12. To support this discussion the technical working group has considered a number of papers about how we can find this balance when resetting the system. The group has agreed the following:
  - A system based on partial resets appears to offer the best approach to balancing the growth incentive with distributing funding according to need
  - The group have asked DCLG to explore options around rolling resets

### *Treatment of resources*

13. The Association of North East Councils (ANEC) presented a paper to the group that illustrated that not all councils were equally able to raise funding through Council Tax. This paper led to a discussion about how the ability of local authorities to raise resources locally should be taken into account when assessing where to set the baseline funding levels in the new system. The group agreed the following:
  - It was very important that the ability to raise income from council tax and other sources was taken into account and that this was an important issue for this technical working group to consider
  - However the fact that good data was already held about local authorities' ability to raise income meant that this work stream should become the focus of the group after the approach to defining and measuring need has been further developed

## POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

### **Next steps**

14. The first priority at the moment is to respond to analysis of the 209 responses the department received to the Fair Funding: Call for evidence, and to plot our next technical consultation which will help us narrow down options around key questions.

### *Identifying Key Cost drivers*

15. Collecting the data for the indicators a needs assessment draws upon has been the most time consuming elements of the previous reviews of local government funding formulas. It is therefore important that the group focuses on identifying the key cost drivers over the next few months.
16. To facilitate this DCLG are arranging for other government departments to attend the technical working group to outline their views on the key factors affecting costs in their policy areas. The Dept. for Health, Dept. for Education and Dept. for Transport have all presented to the group so far.
17. The Association of Local Authority Treasurer Societies (ALATS) have organised a sub group of the technical working group to develop a local government view of what the key cost drivers are.

### *Exploring alternative statistical methodologies*

18. One of the main areas of agreement within the group so far has been the need to consider alternatives to the current approach for measuring relative needs that relies on regressions against past expenditure. However there has been less agreement about what methodologies we could use instead.
19. To progress this conversation, analysts in DCLG have been exploring alternative methodologies ranging from normative modelling to factor analysis and other data reduction techniques such as principle component analysis and are in the process of setting out the strengths and limitations of these different approaches.