Local Government Funding Reform: Final Consultation

Briefing for DCN members

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1. Summary

Overview

- MHCLG has published its final consultation on fundamental changes to the local government funding model: The Fair Funding Review 2.0. The consultation includes final proposals to:
    - make major changes to the main funding formula with a stronger link to levels of deprivation and population.
    - reset the baseline for retained business rates in full in 2026-27.
    - scrap the New Homes Bonus and return the funding to the core settlement.
    - simplify and consolidate several grant pots, including grants for homelessness prevention, rough sleeping and temporary accommodation.
    - provide transitional funding, including a minimum funding floor, to protect councils from the full impact of the funding changes.
    - move gradually towards greater local freedom on setting fees and charges, but no concrete proposals.
- These changes will be implemented over three years, beginning in 2026-27. They will be delivered via a multi-year finance settlement published later in 2025.
- There is one positive development not covered in this consultation. The Government has confirmed that income from the Extended Producer Responsibility (EPR) scheme for packaging producers will continue to be additional to core funding for waste collection authorities for the whole of the Spending Review (SR) period 2026-27 to 2028-29. This will be a significant income stream for districts. It will help cushion the impact of funding reform - provided EPR income is not ringfenced.
- The consultation does not propose any changes to council tax funding. The council tax referendum threshold will continue to be 2.99% or £5 (whichever is greater) for district councils. Social care authorities will continue to be able to raise an additional 2% precept.
- MHCLG has also published a consultation on changes to the administration of council tax. It includes a proposal to shift to 12 monthly payments by default. This is likely to have material cashflow implications for all billing authorities. We do not cover the council tax consultation in this briefing.

Impact of funding reform on DCN members

- Districts budgets have been squeezed harder than other council types since 2010. Between 2010-11 and 2025-26 Core Spending Power (CSP) for districts fell by 23.1% in real terms compared to a 10.4% fall for English councils as a whole.
- Our analysis of the early funding reform consultation (February 2025) suggested that the total reform package would be negative for districts overall. We estimated that:
    - total district losses from the proposals would be 20% in 2026-27 before transitional support.

    - in aggregate, districts would lose 4.5%, 3.2%, 2.3% in cash terms over the three years of the spending review period after transitional support
- The new consultation does not allow us directly to calculate the impact on types of council or on individual councils without further analysis. But our initial conclusion is that, following the changes in the revised proposals, the impact is unlikely to be much better for district councils and may be worse.
- MHCLG has indicated that, on average, local authority CSP will rise by 2.6% per year over the SR period. It has also indicated that the vast majority of councils with social care responsibilities will receive a real-terms increase each year. We think it is likely that many of the councils that do not receive a real-terms increase will be districts.
- The reasons for the negative impact on districts are:
    1. Changes to the main funding formula, especially:
        - stronger link to population and deprivation levels.
        - removal of the specific funding formulae for flood defence and coastal protection.
        - removal of the sparsity adjustment and fixed cost adjustment.
    2. Technical changes to the funding methodology ('control totals') that magnify the impact of the changes to funding formulae and weight funding more towards social care authorities.
    3. Full business rates re-set: this will have the biggest impact for districts and will cut 20% or more from spending power for more than 10 districts.
    4. Abolition of New Homes Bonus: this affects districts more than other councils.
- The negative impact is only partially offset by the inclusion of a new bespoke funding formula for temporary accommodation.
- It is important to stress that some districts will benefit from the funding reforms. Winners are most likely to be councils in areas with high levels of deprivation. But the benefits will only partially compensate for the big cumulative cuts to funding in those areas since 2010.
- We expect that councils facing the biggest impact will be those:
    - in sparsely populated areas;
    - with high need for flood defences and costal protection; and/or
    - with high rates of business rates growth.
- The consultation includes new proposals on transitional funding:
    - This will protect councils from the full impact of all funding changes, including the business rates reset.
    - It will phase in the new funding model over three years so that no council feels the full impact until 2028-29.
    - There will be additional protection through a flat cash (0%) funding floor each year i.e. no council will see a cash reduction in its core funding over the SR period.
- The transitional funding will be vital for many district councils. But it will end more quickly than DCN believes is sustainable. We continue to think a longer transitional period is vital.
- Our conclusion about the likely impact is backed up by initial analysis undertaken by Pixel Financial Management: "*Shire districts have done particularly badly, and the losses in "needs" will only be compounded by the impact of the baseline reset and equalisation.*"
- DCN is commissioning further analysis from Pixel on the full implications of the consultation.

DCN reaction

- We support the principle of directing funding to areas where it is needed most. The principle of targeting deprivation is welcome.

- However, these proposals will have problematic knock-on effects. The package of funding changes in this consultation is likely to tighten the squeeze on valuable district council services. This would be counter-productive and could undermine the Government's wider aims:
    - Preventative services, which can significantly reduce demand on the NHS and other more expensive public services, are likely to be hit hard because councils are not statutorily required to provide them.
    - The New Homes Bonus is being removed despite the Government's aim of building 1.5 million new homes during this Parliament.
    - The business rates reset will penalise areas that have seen an upsurge in business rates receipts in recent years due to their pro-growth attitude which has boosted their local economy.
- You can read the full DCN press statement here.

Next steps and further information

- The consultation includes a calculator to enable any council to estimate its share of resource needs under the new funding model. However, this does not allow councils to calculate their total funding allocation. You can find this calculator as Annex A on the main consultation webpage.
- MHCLG intends to publish a policy statement in early autumn (as it did in 2023 and 2024). The aim will be to provide councils with all the essential information they need to estimate their funding allocation for each year of the multiyear settlement. The policy statement is likely to be published in September or October.
- Final individual funding allocations and Core Spending Power calculations will be provided in the provisional Local Government Finance Settlement in December.
- The funding consultation is open until 15 August. DCN will submit a full response.
- We strongly encourage all DCN member councils to submit a consultation response.
    - We will aim to provide you with a draft DCN consultation response in good time to inform your own council's response.
    - We will work with Pixel Financial Management to produce detailed analysis to fully understand the impact for district councils.
    - In the meantime, we hope this briefing will give you a head start in considering the impact for your council and the points you may wish to raise in a consultation response.
- If you have any questions or comments, please contact dcn@local.gov.uk

2. Detailed overview of consultation proposals

New funding methodology (Chapter 2)

- The Government is proposing major changes to the formula for allocating core grant funding – known as Settlement Funding Assessment (SFA).
- This will bring together an updated assessment of a council's relative need for central grant funding and make a 'resources adjustment' to account for its ability to raise revenue locally (especially its council tax base).
- Councils with greater local revenue raising ability will have their relative share of need adjusted downwards, all things being equal.
- There will be transitional arrangements to blend in the new funding methodology over the three years of the SR period.
- Core Spending Power (CSP) will be a combination of SFA plus transitional funding plus council tax income.
- Whilst the calculation will account for local authorities' ability to raise council tax, they will continue to retain all council tax they raise locally.

Settlement Funding Assessment (SFA) = relative needs share allocation – resources adjustment

New Spending Power = Settlement Funding Assessment ± transitional arrangements + Council Tax income

Funding simplification (Chapter 3)

- The Government proposes to simplify the grant landscape from 2026-27 into a small number of consolidated grants including:
  - **Homelessness and Rough Sleeping Grant** – brings together funding for all homelessness and rough sleeping revenue funding, including the Homelessness Prevention Grant - <u>except for temporary accommodation funding,</u> which will be rolled into Revenue Support Grant (RSG). Broadly speaking, the new grant will be allocated according to the methodology for distributing Homelessness Prevention Grant.
  - **Public Health Grant** – consolidates the existing Public Health Grant with other service-specific grants to create a wider Public Health grant, delivered as a separate grant within the Local Government Finance Settlement.
  - **Crisis and Resilience Grant** – enables local authorities to build the financial resilience of communities and assist those facing financial crisis, incorporating Discretionary Housing Payments and Household Support Fund.
  - **Children, Families and Youth Grant** – consolidates the Children's Social Care Prevention Grant and the Children and Families Grant, alongside further investment in children's social care reform. The Government will explore whether additional grants for children, families and youth services can be consolidated within this grant.
- Where grants outside the settlement cannot be placed into a suitable consolidated grant or do not constitute an exception, the Government will roll them into RSG where appropriate.
- The Government proposes to retain a standalone Section 31 Grant for Local Authority Better Care Grant. The distribution of the Local Authority Better Care Grant will be the same as the

updated Settlement Funding Assessment. Retaining a Section 31 Grant will ensure that current Better Care Fund pooling arrangements continue.

DCN view

- DCN supports the principle of simplifying and consolidating grants.
- We will need to carry out more detailed analysis to be sure that the method for allocating Homelessness and Rough Sleeping Grant does not have perverse consequences or penalise districts.
- We have concerns about consolidating the Discretionary Housing Payments and Household Support Fund into a single grant. There is a risk this will lead to all funding in the grant being allocated to county and unitary councils in the same way as currently happens with the Household Support Fund. DCN's view remains that all grant related to housing should be allocated directly to housing authorities.

Approach to assessing demand (Chapter 4)

- The Local Government Finance Settlement's core distribution has traditionally used 15 relative needs formulae (RNFs) that encompass a range of service areas. MHCLG proposes to update the formulae (see table below for full detail).
- The key points are:
    - Main foundation formula will be more strongly liked to levels of deprivation and population.
    - Separate formulae for adult and children's social care services have been retained and updated as they are critical to support the sector to deliver responsibilities which represent their largest costs.
    - Separate new formula created for Temporary Accommodation (TA).
    - Previous separate formulae for Coast Protection, Flood Defence, and Environmental, Protective and Cultural Services, and Concessionary Travel are removed. Funding for these services will be allocated according to the general foundation formula i.e. not accounting for specific cost/demand drivers for these services.
    - Fixed cost adjustment removed.
- TA is currently funded through multiple sources: Homelessness Prevention Grant (HPG), the Local Government Finance Settlement, and Housing Benefit TA subsidy (funded through the welfare system).
    - TA grant funding will be consolidated.
    - The TA element of HPG will be separated out, then combined with all other TA grant and rolled into the main Revenue Support Grant.
    - There is no change to the Housing Benefit subsidy regime.
- There is an important technical point about 'control totals' which appears to have a negative impact for district councils:
    - Each individual formula is assigned a weight to help determine the impact a formula has in the overall calculation. These are collectively known as the control totals. They reflect the scale of national expenditure on the service areas assessed by the formula.
    - To arrive at control total weights, the Government proposes using Revenue Outturn data to calculate net current expenditure by local government across services.
    - It will then calculate individual control total shares for each formula based on their relative proportion of the total national net current expenditure.

- **The net result is to cause the 'lower tier' share of relative needs to fall, possibly substantially. This is because control totals will be driven by changes in the pattern of actual expenditure, especially the large increase in social care spending which has crowded out other types of expenditure**.

- The table below summarises the changes in the formulae from the existing method to the updated core assessment. Chapter 12 of the consultation provides a detailed explanation of the methodology for each of the relative needs formulae.

Summary of formulae proposed in the updated core assessment

2013-14 formulae in current Settlement Funding Assessment	FORMULAE PROPOSED IN THE UPDATED CORE ASSESSMENT
Adult's Personal Social Services (Social Services for Older Adults)	Updated Adult Social Care (Older Adults)
Adult's Personal Social Services (Social Services for Younger Adults)	Updated Adult Social Care (Younger Adults)
Children's Services (Youth and Community)	New Children and Young People's Services
Children's Services (Children's Social Care)	New Children and Young People's Services
Children's Services (Central Education Functions)	New Home to School Transport
Concessionary Travel	New Foundation Formula (Upper Tier) New Foundation Formula (Lower Tier)
Continuing Environment Agency Levies	New Foundation Formula (Upper Tier) New Foundation Formula (Lower Tier)
Coast Protection	New Foundation Formula (Upper Tier) New Foundation Formula (Lower Tier)
Environmental, Protective and Cultural Services (Lower Tier)	New Foundation Formula (Upper Tier) New Foundation Formula (Lower Tier)
Environmental, Protective and Cultural Services (Upper Tier)	New Foundation Formula (Upper Tier) New Foundation Formula (Lower Tier)
Flood Defence	New Foundation Formula (Upper Tier) New Foundation Formula (Lower Tier)
Fire and Rescue	Updated Fire and Rescue
Highways Maintenance	New Highways Maintenance
n/a	New Temporary Accommodation
Fixed Costs	No longer included in assessment
Legacy Capital Finance	No longer included in assessment

DCN view

- The changes to funding formulae are negative for districts overall and will be negative for many districts individually.

- The new formula for TA will benefit many districts. But for most districts it is unlikely to be outweighed by the changes to the core foundation formula, the negative impact of removing the formulae for coastal protection and flood defence and removing the Fixed Cost Adjustment.
- The changes to the 'control totals' appear to have a significantly negative impact for districts.

Approach to assessing cost (Chapter 5)

- Funding allocations and calculations of relative need will be adjusted for the differential cost of delivering local government services.
- As in the current model, the Government will apply an Area Cost Adjustment (ACA) to the Relative Needs Formulae to account for differences in the costs of delivering services. However, it is making significant changes to the method for calculating the ACA.
- The new ACA will comprise four elements:
    - Rates Cost Adjustment – aims to measure the difference in the cost of property rates / rents between local authorities e.g. cost of using equivalent premises due to differences in local supply and demand factors.
    - Labour Cost Adjustment – aims to measure the difference in the cost of labour between local authorities.
    - Accessibility Adjustment – aims to measure the impact of the difference in travel time to provide services on the cost of labour. It proposes two measures within this adjustment - a dispersal adjustment factor (longer journeys to reach households) and a traversal adjustment factor (longer journeys between households).
    - Remoteness Adjustment – aims to measure the impact of separation from larger concentrations of service users.
- **The most significant change for districts is the removal of the existing Sparsity Adjustment and its partial replacement by the Accessibility Adjustment and Remoteness Adjustment**.
- Table 5 on page 57 of the consultation shows the weighting of these different adjustments for each element of the funding formula. This indicates that the Accessibility Adjustment and Remoteness Adjustment will have a relatively small weighting.

DCN view

- We have not yet carried out full analysis. But it is likely that the removal of the sparsity adjustment will be very negative for councils in sparsely populated areas.

Other resource adjustments (Chapter 6)

- The funding formula will be adjusted to factor in the council tax base of a local authority. This will be done by setting a notional level of council tax for all authorities rather than basing the calculation on actual levels of council tax set and collected.
- The Government proposes to fully include the impact of mandatory council tax discounts and exemptions in the measure of taxbase but to exclude discretionary discounts and premiums. This approach is the same as the one applied in the current funding regime.
- It proposes to uniformly apply the average tier split in multi-tier areas to the measure of council tax in the resources adjustment – known as 'tier splits'. To do this it will calculate the average share in council tax receipts between the shire county precept, the shire district element and the fire element of council tax bills across the country. It will then apply that percentage uniformly to the measure of council tax in the resource adjustment for relevant areas.

- Tier splits are important and can make a material difference to the funding outcome for district councils. The lower the district share, the better the outcome for districts. The table below shows the indicative split.

England average council tax tier split 2024-25

District Council	County Council	Fire Authority
11.0%	84.4%	4.6%

DCN view

- We will need to carry out more detailed analysis before concluding whether the method for council tax equalisation has a significant impact (positive or negative) for districts.
- On initial analysis it appears the proposed methodology for tier splits will be reasonably favourable for district councils.

Business rates retention (Chapter 7)

- MHCLG has confirmed it will fully reset the baselines for retained business rates in 2026-27.
- The current Business Rates Retention System includes a safety net to protect local authorities from significant negative impacts to their income by guaranteeing that no local authority will see its income from business rates fall beyond a set percentage of its Baseline Funding Level. The safety net level is currently 92.5%.
- The consultation proposes to increase the level of protection provided by the Safety Net for 2026-27 before scaling protection back down to the current 92.5% level over the course of the multiyear settlement period.
- The Government is considering whether business rates pooling arrangements should continue from 2026-27. It has made no decisions on this point.
- **Importantly, the impact of the full business rates reset will be included in the calculation of transitional protection funding. This will be critical for the councils badly affected by the reset.**
- There is an unresolved point about how the surplus created by resetting the baseline will be redistributed to local authorities. It would be better for districts if the method for reallocating the surplus takes account of past business rates growth rather than simply using the main foundation formula.

DCN view

- DCN is disappointed that the Government is going ahead with a full reset. In our view this penalises many councils who have worked hard to promote local growth. It will take out a significant chunk of funding for some or many councils, making them reliant on transitional protection or drawing down on reserves.
- We will push MHCLG for further measures to alleviate the impact for the councils worst affected.

New Homes Bonus (Chapter 8)

- The Government intends to scrap the New Homes Bonus (NHB). It argues the NHB does not act as a genuine housing incentive.
- NHB funding will be returned to the core settlement and allocated according to the updated assessment of needs and resources.

- Under the new method for calculating housing need, 38% of the new 371,000 annual national housing target would be delivered in district areas. Of the 66k per year additional homes in the 371,000 target, 82% are in district areas.

DCN view

- DCN does not agree that NHB is an ineffective housing incentive. We continue to think there is a need for a housing incentive and that abolishing NHB will make the job of building our share of 1.5 million homes harder.

Transitional Arrangements (Chapter 9)

- The Government will phase in the new funding model (including the changes to the funding formulae and business rates rest) over the three-year period of the multiyear funding settlement.
- This will blend the allocation of funding between the new allocation method and the current method. In Year 1 (2026-27), 33% of funding will be provided according to the new method. This will rise to 66% in Year 2 and 100% in Year 3.
- The consultation also proposes a minimum funding floor to offer further protection beyond the main transitional arrangements:
  - It is consulting on a proposal for a 'flat cash' (or 0%) funding floor.
  - It proposes to continue the existing policy that any protection offered through a funding floor assumes local authorities use their full council tax flexibility
- The Government recognises that there are some authorities which will require bespoke treatment through the transition e.g. because their new share of funding is furthest from their current share of funding. MHCLG will directly engage these authorities on transitional arrangements. They are likely to include district councils, especially those badly most affected by the business rates reset.

DCN view

- The transitional protections are essential but do not last long enough. DCN will continue to push for a longer transitional period and analyse the case for a more generous funding floor.
- We do not believe it is right or sustainable for councils to be forced to run down unallocated reserves to cushion the impact of funding reform.

Devolution and Local Government Reorganisation (Chapter 10)

- The consultation confirms that all Mayoral Strategic Authorities will receive an Integrated Settlement from 2026-27.
- The consultation acknowledges that areas developing reorganisation (LGR) proposals will need to do so in light of the funding reform proposals. But it does not provide any additional information with which to do this.
- Where two-tier areas reorganise into a single unitary authority during the period of the multiyear settlement, the Government proposes that allocations of the predecessor authorities will be combined to determine the allocation of the successor authority.

DCN view

- The Government continues to assert that LGR will deliver substantial savings. The evidence from previous rounds of reorganisation is far from conclusive that real savings will be delivered. What is certain is that reorganisation brings significant short-term costs.
- LGR can bring long-term economic benefits if done in the right way. DCN strongly believes this means creating smaller unitary councils with a close connection to local places and communities.
- It will continue to be very hard for councils to make a robust financial case for LGR without more detailed information about specific funding allocations.

Sales, Fees & Charges (Chapter 11)

- In the earlier funding reform consultation, the Government sought views on whether changes to certain sales, fees and charges would be justified and whether responsibility for setting levels for some fees and charges should be devolved to local authorities.
- The consultation acknowledges that several significant sources of fee revenue are set by central government and have not been adjusted in line with inflation for a number of years or decades.
- The Government intends to review all fees previously identified as being significantly below full cost recovery and consider where there is the strongest case for reform.
- To support this review, it sets out a proposed framework against which fees can be assessed. It is a simple framework that focuses on assessing the risk to service users from increasing fees or devolving fee setting to local authorities. The elements are:
    - Impacts on working people;
    - Impacts on people who share particular protected characteristics under the Equality Act 2010;
    - Impacts on businesses;
    - Behavioural impacts, for example if changes to the fee level would act as a disincentive to use the service; and
    - Quality, potential for improvement, and financial sustainability of the service
- The Government proposes taking a gradual, phased approach to fees and charges reform, first taking action to update a small number of fees centrally and then seeking to devolve limited fee setting to local government towards the end of the SR period.
- The consultation does not include any proposals to increase or devolve specific fees.

DCN view

- The approach to reforming fees and charges is very timid and slow. Fundamental changes to fees and charges could make a tangible difference to financial sustainability for district councils.
- There is no good reason why councils should not be set free to recover the full cost of providing services for which a fee is charged provided there are sensible and proportionate mechanisms to protect service users from any undue impact.