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Dear Mr Style,

Fair Funding Review

I write further to the government's call for evidence to inform its fair funding review of local authority services. I set out below the views of the Isle of Wight Council for your consideration and inclusion in the review.

To provide some context; the Isle of Wight Council has, since 1995, been a Unitary Council formed by the amalgamation of two borough councils and a county council. It is England's most populated island that does not have a fixed connection with the mainland. The Island has a total area of 147 square miles and 57 miles of coastline. Almost 84 per cent of the Island is rural in nature, and 60 per cent of its 139,000 residents live in a north and eastern coastal belt.

The challenges posed by being an island are not currently part of the local government funding formula. This is, to some extent, understandable, given that it affects such a very small percentage of the national population. It does effectively mean, however, that residents of the Isle of Wight are at a relative disadvantage in being able to access convenient and quality public services, when compared to those in similar mainland authorities. It is also arguable whether there can actually be a comparator authority to the Isle of Wight, given that the Isles of Scilly is the only other English local authority area to be entirely surrounded by sea, and without a permanent link to the mainland.

The Isle of Wight has made this case to successive governments and ministers for many years, to little effect. As a consequence it is of the view that the impact of the austerity agenda has been felt to a much greater extent by Island residents than their mainland neighbours. This is because the council has had to cut further and deeper to sustain a basic level of service, whilst also having to deal with the challenges of

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providing public services in an Island context. Most recently, in June this year, representatives of the council met with the then Secretary of State for Communities and Local Government, the Rt Hon Greg Clark MP, to discuss these challenges. He was kind enough to acknowledge the Island's unique circumstances and suggested that this review would be an ideal opportunity for the government to reconsider making provision for island status in its local government funding formula. This followed comments from the then Prime Minister, the Rt Hon David Cameron MP to Andrew Turner, the Island's MP, referencing the Island's 'unique situation' in the context of a discussion about the sustainability of Isle of Wight Council's financial position.

Prior to the visit by the then Secretary of State, the Isle of Wight Council had commissioned a piece of work from Portsmouth University to review the, "Impact of Physical Separation from the UK Mainland on Isle of Wight Public Service Delivery". This review is intended to substantiate the contention that, 'island status' should be an explicit consideration in the determination of levels of funding for local authority services. The review is being completed in two parts; the first is to identify the factors (if they exist), that lead to higher costs in delivering public services on an island, the second is to make an estimate of what these additional costs might be for the Isle of Wight. Attached to this response is a copy of the outputs of phase 1 of this commission and, if it is of interest, the council would invite the government to input to the design of the phase 2 works, such that they may be of benefit to the fair funding review.

At this juncture I have set out for your consideration, in the following paragraphs, the main findings of the work undertaken by Portsmouth University to date. Essentially there are three overarching themes to be considered when analysing the operation of an island economy and especially the provision of public services within it:

Self sufficiency:

Referring to the (lack of) spillover of public goods and public service provision, to and from neighbouring authorities and the potential for over provision. Self-sufficiency costs occur where there is an obligation that a sufficient and proportionate service is provided on the Island and it is not possible, or too costly, to share or access mainland services or facilitate cross-boundary arrangements for the provision of services that may be available to other authorities.

The Island premium:

This refers to the additional cost of conducting business on and with the Isle of Wight. For the provision of public services, this refers to the relatively higher prices that could be charged by contractors, or reflected in the price of goods and services delivered. This may reflect physical costs, such as additional transport costs, or the need to establish distribution infrastructures. Additionally, it will likely be influenced by the small size of the market and the inherent potential for restricted competition manifesting itself in monopolies and/or oligopolies.

Dislocation:

This refers to the costs associated with the physical, and perceived, separation from the mainland. Dislocation (sometimes referred to as isolation) is the common characteristic of all islands and, "expresses 'objective' and measurable characteristics, including small areal size, small population (small market), isolation and remoteness, as well as unique natural and cultural environments." "These characteristics of islands are not compatible with attractiveness principles of the dominant development model, which is characterised by mass production of standardised goods and the knowledge intensive and highly multi-specialised urban economies."

Dislocation has direct and indirect costs, and is closely tied to the underlying issues of the Island premium and self-sufficiency.

It is the Isle of Wight Council's strong and long held view, that these three factors must be recognised in any revised formula for the funding of local authority services. Its contention being that the Isle of Wight, is now

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at both a financial and competitive disadvantage to the majority of other areas in the country because these 'island factors' have not previously been a consideration of government. The council can point to a significant lack of competition in many markets including, construction, public transportation and adult social care services leading to higher costs, as prime examples of why it is encountering significant financial challenges under the current funding regimes.

The 'island factors' permeate through the whole of the financial system for the Isle of Wight Council, both on the cost side and the funding side of that system. High costs are experienced through lack of competition (and as a consequence, lack of investment in productivity and innovation). Obvious examples of this are exhibited in the relatively high cost of transport related services such as concessionary travel, or where transport is a significant cost driver such as construction, where labour and materials often need to be shipped to the Island. This high cost is often exacerbated where the local authority does not then have the ability to influence the design or criteria for services where they are prescribed nationally, or part of a national scheme such as concessionary fares.

Equally, care related services (which consume close to 60 per cent of the council's controllable spend) exhibit higher costs due to the lack of competition, but also a lack of provision in certain professions and services that then has to be sourced on the mainland and 'imported' to the Island.

The highlighted areas above are significant cost drivers for the council which do not exist for mainland councils.

The cost disadvantage is a barrier to inward investment and business growth, which has the effect of significantly depressing business rate income and therefore funding for the council. Without investment and business growth, the housing market remains depressed which limits the council's opportunity to stimulate its Council Tax income. The local government funding formula does not recognise the 'island factors' and therefore all three components of the council's funding base are constrained in a way that they are not on the UK mainland.

Recognition for the factors of self sufficiency, island premium and dislocation in a revised funding formula, is the council's most important outcome from this consultation exercise. I have however, set out below, some general comments to the specific questions raised in the consultation documentation.

Question 1: What is your view on the balance between simple and complex funding formulae?

As long as the amount of funding available for the delivery public services continue to reduce there will be a consequent increase in need to explain clearly and succinctly to the public, how the relative funding allocated to each area is calculated. This does not need to detract from the relative complexities that will impact on any calculation of funding but should explain how these complexities are assessed.

In this regard of the council would point to the relationships between the health and social care sectors, relationships between local authorities and independent schools, the level of assessed competition from service providers in the market place and the degree to which a local authority has to act to make improvements for its residents. So for example, some businesses will naturally be drawn to many areas without any need for the local authority to do anything, whereas others will need strong incentives even though they may not give the best returns. In a similar vein, some areas will be a natural draw for people with certain characteristics, which may come with a cost to the public service that must be considered in any funding model.

Local authorities will be better placed to explain to the public how their funding is allocated and spent if the formula by which they are funded is simpler. Whilst favouring a simpler model, it must be informed by evidence based cost drivers. Complexity and a large volume of factors can 'design in' double weighting as some factors can also be proxies for others.

Question 2: Are there particular services for which a more detailed formula approach is needed, and – if so – what are these services?

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As set out in question 1, both the absolute scale and the complex relationships between the health and social care sectors demand that a more detailed formula is used for these areas. This must take account of the level of competition in the market place for the provision of health and social care services, and the pressures in the local health system that can lead to a negative impact on the delivery of social care services; all aligned to the projected levels of demand in the system as a whole.

Social care services are a significant share of the council's budget spend and governed by much legislation. The funding formula would be easier if, the legislation was more clear about the level of service people are entitled to receive. Whilst the Better Care Act goes some way to addressing this point, there is more that could be done.

A sparsity factor could also be taken into account for a range of services which recognises that, due to the particular nature of an authority's area, there are some services that are not available to the authority in the same way that they might be by another authority using the "spill over" from an adjoining authority.

Question 3: Should expenditure based regression continue to be used to assess councils' funding needs?

How councils have allocated resources in the past is not a good predictor of how they may spend them in the future, nor does it consider the level of demand for services in a system, or changes in the operating environment which may have an impact on cost. In a small 'closed' economy such as the Isle of Wight for example, the closure of only one or two businesses providing services to the council, or the addition of a small number of complex care cases, would have a disproportionate impact on the level of spending the council may have to incur.

Regression analysis does work at a macro level because it masks the gains and losses in some local authorities caused by small changes in the system, but which could be of a major impact to those authorities (at the micro level). Government performance expectations are set at the local authority level but may be unachievable without appropriate levels of financial support if this was only offered at over a wider geography. Regression analysis also takes no account of the political changes in authorities over the years, where local democracy may have caused a changed in spending plans, or even apparently erratic spending plans, over time.

The value for money that each individual authority is able to secure in the delivery of services is not a significant factor in a regression analysis, therefore those authorities that have always been big spenders, could continue to receive higher levels of funds than actually needed and vice versa.

In addition, local government finance settlements are unlikely to be effective in securing the outputs required by government if they are based on data that is some 5 years (or more) old. If the data does not reflect real need, then smaller authorities such as the Isle of Wight will continue to be disproportionately negatively impacted than larger authorities. Therefore, any expenditure must be based on actual need at the present time, and not just historical spend.

Question 4: What other measures besides councils' spending on services should we consider as a measure of their need to spend?

The three measures that are of the most concern to the Isle of Wight have been identified in the study by Portsmouth University and set out below for completeness:

Self sufficiency – the degree to which a local authority must provide for itself and is unable to take advantage of spill over effects with other local authorities service provision. For example, a specialist care home close to the land border between two or more authorities is easily accessible by those authorities, but not by those further away (or with a sea barrier). In addition, the care home operator is able to provide its service at scale, for the larger market available from multiple authorities, and is therefore able to offer a more competitive price to the local authority users.

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(Island) Premium pricing – the degree to which the geography of an area limits both the size of a local market and the level of competition in the market, leads to the development of monopolies and oligopolies which causes the local authority to have to pay premium rates for bought in services. This factor will be impacted by the level of outsourcing already achieved by the local authority and the degree to which it is reliant on the private sector for the delivery of services.

Dislocation – the degree to which the level of actual and perceived separation of an area, from major conurbations or functional economic areas impacts, on both population demographics and the additional costs of service delivery from shipping including waiting costs, for example. It is also a function of self sufficiency and the island premium.

The impact of dislocation is also relevant in considering future service demand. In the case of the Isle of Wight, it is arguable that dislocation is responsible for the inward migration of older people with more complex health and social care needs and the outward migration of young people to seek work and employment. The overall impact being that the island loses its potential wealth creators and gains those that are the greatest users of public services (the cost generators).

The cost and availability of land and property is also relevant in considering what a council may need to spend. Local authorities in areas with relatively high land values are able to dispose of land or assets and recycle their capital receipts to create wealth or revenue streams that can support public service delivery. This is not the case for small authorities or those where land and property values are relatively poor.

The availability and affordability of housing is of current pressing concern; as the supply of affordable rented properties is reducing so the cost to the public sector of supporting vulnerable families is increasing. Whilst programmes such as supporting people are not mandatory, they are critical to keeping people in their homes, but susceptible to cuts which may have a wider impact across the sector.

Question 5: What other statistical techniques besides those mentioned above should be considered for arriving at the formulae for distributing funding?

Whatever statistical data is used this should be the most up to date that is available and based on significant cost drivers.

Question 6: What other considerations should we keep in mind when measuring the relative need of authorities?

As the government seeks to move towards a scheme of full business rate retention for local government, it will be of concern to many authorities that their ability to grow both their local council tax and business rates base is properly assessed and accounted for. In so doing government will need to be conscious and take account of:

- The relative interest in an area from potential inward investors and the degree to which a council may have to intervene/offer support to make its area more appealing to inward investment.
- The availability of land and premises to support business growth and development and the degree to which the public sector estate may be available/need to support growth.
- The availability of relevant skills in the local employment market to support business growth and the degree to which there can be a spill over of skills from one local authority area to another.
- The relative transport connectivity within and without an area, making travel, accessible, affordable and regular for businesses wanting to base themselves in the area, or do business with it, and also for those wanting to live and or work in the area.
- The current housing market; the degree to which the relative needs of the community and businesses match those of the house building industry, and the degree to which the supply provided by Registered State Landlords are able to impact on local housing need.
- The availability of land for the provision of housing to meet current and existing needs.

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- The degree to which other elements of the public services (eg. health and police) add pressure to the local authority's spending plans and may impact on future growth in the tax base.
- The degree to which environmental designations impact the councils' ability to deliver local services and grow both the tax base and the economy. For example, the extent of a local authority's area that is constrained such as National Parks, Areas of Outstanding Natural Beauty, Heritage Coastline or other conservational restrictions

Question 7: What is your view on how we should take into account the growth in local taxes since 2013-14?

The major point for consideration, is whether the growth has been fortuitous or as a direct result of the actions of a local authority or an intervention from central government.

A local authority should be allowed to retain a growth in taxes where it can be shown to be as a result of the action that local authority. Other growth that has come fortuitously or as a result of government intervention and/or funding, should be retained centrally and redistributed across the local government sector.

This may be a particularly challenging position for the Isle of Wight where tax growth has, in the main, only been achieved through government funding and interventions. This however, further demonstrates the need for an 'island factor' to be part of the fair funding formula so that the Isle of Wight has a clearer base from which to build its own regeneration activities.

Question 8: Should we allow step-changes in local authorities' funding following the new needs assessment?

Yes, especially for those authorities that have been demonstrably underfunded over a number of years and particularly where, full account has not been made of all the factors that impact on the cost of delivering public services. If this is not done quickly, then many authorities that are already struggling to set a balanced and lawful budget may be unable to do so.

Question 9: If not, what are your views on how we should transition to the new distribution of funding?

Tax growth from fortuitous or government sponsored initiatives from 2013-14 should fund a system of transition, with a particular focus on assisting those most underfunded under the previous system, to secure their funding at the proper level. Those authorities most overfunded in the old system will need some limited time to transition, using the balance of the available funds from this source.

Question 10: What are your views on a local government finance system that assessed need and distributed funding at a larger geographical area than the current system – for example, at the Combined Authority level?

As set out earlier in this note the Isle of Wight is unique amongst English local authorities, therefore it is of absolute importance that its needs are assessed as an island, without a land border to any other neighbouring authority and all of the benefits that would bring.

As demonstrated by the Portsmouth University report the island has 'lost out' because its unique challenges of; self sufficiency, island premium pricing and dislocation are not encountered simultaneously by any other local authority and are therefore overlooked in the current funding formula. In the grand scale of local government finance, the financial costs of addressing these challenges, or 'island factor' are insignificant, but they are very real and significant to the Isle of Wight and the needs of its resident population.

Therefore, the Isle of Wight council would be very concerned if any future funding formula, no matter at what level it was assessed, did not properly take account of the Isle of Wight's unique challenges.

The council is an active promoter of the Solent Combined Authority and associated devolution deal, together with its partners, Portsmouth and Southampton City Councils. It is therefore already agreed in principle to

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the distribution of business rates across the combined area; it does consider that this process would be greatly informed by an objective process of assessing the basic needs in each area from which a distribution formula can be agreed.

Question 11: How should we decide the composition of these areas if we were to introduce such a system?

The further development of combined authorities based around functional economic areas would offer one approach to introducing this system. The geographical area of Local Enterprise Partnerships may also give a basis for developing the approach and this should secure as a consequence, closer working between the LEPs and local authorities.

Question 12: What other considerations would we need to keep in mind if we were to introduce such a system?

Any system which aggregates need and demand will tend to hide the range of differences across the area. Therefore some parts of an area may receive more funds than needed and others will receive less than they need. This will only perpetuate the differences in consistency and availability of public services across the area as a whole.

The Isle of Wight has experienced this situation in relation to European Funding. For many years it has been in a statistical basket with the wider Hampshire region, this has hidden the fact that the Island's economy is as bad if not worse than many areas in receipt of European structural funding, for example Cornwall. Cornwall has received significant European support over many years whilst and the Isle of Wight has had none. Such inequalities need to be designed out of any funding system.

Great care must therefore be taken to assess need and demand at the right level and to ensure that the funding finds its way to where it can have the greatest impact.

Question 13: What behaviours should the reformed local government finance system incentivise?

Fundamentally people should be able to expect broadly the same level of local authority services wherever they live in the country. This is not the case at the moment as the funding system takes little account of the needs of an individual or the ability of the local authority, acting in its local environment, to meet those needs.

A meaningful proportion of the proceeds from growth should be retained through resets in order to encourage Local Authorities to invest in growth opportunities and remove a large degree of the funding uncertainty that currently disincentivises investment.

Question 14: How can we build these incentives in to the assessment of councils' funding needs?

Central government needs to be much more explicit about its expectations of local authorities in a range of key service areas. This will create a shared understanding of what is required in each area and the level of funds needed to achieve it. Achieving business growth and increase in council tax base is a helpful start but incentives also need to be more subtle, especially in high spending areas and be linked to local context.

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For example, securing business investment on the Isle of Wight, is likely to be significantly harder than in a more urban environment ; this could be reflected in a weighted scheme which rewards the Island with a an additional payment equivalent to a percentage of the NNDR earned. It might also be possible to weight New Homes Bonus in a similar way.

Yours sincerely

A handwritten signature in black ink, appearing to read 'J Metcalfe', with a long horizontal flourish extending to the right.

John Metcalfe
Chief Executive

Enclosure: Impact of Physical Separation from the UK Mainland on Isle of Wight Public Service Delivery.
Portsmouth University, August 2016.