Fair Funding Review and Business Rates Retention Update

**Purpose**

For information anddiscussion.

**Summary**

This report updates members on progress of the LGA’s work related to the Fair Funding Review and business rates retention reform. In particular, it provides a more detailed update on the delivery of the LGA’s additional work programme on the Fair Funding Review and seeks member approval for the use of LGA reserves to commission modelling on business rates retention.

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| **Recommendation**That the LGA Leadership Board:1. Note the update on the LGA’s Fair Funding Review business rates retention work programme.
2. Comment on and approve the proposed template for evaluating future Fair Funding Review proposals made by the Government or other stakeholders as set out in paragraphs 5 - 8 and **Appendix B**.
3. Endorse the view of the Task and Finish Group to support the use of population projections in the relative needs formulae as set out in paragraphs 14 and 15.
4. Delegate to the LGA Chairman and Group Leaders sign-off of the final versions of relative needs and relative council tax models as set out in paragraphs 18 – 22.
5. Approve the use of LGA reserves for the commissioning of a business rates retention model as set out in paragraphs 27 - 31.
6. Note the forward plan of the meetings of the LGA Fair Funding Review and Business Rates Retention Task and Finish Group as set out in **Appendix C**.

**Action**Officers to proceed as directed. |

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Fair Funding Review and Business Rates Retention Update

**Introduction**

1. This report updates members on progress of the LGA’s work related to the Fair Funding Review and business rates retention reform.
2. In particular, it provides a more detailed update on the delivery of the LGA’s additional work programme on the Fair Funding Review and seeks member approval for the use of LGA reserves to commission modelling on business rates retention.

**Fair Funding Review**

Delivery of the LGA’s additional Fair Funding Review work programme

1. At the November meeting, LGA Leadership Board agreed an additional work programme on the Fair Funding Review.
2. A quick summary of the programme deliverables, and the progress against those deliverables, is set out in **Appendix A**. The following paragraphs expand on the summary table.
3. **Criteria for evaluating emerging proposals.** Following discussions at the LGA’s Leadership Board and Executive, members agreed to the production of a set of criteria against which the LGA could evaluate proposals emerging from the Fair funding Review.
4. Officers worked with the LGA Fair Funding Review and Business Rates Retention Task and Finish Group to agree the criteria against which models should be assessed and to turn these into an evaluation template to be used as part of the assessment process. The criteria include:
	1. Simplicity, transparency and accuracy;
	2. Principles of good formula design, such as future-proofing, minimal use of judgement, completeness and robustness of data; and
	3. Distributional consequences, including the maximum shifts in funding levels for any one local authority covered by the Fair Funding Review.
5. If agreed by LGA Leadership Board, this template could be used by officers and the LGA’s Task and Finish Group to evaluate future proposals and provide recommendations to members of Leadership Board and Executive on whether the model, or aspects of it, could be supported by the LGA.
6. The template is attached as **Appendix B**. Officers are seeking comments on and approval of this template by Leadership Board.
7. **Assessment of how far relative needs change over time.** One of the key questions for the fair funding review is how often the needs assessment should be reset, and to what extent can population projections (as opposed to static population figures) be used in the assessment. In particular, the Government’s most recent consultation document asked for views on whether population projections should be used.
8. There is a balance to be struck between reflecting needs and rewarding growth and efficiency, and in order to set an appropriate balance it is important to understand potential implications of these design choices. The primary purpose of this particular part of the work programme was to estimate how much relative needs of local authorities can change over a period of time.
9. With input from the LGA, the University of Essex reviewed the data that was used in the funding formula system in 2013/14. This is the point at which the needs baseline was set and was used to fix tariffs and top ups (other than being updated by inflation each year) until the point of a reset. Colleagues from the University examined the potential to update the underlying data without changing the weightings in the formulae.
10. There were significant constraints on availability of data. In particular, much of the information in the 2013 formulae came from sources that no longer exist, or were based on one-off modelled datasets which had not been refreshed by the Government since. One example would be the welfare statistics which are no longer collected due to the introduction of Universal Credit. As a result, the main focus was on refreshing population data.
11. Within this context, the results of the University of Essex analysis suggest that updating the population indicators in the old formulae would have delivered a change in relative needs shares (prior to adjusting for council tax/transition/damping) for individual councils within a range of an increase of 19 per cent, and a drop of up to 17 per cent. For 56 per cent of authorities, the change would have been within plus or minus 4 per cent. For 35 per cent of authorities the change is greater than 5 per cent in either direction.
12. The Fair Funding Review and Business Rates Task and Finish Group noted the caveats to this analysis due to data availability. However, it expressed a preference for using population projections in the formula to try and account for future divergence of needs. This would in effect mean that tariffs and top ups are different each year but this is known at the start of the reset period.
13. One alternative would be to change the formula and tariffs and top ups every year, which members of the Group thought would create too much uncertainty. Alternatively, the data could be fixed at a certain point in time as in the current system. The Task and Finish Group felt this would mean the system is not sufficiently responsive to expected future demand changes.
14. Members of Leadership Board are asked to endorse the view of the Task and Finish Group as set out in paragraphs 14 and 15 above.
15. The University of Essex will publish a working paper setting out detailed analysis and recommendations. Rather than being a report produced on behalf of the LGA, it is a product of the University of Essex. LGA officers provided advice on the methodological approach and suggested points of focus and will share the final report with members when published. This work was carried out at no cost to the LGA.
16. **Relative needs assessment and relative resources assessment models.** As agreed at Leadership Board the LGA has commissioned two separate models:
	1. A needs distribution model to allow local authorities to see the impact of different key cost drivers and differential weightings within a needs formulae;
	2. A council tax equalisation model to identify the impact of adjustments for council tax and council tax support on individual authorities.
17. These models will provide member authorities with a set of tools to evaluate the impact of future proposals or to enable them to build proposals of their own. The LGA will also use these tools to see if we can reach agreement on some of these issues.
18. The LGA has appointed TRL Insight to deliver both of these models. Most of the work is being delivered in the 2017/18 financial year and is being funded from within existing budgets. Any cost falling in 2018/19 will require the use of reserves which has previously been agreed by Leadership Board and Executive. The total cost of delivering both models is £14,000 plus expenses although any revisions to the models as a result of suggestions my members would be on top of this. We would not expect these costs to be significant.
19. Officers are looking into the possibility of hosting a webinar for members of the LGA Fair Funding Review and Business Rates Retention Task and Finish Group and would take the recommendations of members into account when finalising the models.
20. Member authorities are keen to see these models. To that end it is recommended that Leadership Board delegate the final sign-off of the models to the LGA Chairman and Group Leaders.
21. **Modelling of damping / transition options.** This piece of work will explore different ways in which local authorities could move from their current funding baseline to the new one resulting from the outcome of the Fair Funding Review. This work will be commissioned shortly and, as agreed by Leadership Board in November, will be funded from LGA reserves.

Other Fair Funding Review updates

1. The LGA has submitted [its response](https://www.local.gov.uk/sites/default/files/documents/LGA%20Response%20to%20FFR%20needs%20consultation%20-%20Mar%202018.pdf) to the [Government’s consultation on the Fair Funding Review](https://www.gov.uk/government/consultations/fair-funding-review-a-review-of-relative-needs-and-resources). The response was cleared by LGA Leadership Board and Executive, under advice from the LGA Fair Funding Review and Business Rates Retention Task and Finish Group.
2. As part of the consultation process, LGA officers organised a series of regional events in partnership with MHCLG officials. Over 200 delegates attended the six events and their views have been fed into the consultation process directly.
3. The officer-led Fair Funding Review Technical Working Group met on 28 March. It discussed the treatment of council tax income, progress on a specific adult social care relative needs formula and the progress of the DfE/MHCLG research into a children’s services formula. Papers and a short summary of the meeting are available on [the LGA business rates hub](https://www.local.gov.uk/topics/finance-and-business-rates/business-rates-retention). The LGA Task and Finish Group will discuss the treatment of council tax in more detail in an upcoming meeting (see below for a full work plan). This will also be discussed at a future meeting of the MHCLG / LGA Steering Group.

**Business rates retention**

Commissioning a business rates retention model

1. Over the coming months, the Government is planning to publish a number of technical discussion papers on the design of the 75 per cent business rates retention system. Comments on these will feed into a full technical consultation in late 2018.
2. This would involve the Government asking for stakeholder input on issues such as:
	1. The setting and measurement of business rates baselines;
	2. The extent and frequency of business rates resets;
	3. Dealing with losses due to appeals;
	4. The level of the safety net and how it is funded; and
	5. The split of business rates income in two-tier areas.
3. In order to be able to evaluate the impact of decisions in each of the individual areas set out above, and how they interact with one another, a complex business rates retention model is required.
4. Such a model would allow LGA officers to quickly evaluate emerging proposals on the design of further business rates retention as well as provide more informed analysis to members when considering the LGA’s own position. It could also be shared with member authorities, in a similar fashion as the relative needs and relative council tax models described above.
5. Due to constraints on the LGA’s own staff resource, officers are seeking LGA Leadership Board approval to use LGA reserves to finance the commissioning of this piece of work. The cost of this work would fall within the delegated authority limit. In addition, due to savings made in the Fair Funding work outlined above this work is mostly being covered by underspends in 2017/18 budgets. We would expect the business rates retention research (and the transition modelling work) to come within the budget envelope originally assumed for the Fair Funding work.

Other business rates retention updates

1. The Secretary of State for Housing, Communities and Local Government published a [Written Ministerial Statement](http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-03-20/HCWS569/) setting out an error made in calculating the size of the allocations of the specific grant to compensate local authorities for caps of the business rates multiplier. This affects 2017/18 and 2018/19 business rate retention pilot authorities.
2. The 2017/18 pilot authorities received £36 million more in compensation in 2017/18 than they should have under the correct methodology. The Government has confirmed it will not be seeking to claw back the extra funding for 2017/18. However, adjustments will be made to funding for pilot areas for 2018/19. We are in contact with pilot authorities and the Government to better understand the implications of this for councils’ 2018/19 budgets.

1. As previously reported, the Business Rates Retention Steering Group continues to meet regularly to oversee the programme of further business rates retention, including the introduction of 75 per cent business rates retention in April 2020, longer term issues for the introduction of 100 per cent retention which will require primary legislation, and the Fair Funding Review work. Working under the Steering Group, the Systems Design Working Group has begun detailed consideration of the issues.
2. The most recent meeting of the Systems Design Working Group on the 21st March considered a DCLG paper on reform of the safety net, the future of the levy and the split of business rates between tiers. Officers will discuss this topic with the Task and Finish Group in its July meeting (see below for a full forward plan of meetings).
3. MHCLG will work directly with the County Councils Network, the District Councils Network and county and district treasurer associations, on developing a proposal for a future tier split for consideration by the Working Group and Steering Group.
4. Further discussions at the Systems Design Working Group leading up to a consultation paper later in 2018 will concern appeals and loss payments, resets, measuring growth and revaluation, transitional arrangements and pooling, data and accounting and operationalisation.
5. During its March meeting, the Steering Group considered proposals on the central and local list which will culminate in a separate consultation paper early next year, and retained growth in business rates for 2018/19, which the Government estimated as £1.3 billion above the baseline at a national level. MHCLG were asked to provide further information on trends in retained business rates, the effect of the levy and pools on retained rates. This more complete work will be published on the LGA website when it is available.

**Fair Funding Review and Business Rates Task and Finish Group forward plan**

1. The Fair Funding Review and Business Rates Task and Finish Group met on 8 March.
2. In addition to the matters covered in paragraphs 9 – 17 above, it discussed the forward plan for its own meetings. It has been prepared on the basis of the officers’ estimation of publication dates of various Government discussion documents and consultations. The meeting dates in the 2018/19 political cycle would continue to be linked to the dates of meetings of the LGA Executive.
3. The forward plan is attached as **Appendix C** for information. It is subject to change depending on any shifts in the officers’ assessment of the timescales of the work of the Government.

**Recommendations and next steps**

1. Members of Leadership Board are asked to:
	1. Note the update on the LGA’s Fair Funding Review business rates retention work programme.
	2. Comment on and agree the proposed template for evaluating future Fair Funding Review proposals made by the Government or other stakeholders as set out in paragraphs 5 - 8 and **Appendix B**.
	3. Endorse the view of the Task and Finish Group to support the use of population projections in the relative needs formulae as set out in paragraphs 14 and 15.
	4. Delegate to the LGA Chairman and Group Leaders the sign-off of the final version of relative needs and relative council tax measurement models, prior to sharing with councils, as set out in paragraphs 18 – 22.
	5. Approve the use of LGA reserves for the commissioning of a business rates retention model as set out in paragraphs 27 - 31.
	6. Note the forward plan of the meetings of the LGA Fair Funding Review and Business Rates Task and Finish Group as set out in **Appendix C**.
2. Officers will proceed on the basis of the discussions at Leadership Board.
3. The LGA will continue to work closely with Government on further business rates retention reform and the Fair Funding Review, including responding to future consultations and technical discussion papers.

**Implications for Wales**

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

**Financial implications**

1. Members of Leadership Board have previously approved spending of LGA reserves on the additional LGA work programme on the Fair Funding Review if required. So far, most of the work has been delivered within the agreed LGA budget for 2017/18 by using underspends.
2. The recommendation set out in paragraph 42.5 asks the LGA Leadership Board to approve the use of LGA reserves to finance the commissioning of a business rates retention model. We would expect the business rates retention research (and the transition modelling work) to come within the cost envelope originally assumed for the Fair Funding Review work.
3. Other work outlined in the paper above is part of the LGA’s core programme of work and as such has been budgeted for in 2017/18 and 2018/19 budgets.

**Appendix A**

**High-level progress update on the additional LGA Fair Funding Review work programme**

| **Project** | **Purpose and description** | **Quick update** |
| --- | --- | --- |
| Key criteria for assessing proposed distribution models and methodologies  | To give the LGA a structured and consistent way to assess new distribution models. | Final version in **Appendix B** for LGA Leadership Board comment and approval |
| Formula grant: update the data | Update the data in the current distribution model (where updated data is available) to see the impact of this on individual allocations separate to any methodology changes. In effect this would provide an updated baseline to inform a discussion on how long the formulae remain ‘future proof’ without any review of weightings.To help the LGA and member authorities form policy on the data used in the formulae and the frequency of distribution resets, or other ways to ‘future proof’ the mechanism. | Key findings of the work of the University of Essex are covered in paragraphs 9-17. Rather than being a report produced on behalf of the LGA, it is a product of the University of Essex. LGA officers provided advice on the methodological approach and suggested points of focus. Officers will share the final report with members when published. This has been delivered at no cost to the LGA.  |
| Distribution model: develop a distribution model | A model to allow local authorities to see the impact of different key cost drivers and differential weightings. To help the LGA and member councils evaluate the impact of various Government and stakeholder proposals on their council and to allow them to put forward their own proposals | Supplier appointed; expect this to be delivered in the middle of April, with a potential webinar for the LGA Fair Funding Review and Business Rates Retention Task and Finish Group in April or May. Total cost together with the council tax model is below £14,000 plus expenses, with the majority of the cost included within the 2017/18 LGA core programme budget.  |
| Council tax equalisation: develop an equalisation model | A model to identify the impact of adjustments for council tax and council tax support on individual authorities.To inform LGA policy and to help individual member councils evaluate Government proposals.  | Supplier appointed; expect this to be delivered in the middle of April, with a potential webinar for LGA Fair Funding Review and Business Rates Retention Task and Finish Group in April or May. Total cost together with the council tax model is below £14,000 plus expenses, with the majority of the cost included within the 2017/18 LGA core programme budget. |
| Damping/transition mechanisms  | An analysis of historic damping / transition mechanisms and a model to inform discussions on the guiding principles of transition. To inform LGA and member authorities’ policy. | To be commissioned. |

**Appendix B**

**Revised Fair Funding Review proposal evaluation form**

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| **Fair Funding ReviewProposal Evaluation Form** |
| Name of proposal |   |
| Proposed by |   |
| Proposal produced on |   |
| Any useful links |   |
| General description |
| *To include commentary on how needs and resources are reflected.*  |
| Key strengths |
|   |
| Key weaknesses |
|   |
| Simplicity and transparency |
| Number of formulae |   |
| Services covered by the formulae |   |
| Number of cost drivers used in total |   |
| Does the model calculate final allocations transparently? (1 – strongly disagree, 5 – strongly agree) |   |
| *Comments* |
| Completeness |
| Does the needs assessment account for all relevant types of authority? (y/n) |   |
| Is there a resources adjustment calculation for each authority or a deliberate exclusion of a resources adjustment? (y/n/ not applicable) |   |
| Are there exemplifications available for all local authorities covered by the Fair Funding Review? (y/n) |   |
| *Comments* |
| Credibility and future proofing |
| Data used is up-to-date (1 - strongly disagree, 5 - strongly agree) |   |
| *Comments*  |
| Data used is easy to update in the future (1 - strongly disagree, 5 - strongly agree) |   |
| *Comments*  |
| It is clear if and where judgement has been used and the reasons for doing so (1 - strongly disagree, 5 - strongly agree) |   |
| *Comments*  |
| There is little judgement in the system(1 - strongly disagree, 5 - strongly agree) |   |
| *Comments*  |
| Data is not subject to historic fluctuations (1 - strongly disagree, 5 – strongly agree) |   |
| *Comments*  |
| Model considers ways to future-proof the system (1 - strongly disagree, 5 - strongly agree) |   |
| *Comments*  |
| Data used in the model cannot be affected by council policy decisions (1 – strongly disagree, 5 – strongly agree) |  |
| *Comments* |
| Number of positive answers on completeness (out of 3) |  |
| Average score |   |
| Criteria scoring '2' |   |
| Criteria scoring '1' |   |
| *Comments on potential incentives that the model will provide (positive and perverse)* |
| *Any further comments* |
| Distributional impact |
| Maximum percentage reduction for any one authority |   |
| Maximum percentage increase for any one authority |   |
| Authority type | Highest percentage change | Lowest percentage change | Average percentage change |
| Shire countiesShire districtsEnglish unitariesMetropolitan districtsLondon boroughsFire and rescue authoritiesGreater London AuthorityCombined authorities |  |  |   |
| Authority region | Highest percentage change | Lowest percentage change | Average percentage change |
| LondonSouth EastSouth WestNorth EastNorth WestEast MidlandsWest MidlandsYorkshire and HumbersideEast of England |  |   |   |
| Conclusion |
| *Final general comments* |
| Suitable for discussion at Leadership Board and Executive? (Yes/No) |   |
| *If no, comments on what could be improved* |
| Reviewed by |   |

**Appendix C**

**Draft forward plan for the Task and Finish Group**

At all meetings a general progress update will be given on business rates retention and the Fair Funding Review where this is not covered by the papers below.

|  |  |  |
| --- | --- | --- |
| **Date (subject to change)** | **Business rates retention** | **Fair Funding Review**  |
| **Late April (webinar)** |  | **Update on LGA commissioned work** on the relative needs distribution model and council tax equalisation model.  |
| **7 June 2018** | **Central and local rating lists** To provide an update on the Government’s work and next steps, and to get a steer from the Group on the LGA’s position on how properties are allocated | **Further discussion on council tax adjustments** To review the Government’s discussion paper if published, with a view to inform an LGA policy response in the light of the LGA’s commissioned resources adjustment scenario model |
| **19 July 2018** | **Tier splits, safety net and levy payment**To review MHCLG research on how different tier splits impact on safety net and levy payments.**Appeals provision**To revisit MHCLG work and LGA policy on how business rates appeals costs should be funded in the 75% system. | **Area Cost Adjustments.** To review the Government’s discussion paper if published, with a view to inform an LGA response |
| **September 2018** | **Business rates retention to date and resets** Toshare analysis of how much individual local authorities have retained/lost in business rates above baseline since the introduction of 50% retention; andTo revisit LGA policy covering business rates and fair funding review resets after 2020 implementation | **Transition between funding baselines.** To review the Government’s discussion paper if published, with a view to inform an LGA policy response on the basis of the commissioned transition scenario model |
| **October 2018** | **The Government’s consultation on System Design issues in75 per cent retention**To discuss the consultation and inform the LGA’s response. |  |

*NB. This plan is based on the current assessment of the likelihood and timing of various Government consultation documents, discussion papers, and likely topics of the meetings of technical working groups. As such this is subject to change.*