

REPORT TO:	FINANCE AND MANAGEMENT COMMITTEE	AGENDA ITEM: 10
DATE OF MEETING:	13th JUNE 2019	CATEGORY:
		DELEGATED
REPORT FROM:	STRATEGIC DIRECTOR (CORPORATE RESOURCES)	OPEN
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SUBJECT:	THE FAIR FUNDING REVIEW	
WARD(S) AFFECTED:	ALL	TERMS OF REFERENCE: FM 08

1.0 Recommendations

- 1.1 That the response to the Technical Consultation on the Relative Needs and Resources of Local Authorities is noted.
- 1.2 That a further report is submitted to the Committee to provide an update on the implications for the Council following approval by the Government of the final funding formula.

2.0 Purpose of the Report

- 2.1 To provide details on the Government's proposals to amend the basis of measuring the relative needs and resources of local authorities as part of the Fair Funding Review. It is currently envisaged by the Government that this will provide a new funding formula which will be used to allocate resources to local councils from 1 April 2020.

3.0 Detail

Background

- 3.1 The use of formulas to distribute financial resources to local authorities has been used since its inception in the 19th century. However, the basis on which distribution takes place has been subject to periodic review.
- 3.2 The current funding baselines for local authorities in England are based on an assessment of their relative needs and resources. The methodology behind this assessment was first introduced over ten years ago and has not been updated since the introduction of the 50% Business Rates Retention System in 2013/14.
- 3.3 Whilst this approach has ensured that councils, which have grown their business rates since this time above their baseline, have benefitted from the additional income generated, it also means that underlying levels of need have not been updated since the 2013/14 Financial Settlement.

- 3.4 In addition, a desire to fully capture every aspect of need has led to increasingly large numbers of variables being included in the formula, many of which, it is considered, have a relatively minimal impact on the overall distribution of funding.
- 3.5 The current situation has been backed up by independent research. In order to address concerns that the current formula is unfair, out-of-date and too complex, the Government has undertaken a review (*the Review*) of relative needs and resources to develop a more robust and up-to-date approach to distributing funding to councils.
- 3.6 The independent research, which reported to a House of Commons Select Committee, concluded that a simplified needs formula, based on a smaller number of cost drivers could achieve outcomes that were a good approximation of those of a more complex system. Therefore, the Review has focussed on local authority cost drivers and the resources available locally to fund them.
- 3.7 Following the independent research, there was a call for evidence in 2017. This preceded a consultation which concluded in March 2018. Having considered the outcomes of the consultation, the Government set out in principle:
- The structure of the needs assessment – the number and type of formulae needed.
 - The key cost drivers that should be included.
 - The basis on which the relative importance (or weighting) is applied to each cost driver.

Measuring Relative Need

- 3.8 The relative needs of local authorities are determined through the funding formula which incorporates relevant demographic data, designed to predict the relative demand councils face when delivering different services. In order to reflect that some cost drivers are more significant than others in determining a council's need to spend, each cost driver is weighted in the formula.
- 3.9 The relative need of shire districts is currently measured as shown in the following table. This also shows the indicators proposed under a new “**Foundation Formula**”:

Formula Component	Main Indicators	Current	Proposed
Currently Environmental, Protective and Cultural Services	Resident population – basic amount per person	√	√
Proposed <i>Foundation Formula</i>	Density	√	x
	Sparsity	√	x
	Visitors	√	x
	Net Commuters	√	x
	Deprivation	√	x
Fixed Costs	£350,000 per authority	√	x

Area Cost Adjustment	Labour costs	√	√
	Business Rates payable	√	√
	Rent Costs (new)		√
	Journey Times (new)		√
Flood Defence	Geographical variables (major watercourses)	√	√
Coast Protection	Geographical variables (coastline)	√	√
Capital Costs	Historic Debt	√	√

- 3.10 The indicators are mainly based on data independently collected and assessed by the Office of National Statistics (ONS). The measures are converted into mathematical formulae which are designed to allocate a finite pot of money between shire districts relative to each other.
- 3.11 Once the needs of councils have been established through the above formula, the Government then assess how much resource (mainly through Council Tax) can be raised locally to meet costs. Again, this is measured on a relative basis.
- 3.12 It is important to note that the funding mechanism does not determine absolutely the amount of funding required, it only allocates the funding provided centrally by the Government for local authorities.
- 3.13 In its simplest terms, the total amount is then split between the different types of authority, i.e. upper tier and lower tier, with the indicators in the above table allocating the lower tier share between districts/boroughs.

Settlement Funding Assessment (SFA)

- 3.14 The outcome of the needs and resources assessment is a SFA for each council. This is the Baseline Funding Level split between Revenue Support Grant (RSG) and Redistributed Business Rates. In South Derbyshire's case, the Council's SFA is not high enough to qualify for the RSG element (*Note: the calculation and allocation of the New Homes Bonus is determined separately*).
- 3.15 The Baseline is a fixed amount determined prior to the start of each financial year and equates to the Government's funding. However, if business rates receipts are higher than the Baseline, this is largely kept by the local authority. If actual receipts fall below the Baseline, some protection is afforded by the Government through a "safety net".
- 3.16 The Business Rates Retention System itself is subject to other parameters. The Government are due to make additional proposals for resetting the Rates Baseline in accordance with the move towards 75% retention. In addition, the allocation of the New Homes Bonus remains subject to review.

A New Foundation Formula

- 3.17 The major change proposed by the Government is the introduction of a Foundation Formula. This would be based on a standard amount paid per resident (or per capita basis). Current indicators for density, sparsity, visitors, commuters and deprivation will be deleted.
- 3.18 The Government's reason for this change is to simplify the basic Formula and make it more transparent. The Government also reference the independent research which concluded that factors such as the effects of deprivation only account for a small proportion (0.4%) of a local authority's cost base.
- 3.19 The other main change is the deletion of a standard amount of £350,000 per authority towards fixed costs regardless of its size, known as the "*cost of being in business*" i.e. effectively statutory and democratic costs.

Area Cost Adjustment (ACA)

- 3.20 The other main element in the current formula is the Area Cost Adjustment. This adjusts the needs assessment to reflect differences between authorities in local labour rates, together with business rates payable.
- 3.21 The Government are proposing to retain an ACA and to add two new indicators, i.e. local rent costs and journey times. The journey times' indicator is designed to be a new method of measuring the sparsity or rurality of an area.

Available Resources

- 3.22 As highlighted previously, the Government's proposals also contain provisions to change the way in which the Formula measures the ability to raise funding locally through Council Tax receipts, i.e. the Local Tax Base. This is then offset against the Needs Assessment.
- 3.23 The current formula is based on average rates rather than actual rates locally and includes:
- Band D Council Tax Rate
 - Council Tax Collection Rate
 - Council Tax Discounts awarded under local schemes
 - The split in the local Council Tax bill between the District and the County Council
- 3.24 The Government's proposals contain provisions to move away from average rates to actual rates at an individual authority level.
- 3.25 In addition, the Government are proposing to include other income streams in the calculation of available funding and in particular, surplus receipts from car parks.

Technical Consultation

- 3.26 Following the release of the Local Government Financial Settlement for 2019/20 in December 2018, the Government issued a technical consultation on their proposals. The consultation ended on 22 February 2019.
- 3.27 During the consultation process, the Society of District Council Treasurers (SDCT) of which this Council is a Member engaged a consultant specialist to examine the potential impact of the Government's proposals on district councils in order to provide an informed response back to the Government.
- 3.28 The consultation asked for responses to 16 questions covering the needs and assessment formula, together with transitional arrangements designed to limit the impact of large annual changes to funding between authorities. Not all questions were applicable to district/borough councils. The SDCT identified 7 where it was deemed possible to estimate the effect on shire districts.
- 3.29 The specialists provided illustrations for each authority. This was based on certain assumptions but they broadly recalculated the actual settlement figures for 2019/20 on the Government's proposals as detailed above.
- 3.30 Clearly, this can only provide an illustration and will ultimately depend on overall proposals in a final settlement. Although exact figures cannot be calculated, the illustrations do at least indicate the potential "direction of travel" for future funding.
- 3.31 The modelling for the Council is detailed in the following table.

Indicative Impact of Proposed Changes to the Funding Formula

Factor		SDDC Change (%)	District Average (%)	Reason
Changes to the Cost Base				
Exclude Deprivation	A	5.8	3.5	The Council does not currently benefit from this measure and its exclusion would benefit the Council.
Exclude Visitors and Net Commuters	A	0.4	0.6	As above.
Exclude Fixed Amount	A	-1.3	-1.2	£350,000 currently guaranteed would be removed.
Exclude all 3 Variables above	A	5.1	3.1	Moving to a purely population based formula with an Area Cost Adjustment that measures the Council's rurality more favourably, benefits the Council's position overall. Districts gain overall.
Changes to the Assessment of the Tax Base				
Include Actual Council Tax Discounts awarded and not a uniform rate	B	1.8	2.1	The number of local residents receiving Council Tax support is less than the national average. Therefore, the reduction in the Council Tax base is lower in comparison, although it is less than the average for all districts.
Include Actual Band D Council Tax rather than the national average	B	-7.8	6.6	The Council would gain as its current level of Council Tax is below the national average and more significantly lower compared to other districts, which overall, would potentially lose funding.
Include Actual Council Tax Collection Rates rather than the national average	B	1.1	0.8	The Council would lose as its collection rate is above the national average.
Use Actual tax split between District and County rather than the national average	B	-11.2	1.7	As using actual Band D rates, the Council's share of the bill for all Derbyshire is low for a district compared to the national average and so the Council gains under this proposal.
Use projected tax base growth over 5 years rather than an actual base	B	-0.1	-1.5	A marginal gain, as the Council's Tax Base has historically increased significantly year-on-year, generally in line with projections. Many districts would gain overall as tax bases are not increasing as quickly and this proposal would allow projected income to be taken into account.

Impact on the Annual Change in Funding				
Include Retained Business Rates in the transition baseline	C	-16.9	-9.9	Although this factor shows the Council qualifying for transitional protection, this assumes that overall resources for the Council would reduce and at a faster rate compared to other districts.
Include New Homes Bonus in the transition baseline	C	-27.5	-10.6	As above.
Include funding to offset negative RSG in the transition baseline	C	0.1	-1.9	A marginal loss as this does not currently apply to the Council.

A: Positive percentages are better as this indicates a greater share of assessed need.

B: Negative percentages are better as this indicates a smaller relative tax base and therefore a smaller reduction in funding.

C: Negative percentages are better as this indicates a greater reduction in overall funding so greater eligibility for transitional protection

Overall Implications

- 3.32 Effectively, this is an academic process at this stage. However, overall, if these proposals were implemented, it would be more positive for the Council when resources are allocated in future settlements. Indeed, if the Funding Settlement for 2019/20 had been allocated on these proposals, the Council would have received more funding, all other things being equal.
- 3.33 The move towards a “per capita” basis allocation and the introduction of journey times to measure sparsity, would appear to benefit the Council and indeed district councils overall. As the Council’s resident population continues to grow, this would be recognised to a greater extent compared to the current formula.
- 3.34 However, this change would disadvantage other classes of authority and in particular County Councils; this could lead to representations against the proposals from these authorities.

Car Park Income

- 3.35 The issue of including surplus income from car parks in the calculation of available resources is an interesting proposal. This would not affect the Council directly as clearly the Council do not charge for parking.
- 3.36 However, where authorities generate large surpluses, they could receive less funding (all other things being equal) as the formula would assume that they had access to greater resources locally to meet their needs. Consequently, this could mean that other authorities (including this Council) would gain relatively, assuming that the overall resources allocated remained unchanged.

Transitional Arrangements

- 3.37 To-date, the Government have made it clear that if the allocation of funding is to undergo such a fundamental change, they will implement a transitional protection scheme alongside the changes. This will alleviate large swings in funding allocations between authorities in one year.
- 3.38 As previously highlighted, it is the level of overall resources allocated for district councils that is the major concern. Although the modelling around the transitional arrangements are positive for the Council and protection would be awarded, this seems to indicate that resources will reduce for the Council in the medium-term and at a much faster rate compared to other District Councils.
- 3.39 This implies that the baseline for Retained Business Rates will be increased meaning that the Council will retain less income compared to that in 2019/20 and that funding for the New Homes Bonus will be reduced.
- 3.40 The current Medium-Term Financial Plan (MTFP) for the Council assumes an overall reduction in Retained Business Rates and the New Homes Bonus between 2019/20 and 2023/24.

Response to the Consultation

- 3.41 Based on this analysis, the Chief Finance Officer submitted a response to the technical consultation and this is attached to the report. The response reflected

support where the proposals favoured the Council but was more guarded where this was less so.

- 3.42 The response also urged the Government to provide some early reassurances regarding the future of the New Homes Bonus and that allocations earned in previous years should be protected.

Next Phases

- 3.43 The Government are due to respond to the consultation shortly. It is then expected that the Government will provide final proposals ahead of the next Spending Review in the autumn. At this point, it is expected that authorities will have a further opportunity to respond as funding figures are made available.

- 3.44 In the meantime, the Commons Housing, Communities and Local Government Select Committee, announced in March, that they had launched a new inquiry into local government finance ahead of the Spending Review.

- 3.45 The Chair of the Committee commented:

“We have launched this inquiry to understand the impact of the current arrangements for funding local government services and the effect this has in different areas with different challenges and demands, the total local funding and how this is calculated.

We will also investigate how the Government arrives at its spending decisions and what mechanisms are in place to assess local need.

Our aim is to provide constructive recommendations that can feed into the upcoming spending review to provide a fair and effective funding system to support the provision of local services”.

- 3.46 There have been calls to delay the Fair Funding Review. At this stage, the Government have made no further announcements.

4.0 Financial Implications

- 4.1 None at this stage. The effect on the Council’s Budget and MTFP, when known, will be reported later in the Year.

5.0 Corporate Implications

Employment Implications

- 5.1 None

Legal Implications

- 5.2 None

Corporate Plan Implications

- 5.3 The response to the consultation is designed to protect the Council's financial position ("*Maintaining Financial Health*") by pressing for a fair share of central resources.

Risk Impact

- 5.4 The outcome from the Fair Funding Review is a key risk on the Council's Strategic Risk Register. The potential impact has been built into the MTFP.

6.0 Community Impact

Consultation

- 6.1 None required

Equality and Diversity Impact

- 6.2 Not applicable in the context of the report

Social Value Impact

- 6.3 Not applicable in the context of the report

Environmental Sustainability

- 6.4 Not applicable in the context of the report

7.0 Background Papers

- 7.1 None