

Fair Funding Review and Business Rates Retention Update

Purpose

For comment.

Summary

This report updates members on progress on the Fair Funding Review and Business Rates Retention reform. In particular, it provides a detailed update on the delivery of the LGA's work programme on the Fair Funding Review since the March 2018 meeting of LGA Executive.

Recommendation

That members of LGA Executive comment on this update.

Action

Officers to proceed with delivery of the LGA work programme on business rates retention and the Fair Funding Review in line with comments from the LGA Executive.

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Fair Funding Review and Business Rates Retention Update

Introduction

1. This report updates members on progress on the Fair Funding Review and Business Rates Retention reform, since the March meeting of the LGA Executives. In particular, it provides a detailed update on the delivery of the LGA's work programme on the Fair Funding Review.
2. Since the previous meeting of the LGA Executive, James Brokenshire MP has become the Secretary of State for Housing, Communities and Local Government. At the time of writing, this has not resulted in a change to the Government's work on these two reforms.

Fair Funding Review – delivery of the Fair Funding Review programme

3. The high level update on the deliverables of the LGA Fair Funding Review work programme is attached as **Appendix A** and the following paragraphs provide more detail.

Criteria for evaluating future Fair Funding Review proposals

4. Following discussions at the LGA's Leadership Board and Executive in November 2017, members agreed to the production of a set of criteria against which the LGA could evaluate proposals emerging from the Fair funding Review.
5. Officers worked with the LGA Fair Funding Review and Business Rates Retention Task and Finish Group ('Task and Finish Group') to develop 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 template was agreed by the LGA Leadership Board during its April 2018 meeting. The template is attached as **Appendix B**.
6. It will be used by officers and the LGA's Task and Finish Group to evaluate future proposals emerging from the Fair Funding Review and provide recommendations to members of Leadership Board and Executive on whether the model, or aspects of it, could be supported by the LGA.
7. The criteria include, but are not limited to:
 - 7.1. Simplicity, transparency and accuracy;
 - 7.2. Principles of good formula design, such as future-proofing, minimal use of judgement, completeness and robustness of data; and
 - 7.3. Distributional consequences, including the maximum shifts in funding levels for any one local authority covered by the Fair Funding Review.

Divergence of relative needs over time and use of population projections

8. One of the questions for the Fair Funding Review is how often the needs assessment should be reset. Related to this is 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.
9. With input from the LGA, the University of Essex reviewed the data that was used in the funding formula system in 2013/14, the point at which the needs baseline was set and 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 to estimate how much relative needs of local authorities can change over a period of time.
10. There were significant constraints on the 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. For example, a number of welfare statistics were not available 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 provided to LGA Leadership Board suggested 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 considered a number of alternative options and 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. During their April 2018 meeting, members of Leadership Board endorsed the view of the Task and Finish Group. Since this meeting, the University of Essex was able to access data from the schools census and update that in the formulae. This led to even greater divergence of relative needs than was previously presented to LGA Leadership Board and the Task and Finish Group. The greater divergence further reinforces the Leadership Board's decision to use population projections in the formulae.
14. The University of Essex has published 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.

15. LGA officers presented these two pieces of work to a meeting of the LGA/MHCLG joint technical working group on the Fair Funding Review in May and they are now on the [LGA business rates retention hub](#). This work was well received by members of the group.

Relative needs assessment and council tax adjustment models

16. As agreed at Leadership Board the LGA has commissioned two separate models:

- 16.1. A needs distribution model to allow local authorities to see the impact of different cost drivers and differential weightings within needs formulae;
- 16.2. 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. In March 2018, The LGA appointed TRL Insight to deliver both of these models, and members of the LGA Business Rates Retention and Fair Funding Review Task and Finish Group will receive a demonstration of the two models at its June meeting. Following this, the LGA Leadership Board agreed that the Chairman and Group Leaders will provide final clearance for these technical models to be shared with all member authorities.

Transition options appraisal

19. As agreed at previous meetings of the LGA's Leadership Board and Executive, officers have started the commissioning process for an analysis of ways in which the transition from the current pattern of funding to the one implied by the Fair Funding Review results could work. This will help member authorities and the LGA develop policy on this issue.

Fair Funding Review technical working group update

20. The officer-led Fair Funding Review Technical Working Group has met twice since the March meeting of LGA Executive.

21. Over the course of the two meetings the group discussed:

- 21.1. Factors to consider when taking council tax income into account such as council tax support. The LGA Task and Finish Group will discuss the treatment of council tax in more detail at its next meeting. This will also be discussed at a future meeting of the MHCLG / LGA Steering Group.

- 21.2. An adult social care relative needs formula based on work commissioned by the Government in 2013. This work took place in parallel to the research to develop a distribution formula for funding of new burdens of the 2015 Care Act, and the implementation of a cap on costs of care. Officials from the Department for Health and Social Care are undertaking a peer review of the research and LGA officers expect to see this work published later in 2018.
- 21.3. Progress of the recently commissioned DfE/MHCLG research into a children's services formula.
- 21.4. A draft summary paper from MHCLG on the key issues that were raised during the consultation on relative needs which was published in December 2017. The overall pattern of responses was reflective of the LGA's own response. For example, stakeholders stressed the importance of transparency and fairness, noted the need to explore the inclusion of a specific formula for non-HRA housing services, to consider inclusion of both population density and population sparsity in funding formulae where there is an evidence base to do so, and to 'sense check' the results of the statistical analysis with service delivery experts.
- 21.5. A paper from the Department for Health and Social Care on the Public Health Grant. The Department's current preferred approach is to use the funding formula which was consulted on, but never implemented, in 2016. The Advisory Committee on Resource Allocation will review the case for this model. It was agreed that this work needs to be more closely aligned with the Fair Funding Review.
- 21.6. A fire and rescue formula, which is being created through a partnership of the National Fire Chiefs' Council, the Home Office and MHCLG officers.
- 21.7. As noted above, an update on the LGA's Fair Fund Review work programme, in particular the evaluation template and the work on divergence of relative needs.

The next steps of the Fair Funding Review

22. The Government's work is building towards a wider consultation on the Fair Funding Review, expected in autumn 2018. The consultation is likely to cover:
 - 22.1. The Government's preferred options for the relative needs assessment, in particular the foundation formula and the number and types of service-specific formulae including the cost drivers being explored for each of the formulae.
 - 22.2. The Government's emergent thinking on adjusting for relative resources.
 - 22.3. Potentially, initial thoughts on the transition mechanism.

23. This is in line with the LGA's work programme on the Fair Funding Review, with the core LGA work programme and meetings of the Business Rates Retention and Fair Funding Review Task and Finish Group all helping explore policy options ahead of the publication of the consultation document.

Business rates retention

Commissioning a business rates retention model

24. As part of the work of the officer-level systems design technical working group, the Government is publishing a number of technical 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.

25. This would involve the Government asking for stakeholder input on issues such as:

25.1. The setting and measurement of business rates baselines.

25.2. The extent and frequency of business rates resets.

25.3. Dealing with losses due to appeals.

25.4. The level of the safety net and how it is funded.

25.5. The split of business rates income in two-tier areas.

26. During the April 2018 meeting of the LGA Leadership Board, members agreed to the commissioning of a business rates retention to allow the LGA and member authorities to assess the impact of a number of system design issues. Officers are in the process of commissioning this work. Further updates will be given to LGA Leadership Board and Executive as the work develops.

Other business rates retention updates

27. The Secretary of State for Housing, Communities and Local Government published a [Written Ministerial Statement](#) 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.

28. 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 have been made to funding for pilot areas for 2018/19.

29. The Business Rates Retention Steering Group continues to meet regularly to oversee the programme of further business rates retention and the Fair Funding Review. Working under the Steering Group, the Systems Design Working Group has begun detailed consideration of the issues. Since the last meet of Executive the groups have discussed:

- 29.1. Proposals on the central and local lists which will culminate in a separate consultation paper early next year;
 - 29.2. Retained growth in business rates in 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.
 - 29.3. Tier splits, safety nets and levies in the 75 per cent system. MHCLG is working 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.
 - 29.4. Funding appeals centrally. MHCLG is seeking views on a paper on dealing with appeals which appears to suggest that there is concern about the level of complexity within the business rates retention system and that, though addressing appeals losses is desirable, the level of complexity created will need to remain a consideration. As the impact of appeals on local authorities is one of the key concerns with the business rates retention system, we are encouraging all authorities to respond to the MHCLG request for comments by 1 July 2018. We have brought this to the attention of our members through the Chief Executives and Chairman's bulletins and the LGA Finance bulletin in May. The LGA is also seeking opportunities to stress the importance of finding a better way to deal with the impact of appeals directly with Government.
30. Further discussions at the Systems Design Working Group leading up to a consultation paper later in 2018 will concern resets, measuring growth and revaluation, transitional arrangements and pooling, data and accounting and operationalisation.
 31. MHCLG is expected to publish a prospectus shortly inviting bids for 2019/20 pilots. At this stage no further details are known. MHCLG is working with 17/18 and 18/19 pilots to consider their experiences and will be commissioning external work on lessons to be learnt from the existing pilots.
 32. Officers have continued to press MHCLG colleagues to provide feedback to areas which were unsuccessful in their bids to become a 2018/19 pilot.

Implications for Wales

33. 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

34. Members of Leadership Board have previously approved spending of LGA reserves on the LGA work programme on the Fair Funding Review and commissioning of a business rates model.

35. 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 LGA Fair Funding Review and Business Rates Retention work programme

Project	Purpose and description	Quick update
Criteria for assessing proposed distribution models and methodologies	To give the LGA a structured and consistent way to assess new distribution models.	Complete
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.	Complete
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	Demonstration to the members of the Business Rates Retention and Fair Funding Review Task and Finish Group in June Final clearance by LGA Chairman and Group Leaders shortly thereafter
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.	Demonstration to the members of the Business Rates Retention and Fair Funding Review Task and Finish Group in June Final clearance by LGA Chairman and Group Leaders shortly thereafter
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.	Request for quotation published, suppliers invited to bid
Business Rates Retention model	A model to enable LGA and local authorities to assess the impact of system design choices in areas including: <ul style="list-style-type: none"> • The setting of business rates baselines; • The extent and frequency of business rates resets; • Dealing with losses due to appeals; • The level of the safety net and how it is funded; and • The split of business rates income in two-tier areas. 	Commissioning process started.

Appendix B. Proposal Evaluation Form

Fair Funding Review Proposal Evaluation Form	
Name of proposal	
Proposed by	
Proposal produced on	
Any useful links	
General description	
<i>To include commentary on how needs and resources are reflected.</i>	
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)	
Is the proposed model easy to explain to a member of the public? (1 – strongly disagree, 5 – strongly agree)	
<i>Comments</i>	
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 exemptions available for all local authorities covered by the Fair Funding Review? (y/n)	
<i>Comments</i>	
Credibility and future proofing	
Data used is up-to-date (1 - strongly disagree, 5 - strongly agree)	
<i>Comments</i>	
Data used is easy to update in the future (1 - strongly disagree, 5 - strongly agree)	
<i>Comments</i>	
It is clear if and where judgement has been used and the reasons for doing so (1 - strongly disagree, 5 - strongly agree)	
<i>Comments</i>	
There is little judgement in the system(1 - strongly disagree, 5 - strongly agree)	
<i>Comments</i>	
Data is not subject to historic fluctuations (1 - strongly disagree, 5 -	

strongly agree)			
<i>Comments</i>			
Model considers ways to future-proof the system (1 - strongly disagree, 5 - strongly agree)			
<i>Comments</i>			
Data used in the model cannot be affected by council policy decisions (1 – strongly disagree, 5 – strongly agree)			
<i>Comments</i>			
Number of positive answers on completeness (out of 3)			
Average score			
Criteria scoring '2'			
Criteria scoring '1'			
<i>Comments on potential incentives that the model will provide (positive and perverse)</i>			
<i>Any further comments</i>			
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 counties			
Shire districts			
English unitaries			
Metropolitan districts			
London boroughs			
Fire and rescue authorities			
Greater London Authority			
Combined authorities			
Authority region	Highest percentage change	Lowest percentage change	Average percentage change
London			
South East			
South West			
North East			
North West			
East Midlands			
West Midlands			
Yorkshire and Humberside			
East of England			
Conclusion			
<i>Final general comments</i>			
Suitable for discussion at Leadership Board and Executive? (Yes/No)			

If no, comments on what could be improved

Reviewed by