



# **Distribution of Formula Grant to Local Authorities in England**

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## Introduction

This paper describes how formula grant is allocated to local authorities via the *Local Government Finance Settlement* in England. A glossary of terms can be found at the end of the document.

## What is the Local Government Finance Settlement?

Central Government has set up three separate systems to fund the three main blocks of local authority spending in England. These blocks are:

- spending on capital projects such as roads, school buildings or computers;
- revenue spending on council housing; and
- revenue expenditure, mainly on pay and other costs of running services other than council housing. Government supports local councils' revenue expenditure through formula grants and ring-fenced grants. In 2006/07 funding for schools switched from formula grant to the ring-fenced Dedicated Schools Grant (DSG). Together these total some £62 billion in 2006/07 and £65 billion in 2007/08.

The annual *Local Government Finance Settlement* is concerned with the distribution of Formula Grant, which is made up of Revenue Support Grant, redistributed business rates and principal formula Police Grant. Formula Grant totals some £25 billion in 2006/07 and £26 billion in 2007/08.

Ring-fenced and specific grants are not part of this annual settlement but are usually announced at the same time. These will total some £37 billion in 2006/7 and £39 billion in 2007/08, including the DSG.

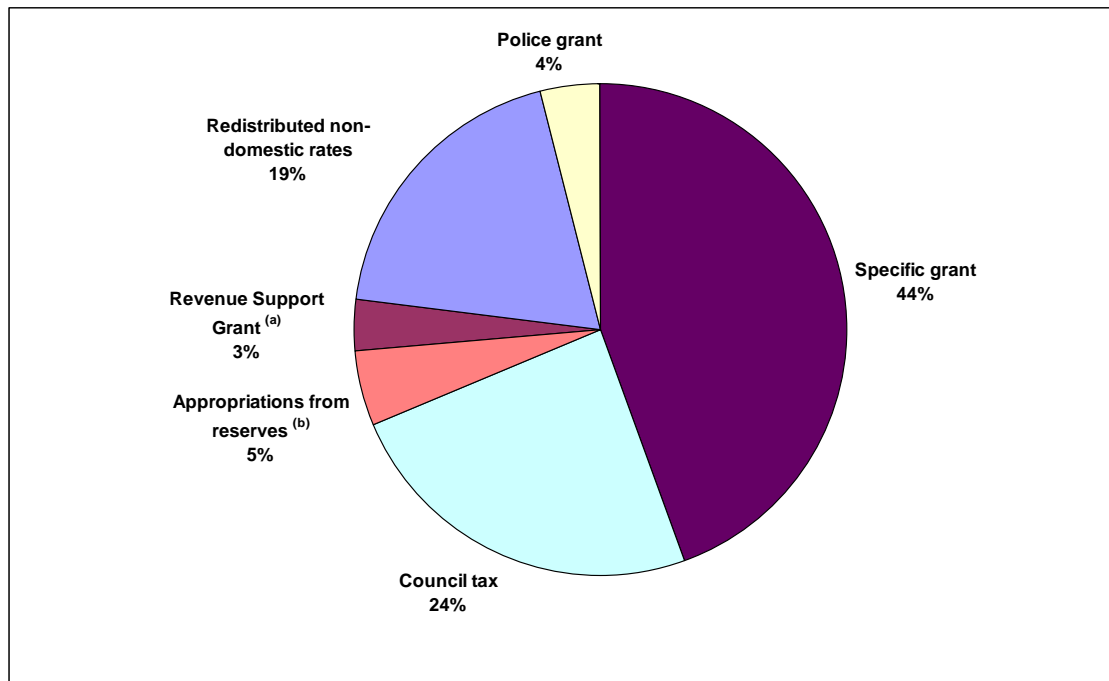
## Deciding the Overall Amounts of Grant

In Spending Reviews, the Government decides how much it can afford to spend, reviews expenditure priorities and sets improvement targets to be delivered from additional funding. In July 2004, the Government announced the results of its latest Spending Review, which set the framework for Government grant support to local government in 2005/2006 to 2007/2008. The first year of the next Spending Review will determine the total level of grant to local authorities for the 2008/09 to 2010/11.

Government grant (of all kinds) and business rates together are known as Aggregate External Finance (AEF). Formula Grant (made up of Revenue Support Grant, redistributed business rates and principal formula Police Grant) is part of AEF.

Councils also fund spending through Council Tax. Local authorities set their budgets, taking into account local priorities. They then work out the amount of money that needs to be raised locally in order to meet the difference between their budget and the grant paid by central government, etc.

**Chart 1: Financing of revenue expenditure planned in 2007-08 in England**



(a) Appropriations from reserves includes adjustments, and appropriations from the pensions reserve.

(b) Revenue support grant includes GLA grant and 'Other items'

Source: Statistical Release: Local Authority Revenue Expenditure And Financing England 2007-08 Budget

Changes do occur between the plans laid out in the Spending Review and the grant available for distribution in any one year. This is because the responsibilities placed on councils by Government change. If a change involves more work for councils, then Government gives them more grant. If it involves less work, then grant is taken away. These changes in funding are often known as 'transfers'. The principle is that funding follows responsibility.

## **Different types of revenue grants**

Formula Grant is distributed by formula through the Local Government Finance Settlement. There are no restrictions on what local government can spend it on.

Specific formula grants are distributed outside the main settlement. Some of these are known as ring-fenced grants which control council spending. These usually fund particular services or initiatives that are a national priority. For example, funding for schools is paid through the Dedicated Schools Grant reflecting the priority the Government place on education.

Other specific formula grants are unfenced and are sometimes called targeted grants. They are distributed outside of the annual settlement, because the general formulae are not appropriate. There are no restrictions on what councils can spend the money on. With the exception of grants for schools, there is generally no ring-fencing of grants for authorities judged "excellent" in the Comprehensive Performance Assessment.

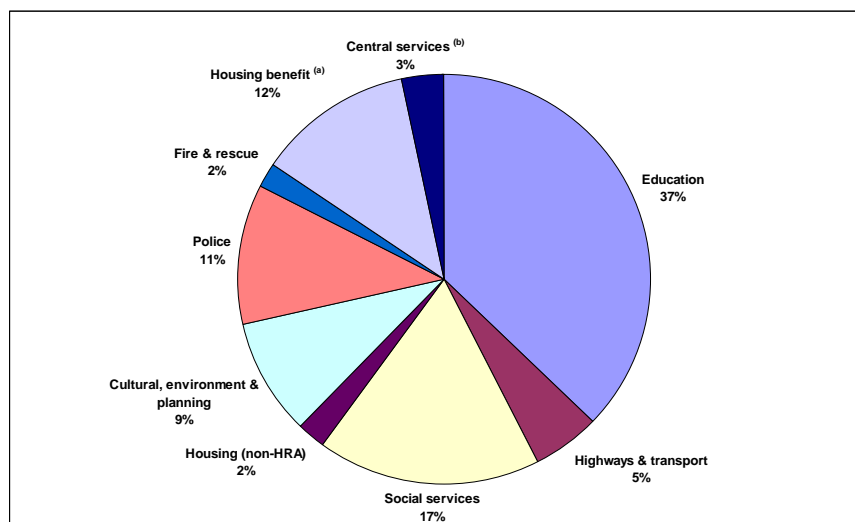
**Table 1: Examples of the main grants of each type**

	£ million	
	2006/07	2007/08
<b>FORMULA GRANT</b>		
Revenue Support Grant	3,378	4,105
National Non Domestic Rates	17,500	17,500
Police Grant (including Met Police special payment)	3,936	4,028
<b>Total</b>	<b>24,814</b>	<b>25,633</b>
<b>EXAMPLES OF UNFENCED (TARGETED) GRANT</b>		
Neighbourhood Renewal Fund	525	525
Planning Delivery Grant	104	92
Children's Services Grant	152	193
Access and Systems Capacity	546	546
Carers Grant	185	185
<b>EXAMPLES OF RING-FENCED GRANT</b>		
Dedicated Schools Grant	26,576	28,172
Mental Health Grant	133	133

## How does Local Government spend its money?

Local Government revenue spending can be broadly split into 9 categories: education, personal social services, police, fire, highways and transport, environmental, protective and cultural services, housing benefit, non-HRA housing and housing benefit.

**Chart 2: Budgeted net current revenue expenditure 2007-08 in England**



(a) Housing benefit includes mandatory rent allowances and mandatory rent rebates.

(b) Central services includes courts and other services.

## Who is funded through formula grant?

Formula grant goes to all major tiers of authorities in England. Formula grant only funds the following seven services: children's services, adult personal social services, police, fire, highway maintenance, environmental, protective and cultural services, and revenue-support for capital financing. Housing for example is not funded through Formula Grant but instead through the Housing Revenue Account.

**Table 2: Services by class of authority**

Local Authority	Children's Services	Personal Social Services	Police	Fire	Highway Maintenance	Environmental, Protective & Cultural Services	Capital Financing
City of London	✓	✓	✓		✓	✓	✓
London Boroughs	✓	✓			✓	✓	✓
Metropolitan Districts	✓	✓			✓	✓	✓
Isles of Scilly	✓	✓		✓	✓	✓	✓
Isle of Wight	✓	✓		✓	✓	✓	✓
Other Shire Unitary Authorities	✓	✓			✓	✓	✓
County Councils with Fire Responsibility	✓	✓		✓	✓	✓	✓
County Councils without Fire Responsibility	✓	✓			✓	✓	✓
District Councils						✓	✓
Police Authorities			✓				✓
Fire Authorities				✓			✓

Since for every area in England at least two authorities provide services, the finance system is necessarily quite complicated.

## Allocating Formula Grant – Historical systems

In 1990/91, Standard Spending Assessments (SSA) were introduced for the first time. SSAs were formulae based on the social, economic and physical characteristics of an authority. When they were first introduced they were described as the Government's assessment of how much an authority should be providing on a particular service.

The Government then took into account an authority's relative ability to raise tax locally when distributing formula grant.

<b>Formula Grant = Standard Spending Assessment – Assumed Council Tax Yield</b>
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The system was said to equalise for needs and resources.

The SSAs differed from the previous system, Grant-Related Expenditure (GRE) as we combined many of the smaller services into broader headings – there were around 60 separate service formulae in GREs.

In 1994/95, the SSA formulae were changed to incorporate the results from the 1991 Census. Due to the large changes in these formulae, *SSA Reduction Grant (SSA Review)* was introduced for the first time. This was a special grant that damped the changes in methodology (formula).

In 1995/96, following the review of police funding, *SSA Reduction Grant (Police Funding Review)* was first introduced. This special grant damped changes in methodology for the police.

In 1999/2000, *Central Support Protection Grant* was introduced for the first time. This ensured that no authority would receive less than last year's formula grant on a like-for-like basis after adjusting for changes in funding and function. At around this time, the Standard Spending Assessments were no longer considered to be the Government's assessment of how much a council was expected to spend.

The Government started a major review of local government funding. During this review the SSA formulae were frozen, although the data was updated each year.

In 2001/02, floors and ceilings were introduced for authorities with responsibility for education and personal social services. Instead of using a special grant, such as Central Support Protection Grant, to damp changes in grant support, Revenue Support Grant was itself used to ensure that no authority received less than a minimum percentage increase (the 'floor') year-on-year on a like-for-like basis and that no authority would receive more than a maximum percentage increase (the 'ceiling'). In 2002/03 this method of damping grant support was extended to all authorities.

In 2003/04, the system was changed following the conclusion of the major review of local government funding. The SSAs were abolished and replaced with Formula Spending Shares (FSS). The FSSs were neither the Government's assessment of how much an authority should spend on a particular service nor were they grant. They were simply the formulae used in the calculation of formula grant. The Control Totals for each FSS were aligned to the actual amount of money that Local Government spent on the service. The assumed council tax was therefore much closer to that actual annual average.

The Formula Spending Shares were again frozen for three-years, to cover the period of the Spending Review i.e. 2003/04 to 2005/06. Data continued to be updated annually.

In 2004/05, ceilings were abolished for the first time. Floors were paid for solely by a scaling factor on the grant increases above the floor.

### **Allocating Formula Grant – 3 year settlements**

In 2006/07, for the first time, the Government has decided to produce forward allocations of most grants for 2006/07 and 2007/08. One exception is the funding of some capital projects where allocations cannot be forecast, and are instead funded through capital grant.

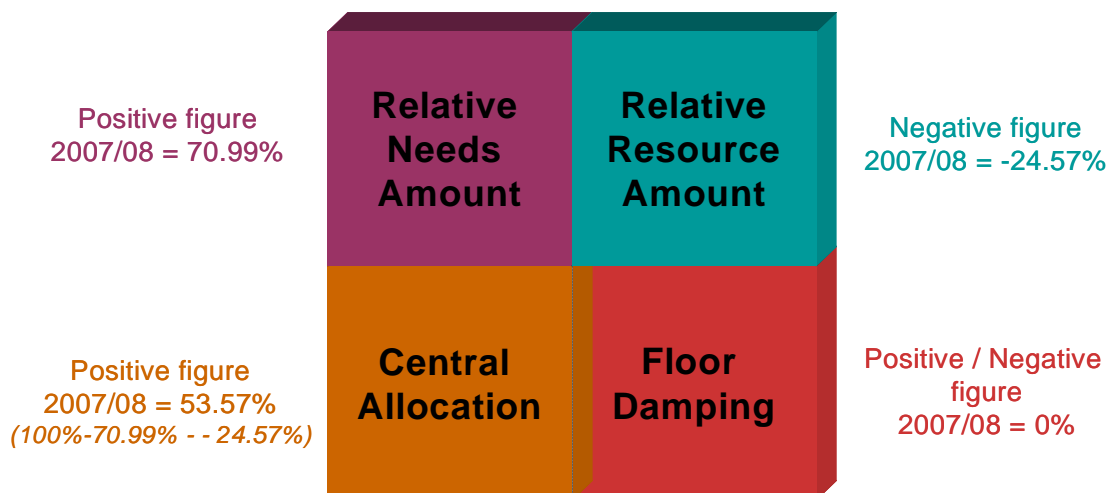
The arrangements for allocating ring-fenced and specific grants vary: some schemes use formulae or entitlement rules; others allocate fund by bid appraisal. Formula Grant is allocated by mathematical formulae – with changes limited by floor damping. This allocation of Formula Grant is known as the Local Government Finance Settlement. The following sections give more detail about how this is done.

## Sharing out resources through the 4- block model

In 2006/07 the government introduced a new system to distribute Formula Grant. The rationale for introducing this new model was that in a system whose sole purpose is distributing grant, such assumptions really have a role. Under the previous system of SSAs, the formula grant distribution system made use of notional figures for spending, both by service and by individual authority; and for council tax, both nationally and for groups of authority depending on the range of services they deliver. Over the years, these figures have been used for a variety of purposes, such as spending or tax targets, for which they were neither intended nor suitable. The Government saw merit in considering replacement grant distribution systems that did not contain such figures. The new systems focuses on grant, and does not contain notional measures of spending and council tax.

Under the new system the distribution of Formula Grant is determined wholly by the Relative Needs Amount (and Police Grant formulae in the case of police authorities), the Relative Resource Amount, the central allocation (an amount per head) and the floor damping scheme. It continues to have no assessment of how much an authority should spend on a particular service.

## The 4 - Block Model



## Block 1 - Relative Needs Amount

The Relative Needs Amount is determined from combining the results of the Relative Needs Formulae (RNFs) for different groups of authorities that provide the same services. The RNFs are mathematical formulae that include information on the population, social, economic and physical characteristics of the authority.

### Sources of Indicator Data

We use data from many different sources with the calculation of Formula Grant.

**Table 3: Examples of indicators and their sources**

Source	Indicators
Office for National Statistics (ONS)	Sub-national population projections and Mid-year estimates, 2001 Census, Labour Force Survey data, Annual Business Inquiry data, International Passenger Survey data, Claimant counts
Department for Children, Schools & Families (DCSF)	Pupil Level Annual School Census data, Absences data
Department for Work & Pensions (DWP)	Income support /Income based Jobseekers' Allowance, Incapacity Benefit and Severe Disablement Allowance, Attendance Allowance, Disability Living Allowance
Department for Transport (DfT)	Road lengths, Traffic flows
Other Govt Depts & Agencies	UK Tourism Survey data, Flood Defence Expenditure, Internal Drainage Board Levies, COMAH sites
Commercial Organisations	ACORN data (CACI)

## Area Cost Adjustment

One of the most important indicators used in the Relative Needs Formulae is the Area Cost Adjustment (ACA). This reflects the differences in costs of inputs which local authorities need to buy. Thus, it reflects the differences in the cost of labour and business rates in their area.

The Labour Cost Adjustment is essentially based on the differences in wage costs between areas. The adjustment is applied to the proportion of the expenditure on each block of services which relates to staff. Differences in labour costs account for the great majority of the ACA.

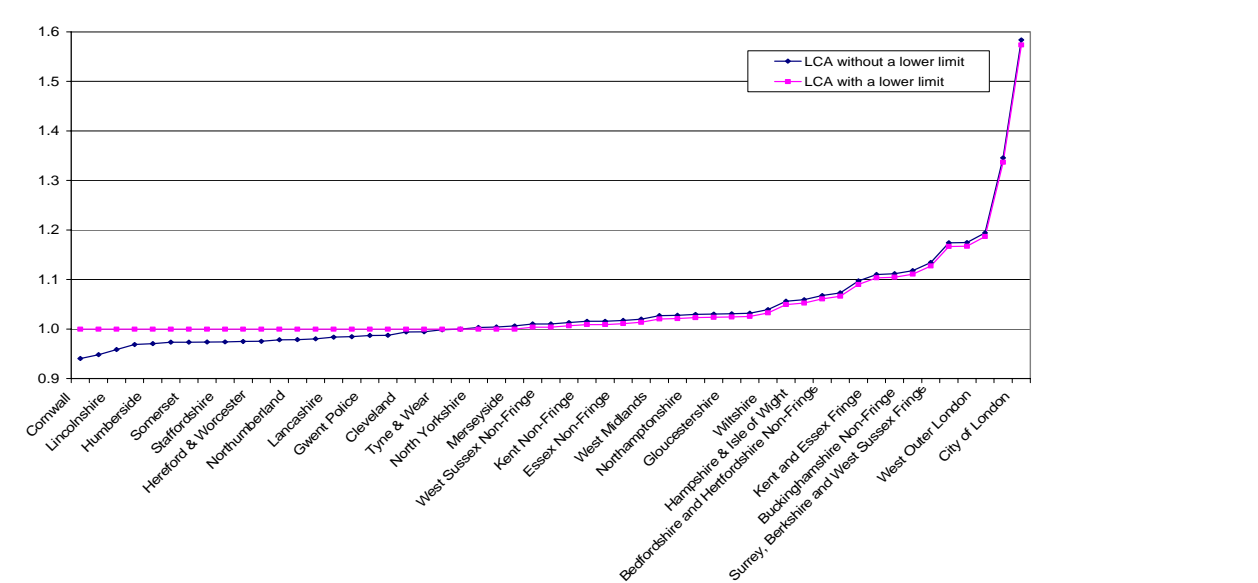
It is based on what is sometimes called a 'general labour market' approach. The underlying rationale is that local authorities have to compete for staff with other potential employers. Hence, in order to secure and retain various categories of staff of a given quality, they will need to pay the local 'going rate'. This is measured by comparing wage evidence in each ACA area.



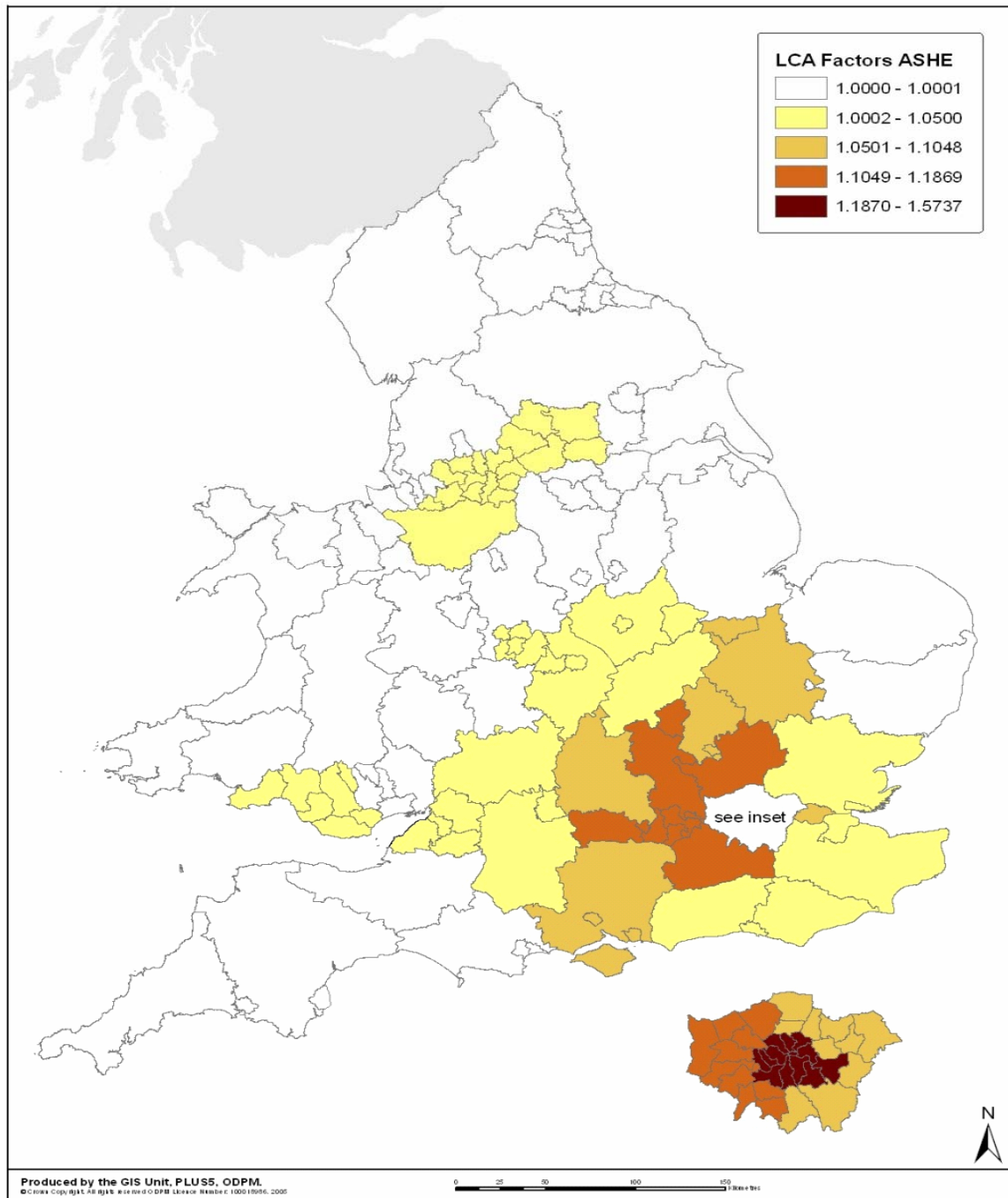
The LCA factors are calculated for each English county area based on historic 1991 boundaries, with two refinements. Counties neighbouring London have been divided into fringe and non-fringe areas. The fringe areas are those districts where teachers are eligible for London fringe payments. Outer London has been divided into two in line with evidence suggesting there is variation in wage pressures across Greater London.

Labour Cost Adjustment factors are calculated based on the hourly earnings which are smoothed to reduce volatility. This is done by using a three-year average. A lower limit is then applied to the smoothed LCA factors. Occupations such as teachers, police and fire-fighters are on national pay scales, and they make up a higher proportion of local government employment than of the economy as a whole. The lower limit recognises this lower wage flexibility in the public sector. The lower limit is set by judgement, aiming to strike a balance between the presence of national pay scales for teachers, police and fire-fighters and the fact that authorities contract out services to the private sector particularly within Social Services and the Environmental, Cultural and Protective Services (EPCS) blocks.

Chart 3: The Action of the Lower Limit



**Map 1: Labour Cost Adjustment factors**



The Rates Cost Adjustment is essentially based on the differences in rateable values per square metre between authorities in the seven RCA areas (City of London, inner London, outer London, London's fringe area, the rest of the south-east, the south east fringe and northern ACA area) and those elsewhere in England; a slightly different approach is used for school buildings. The adjustment is applied to the proportion of the expenditure on each block which relates to business rates.

## The Relative Needs Formulae

The Government (in consultation with local government) has developed separate formulae to cover the major services which local authorities provide. RNF's are divided into these major service areas, because there are different factors influencing each service area. For example, the factors which appear to explain variations in the cost of providing social services for the elderly, are very different from those which appear to explain variations in the cost of maintaining roads. These formulae apply to all authorities providing a particular service.

**Table 4: Funding Blocks for Service Areas**

<b>Service Block</b>	<b>Sub-block (where relevant)</b>
<b>Children's Services</b>	
<b>Composed of:</b>	<i>Youth and Community</i> <i>Local Education Authority Central Functions</i> <i>Children's Social Care</i> <i>Children's Social Care damping</i>
<b>Adults' Personal Social Services</b>	
<b>Composed of:</b>	<i>Social Services for Older People</i> <i>Social Services for Younger Adults</i> <i>Social Services for Younger Adults damping</i>
<b>Police</b>	
<b>Fire</b>	
<b>Highway Maintenance</b>	
<b>Environmental, Protective and Cultural Services</b>	
<b>Composed of:</b>	<i>Services provided predominantly by non-metropolitan district councils in non-metropolitan areas (District level EPCS)</i> <i>Services provided predominantly by county councils in non-metropolitan areas (County level EPCS)</i> <i>Fixed Costs</i> <i>Flood Defence</i> <i>Continuing EA Levies</i> <i>Coast Protection</i> <i>Fixed Costs</i>
<b>Capital Financing</b>	

Relative Needs Formulae are designed to reflect the relative needs of individual authorities in providing services. They are not measuring the actual amount needed by any authority to provide local services, but simply recognise the various factors which affect local authorities' costs locally. They do not relate to the actual monetary amount of grant that a council needs for providing services for its residents. The amount of grant a council will receive from Government depends also on the results of the other three blocks detailed below.

The formula for each specific service area is built on a basic amount per client, plus additional top ups to reflect local circumstances. The top ups take account of a number of local factors which affect service costs, but the biggest factors are deprivation and area costs.

### Example 1: Relative Needs Formula Calculation – Younger Adults Personal Social Services (PSS)

#### Basic amount

Younger Adults' PSS Basic Amount	8.4103
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#### Top-Up

Younger Adults' PSS Deprivation Top-Up	<p>251.0467 multiplied by People Aged 18 to 64 Receiving Disability Living Allowance (0.0499); plus</p> <p>67.9234 multiplied by People Aged 18 to 64 Who are Long Term Unemployed or Have Never Worked (0.0308); plus</p> <p>22.9762 multiplied by People Aged 18 to 64 Who Work in Routine or Semi Routine Occupations (0.2683); plus</p> <p>19.2000 multiplied by Households with No Family (0.3206); minus</p> <p>13.0472</p>
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#### Social Services for Younger Adults

- (a) Projected Population Aged 18 to 64 in 2006 (311,526) multiplied by the result of:  
 Younger Adults PSS Basic Amount (8.4103); plus  
 Younger Adults PSS Deprivation Top-Up (13.89211);
- (b) The result of (a) is multiplied by ACA for Children and Younger Adults PSS (1.000);
- (c) The result of (b) is then multiplied by the scaling factor given in Annex F for the Social Services for Younger Adults sub-block (0.99999876955482).
- (d) The result of (c) is then divided by 10,000,000,000.

**Social Services for Younger Adults RNF for the local authority = 0.00069477706300**

As RNFs are only intended to reflect the relative differences in the cost of providing services in different areas, they are expressed as a proportion of the total relative needs in 2005/06.

Once RNFs for service blocks have been calculated for all authorities, the next step is to generate cash amounts that are correlated to the measure of relative need. To do this fairly, Government has to group the individual service formulae into six groups so that councils are only being compared to authorities providing the same range of services.

For example, an 'Upper tier RNF' is determined from the RNFs for Children's Services, Adults PSS, Highways Maintenance, County level EPCS and Continuing Environment Agency Levies as these are all provided by the same group of authorities (counties, met districts, unitaries, London boroughs, City of London and the Isle of Scilly).

**Table 5: Services included in the 6 RNF service groups**

<b>Service Block</b>	<b>Upper Tier</b>	<b>Lower Tier</b>	<b>Police</b>	<b>Fire</b>	<b>Mixed Tier</b>	<b>Capital</b>
<b>Children's Services</b>	✓					
<b>Adults' Personal Social Services</b>	✓					
<b>Police</b>	✓		✓			
<b>Fire</b>	✓			✓		
<b>Highway Maintenance</b>	✓					
<b>Environmental, Protective and Cultural Services</b>						
<i>County level EPCS</i>	✓					
<i>Continuing EA levies</i>	✓					
<i>District Level EPCS</i>		✓				
<i>Fixed Costs</i>					✓	
<i>Flood Defence</i>					✓	
<i>Coast Protection</i>					✓	
<b>Capital Financing</b>						✓

The RNFs are added together to give a total RNF for each group. The total RNF for each group is then divided by the total population for that group of councils as measured by the mid-year population projections for the year in question. The minimum RNF per head across all councils providing the group of services is then subtracted from the RNF per head for each council. The sum of the RNFs above the minimum for each council is then calculated and this is then multiplied by the mid-year projected population. The control total for the Relative Needs Block is then distributed in proportion to this.

## Example 2: An Example of Relative Needs Amount Calculations

Service block	Result for LA
Youth & Community	0.00007489187282
Local Authority Central Education Functions	0.00047341713208
Children's Social Care	0.00059188635792
Children's Social Care damping	-0.00004889798654
Social Services for Older People	0.00123890842363
Social Services for Younger Adults	0.00066956715485
Younger Adults damping	-0.00010142144290
Highways Maintenance	0.00035116858025
County-level EPCS	0.00057367849641
Continuing EA levies	0.00000086210934
<b>TOTAL UPPER-TIER RNF</b>	<b>0.00382406069787</b>
Total Upper-Tier RNF per head divided by 1,000,000	0.00728549325448

Service block	Result for LA
Fixed Costs	0.00000506385425
Flood Defence	0.00000000000000
Coast Protection	0.00000286619445
<b>TOTAL MIXED TIER RNF</b>	<b>0.00000793004870</b>
Total Mixed-Tier RNF per head divided by 1,000,000	0.00001510810651

	RNF per head	Minimum RNF per head for group	Difference
Upper Tier	0.00728549325448	0.00550497245490	0.00178052079958
Fire & Rescue	0.00064379380648	0.00045756059840	0.00018623320809
Mixed Tier	0.00001510810651	0.00000369451412	0.00001141359239
Capital Financing	0.00109576445555	0.00000930743633	0.00108645701921
Sum			0.00306462461927
Divide by 1,000,000 and multiply by projected population			0.00160858162254
Sum for all authorities			0.23098045438443
Total Relative Needs Amount			£14,821,378,613
<b>Relative Needs Amount for LA</b>			<b>£103,218,253</b>

## Block 2 - Relative Resource Amount

The Relative Resource Amount (RRA) is a negative figure. It takes account of the fact that areas that can raise more income locally require less support from Government to provide services. The negative Relative Resource Amount is balanced against the positive proportion calculated for each authority by the Relative Needs Amount. This is done by looking at authorities' council taxbase data (a measure of the number of properties equivalent to Band D for council tax in an area). The greater an authority's taxbase, the more income it can raise from a standard increase in band D council tax.

Negative RRAs are then generated using the amounts above the minimum council tax base per head. Again, to do this fairly, the RRA is applied to four separate groups of authorities depending on the services they provide. These are upper tier services, lower tier services, fire authorities and police authorities.

### Example 3: Example of Relative Resource Amount calculation

Service	Share of Taxbase	Relative Resource	Minimum Relative Resource	Difference
Upper Tier	0.72103328	0.25518217677918	0.19839641604443	0.05678576073474
Fire	0.03378238	0.01195598248278	0.01012599908496	0.00182998339782
Sum				0.05861574413256
Multiplied by population projection				30,766.642090508
Sum for all authorities				4,075,872.830654
Total Relative Resource Amount				-£5,129,754,854
<b>Relative Resource Amount for LA</b>				<b>-£38,721,849</b>

### Block 3 - Central Allocation

Once we have taken account of the Relative Needs and Relative Resources of local authorities, there is still an amount of money left in the overall grant pot for distribution to local authorities.

The Government shares this out on a per head basis; the per head amounts are based on the appropriate minimums for each authority already calculated for the needs and resources blocks.

#### Example of Central Allocation Calculation

Minimum Upper tier RNF per head	0.00550497245490
Minimum Fire & Rescue RNF per head	0.00045756059840
Minimum Mixed tier RNF per head	0.00000369451412
Minimum Capital Financing RNF per head	0.00000930743633
Sum of Minima	0.00776604834274
Divided by total RNF above the minimum multiplied by RNA (£) multiplied by 1,000,000	<b>£383.433623929129</b>
Minimum Upper Tier taxbase per head	0.19839641604443
Minimum Fire & Rescue taxbase per head	0.01012599908496
Sum of Minima	0.20852241512939
Divided by total taxbase above the minimum multiplied by RRA (£) multiplied by 1,000,000	<b>-£262.43921624175</b>
Sum amounts per head	<b>£120.994407687377</b>
<i>Multiplied</i> by population projection	£63,508,391.668
Sum for all authorities	£11,192,576,890
Total Central Allocation	£11,205,498,375
<b>Central allocation for LA</b>	<b>£63,581,710</b>

### Adjustments to Base Period

Adjusted RNFs and formula grant are calculated for use in the floor damping mechanism and to allow a like-for-like comparison with the current year. **As they are notional amounts, they do not affect any authority's grant entitlement for the previous year.**

Adjustments to RNFs are made when a new burden is imposed on or taken away from authorities or where the funding stream is altered (for example, between formula grant



and special grant). So that the adjustments allows the base period of the comparison to reflect the position it would have been in if the transfer or new burden had taken place in that year. For example, in 2006/07, mainstream funding for schools was transferred to special grant. In 2005/06, support for schools was provided as part of the Local Government Finance Settlement. An allowance for school funding therefore needed to be removed from the 2005/06 grant before a comparison could be made. Some transfers of function are included within the SR announcement totals without being costed separately. There have therefore been no adjustments to the base year in respect of these.

Adjustments are not made for general control total increases (for example, to allow for demographic pressures) or for changes not confined to local government (for example, National Insurance Contributions). We have not adjusted for transfers that amount to apportioning the results of the Spending Reviews where these have been given on a gross Total Standard Spending basis (for example, the transfer for PFI special grant).

The majority of adjustments are made in the same way i.e. taking the transfer amount in the current year and deflating. The control total for the previous year is thereby revised and the current year's formula applied to it.

Where a special grant has moved into general funding, the actual distribution in the previous year has been used. Where a transfer is being made from the settlement and an appropriate RNF amount in the base year is clearly identified, that amount is used to revise the control total.

The main changes in 2006/07 were:

- schools funded via the Dedicated Schools Grant
- changes to the police and fire fighters pensions funding arrangements
- residential allowances moving into Formula Grant; and
- to reflect the change from statutory half-fare concessionary fares to statutory free-fare scheme.

## **Block 4 - Floor Damping Block**

The mechanism for damping grant changes remains the same as in the previous grant distribution system.

Following the calculations in the three blocks described above, each authority will have a grant amount allocated to it. However, Government ensures that all individual local authorities receive a reasonable grant increase year-on-year.

In order that authorities are protected from detrimental grant changes, the Government sets a guaranteed minimum increase in grant. It is important to note that all floor calculations (as with all the comparisons of grant that Government makes from one year to the next) are adjusted to make sure they are on a like-for-like basis. For instance, in 2006/07, the transfer of the Residential Allowance grant into formula grant means that upper tier authorities need more formula grant than before.

So when floors are calculated, the baseline year (2005-06, for the 2006-07 settlement) is adjusted to include the Residential Allowance grant transfer. That is why the quoted increase in grant may not be the same as the change in the cash an authority receives. The Government knows that this appears to make the system more complicated – but

local government agrees that it is fair.

Separate floors levels are set for four groups of authorities: authorities with education and social services responsibilities; single-service police authorities; single service fire authorities; and shire districts. Separate parts of the Formula Grant calculations for the GLA are included in the floor arrangements for police and fire authorities.

These groups are treated separately because each group receives a different overall grant increase, and the Government believes it would be wrong for groups of authorities with radically different responsibilities to cross-subsidise each other.

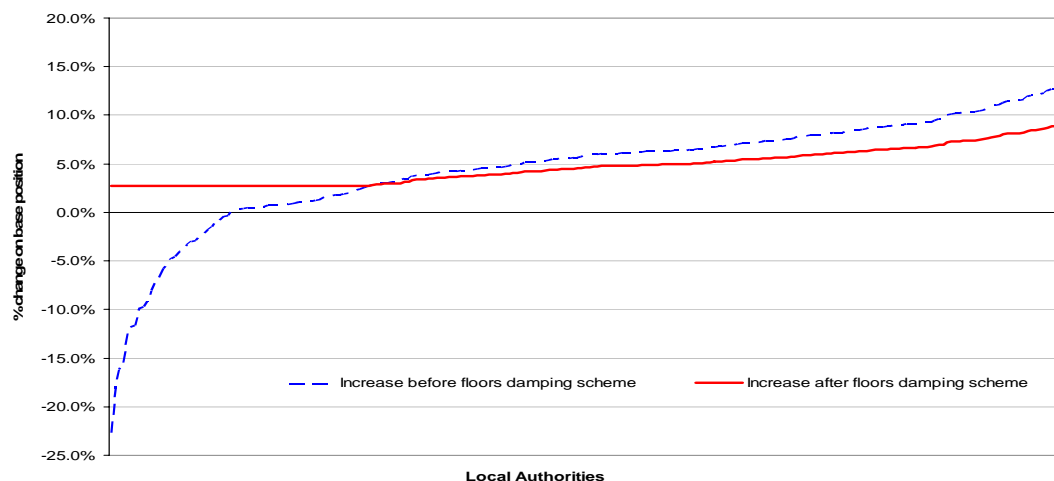
#### Example 5: Example of Floor Damping

	Floor Authority	Scaled Authority
2006/07 Adjusted Formula Grant (£ million)	2.842594	7.578283
2007/08 Formula Grant before Floor Damping (£ million)	2.198355	8.608564
Difference (£ million)	-0.644239	1.030281
Difference (%)	-22.66	13.60
Floor Increase	0.076750	0.204614
Cash Above Floor	0	0.825668
Scaled Cash Above Floor	0	0.508514
2007/08 Formula Grant after Floor Damping (£ million)	2.919344	8.291411
Increase (%)	2.70	9.41

The floor mechanism considers the change between the adjusted 2006/07 and 2007/08 formula grant. For authorities below the floor, additional grant is allocated to them to ensure that they receive the minimum increase.

As all the Formula Grant to be paid to local authorities must come from within the finite overall pot, the cost of providing the guaranteed floor must also be met from this pot. In order to do this grant increases above the floor are scaled back. The amount of grant scaled back is then used to pay for the floor guarantee.

#### Chart 4: Illustration of the floor damping scheme



## Levels of floors in 2006/07 and 2007/08

The Government has set the floor levels to give the fairest distribution of the money available, and to ensure that all authorities receive a fair formula grant increase.

**Table 6: Levels of Floors for 2006/07 and 2007/08**

Type of Authority	2006/07 Floor	2007/08 Floor
Education/social services authorities	2.0%	2.7%
Police authorities	3.1%	3.6%
Fire authorities	1.5%	2.7%
Shire districts	3.0%	2.7%

The level of the floor is decided by Ministers, taking into account the average increase across all authorities in the group and the rate of inflation for the period to which the grant relates, as measured by the GDP deflator.

## Total Grant Allocation

The actual amount of Formula Grant which an authority receives is the sum of the four blocks detailed above, plus police grant, where appropriate. Police Grant is distributed using the same formula as the Police Relative Needs Formula.

Full details of how the calculations work are set out in the Local Government Finance Report which is approved by Parliament each year.

### Example 6: Example of final Formula Grant calculations for 3 authorities

£ million

	Scaled Authority	Floor Authority	Police (Scaled) Authority
Relative Needs Amount	103.218253	80.306053	13.429940
Relative Resource Amount	-38.721849	-67.833328	-4.199314
Central Allocation	63.431475	71.560426	38.135214
Police Grant			63.567388
Floor Damping	-5.750691	2.877320	-0.651134
Formula Grant	122.177188	86.910470	110.282095

## **Key Aims**

The key aim of the Local Government Finance Settlement is to provide stability and predictability for local authority grant allocations.

Predictability is achieved through three-year settlements, where the data and formula are not changed between years. Authorities receive notice of their grant allocation for the next three years at the beginning of the CSR period thus enabling them to implement medium-term planning.

Stability is provided by floor damping which ensures that every authority receives at least a minimum increase (the 'floor') year-on-year on a like-for-like basis after adjusting for changes in funding and function.

## **Further Information**

Further information about the Local Government Finance Settlement can be found on our website at:

<http://www.local.odpm.gov.uk/finance/0708/grant.htm>

## Glossary

### ***Aggregate External Finance (AEF)***

The total level of revenue support the Government provides to local authorities for their core functions. This support is normally made up of Revenue Support Grant, police grant, specific formula and ring-fenced grants and the amount distributed from business rates.

### ***Area Cost Adjustment (ACA)***

The scaling factor applied to RNF to reflect higher costs – mostly pay – in some council areas.

### ***Business rates***

These rates, called National Non-Domestic Rates, are the means by which local businesses contribute to the cost of providing local authority services. Business rates are paid into a central pool. The pool is then divided between all authorities.

### ***Control Totals***

These are the totals of all authorities' Relative Needs Formulae for each major service area. They are set out in Annex E to The Local Government Finance Report.

### ***Council Tax***

A local tax on domestic property set by local authorities in order to meet their budget requirement.

### ***Council Tax base***

The Council Tax base of an area is equal to the number of band D equivalent properties. To work this out, the Government counts the number of properties in each band and works out an equivalent number of band D properties. For example, one band H property is equivalent to two band D properties, because it pays twice as much tax. The amount of revenue which could be raised by Council Tax in an area is calculated allowing for discounts and exemptions but, for the purpose of the Formula Grant calculation, assuming that everyone pays. How this is calculated is set out in Annex C to the Local Government Finance Report.

### ***Council Tax bands***

There are eight Council Tax bands. How much Council Tax each household pays depends on the value of the homes. The bands are set out below.

<b>Council Tax bands</b>		
	<b>Value of home estimated at April 1991</b>	<b>Proportion of the tax due for a band D property</b>
<b>Band A</b>	under £40,000	$\frac{6}{9}$
<b>Band B</b>	£40,001 - £52,000	$\frac{7}{9}$
<b>Band C</b>	£52,001 - £68,000	$\frac{8}{9}$
<b>Band D</b>	£68,001 - £88,000	$\frac{9}{9}$

<b>Band E</b>	£88,001 - £120,000	<sup>11</sup> / <sub>9</sub>
<b>Band F</b>	£120,001 - £160,000	<sup>13</sup> / <sub>9</sub>
<b>Band G</b>	£160,001 - £320,000	<sup>15</sup> / <sub>9</sub>
<b>Band H</b>	over £320,001	<sup>18</sup> / <sub>9</sub>

### ***Damping***

‘Damping’ is sometimes used to describe the way limits are applied to the effect on grant funding of changes to the distribution formulae or data used. Minimum increases, floors, on Formula Grant changes from one year to the next are now the major damping mechanism. There is also damping specifically for children's social care and younger adults' social services RNF's.

### ***Fixed Costs***

An element of an authority's costs which do not vary with size; this mainly consists of the costs of running the corporate and democratic core of an authority, sometimes described as “the costs of being in business, not the costs of doing business”.

### ***Floor damping***

A method by which stability in funding is protected through limiting the effect of wide variations in grant increase. A floor guarantees a fixed level of increase in grant. The grant increases of authorities who receive more than the floor are scaled back by a fixed proportion to help pay for the floor.

### ***Formula Grant***

Comprises Revenue Support Grant, redistributed business rates, and (for relevant authorities) principal formula Police Grant.

### ***Indicators***

In this context, information used in the calculation of the Relative Needs Formulae, such as projections of population, numbers of school children, numbers of elderly people or lengths of road. The indicators are generally defined in Annex D to the Local Government Finance Report.

### ***The Local Government Finance Settlement***

The Local Government Finance Settlement is the annual determination of formula grant distribution as made by the Government and debated by Parliament. It includes:

- the totals of formula grant;
- how that grant will be distributed between local authorities; and
- the support given to certain other local government bodies.

### ***Lower Tier Authorities***

Authorities that carry out the functions that, in shire areas with two tiers of local government, are carried out by shire districts.

***Net Revenue Expenditure (NRE)***

This represents an authority's budget requirement and use of reserves.

***Non-Domestic Rates***

See business rates.

***Relative Needs Formulae (RNF's)***

These are the first stage in the calculation the Government uses to distribute formula grant. The relative needs formulae for each service block are set out in Section 4 of the Local Government Finance Report.

***Reserves***

This is a council's accumulated surplus income (in excess of expenditure) which can be used to finance future spending.

***Resource Equalisation***

The way in which the formula grant distribution system takes account of councils' relative ability to raise council tax.

***Revenue Expenditure***

Expenditure financed by AEF grants, council tax and use of reserves.

***Revenue Support Grant (RSG)***

A Government grant which can be used to finance revenue expenditure on any service. The total amount is set out in Section 2 of the Local Government Finance Report.

***Ring-fenced grant***

A grant paid to local authorities which has conditions attached to it, which restrict the purposes for which it may be spent.

***Specific Grants***

Targeted or ring-fenced grants are sometimes referred to as specific grants.

***Targeted grant***

A grant which is distributed outside the general formula, but has no conditions attached.