REPORT OF:	**CHIEF EXECUTIVE**
TO:	**SPECIAL BUDGET POLICY AND RESOURCES COMMITTEE**
DATES:	**12th FEBRUARY 2019**

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REFORMS TO LOCAL GOVERNMENT FINANCE SYSTEM RESPONSE TO CONSULTATIONS

PURPOSE OF REPORT

1. The purpose of this report is to inform the Committee of recent consultations on reforms to the Local Government Finance System and to consider the draft response to those consultations.

RECOMMENDATIONS

2. The Policy and Resources is recommended to:-

   a) Note the consultations on the Fair Funding Review and Business Rate Retention Reforms;

   b) give delegated authority to the Chief Executive, in consultation with the Leader of the Council, to finalise the Council's response to the consultations referred to in the report;

   c) agree to share the Council's final response to the consultations with Pendle's Member of Parliament and to seek his support in lobbying to ensure that the Council's funding position from 2020/21 is maximised.

REASONS FOR RECOMMENDATIONS

3. To continue with the implementation of the Council's Financial Strategy and to inform the development of the Council's budget for 2020/21.

ISSUE

Background

4. Over recent years, the funding of local government has been the subject of significant changes. Aside from the impact of austerity, which has seen a significant reduction in the quantum of funding available for local government, the Government has embarked on major reforms to the structure of the local government finance system.

5. These reforms have been predicated on Councils having a greater control over the funding they raise locally and are seen by the Government as paving the way for Councils to become self-sufficient. This has seen the emergence of the Business Rates Retention and New Homes Bonus Schemes, both of which are intended to incentivise economic growth in a local area by allowing Councils to share in the financial benefits of that growth. At the same time, the Government has reduced significantly the amount of direct grants (mainly in the form of Revenue Support Grant) payable to Councils.

6. The start of these reforms was in 2013/14 with the introduction of the current Business Rates and was followed up by the 4-year funding settlement offer to Councils (which set out year on year reductions in Revenue Support Grant). In the meantime, the Government has invited Councils to test variants of the Business Rate Retention Scheme, including Business Rate pooling arrangements.

7. All of these reforms are now expected to be implemented from April 2020 (financial year 2020/21) coinciding with the end of the final year of the 4-year funding settlement in 2019/20. The consultations referred to in this report deal with key aspects of the reforms – The Fair Funding Review which will set baseline funding allocations for each Council and the Business Rates Retention Reforms which will change the rate of retained business rates growth from 50% to 75%.

8. Notably, the Government has also indicated that Revenue Support Grant will no longer be payable to Councils from 2020/21 onwards.

Comprehensive Spending Review 2019

9. In advance of the changes referred to above, the Government has indicated that there will be a Comprehensive Spending Review (CSR) in Autumn 2019 which is expected to inform spending limits in the period from 2020/21 to 2022/23. The CSR is the process used by HM Treasury to set firm spending limits for individual Government Departments (Health, Education, Defence, Welfare, Local Government etc.). Given there is generally a finite amount of funding available, inevitably the CSR is a competitive process between Government Departments and it is fair to say that, in recent CSRs, Local Government has not fared well in comparison to other Government Departments. And given other national funding pressures, it is not expected that Local Government will fare any better in CSR 2019.

Local Authority Funding Allocations from 2020/21 onwards

10. Once Local Government has been informed of its spending limit through the CSR process, and subject to any funding top-slices for policy specific matters, the remaining funding is distributed to individual local authorities. Up until 2013/14, this distribution was based on an increasingly complex set of formula reflecting a wide range of factors (Population, Deprivation, Sparsity, Rurality, etc) reflecting the ‘underlying levels of relative need (and relative resources)’ of each local authority area. This distribution of relative needs/resources was used to set a baseline funding allocation for each Council.

11. With the introduction of the 50% Business Rates Retention system in 2013/14, Councils have since benefited from retaining some growth in the business rates generated locally. Combined with the introduction of the New Homes Bonus around the same time (which was, in the main, funded from top-slicing Revenue Support Grant), this was the start of a move away from a wholly ‘needs-based’ funding system (which benefited Pendle) to one that incorporated funding for local authorities based on the economic and housing growth in their local area.

12. A consequence of this shift is that since 2013/14, the methodology behind the assessment of relative needs and resources (which, in fact was introduced 10 years ago) has not been updated and, therefore, any changes in the relative needs/resources between Councils since 2013/14 has not been reflected in the baseline funding allocations for each Council.

13. Acknowledging this, in 2017 the Government indicated that it would undertake a ***Fair Funding Review*** to reset the funding baselines for each local authority and these new baselines would be used from 2020/21 onwards. According to the Government, at the same time, the Fair Funding Review would seek to simplify the formulaic approach to funding distribution (the view being that whilst the complex formula had many variables, many of them had a relatively minimal impact on the overall distribution of funding) and bring up-to-date the data used.

14. In conjunction with the Fair Funding Review, the Government is also pressing ahead with the implementation of a 75% Business Rate Retention Scheme, again with effect from 2020/21.

15. As a consequence, alongside the provisional Local Government Finance Settlement for 2019/20, the Government has opened consultations on both the Fair Funding Review and the Business Rates Retention Scheme. This report provides details of both consultations and provides a draft response to each.

Fair Funding Review - A review of local authorities’ relative needs and resources

16. As indicated above, the Fair Funding Review is an assessment of local authorities’ relative needs and resources to develop a more robust and up-to-date approach to distributing funding across all Councils. The Review enables the Government to reconsider the drivers of local authorities’ costs, the resources available to them and how to account for these in way that allows a more transparent and understandable link between local areas and their resource allocations.

17. The Terms of Reference for the Review included setting new baseline funding allocations for each local authority, providing an up-to-date assessment of each authority’s relative needs and relative resources and to consider what transitional arrangements may be necessary between the current and new funding allocations. These Terms of Reference were accompanied by various guiding principles for the new system – making it simple, transparent, contemporary, sustainable, robust and stable.

18. The Council has previously responded to a consultation on this matter and the Council’s draft response to the current consultation is provided at **Appendix A** for Councillors to consider. The current consultation is largely technical in content, focusing on the components of the funding formula. In its simplest form, that funding formula is as follows:-

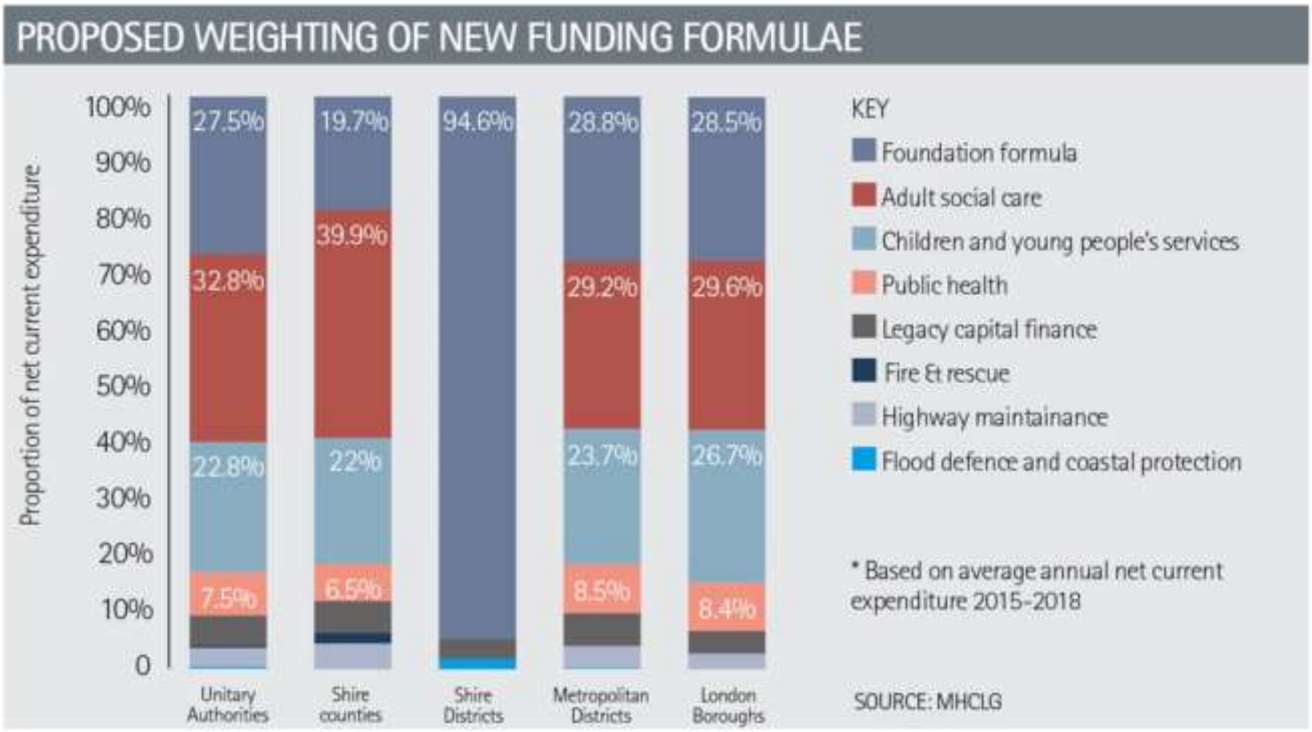
*Final funding position = (**relative needs** share – relative resources adjustment)* *± possible transitional arrangements + actual resources income*

19. The ***Relative Needs Share*** for each local authority is determined by the use of funding formulas which incorporate relevant local demographic or other data which predict the relative[1] demand each Council faces when delivering different services. The Government proposes to streamline the current funding formulae (which comprises over 120 costs drivers). As a starting point, there will be a Foundation Formula for all services other than those services where there is a strong enough case for a service specific formula.
20. The ***Relative Resources Adjustment*** is intended to reflect local authorities capacity to raise funding locally and is a well-established part of previous funding formulas. Local resources include Council Tax and Sales, Fees and Charges.

21. ***Transitional Arrangements*** are generally included within funding formulas to manage the basis on which local authorities move from existing to new funding allocations. These arrangements are put in place to prevent significant gains/losses in funding from one year to the next.

22. The consultation is focused on the technical aspects of the proposed changes and it is not possible to be certain about the precise impact on the Council's position. That said, there are two key issues for Councillors to note (and which are reflected in the draft consultation response) where there is a disagreement with the Government's proposed approach. These are as follows:-

    - the ***exclusion of deprivation*** as a cost driver in the funding formula (Question 1). As the chart below shows, the Foundation Formula will represent the most significant component of the needs assessment for District Councils:-



[1] This means relative to all other local authorities

The significance of this for Pendle is that the only cost driver for the Foundation Formula is relative population. Unlike previous funding formulas, relative levels of deprivation do <u>not</u> feature in the Foundation Formula. The Government's rationale for excluding deprivation from the Foundation Formula is twofold:-

- deprivation ***in aggregate terms***, is not shown to be a major cost driver for services included in the Foundation Formula – *this ignores the specific impact of deprivation in Pendle which, in our view, is dampened if deprivation is considered in aggregate terms;*

- deprivation, or a suitable proxy, is included in specific service areas (adult social care, children, young people, public health) – *these have no impact of the relatives needs allocation of Pendle Council but may impact on Lancashire County Council's needs assessment*.

- The ***exclusion of surplus sales, fees and charges*** in the assessment of local authorities' relative resources adjustment (Question 12). Given Pendle has a relatively low capacity to general fees and charges compared to other places, the Council's view is that such income streams should be taken into account. In this context, the Council's views is also that surplus car parking income should be taken into consideration (Question 13);

23. At this stage, the consultation is based on the principles of the Fair Funding Review and no information is available to enable the Council to model the financial impact of the proposals to determine future funding levels for the Council; indeed, until the CSR is concluded, any such calculations would be indicative in any event.

Business Rate Retention Reform

24. The current Business Rates Retention Scheme was introduced in April 2013. The scheme allows Councils to keep 50% of any growth ('retained growth') in business rates from one year to the next (subject to a levy to prevent exceptional growth and to provide for a safety net for those authorities that experience exceptional losses).

25. The Government's aim is to increase the amount of retained growth to 75% with effect from the financial year 2020/21. This is to give Councils greater control over the money raised and to incentivise Councils to support local economic growth. In view of this, the Government acknowledges that the present scheme needs to be both updated and reformed to allow more growth to be retained and is, therefore, consulting on the proposed reforms.

26. The consultation is again largely technical in nature and the Council's draft response is set out at **Appendix B.** The key points to note are as follows:-

- significantly, there will be a full reset of the Business Rates Retention System in 2020/21 (this is not a matter for consultation). The reset will be done in conjunction with the Fair Funding Review referred to above and will add a further degree of uncertainty about funding baselines and allocations from 2020/21 onwards;

- the Government is consulting on the frequency and extent of subsequent resets and our response is to balance the certainty of funding allocations with the need to ensure that baselines do not become too dated. In this context, a five yearly reset appears reasonable so long as the distribution of resources is aligned with relative needs. Likewise, our view is that resets should, if possible, coincide with the business rates revaluation cycle;

- there will continue to be a safety net to protect Councils from significant downturns in their business rates income. This is accepted as method of managing the volatility in the business rates system;

- Likewise, a levy on growth will remain although given the Council's present pooling arrangement with other Lancashire Councils, this is unlikely to be an issue for the Council;

- The government is not minded at this stage to change the split is resources between tiers of Council (Pendle currently retains 56% of business rates income, Lancashire County Council 17.5% and Lancashire Fire Authority 1.5%). That said, the Government has indicated that decisions on tier splits should be sector led where possible and, in the case of pooling arrangements, for the Pool partners to determine the splits themselves. The Council's response on this is to acknowledge the Government's proposals but to remain non-committal subject to these proposals being further developed. Ultimately, the Council will resist any changes that lead to lower funding retention by the Council.

27. As with the Fair Funding Review, there is no information at this stage that allows the Council model specifically what the impact of the proposed changes might be on future funding levels. Once such information becomes available, it is assumed that it will form the basis of a subsequent consultation by the Government with the likelihood being that this will take place later in the current calendar year.

IMPLICATIONS

Policy

28. There are no policy implications arising directly from the contents of this report.

Financial

29. The consultations referred to in this report are directly linked to the Council's future funding allocations and how they might be derived. However, other than commenting on the broad principles as set out above, it is not possible to provide any detailed analysis of the Council's future funding.

Legal

30. There are no legal implications arising directly from the contents of this report.

Risk Management

31. Councillors will be aware of the precarious financial position of the Council given the impact of austerity on funding allocations for the Council. As indicated in the report, the CSR will determine the funding envelope for local government and both the Fair Funding Review and the Business Rates Retention Reforms will have a bearing on the future funding allocations for the Council (as with all Councils)

32. Given the anticipated timeline for the CSR, the implementation of the Fair Funding Review and the Business Rates Retention Reforms, it is unlikely that the Council will have a firm indication of its funding allocations until the provisional Local Government Finance Settlement in December 2019. As Councillors will appreciate, this will make financial planning for 2020/21 onward difficult.

33. Nevertheless, the Council will continue to develop and update its Financial Strategy and Medium Term Financial Plan using the best information available and this will form the basis of the reports to Councillors in due course.

Health and Safety

34. There are no Health and Safety implications arising directly from the contents of this report.

Climate Change:

35. There are no climate change implications arising directly from this report.

Community Safety

36. There are no community safety issues arising directly from the contents of this report.

Equality and Diversity

37. There are no equality and diversity implications arising directly from the contents of this report.

APPENDICES

Appendix A – Draft Response – A review of local authorities' relative needs and resources.
Appendix B – Draft Response – Business Rates Retention Reforms.

LIST OF BACKGROUND PAPERS

Papers held in Financial Services