

## **LANCASHIRE COMBINED FIRE AUTHORITY**

Meeting to be held on 18 February 2019

### **A REVIEW OF LOCAL AUTHORITIES' RELATIVE NEEDS AND RESOURCES**

Contact for further information:

Keith Mattinson - Director of Corporate Services – Telephone Number 01772 866804

#### **Executive Summary**

The Government published a consultation document A Review Of Local Authorities' Relative Needs And Resources in December, setting out proposals relating to future funding formulas. The consultation closes on 21 February 2019.

The consultation only relates to the funding formula used i.e. how overall funding will be divided across the various authorities, it does not refer to the overall level of funding that will be made available in future settlements.

At the time of writing the report there are a number of workshops being held to discuss the issues, hence it is not possible to draft a response until such time as these have taken place.

#### **Recommendation**

The Combined Fire Authority is asked to delegate agreement of a response to the Treasurer in consultation with the Chief Fire Officer and the Chairman.

#### **Introduction**

The current funding baselines for local authorities in England, as determined by the annual local government finance settlement, 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.

Whilst this approach has ensured that authorities which have grown their business rates since this time have benefited from the additional income generated, it also means that authorities' underlying levels of 'need' have not been updated since the 2013-14 settlement. In addition, a desire to fully capture every aspect of local authorities' needs has led to increasingly large numbers of variables being included in the formulas, many of which had a relatively minimal impact on the overall distribution of funding.

As such it has been agreed that a simplified needs assessment formula, based on a smaller number of indicators, could achieve outcomes that are a good approximation of those of a more complex system.

## Overview of Intended Approach

The review of local authorities' relative needs and resources will:

- set new baseline funding allocations for local authorities;
- produce an up-to-date assessment of the relative needs of local authorities;
- examine the relative resources of local authorities;
- provide details of transitional arrangements.

The review is based on the following guiding principles:

- **Simplicity** – a more straightforward methodology with enhanced levels of simplicity, but recognise that this should not be at the expense of accuracy and fairness;
- **Transparency** – an understanding of what factors have influenced the levels of funding received by a local authority so that they can hold their local representatives to account for the decisions they make;
- **Contemporary** – the new relative needs assessment will be based on the most up-to-date data possible;
- **Sustainability** – an evidence-based approach will be deployed to identify the factors which drive costs for local authorities;
- **Robustness** – to withstand scrutiny;
- **Stability** – the funding formula should support predictable, long-term funding allocations, ideally as part of a multi-year settlement.

The Government is working towards implementing the outcome of the review as part of the 2020-21 local government finance settlement, alongside increased business rates retention, a full business rates baseline reset, and the 2019 Spending Review.

The Government's current aim is to publish indicative allocations through a further stage of formal consultation before the 2020-21 provisional local government finance settlement.

## Key Elements of the Review

Future baseline funding levels will equal;

The Relative Needs share of the Authority (adjusted for Area Cost);  
LESS;

A Relative Resources adjustment;

With the Authority's final funding position (or baseline funding level), subject to possible transitional arrangements.

## Relative Needs

The relative needs of local authorities are determined by the use of funding formulas, which incorporate relevant local demographic or other data, thought to predict the relative demand authorities face when delivering different services. In order to reflect the fact that some 'cost drivers' are more significant than others in determining authorities' 'need to spend', each cost driver is 'weighted' in the formula to reflect its

relative importance. The formula can then be adjusted for other factors which affect the relative costs of service delivery – such as salary or property costs.

At present, 15 different relative needs formulas and several tailored distributions for services previously supported by specific grants are used to determine annual funding allocations through the settlement. These formulas involve over 120 cost drivers and were last updated in 2013-14

The general consensus was that deploying several service-specific formulas, alongside a Foundation Formula, would help to ensure an appropriate balance between simplicity, transparency and precision. Inclusion of such areas would be based on:

- Complexity – services for which demand is driven by unique cost drivers that are not correlated with the overall size of the population of an area may require a separate funding formula. This could include services with complex means testing arrangements or eligibility criteria, which do not serve the wider population;
- Scale – many local authority services represent a relatively small proportion of overall expenditure. Consideration has been given to the proportionality of introducing specific funding formulas for different service areas;
- Distribution of relative need – some service areas may only account for a small proportion of overall local government expenditure, but have a significant impact on particular outlying authorities. Where the distribution of relative need is concentrated in particular geographic areas or groups of authorities, and is driven by unique cost drivers, the case for introducing a specific funding formula has been considered;
- Similarity – some service areas have similar ‘bases’; for example the size of a local population, the number of children in an area, or road length. Where this is the case consideration has been given as to whether it is analytically more robust to group these services together under one relative needs formula.

Based on the trade-off between simplicity, transparency and precision, the Government is minded to deploy a ‘per capita’ Foundation Formula for upper and lower tier authorities, alongside seven service-specific funding formulas.

Population Size is the only cost driver in the Foundation Formula (based on Office for National Statistics population projections), with an Area Cost Adjustment applied.

### **Fire and Rescue Services Relative Needs**

There is a strong rationale for retaining a separate funding formula for Fire and Rescue Services in the needs assessment on the basis that these services are carried out by stand-alone fire authorities in some instances. In addition, this service area is distinct as it takes account of risk as well as demand factors, which may justify taking a more specific approach.

Following the December 2017 consultation and wider engagement with the sector including the National Fire Chiefs Council, the Government has used an expenditure based regression approach to develop a formula based on cost drivers with the greatest explanatory power for Fire and Rescue Services spending. The cost drivers

which have been identified so far as having the greatest explanatory power and aligning with the policy objectives for this service area are as follows:

- total population;
- deprivation, and
- proportion of residents aged 65 and over.

Our analysis suggests the expenditure based regression approach results in significant changes compared to the current funding shares, specifically for those authorities which benefited previously from the density and coastline top-up. Whilst this approach broadly meets the principles for needs-based allocation of the review, the relatively small size of the expenditure data sample means this approach may not fully identify the factors which drive costs and take account of future needs; other cost drivers may need to be taken into account if this formula is developed further. The Government believes it is important to build consensus behind the approach we adopt and has therefore identified potential alternative approaches in order to seek views on the best way forward.

If the Government were minded to minimise the change in sector funding shares, an option is to update the existing Fire funding formula as far as possible. This would involve updating the indicators in the current funding formula (where possible) and keeping the original weightings (the coefficients from the original Fire funding regression model) as well as the supplementary top-ups. It is not possible to update the risk index (an index which includes measures of deprivation), the property and societal risk index (an index which includes measures of building type and the associated risk) or the community fire safety indicator (an index of demographic groups with greater need for fire safety assistance) due to data availability. These indicators would either be removed from the formula or kept at their current values and weightings. Sparsity, coastline and density are included as cost drivers in the current formula. Careful consideration will be given to the application of the proposed Area Cost Adjustment which includes measures of accessibility and remoteness, in order to mitigate any risk of 'double counting' similar factors in a Fire and Rescue Services formula.

Another option under consideration is to develop a multi-level model using fire incident data as a proxy for relative risk. Fire incident data is available at a more granular level (e.g. Mid Super Output Area which provides around 7,200 data points). This allows the testing of a more sophisticated multi-level model to analyse variation in data at lower levels. Preliminary analysis demonstrates this is a viable approach, although further work and views from the sector are needed to determine if fire incidents adequately reflect fire service activities.

Further work is required to identify an appropriate approach to develop the new funding formula for this service area. As this work progresses the Government will sense-check the results of our analysis with experts in the sector, including the National Fire Chiefs Council. Subject to the outcome of this consultation and additional analytical work the Government will form a view on the best approach.

## **Area Cost Adjustment**

The cost of delivering the same services may vary between local authorities for a number of reasons - for example:

- the costs of employing staff or renting non-domestic properties can vary considerably between different places, and
- some local authorities face unique pressures related to their geography; such as the costs associated with conducting business from isolated or
- peripheral communities (including islands and coastal areas), or providing services to widely dispersed or densely concentrated populations.

These are referred to as 'multiplicative' factors, and mean that even authorities with broadly similar characteristics (e.g. population size) could experience different costs in service provision as a result of factors that are outside of their control.

The Government has stated the importance of an Area Cost Adjustment in the assessment of relative needs and has identified the following criteria to determine which factors are taken into account:

- significance - the impact of a factor on local authority spending must be sufficiently large;
- variation - the impact of a factor must vary sufficiently between local authorities;
- data availability - there must be sufficiently detailed data available at the right level of geography, and
- appropriate incentives - the Area Cost Adjustment should maintain incentives for local authorities to design services which deliver at the lowest possible cost.

The Government has stated that it is minded to incorporate the factors set out below:

- a rates cost adjustment, including rents, to reflect the variation between areas in the cost of using equivalent premises due to differences in local supply and demand factors;
- a labour cost adjustment, including accessibility, to reflect the fact that authorities will need to compete with other potential employers to secure and retain suitably skilled staff;
- a remoteness adjustment, to account for variation in the cost of some inputs due to the size of local markets or isolation from major markets.

The factors set out above will be weighted together into a single index for each funding formula, using evidence-based weights which are appropriate for the relevant service(s).

## **Relative resources**

An authority's capacity to raise resources locally depends on a number of factors, including local circumstances and priorities, central Government policy and the legal framework in which they operate. As such, there is significant variation between

authorities in respect of both their relative levels of need and the resources they can raise.

Local resources include:

- Council tax – which now accounts for a greater proportion of their income since the last review of the funding formula. However, the proportion varies at an individual local authority level, and
- Sales, fees and charges – which, like council tax, varies by local authority.

The Government has identified supporting principles that will be used to determine an approach to a new relative resources adjustment:

- assessing relative resources will result in no redistribution of council tax or sales, fees and charges resources between authorities;
- there is no intention to reward or penalise authorities for exercising local discretion;
- local authorities with a lesser capacity to fund services through locally raised resources will receive a smaller reduction to their relative needs share.

## **Council Tax**

A local authority's council tax precept depends on:

- Tax base;
- Council tax level;
- Collection rates.

Local authorities have relatively little discretion over the size of their tax base as most discounts and exemptions which affect them are set centrally by the Government

Council Tax levels are determined by individual authorities on an annual basis as part of their budget setting process. Whilst local authorities have discretion over the level of council tax they set, the Government ensures that council tax-payers have the ability to veto excessive increases through a local referendum

In 2018-19, the national average Band D council tax level for stand-alone Fire Authorities is £75, ranging from £59 to £101, Lancashire's is £67.

There are two options for the treatment of council tax levels in the measure of council tax income:

- taking 'actual' level into account or
- taking a 'notional' level into account.

An 'actual' approach would undermine the Government's intention not to reward or penalise authorities for historic local decision making, and this approach would see a greater reduction in those areas with higher council tax, regardless of the historical reasons or circumstances that have led to this.

The Government is therefore minded to use a notional assessment of council tax levels when making the relative resources adjustment

Using a notional council tax level, as part of a notional measure of council tax resources, would mean that two local authorities with similar tax bases and a similar assessment of relative needs would receive broadly similar baseline funding levels, irrespective of their actual council tax levels. However, it also means that the authority with the higher actual council tax level would have a higher funding allocation. This is as a result of retaining the actual council tax income raised (which is not redistributed).

In calculating a council's baseline funding level, if the relative resources adjustment exceeds their relative needs share they would be subject to a 100% tariff on their retained business rates. Since the Government is committed to no redistribution of council tax, the tariff would be capped at a maximum of 100%. In effect this would mean that the council would not retain any business rates locally because their relative need was assessed as met through other local resources; however, the authority would continue to retain a proportion of business rates growth as determined by the national business rates retention scheme.

In summary, a higher notional council tax level supports greater equalisation of funding relative to assessed need. However, it increases the likelihood of a small number of authorities paying 100% of their business rates baseline as a tariff. A high notional council tax level also increases the number of authorities with an actual council tax level significantly below the notional level.

Conversely, a lower notional level reduces these effects. However, the lower the notional council tax level, the greater the incidence of authorities with higher need or higher tax levels who have lower settlement funding allocations than other authorities with lower need or lower tax levels.

The measure of council tax in the relative resources adjustment requires an assumption around collection rates at the local authority level.

- One approach would be to use authorities' actual collection rates. However, this would mean that for two authorities that are identical aside from their collection rate, the one with the higher collection rate would receive a lower baseline funding level.
- Another approach is to apply a single, uniform collection rate to the measure of each local authority's council tax income.

In all scenarios, the incentive towards full council tax collection remains.

### **Council tax in successive years**

In the case of a multi-year settlement from 2020-21 onwards, it will be necessary to consider the treatment of council tax income in successive years as part of a resources adjustment.

There are broadly two approaches:

- a single measure of council tax resource fixed over the period. This approach has a precedent in the 2015-16 four-year settlement methodology. This approach may reward local authorities who build more houses and grow their tax base over time as they will be able to retain that growth in their tax base – the increase in council tax resources will not be taken into account in the resources adjustment beyond year one;
- Include full or partial projections of council tax resource at the outset of the period including tax base and/or tax levels. Such an approach may support authorities who are less able to grow their council tax receipts to meet their need. However, this approach may disadvantage areas whose tax base does not grow in line with projections due to unforeseen shocks or local policy choices, since the reduction in their baseline funding level due to this measure of their tax base will not be offset by an increase to their actual council tax income.

In line with the guiding principles of the review, the Government has said it is minded to fix a single measure of council tax resource over the period. This approach has the advantage of rewarding authorities for growth in their council tax receipts whilst not linking the methodology to a measure of projections of council tax resources that may be uncertain.

### **Sales, Fees and Charges**

Sales, fees and charges are another source of income for many local authorities, which - like council tax – vary by local authority.

The Government has considered whether it is appropriate to make a more direct adjustment for sales, fees and charges income when assessing local authorities' relative resources; the practicalities that have said they would consider are:

- Scale;
- Ability and choice and incentive effects;
- Volatility of income;
- Data availability.

Having taken the above considerations into account, the Government recognises that there are practical challenges in taking a direct account of sales, fees and charges income through the resources adjustment and therefore they have said that they are broadly minded not to do so.

### **Transitional arrangements**

Once new funding baselines have been established, the Government intends to introduce transitional arrangements that will determine the basis on which authorities reach their new funding allocation levels.

Given the wide range of options available, the Government intends to use the principles set out below, along with the wider principles of the review in designing transition arrangements:



- Maintain stability;
- Ensure transparency;
- Ensure they transition period is time-limited;
- Provide flexibility.

The scale of transition will depend on the baseline it is measured from, and as such they are proposing that the starting baseline for the purposes of transition will be a measure of the funding available to each local authority in 2019-20.

### **Financial Implications**

No exemplifications are provided at this stage so it is impossible to predict the financial impact, although obviously the eventual outcome will have a significant impact on future funding and therefore the Authorities future budgets.

### **Human Resource Implications**

None

### **Equality and Diversity Implications**

None

### **Environmental Impact**

None

### **Business Risk Implications**

Clearly the outcome of the consultation will have an impact on our level of funding received in future years, and as such it is a major risk to the Authority. However, until the outcome of the consultation is known it is impossible to be more specific.

### **Local Government (Access to Information) Act 1985**

#### **List of Background Papers**

Paper	Date	Contact
Consultation Document A Review Of Local Authorities' Relative Needs And Resources	December 2018	Keith Mattinson
Reason for inclusion in Part II, if appropriate:		