

Fair Funding Review and Business Rates Retention

Purpose

For information and discussion.

Summary

This report updates members on progress of the LGA's work related to business rates retention and the Fair Funding Review. In particular, it seeks members' initial views on the Government's recently published consultation on assessing relative needs as part of the Fair Funding Review.

Recommendation

That the Executive note the report and provide comments in line with paragraph 17 and Appendices A and B.

Action

Officers to proceed as directed.

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Fair Funding Review and Business Rates Retention

Introduction

1. This report updates members on progress of the LGA's work on Business Rates Retention and the Fair Funding Review since the last meeting of the LGA Executive. In particular, it seeks members' initial views on the Government's consultation on assessing relative needs as part of the Fair Funding Review.

Fair Funding Review

Timing and scope

2. Alongside the provisional 2018/19 local government finance settlement, the Government confirmed that it is looking to implement the Fair Funding Review by April 2020. The results of the Review will be used to form funding baselines as part of the move to 75 per cent business rates retention (see below) which will be implemented at the same time. This is the date that the joint DCLG / LGA working group on the Fair Funding Review has been working to.
3. The announcement of the move to 75 per cent business rates retention means that potentially up to £19 billion (£16 billion if public health grant is excluded) will be redistributed on the basis of the results of the Review. This total is the sum of currently retained business rates as well as the grants that are expected to be rolled in to business rates retention (see below for a full list).
4. At the time of writing this report, the Fair Funding Review Working Group was due to meet on 16 January. Key items to be discussed include the consultation document and in particular the progress of government thinking on which analytical techniques could be used to weight cost drivers against one another in the formulae. The papers will be available [on the LGA website](#).

Consultation document

5. Following our calls to inject further pace into the process of the Review to maintain its credibility with our members, the Government also published the awaited [consultation on the design of the relative needs assessment](#).
6. The consultation does not cover the relative resources adjustment, transition or other technical matters. We expect these to be addressed through a series of technical papers throughout 2018 and the expanded LGA work programme will be used to feed into these discussions.
7. Overall, it is notable that the Government has accepted the case made by stakeholders and supported by the LGA that the new needs assessment should aim to be simpler but without a disproportionate cost to fairness. Discussions about a much reduced number of formulae and cost drivers are a welcome recognition of the proposals made and concerns raised by councils.

8. The full list of consultation questions is attached as **Appendix A**. In summary, the consultation covers four key topics.
9. **The extent to which a single formula could be used to assess relative spending needs.** The consultation notes that there are a number of factors, such as the basic demographic characteristics of an area, which affect the cost of providing multiple services. Therefore, it is suggested that it may be possible to use a simple foundation formula to allocate funding to each type of local authority based solely on these cross-cutting or 'common' cost drivers. This approach would make the relative needs assessment much simpler.
10. However, there are significant limitations to this approach, due to the fact that some services are experiencing higher or unique spending pressures. The consultation notes that a single, simplified formula would also be subject to more Ministerial judgement and that the local government landscape is too complex for a simple, single formula to take account of, with multiple tiers and types of local authorities. The Government is not proposing that a simplified foundation formula is used to cover the whole relative needs assessment.
11. **Which services might require specific formulae to assess their relative spending needs.** As the single formula approach is likely to be too simplistic and not workable for the complex local government landscape, the consultation considers a 'mixed' option, with relative spending needs for certain services assessed on the basis of specific formulae, with relative spending needs for any remaining services considered on the basis of the single formula. The consultation lists six spending areas, which the Government assesses as being the most significant areas of spend or considers are affected by very specific cost drivers. These are being considered for specific formulae and the Government is inviting views on whether there should be more/less:
 - 11.1. Adult social care;
 - 11.2. Children's services;
 - 11.3. Highways maintenance and public transport;
 - 11.4. Waste collection and disposal;
 - 11.5. Fire and rescue services; and
 - 11.6. Historic supported capital borrowing (borrowing that was enabled by Government capital allowances prior to introduction of the prudential borrowing system in 2003).
12. The consultation also acknowledges that some duties, which only account for a small proportion of the overall expenditure of local government, can have a significant impact on individual authorities. It uses an example of flood defences as an example of such pressures. The consultation asks for suggestions on how these pressures could be factored into a simplified method of assessment, as well as for suggestions on what these locally significant pressures are.
13. It is worth noting that housing-related services are not explicitly mentioned in Government's consultation. Officers believe this is because the majority of housing spending and pressures are related to social landlord functions and capital spending pressures, both of which fall outside the remit of the Review. However, revenue

spending on temporary accommodation would fall within the scope of the Review, and associated funding would be distributed through the single 'foundation' formula (see paragraph 9) if a specific formula for housing services is not included in the assessment. Members might wish to consider including some commentary on this in the response.

14. **What cost drivers could be used in these formulae.** While ultimately the Government will look at statistical techniques to verify which cost drivers have the most impact on service spending, it is inviting stakeholders to comment on the 'starter list' of cost drivers. It will be from this list that statistical techniques will be used to select the final set of indicators used in the formulae. The list of potential indicators in the consultation document has been built on the basis of discussions between the joint LGA/DCLG Fair Funding Review technical working group and relevant Government departments. Appendix B provides a table with the proposed cost drivers for each of the formulae listed above.
15. **What techniques could be used to give weightings to different cost drivers as well as the formulae against one another.** At this stage, how to weight indicators within a particular formula has been left open to suggestion. The main contenders are:
 - 15.1. Regression based on past expenditure trends. This approach has attracted some criticism in the past due to the perception that it reinforces past funding levels. However, the Government is considering ways to "produce regression models that show the relationship between spending and cost drivers where all local authorities received the same level of funding per head". This would aim to isolate the impact of past funding levels.
 - 15.2. Small or multi-level modelling which look at population characteristics at ward (Lower Super-Output Area) level. These techniques do not attract the same criticism as past expenditure-based regression in that historic patterns of spend between authorities will not influence the results, but data collection is much more costly and time-consuming and the approach is more complex to explain. The Government is looking to use multi-level modelling in particular for adult social care and children's services elements of the assessment.
16. Finally, the different services areas and formulae would have to be weighted against one another which affects how much each service specific formula and the foundation formula each distribute. The consultation asks for proposals on how this could be done. One way of doing so which avoids Ministerial judgement would be to calculate this based on the spending levels on different services at a national level.
17. Officers welcome comments from members of the Board on the lines the LGA's draft response could take. The full list of questions is listed in **Appendix A** for reference and should be read with paragraphs 7 to 16 above.

Next steps

18. The deadline for consultation responses is 12 March 2018. The Business Rates Task and Finish Group will oversee the production of the draft LGA response, with LGA Leadership Board and Executive providing final clearance at its meetings on 7 and 8 March, respectively.

19. Officers are in the process of organising a series of regional workshops, which will be attended and co-delivered by DCLG colleagues, to discuss the consultation and councils' views in February and March 2018. These workshops will follow the previous two series of workshops in spring and autumn of 2017, attended by approximately 500 delegates.
20. Officers will proceed on the basis of the discussions at Leadership Board, Executive and the Business Rates Retention Task and Finish Group, as well as views expressed in the joint LGA/DCLG regional workshops on the Fair Funding Review.

Business Rates Retention

21. At the time of the provisional 2018/19 Local Government Finance Settlement, the Government announced that it will proceed with introducing 75 per cent business rates retention from April 2020. To achieve greater retention the following grants will be phased out and funded through business rates retention:
 - 21.1. Revenue support grant;
 - 21.2. Rural services delivery grant;
 - 21.3. Public health grant; and
 - 21.4. GLA transport capital grant.
22. Following this switch, English councils will collectively keep 75 per cent of any future growth in business rate income. The top-up and tariff mechanism will be retained, but will be reset at the point of implementation of greater retention and will take the Fair Funding Review into account.
23. The Government still needs to make a number of decisions about the design of the system before implementing greater business rates retention including:
 - 23.1. The split of business rates income between different tiers of local government;
 - 23.2. The future of the business rates levy on 'disproportionate growth';
 - 23.3. The level of, and the funding mechanism for, the safety net against business rates losses;
 - 23.4. Ways to minimise the uncertainty arising from business rates avoidance and appeals; and
 - 23.5. The extent and frequency of resets – prior to the General Election the Government was looking at partial resets, allowing local authorities to keep some of the growth accumulated directly.
24. The list above will be used to form the work programme of the joint DCLG/LGA officer-led Steering Group and technical working groups, most notably the systems design working group.
25. The Government also announced that 10 areas were successful in applying to pilot retention of 100 per cent of business rates growth in 2018/19 – Berkshire, Derbyshire, Devon, Gloucestershire, Kent & Medway, Leeds, Lincolnshire, Solent, Suffolk and Surrey.

26. The previous pilots have been extended for another year. The London pilot has also been expanded to include London boroughs as well as the Greater London Authority. This means that in 2018/19 there will be 16 business rates retention pilots in operation. The Government has committed to the pilots process continuing in 2019/20.
27. The LGA also submitted written evidence to the [business rates retention inquiry by the Communities and Local Government Select Committee](#). This will be published in due course according to usual House of Commons procedures.

Implications for Wales

28. There are no direct implications for Wales arising from this report. The funding of Welsh local authorities is a devolved matter in Wales.

Next steps

29. Officers will proceed on the basis of the discussions at Leadership Board, Executive and the Business Rates Retention Task and Finish Group, as well as views expressed in the joint LGA/DCLG regional workshops on the Fair Funding Review.
30. Members of Leadership Board and Executive will be provided with a final draft Fair Funding Review consultation response for comments and clearance on 7 and 8 March 2018, respectively.
31. The LGA will continue to work closely with the Government on further business rates retention and the Fair Funding Review, including responding to future consultations and technical discussion papers.

Financial implications

32. With the exception of the work mentioned in paragraph 6, for which additional funding has been agreed by the Leadership Board, the work is part of the LGA's core programme of work and as such has been budgeted for in 2017/18 budgets.

Appendix A – List of all Fair Funding Review consultation questions

General

1) What are your views on the Government's proposals to simplify the relative needs assessment by focusing on the most important cost drivers and reducing the number of formulas involved?

Single 'foundation' formula and constituent cost drivers (see **Appendix B** for full list)

2) Do you agree that the Government should use official population projections in order to reflect changing population size and structure in areas when assessing the relative needs of local authorities?

3) Do you agree that these population projections should not be updated until the relative needs assessment is refreshed?

4) Do you agree that rurality should be included in the relative needs assessment as a common cost driver?

5) How do you think we should measure the impact of rurality on local authorities' 'need to spend'? Should the relative needs assessment continue to use a measure of sparsity or are there alternative approaches that should be considered?

6) Do you agree that deprivation should be included in the relative needs assessment as a common cost driver?

7) How do you think we should measure the impact of deprivation on 'need to spend'? Should the relative needs assessment use the Index of Multiple Deprivation or are there alternative measures that should be considered?

8) Do you have views on other common cost drivers the Government should consider? What are the most suitable data sources to measure these cost drivers?

9) Do you have views on the approach the Government should take to Area Cost Adjustments?

10a) Do you have views on the approach that the Government should take when considering areas which represent a small amount of expenditure overall for local government, but which are significant for a small number of authorities?

10b) Which services do you think are most significant here?

Service-specific formulae and proposed cost drivers (see **Appendix B** for full list)

11a) Do you agree the cost drivers set out above are the key cost drivers affecting adult social care services?

11b) Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting adult social care services?

12a) Do you agree that these are the key cost drivers affecting children's services?

12b) Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting children's services?

13a) Do you agree that these are the key cost drivers affecting routine highways maintenance and concessionary travel services?

13b) Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting routine highways maintenance or concessionary travel services?

14a) Do you have views on what the most suitable cost drivers for local bus support are?

14b) Do you have views on what the most suitable data sets are to measure the cost drivers for local bus support?

15a) Do you agree that these are the key cost drivers affecting waste collection and disposal services?

15b) Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting waste collection and disposal services?

16a) Do you agree these remain the key drivers affecting the cost of delivering fire and rescue services?

16b) Do you have views on which other data sets might be more suitable to measure the cost drivers for fire and rescue services?

17a) Do you agree these are the key cost drivers affecting the cost of legacy capital financing?

17b) Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting legacy capital financing?

18a) Are there other service areas you think require a more specific funding formula?

18b) Do you have views on what the key cost drivers are for these areas, and what the most suitable data sets are to measure these cost drivers?

Weightings of cost drivers and services against one another

19) How do you think the Government should decide on the weights of different funding formulas?

20) Do you have views about which statistical techniques the Government should consider when deciding how to weight individual cost drivers?

21) Do you have any comments at this stage on the potential impact of the options outlined in this consultation document on persons who share a protected characteristic? Please provide evidence to support your comments.

Appendix B – List of proposed formulae and ‘starter’ cost drivers

Service/spending area	Proposed ‘starter’ cost drivers
Adult social care	Number of adults by age groups Number of adults with income and wealth that meet the means test Number of people with higher levels of impairment Number of people who live alone Sparsity Area Cost Adjustment – to be considered
Children’s services	Number of children (under 18 years of age) Number of children for whom parents receive Disability Living Allowance Deprivation Distance to schools Area Cost Adjustment – to be considered
Highways Maintenance and Public Transport	Road length Traffic flow Forecast snow days / predicted grit days Concessionary bus boardings (need to also consider cost drivers for local bus support outside of London) Area Cost Adjustment – to be considered
Waste collection and disposal	Number of households Types of property Travel times Deprivation Area Cost Adjustment – to be considered

Service/spending area	Proposed 'starter' cost drivers
Fire and Rescue Services	<p>Projected population – A basic amount of funding per resident</p> <p>Adjustments:</p> <ul style="list-style-type: none"> Coastline Population Density Population Sparsity Risk index – A measure of deprivation Control of Major Accident Hazards (COMAH) sites Property and Societal Risk Community Fire Safety Area Cost Adjustment for Fire and Rescue
Legacy Capital Financing	<p>Outstanding debt – The remaining proportion of debts still outstanding based on the initial value of the relevant debts and assumed capital repayments, and</p> <p>Interest Rates – An assumed rate of interest that may be chargeable on the outstanding debt until the principal is fully repaid.</p>
Single 'foundation' formula for everything else	<ul style="list-style-type: none"> Population Deprivation Sparsity Area Cost Adjustment – to be considered