

AGENDA ITEM:

REPORT TO:	MERSEYSIDE FIRE & RESCUE AUTHORITY MEETING
DATE:	30TH SEPTEMBER 2010
REPORT NO.	CFO/159/10
REPORTING OFFICER:	ASSISTANT CHIEF EXECUTIVE & TREASURER
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OFFICERS CONSULTED:	
SUBJECT:	CLG CONSULTATION PAPER: LOCAL GOVERNMENT FINANCE FORMULA GRANT DISTRIBUTION

THERE ARE NO APPENDICES TO THIS REPORT

***There is a Glossary of Terms at the end of this report for your information**

Purpose of Report

1. To propose a response to the Government's consultation paper on revising the Formula Grant distribution mechanism. Within the body of this report each of the consultation questions that relate to the distribution of Formula Grant for fire authorities is considered together with a proposed Authority response.

Recommendation

2. That Members:
 - a) Note the consultation and potential impact on the Authority.
 - b) Agree the proposed response to the consultation document from MFRA
 - c) Members agree to submit a co-ordinated Merseyside response.

Executive Summary

The Government has issued a consultation paper that contains options for revising a number of the components of the Formula Grant distribution system.

This report proposes a response to the consultation which in summary;

- Challenges CLG's proposal to update the expenditure data used within the formula as it:
 - a. Rewards those authorities where expenditure has increased, often at the expense of those who have made efficiencies, and

b. Move resources away from those authorities with the highest levels of deprivation and therefore ignores the link between fire death and injuries and deprivation which is intuitively wrong.

- Supports CLG's proposal to update the fire risk index with a number of factors which appear to be more directly linked to deprivation and hence fire risk.
- Suggests CLG sets a floor level (that guarantees a minimum increase in an individual authority's Formula Grant) that avoids excessive extremes – over the last 3 years a number of FRAs received double digit increases in grant compared to those on the floor receiving just 2% in total across the three years.

Introduction & Background

3. The Formula Grant distribution system is the basis by which the Government allocates out funding to individual authorities as part of the Local Government Finance Settlement.
4. The Communities and Local Government issued a consultation document titled "Local Government Finance Formula Grant Distribution" in July 2010, which outlines various options for reviewing the funding formula. A response to the document is required by 6 October 2010.
5. The grant distribution formula was last reviewed before the 2008/09 local government finance settlement that was applied to the 2008/09 – 2010/11 grant allocations.
6. The Government believes that the options in the paper could be used to update the Formula Grant Distribution system. However options could be further refined following consultation and respondents may propose new options. Hence the final components of the system may not necessarily be drawn from this consultation document.
7. The Government has been clear the Spending Review will require tough decisions at both national and local levels and the proposals in the document do not prejudice the outcome of this.
8. The exemplifications in the paper illustrate the effects of the options for change had they applied in 2010/11. However, the detailed effects of options in the context of the 2011/12 settlement would be different as the comprehensive Spending Review will have produced new totals for the various formula blocks and grant; and updated data will be used.
9. This report only considers proposals which have a direct impact on the formula used to calculate the grant for the Authority, or where there are specific concerns as to the basis on which grant is currently allocated.

10. The Formula Grant has four elements:-

- The **Relative Needs Formula** - designed to reflect the relative needs of individual authorities in providing services and takes account of factors which appear to explain variations in the cost of providing services;
- The **Relative Resources** Amount – takes account the fact that areas that can raise more income locally require less support from Government to provide services, and looks at authorities potential to raise resources through council tax relative to other authorities;
- **Central Allocation** – the amount left over after the above calculations and is allocated out on a per head basis;
- **Floor Damping Block** – adjustment required to ensure stability in the financing of local services by setting a floor or lower limit to any authority's change in their Formula Grant allocation year-on-year.

THE PROPOSED CHANGES

Fire & Rescue Services Relative Needs formula

11. The main determinants of the Fire & Rescue Relative Needs Formula are:

- Resident population
- Fire Safety
- Coastline
- Deprivation
- Control of Major Accident Hazard sites
- Area Cost Adjustment

The relative weightings of these facts are determined using a process called regression comparing with expenditure data.

The consultation paper proposes 2 changes to the Relative Needs Formula regarding the:

- I. expenditure base data, used for the regression exercise and (FIR 1 + 2
- II. the factors used in the risk index, (FIR 3 + 4)

	Option	Proposed Change	Increase / (Decrease) £m
1 Options for changing Expenditure Data	FIR 1	This option updates the expenditure base used in the regression analysis from the current 1998 – 2001 data to 2006 – 2009.	(2.9)
	FIR 2	This option is as per FIR 1 but adds back the average annual cashable efficiencies achieved in 2006 - 09	(2.7)
2 Options for changing Risk Index	FIR 3	<p>To replace current standard factors in the risk index with factors that appear more directly linked to deprivation and consequently fire risk:</p> <ul style="list-style-type: none"> ➤ Proportion of people of working age with no qualifications ➤ Proportion of people of working age who are not in employment ➤ Proportion of people receiving Income Support / income based Jobseeker's Allowance/ guarantee element of Pension Credit ➤ Proportion of people in ACORN Group G: Starting Out (reflecting Type 24: Young Couples, Flats and Terraces and Type 25: White-Collar, Single and Sharers, Terraces) ➤ Standardised Mortality Ratio 0 – 74 years ➤ In addition, population sparsity is included as a separate indicator 	0.8
	FIR 4	<p>As per FIR 3 but excluding:</p> <ul style="list-style-type: none"> ➤ Proportion of people in ACORN Group G: Starting Out (reflecting Type 24: Young Couples, Flats and Terraces and Type 25: White-Collar, Single and Sharers, Terraces) ➤ Population sparsity is included as a separate indicator <p>In addition: Population density is included as a separate indicator in the deprivation top-up</p>	1.1

12. Consultation Response:

Question 6 - Do you agree that the expenditure data used to determine the coefficients should be updated (FIR1)?

The Authority is opposed to such a change as the idea that past expenditure is a good indicator of future need is considered fundamentally flawed as it would reward those authorities where there has been growth during the period at the expense of those who have reduced expenditure through efficiencies.

The proposals would move significant resources away from the London and Metropolitan areas estimated at £25m, where there are the highest levels of deprivation coupled with the highest risks of all sorts including new dimensions, intuitively this seems wrong.

(1) Response

The proposal is opposed because the fundamental idea that past expenditure is a good indicator of future need is considered fundamentally flawed as it would reward those Authorities where there has been growth during the period at the expense of those who have reduced expenditure through efficiencies.

The biggest drivers for fire expenditure are salaries and pensions costs, which are all negotiated nationally and consequently you would not expect any great change in the expenditure profile as a result of updating the data set. The fact that there is such a significant shift can only be a result of changes in the level of service provision during the period.

The major factor causing this shift in expenditure is the ratio of expenditure funded by revenue support grant as compared to precept. Total expenditure is controlled by the amount of revenue support grant plus income from the precept. Whilst the revenue support grant is fixed there is some flexibility in precept income subject to the capping criteria which is normally set as a percentage increase.

In the case of the Metropolitan Authorities and London revenue support grant accounts for between 60% and 70% of funding leaving between 30 and 40% funded by precept.

In the Combined and Shire Authorities the ratio is reverse with around 30% funded from grant and 70% from precept. This change has a significant impact on total income as shown in the example below.

As an example in 2010/2011 where as the floor for grants was set at 0.5% precepts were allowed to rise by 3%. An Authority with a 70 30 ratio grant to precept would have received a total increase in income of 1.25% and an authority with the reverse would have received a total increase in income 2.25%. Over the 3 year period on the last spending review this gap will have been in excess of 3%. As precept increases have exceeded increases in revenue support grant for the last 10 years this could account for over 10% shift in resources.

This demonstrates that the shift in expenditure from metropolitan authorities to the different classes of authorities reflects the ability to raise income not the need to spend.

Other factors affecting the shift include:

1. The period includes the first three years of efficiency savings. Data provided by the Audit Commission shows that the Metropolitan Fire Authorities were the first to achieve savings and have generated the lions share of all savings currently delivered. In addition the use of historic expenditure data to inform grant award has inherent tension with the efficiency agenda. (End result is reducing expenditure leads to reduce grant) **This can be seen as the reintroduction of a perverse incentive into the grant formula.**
2. Any increase in expenditure outside Mets over the period was driven by the need to meet the wider range of services within modern FRA framework. This is a growth pressure not a resource allocation pressure. This included the period where combined Authorities were changed to precepting Authorities and were budgeting to establish revenue balances thus artificially increasing their expenditure.

In the last few years we have seen the increased threat from new dimensions type incidents with the greatest threat acknowledged to be in the metropolitan areas.

Finally the government funded Greenstreet Berman report established the link between deprivation and fire deaths and injuries which no doubt initiated the review of the deprivation factors. Without commenting specifically on options 3 and 4 these implications if implemented would have exactly the opposite impact of options 1 and 2 which suggests there is no risk based need to update the data.

Question 7 - Should annual cashable efficiency savings be added to the updated expenditure data used to determine the coefficients (FIR2)?

It is appropriate that the mechanism should not penalise those authorities that have modernised most and been most efficient. The formula should have a mechanism to ensure this.

Unfortunately the data in relation to efficiencies is not robust enough at a national level and does not reflect the true cashable efficiencies achieved by some organisations particularly the Metropolitan FRS's.

The system for recording efficiency savings left flexibility to claim savings whilst not reducing expenditure by reinvesting the savings elsewhere in the service. Therefore the adjustment for efficiency savings rewards those Authorities that have reinvested the savings at the expense of those who have reduced the base budget.

The Authority would argue that savings should be added back to avoid penalising those services who have modernised working practices to deliver more efficient and improved services. However, the same opposition identified in Question 6 is still applicable in that past expenditure is not a good indicator of future need.

Question 8 – Would you prefer either FIR3 or FIR4 as an alternative to the current risk index?

The proposed alternative factors appear to be more directly linked to deprivation and consequently fire risk and hence the Authority supports the introduction of these factors. The Authority would also prefer FIR4 to FIR3 as the use of population density rather than sparsity reflects the fact that more people are at risk from fire in densely populated areas.

The Authority believes that any formula should take account of the significant impact of deprivation on fire risk and believes this should have an even greater impact on grant allocation than present.

Floor Damping Levels

13. As part of the annual settlement process a “floor” or lower limit to any change in an authority’s Formula Grant is set, thus ensuring a degree of stability within the system. In order to pay for this authorities above the floor have their overall grant increase scaled back in direct proportion to their increase.
14. Where the scaling factor is higher more of the formula change will come through for authorities above the floor than if the scaling factor was lower. CLG set a floor of 1%, 0.5% and 0.5% over the 2008/09 – 2010/11 period. MFRA was at the floor but in 2010/11 the level of “protection” was only £0.183m under the existing Formula Grant process.
15. Over the next Spending Review it is possible a range of floor levels, including setting negative floors, may be proposed.

Question 17 – Over the next Spending Review period do you think that the floor level should be set close to the average change or such that it allows some formula change to come through for authorities above the floor?

The Authority believes that the stability in grant entitlement is very important at a time when the overall quantum available is likely to change significantly. T sufficiently high to allow some element of the revised grant to flow through the system; however this has been set too high in previous years resulting in some authorities receiving an increase 6 or 7 times greater than those on the floor over the last 3 year settlement period. The floor should be close to the average change.

Equality & Diversity Implications

16. None directly arising out of this report.

Financial Implications & Value for Money

17. Decisions made by CLG over the way in which the Formula Grant distribution mechanism will work will impact on grant settlement received by the Authority. Currently 63% of the Authority's revenue funding is from the Formula Grant settlement.

Health & Safety and Environmental Implications

18. None directly arising out of this report.

Contribution to Achieving Our Purpose:

19. None directly arising out of this report.

BACKGROUND PAPERS

Local Government Finance Formula Grant Distribution – Consultation paper from CLG.

Glossary of Terms

CLG - Communities and Local Government.