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INTRODUCTION

Summary

On 19 December 2017 the Department for Communities and Local Government released the '[Fair Funding Review – a review of relative needs and resources](#)' to consult interested parties, particularly local government (including FRAs), on the structure of a replacement 'Needs' formula.

Background

Following the 2017 General Election, the Government's pursuit of 100% Business Rates Retention plateaued with the Steering Group officially meeting for the first time on 3 October. Regarding the reform of business rates retention, much can be achieved without involving primary legislation. In the 2018-19 Provisional Local Government Finance Settlement (also published on 19 December) it was announced that the Government has revised its aims to 75% retention. Nonetheless 75% Business Rates Retention is conspicuous by its absence in this consultation.

Unlike the Steering Group and other 100% Rates Retention Technical Working Groups, the Fair Funding Review TWG (formerly Needs and Redistribution TWG) has continued its work following the General Election with just minor delays. Meeting dates through to 21 September 2018 have been scheduled and Fair Funding Review work continues.

This consultation focuses specifically on potential approaches that have been identified to measure the relative needs of local authorities and runs for 12 weeks through to 12 March 2018. The Somerset TST will assist the NFCC in its response to the consultation.

The Case for Change

The case for change has been made by parts of local government for many years regarding changes in demography and service delivery, factors which the consultation makes note of. The consultation states that it is important to ensure that "Funding allocations reflect where the overall 'need to spend' is greatest" whilst taking into account authorities' capacities to raise retained income locally.

The DCLG is also looking to remove some of the complexity within the current formula and to increase transparency. It should be pointed out however, that a lot of the opaqueness of the

current system is due to seemingly arbitrary scaling factors and levers, rather than formula complexity. Another aim is to provide as much local discretion and accountability as possible.

Therefore, the Review will set new baseline funding allocations for authorities and deliver an up-to-date assessment of their relative needs and relative resources. It is the Government's intent that this process initially focuses on the services currently funded through the local government finance settlement and is developed through close collaboration with local government. Technical papers are expected to be published throughout the Review period.

Guiding Principles

Based on responses to the July 2016 consultation the Government has set out some guiding principles to be used in designing the new relative needs assessment methodology. Namely these are: **Simplicity** and **Transparency** (both to increase accountability), **Contemporary** (data should be regularly updatable in order to reflect change in circumstances), **Sustainability** (the formula should predict future demand), **Robustness** (the best possible objective analysis should be used) and **Stability** (allocations should be relatively predictable both immediately and in the future). Additionally, incentivising authorities to grow their economies is a key objective.

The implementation date for the Review is currently set to be 2020-21 and the work is to be divided into three closely related strands: **relative needs**, **relative resources** and **transitional arrangements**. This consultation is focused on the measurement of relative needs with future technical papers to be focused on relative resources and transitional arrangements. The consultation outlines some of the options available as set out below.

MEASURING NEED

The consultation details some of the previous approaches used to measure relative needs. It proposes that there be fewer cost drivers than the number currently used and that all potential cost drivers in the new formula are assessed based on the following criteria:

Relevant – there should be evidence to demonstrate that the cost driver has a significant impact on the cost of providing services,

Objective – the cost driver should be measurable using robust, up-to-date data that is collected on a consistent basis across England. It should not create perverse incentives to 'game' the system,

Distinct – the cost driver should explain significant variation in the 'need to spend' that is not covered by another cost driver,

Stable – the cost driver should not exhibit unpredictable or large changes year on year, and

Future proof – the cost driver should be expected to drive the on-going costs of providing services.

Following the July 2016 consultation the Government proposes to develop a foundation formula to allocate all or rather an allocation of funding to each authority (see [Common Cost Drivers](#) below). It also acknowledges that there may be particular service areas where a more specific approach is required (see [Service Specific Cost Drivers](#) below).

Q1: 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?

COMMON COST DRIVERS (Population, Rurality and Deprivation; and Area Cost Adjustments)

The consultation gives three potential common cost drivers that the Government believes affect the costs of delivering a wide range of services. It also considers whether adjustments need to be made for the different costs facing authorities across different parts of the country.

The first (and universally identified to be the most important) predictor is **population**. The Government believes it is highly likely that the cost of providing services is not just dependent on an area's overall population but its age profiles as well, and that it is therefore necessary to reflect this in a formula. The consultation also highlights the importance of reflecting future population changes with future funding.

The consultation proposes using Sub-National Population Projections to allow the formula to reflect expected future population changes while giving authorities certainty over their income for the duration of a funding period. It expresses concern over any unpredictability regarding population changes, and specifically the inability of SNPPs to reflect these. A more accurate reflection of actual population would require more frequent updates and the Government is concerned that this could reduce medium term certainty.

Q2: 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?

Q3: Do you agree that these population projections should not be updated until the relative needs assessment is refreshed?

The second common cost driver included in the consultation is **rurality**. Independent analysis, as well as work in the Fair Funding Review TWG, has recognised that there are specific challenges in rural areas, which include scattered and remote populations, a lack of private sector service providers, and poor broadband or mobile phone coverage. The higher unit cost of some services that require travel time in rural areas is noted by the consultation as are potential lower costs for other services. The consultation highlights the potential unmet need for certain services in rural areas (which could skew empirical analyses) but also highlights the 'several' limitations to work done by LG Futures which tried to quantify the costs of service provision in rural areas.

In part due to the aforementioned limitations, the Government is proposing to explore whether alternative data sources are available that measure or proxy the relative cost of providing services in rural areas.

Q4: Do you agree that rurality should be included in the relative needs assessment as a common cost driver?

Q5: 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?

The third predictor included is **deprivation**. The Government takes the view that levels of deprivation remain an important cost driver for a wide range of services that must be captured by

any new relative needs formula. However, as with the other issues being considered by this Review, changing patterns of deprivation across the country means it is important to reconsider this relationship and the impact that deprivation has on authorities' 'need to spend'.

The consultation points out that during the rollout of Universal Credit, the number of benefit claimants will not be directly comparable across the country. It states that there is scope to move from the current "relatively narrow" measure of deprivation to either a wider measure (e.g. the Index of Multiple Deprivation (IMD)) or to more specific measures for each particular service (e.g. using Income Deprivation Affecting Children for a Children's Services formula).

Q6: Do you agree that deprivation should be included in the relative needs assessment as a common cost driver?

Q7: 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?

The Government intends to use the three common cost drivers outlined above as the starting point for a foundation formula but will consider whether there are other, service specific cost drivers that should also be included.

Q8: 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?

To reflect the differing costs of purchasing inputs, the Government proposes the use of an **Area Cost Adjustment**. It is considering how the current ACA could be updated to reflect additional costs for islands and areas with widely dispersed populations as well as those factors currently accounted for in the ACA (namely: labour cost, share of total cost spent on employees, local business rates level and share of total costs spent on business rates). The review will also consider whether rurality could be included in the ACA and how the ACA would work in a foundation formula.

Q9: Do you have views on the approach the Government should take to Area Cost Adjustments?

The consultation points out that some duties (e.g. flood defences) which only account for a small proportion of the overall expenditure of local government can have a significant impact on some individual authorities.

Q10a: 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?

Q10b: Which services do you think are most significant here?

SERVICE SPECIFIC COST DRIVERS

Although, the Government is looking for a formula with greater simplicity than the current formula, it recognises the need for some service specific RNFs. Specifically (with support from responses to the Call for Evidence) it highlights the potential need for service specific formulas for the services covered below. These services either account for a significant proportion of local government expenditure, or have a unique set of factors which drive costs for many authorities. They aren't primarily based on universal population and are, on the whole, performed at one level of local government.

Adult Social Care

The Government believes that the following factors represent its key cost drivers: **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 and sparsity.**

Q11a: Do you agree that the cost drivers set out above are the key cost drivers affecting adult social care services?

Q11b: 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?

Children's Services

The Government believes that a Children's Services formula would use the following factors: **number of children (under 18), number of children whose parents receive Disability Living Allowance, deprivation and distance to schools.**

Q12a: Do you agree that these are the key cost drivers affecting children's services?

Q12b: Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting children's services?

Highway Maintenance and Public Transport

The Consultation proposes using factors from the current Highways RNF, namely: **road length, traffic flow and forecasted snow days/predicted grit days** as well as **concessionary bus boardings.**

Q13a: Do you agree that these are the key cost drivers affecting routine highways maintenance and concessionary travel services?

Q13b: 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?

Q14a: Do you have views on what the most suitable cost drivers for local bus support are?

Q14b: Do you have views on what the most suitable data sets are to measure the cost drivers for local bus support?

Waste Collection and Disposal

The following cost drivers are proposed regarding waste collection (districts) and disposal (counties): **number of households, types of property, travel times and deprivation.**

Q15a: Do you agree that these are the key cost drivers affecting waste collection and disposal services?

Q15b: 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?

Fire and Rescue Services

The Consultation lists the indicators in the current Fire and Rescue RNF, namely: **projected population, coastline, population density, population sparsity, risk index, COMAH sites, property and societal risk, community fire safety and Fire and Rescue ACA.** For further details regarding the current Fire and Rescue RNF, please see the Somerset TST briefing linked below:



Briefing on Current
Formula.docx

Q16a: Do you agree these remain the key drivers affecting the cost of delivering fire and rescue services?

Q16b: Do you have views on which other data sets might be more suitable to measure the cost drivers for fire and rescue services?

Legacy Capital Financing

The purpose of the Capital Financing relative needs formula is to ensure that local authorities with borrowing commitments that were agreed to be funded through the local government finance settlement have that cost recognised in their relative needs assessment. The current Capital Financing RNF is based on both **outstanding debt** and **interest rates**. For further details regarding the current Capital Financing RNF, please see the Somerset TST briefing linked above.

Q17a: Do you agree these are the key cost drivers affecting the cost of legacy capital financing?

Q17b: Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting legacy capital financing?

Other Service Areas

The Government recognises that there may be other areas which need to be considered. Historic documentation that sets out the relative need formulas and data that were used in the 2013/14 relative needs assessment is available from the National Archives ([report](#), [calculations](#)).

Q18a: Are there other service areas you think require a more specific funding formula?

Q18b: 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?

WEIGHTING FUNDING FORMULAS AND COST DRIVERS

Once a decision is reached regarding which cost drivers are to be included in the common and service specific formulas, it will be necessary to determine the weightings for which each factor is applied in the formulas. The consultation presents potential techniques and approaches regarding the establishment of such weightings.

If more than one relative needs formula is developed, it will be necessary to decide the proportion of the overall funding that is to be allocated by each formula. The current control totals saw particular opposition in the Call for Evidence (due to the lack of transparency).

The Consultation states that an alternative to the use of judgement in determining the weighting of different formulas would be to base these on the proportion of spending local government as a whole currently commits to different services. It states that this could be supplemented with some trend analysis or time series modelling to set control totals that reflected the pressures that local government is expected to face in the coming years.

Q19: How do you think the Government should decide on the weights of different funding formulas?

The role of statistics in weighting cost drivers

The Consultation gives some of the statistical techniques used across Government to help construct funding formulas as set out below. It states that without these techniques (which aim to quantify the affect that each cost driver has on 'need to spend'), judgement would necessarily play a far larger role in determining funding allocations.

Regression Analysis

After explaining the methodology involved in regression models and some of its benefits, the consultation states some of the limitations of **expenditure based** regression models. In short, regression models work by measuring how a dependent variable (the concept that you are interested in predicting) changes in relation to a series of independent variables.

The consultation states that regression models work best when they are measuring the relationship with a well-defined dependent variable. Ideally the dependent variable for a local government relative needs assessment would be LAs' need. However there is no data set that measures this concept. Historically, expenditure has been used as a proxy for need but there are limitations with this approach. If historic expenditure is not a good proxy for the relative needs authorities to spend money in the future, then the outcomes of the model will also not be good predictors of future need. In short, this can produce a cyclical problem, locking-in previous funding inequalities, as historic spend is dependent on historic funding.

The Government raise four distinct issues with expenditure based regression models namely: authorities may currently provide different levels of support, authorities could be providing the same service with greater or less efficiency, authorities spend is dependent upon historic funding levels (as stated above) and there may be unmet need at present. Each of these issues could mean that current spend is not a suitable proxy for actual need.

The consultation does also point out that a regression model would be likely to benefit efficient authorities. It states that authorities would still be able to determine how much they choose to spend on a particular service irrespective of the amount they are allocated by each service specific formula.

Controlling for Historic Levels of Funding

Due to the aforementioned issues, the Consultation sets out advanced analytical techniques which could mitigate the problems relating to the influence that historic levels of funding have on levels of spending. These techniques rely on data at a sub-authority level as they broadly work by looking at the relationships between spending and cost drivers within an authority, as funding relative to another part of the same authority will be unaffected by the level of funding that the authority received at the time.

The first technique set out is **small area modelling (SAM)** which works by collecting expenditure data from authorities about the amount of spending in smaller areas within the authorities (e.g. Lower Super Output Areas). Between authorities variation can be controlled against to mitigate non-need variation.

The second technique set out is **multi-level modelling (MLM)** which has a similar function to SAM. MLM works by combining sub-authority level data with authority data to create a hierarchical dataset. This can then be used to identify the relationship between cost drivers independent of authorities' historic funding.

The Consultation points out that either SLM or MLM would require the collection of detailed information as sub-LA level data is unavailable for many of the proposed cost drivers. Such collection could be time consuming. A possible alternative approach set out would be to effectively produce regression models that showed the relationship between spending and cost drivers where all authorities received the same level of funding per head. This approach may also help address the issues associated with unmet need but may also lack analytical robustness. The Government is proposing to explore these techniques in order to address the simple regression model limitations.

Alternatives to expenditure based regression models

Finally, the Consultation provides three alternatives to using regression models linked to expenditure as set out below.

First, **Outcome based regression models** would look to relationship between cost drivers and outcome variables (e.g. road quality). This approach wouldn't be suitable for the foundation formula as it is not possible to identify a single outcome variable to describe a range of authority activity. This approach could have perverse implications by rewarding authorities with currently poor outcomes.

Second, **Factor Analysis and Principal Component Analysis** are designed to simplify complex data sets down to the most important factors that explain the relationship between the overall dataset. These techniques require large assumptions to be made and are highly sensitive to outliers.

Third, **Unit Cost Functions** is a 'bottom up' approach that is based on quantifying the precise costs involved in providing services to individuals. These unit costs are then multiplied up by the size of the client group for those services in each authority. This would require a vast amount of data about the activity of authorities and standardised measures of service delivery - information that is not available on a consistent basis for the majority of local authority services.

Q20: Do you have views about which statistical techniques the Government should consider when deciding how to weight individual cost drivers?

EQUALITIES IMPACTS

The final question in the consultation asks if there are likely to be any impacts on persons and groups with shared protected characteristics in accordance with the Public Sector Equality Duty and the Equality Act 2010.

Q21: 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.

NEXT STEPS

As stated above, the deadline for responses is 12 March 2018. The Somerset Technical Support Team will provide assistance regarding the NFCC response to the consultation. The Team can be contacted at TechnicalSupportTeam@somerset.gov.uk should NFCC members have any questions in the meantime.

Somerset TST Briefing: Fair Funding Review – Technical Consultation

Annex A – List of Consultation Questions

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?
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?
10. 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? Which services do you think are most significant here?
11. Do you agree the cost drivers set out above are the key cost drivers affecting adult social care services? 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?
12. Do you agree that these are the key cost drivers affecting children’s services? Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting children’s services?
13. Do you agree that these are the key cost drivers affecting routine highways maintenance and concessionary travel services? 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?
14. Do you have views on what the most suitable cost drivers for local bus support are? Do you have views on what the most suitable data sets are to measure the cost drivers for local bus support?
15. Do you agree that these are the key cost drivers affecting waste collection and disposal services? 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?
16. Do you agree these remain the key drivers affecting the cost of delivering fire and rescue services? Do you have views on which other data sets might be more suitable to measure the cost drivers for fire and rescue services?
17. Do you agree these are the key cost drivers affecting the cost of legacy capital financing? Do you have views on what the most suitable data sets are to measure these or other key cost drivers affecting legacy capital financing?
18. Are there other service areas you think require a more specific funding formula? 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?
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.