Ministry of Housing,
Communities &
Local Government

Review of Relative Needs and Resources

Area Cost Adjustment (ACA)

BRR Steering Group April 2019

Ministry of Housing, Communities & Local Government

Proposed structure of the Area Cost Adjustment (ACA)

Area Cost Adjustment

Weights determined by **Subjective Analysis Return** and **Revenue Outturn** (*Slide 6*)

1) Labour Cost Adjustment (LCA)
Based on local wage data
Slide 4

2) Rates Cost Adjustment (RCA)
Based on local Rateable Values
Slide 4

3) Remoteness
Based on **journey times** to major cities
Slide 5

Accessibility (within LCA)
Weights determined by **National Travel Survey** data or service-specific cost modelling (*Slide 6)*

Dispersal
Based on **journey times** to "hub" towns
Slide 5

Traversal
Based on **journey times** between households
Slide 5

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What the ACA *does* and *does not* do

The ACA does..

- Adjust for factors that affect the ***costs*** of delivering services for authorities (holding all else constant) including: labour, premises, and 'remoteness'
  - The **journey times** adjustments capture additional costs that may arise due to isolation from competitive markets, as well as lower staff productivity resulting from the delivery of services to populations separated by large journey times.
- Therefore, **a higher ACA *compared to similar authorities* will result in a greater share of funding** (i.e. compared to authorities with similar values for each cost driver).

The ACA does not…

- Adjust for factors that affect the ***demand*** or volume of services to be delivered (for example, population.)
- However, **increasing an authority's ACA does not necessarily increase funding** since the ACA is applied both before and after running the regressions**:**
  - A higher ACA *compared to an alternative ACA* (e.g. the 2013/14 methodology) for the same authority does not necessarily imply a greater share of funding. This is because when the new ACA is applied, the coefficients in any expenditure based regression will change and this affects assessed need. Although this means changes to the ACA are not exactly replicated in assessments of need, our initial analysis suggests there can be a strong link between the two. Furthermore, the ACA does have a direct impact on non-EBR formulas.
  - If we did not deflate by costs first, our coefficients in the regression would be biased since expenditure would appear higher in areas with higher costs – i.e. the coefficients would pick up a cost effect as well as a volume effect. This would be a particular concern if any cost drivers were correlated with costs, since when we re-inflate by the ACA at the end, **costs may be double counted**.

Data in the ACA

- We propose to use the **best available** evidence (the latest Subjective Analysis Return) to weight elements of the Area Cost Adjustment, however, the sources rely in part on Local Authorities' interpretations of their spending.
- The measures proposed **meet the criteria for inclusion** we have consulted: they vary between local authorities, are independent from each other, and spending varies with journey times.
- We believe our proposed measure of remoteness is the **best available proxy** to measure access to competitive markets and scale.

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Description of LCA and RCA methodology

	What are we measuring?	Data	Method	What factors are controlled for?	Why do we control for these?	Why don't we use local authority data?
LCA	Spatial variation in the going rate for similar *workers,* accounting for the effects of other factors known to affect wages.	ONS Annual Survey of Hours and Earnings (ASHE) 2015, 2016 & 2017	Mincer regression (from the human capital literature)	• Age Sex • Full-time vs Part-time • Public vs Private sector • Occupation (e.g."Chief Executive" or "Dental Therapist") • Industry (e.g. "Advertising" and "Youth Work")	Averaging these effects out avoids us ascribing high costs to areas with a large number of workers in highly-paid occupations or industries such as finance.	We use a sample of all workers partly because outsourcing and other arrangements have made it more difficult to separate private and public sector profession, and partly to maintain incentives for LAs to exercise pay restraint - using LA paybills would compensate authorities which have chosen to pay above the local going rate.
RCA	Spatial variation in the going rate for similar *properties*, accounting for the effects of building characteristics known to affect valuation.	A detailed database of property valuations from the Valuation Office Agency (VOA)	Hedonic regression	• Property Type • Types of Features (e.g. air conditioning) • Valuation adjustments (e.g. age, variations in floor level) • Plant and Machinery value • Area of property • Proportion of area taken up by additional features such as car parks.	Averaging these effects out avoids us ascribing high costs to areas with higher quality buildings.	We use a sample of all buildings partly because outsourcing and other arrangements have made it more difficult to separate private and public sector buildings, and partly to maintain incentives for LAs to exercise pay restraint - using LA rent bills would compensate authorities which have chosen to pay above the local going rate.

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Description of journey times measures: *accessibility* and *remoteness*

Measure		Data source	Purpose
Accessibility	**Traversal**	• MHCLG-commissioned journey times from **LSOA** to the closest **LSOA** in an area totalling 10,000 people.	• Measures the additional cost – in terms of employee time and therefore paybill – of longer journeys between households **when delivering services** such as waste collection
	Dispersal	• DfT Journey Times from **Output Areas** to the closest "**hub town**".	• Measures the additional cost – in terms of employee time and therefore paybill – of longer journeys **to reach households in order to provide services** such as child protection visits
Remoteness		• DfT Journey Times from **Output Areas** to **Major Towns and Cities**.	• A **proxy** for separation from larger concentrations of service users, since outside of larger service markets, fewer providers can sustainably operate, reducing competition and increasing the **cost of procuring specialised goods and services** such as social care beds for local authorities. The cost of "in house" services will also be higher due to lower **economies of scale**.

Geography	Description
Lower Super Output Areas (LSOA)	400 to 1,200 households
Output Areas	Average 129 households
Hub Town	Settlement of over 10,000 people
Major Towns and Cities	Areas identified by the **ONS as Built Up Areas** - contingent areas of high density development, also used by Defra to define Urban/Rural Classifications - with more than 75,000 residents

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Weights are calculated using the most recent local authority expenditure and service-specific data

Revenue Outturn (RO)

- Local Authorities record the split of their spending on each service line between "employee costs" and "running costs" in the **RO**
- Agency and other provider staff delivering e.g. social care are counted under "running costs" and need to be identified using the **SAR** (see below).
- **The RCA is applied to greater proportion of "running costs"** than in the previous ACA, as under the revised methodology it reflects variation in all premises costs (including costs incurred by contractors).

Weighting accessibility

- The default weight is calculated using the average number of **hours per year spent travelling for work** by relevant workers in the **National Transport Survey** as a proportion of all paid time**.**
- The weight for domiciliary **adult social care** uses travel time estimates published by the UKHCA, and the weight for **waste collection** estimates total travel time from WRAP's ICP2 published model of waste collection costs.

Annex A11: Subjective Analysis (SAR) 2016-17 Part B

£ thousand

	TOTAL ALL SERVICES	of which: Social Care	Police services	All other services
PART B - RUNNING EXPENSES				
18 Repairs, Alterations and Maintenance of Buildings	1,300,581	71,729	113,003	1,115,849
19 Energy Costs - Electricity, Gas and Other	855,297	30,498	69,604	755,194
21 Rents	720,858	46,611	71,361	600,886
22 Rates	910,872	26,102	91,784	792,986
23 Water Services	144,244	7,677	7,719	128,848
24 Fixtures & Fittings	57,224	10,964	114	46,146
25 Cleaning and Domestic Supplies	537,398	33,596	34,835	468,967
26 Grounds Maintenance Costs	366,725	5,097	542	361,086
27 Premises Insurance	126,472	4,651	8,235	113,585
28 Other Premises Related Expenditure	627,515	116,736	21,241	489,537
29 TOTAL PREMISES EXPENSES (Total of lines 18 to 28)	**5,647,106**	**353,654**	**418,438**	**4,873,094**
30 Direct Transport Costs - Vehicle Running Costs, Repair & Maintenance	561,236	33,358	127,065	400,813
32 Contract Hire and Operating Leases	888,387	82,258	34,243	771,886
33 Car Allowances for Travelling Expenses	241,344	87,968	32,091	121,285
34 Public Transport Allowances for Travelling Expenses	208,536	44,388	5,899	158,249
35 Transport Insurance	73,833	2,136	27,164	44,532
36 Other Transport Related Expenditure	374,369	40,498	18,810	315,061
37 TOTAL TRANSPORT EXPENSES (Total of lines 30 to 36)	**2,347,705**	**290,627**	**245,271**	**1,811,806**
38 Equipment, Furniture & Materials	1,534,733	177,882	104,606	1,252,285
39 Catering	769,240	79,585	8,807	680,868
40 Clothing, Uniforms & Laundry	109,357	4,845	34,065	70,447
41 Printing, Stationery and General Office Expenses	447,865	24,647	22,284	400,933
42 Communications and Computing - Postage, Telephone, Computer Costs and Other	1,883,989	124,639	380,331	1,379,019
46 Subsistence and Conference Expenses	146,674	13,598	21,993	111,083
47 Subscriptions	420,818	58,293	5,185	357,340
48 Insurance	287,583	7,847	40,125	239,611
49 Schools' Non ICT Learning Resources	354,506	30,860	0	323,647
50 Schools' ICT Learning Resources	149,107	105	0	149,002
51 Exam Fees	80,750	4,440	20	76,291
52 Other Supplies and Services Expenditure	10,606,990	2,130,928	421,039	8,055,023
53 TOTAL SUPPLIES & SERVICES EXPENDITURE (Total of lines 38 to 52)	**16,791,611**	**2,657,628**	**1,038,455**	**13,095,528**
54 Joint Authorities and Other Local Authorities	4,125,203	1,827,636	165,970	2,131,598
55 Payments to Voluntary Bodies				
56 Private Contractors and Other Agencies - Professional Services	5,468,289	3,566,965	33,387	1,867,937
57 Private Contractors and Other Agencies - Agency Staff	1,352,333	523,705	31,749	796,879
58 Private Contractors and Other Agencies - Other	19,627,373	11,387,274	189,875	8,250,224
59 Internal Trading Organisations	779,469	154,776	5,430	619,263
60 TOTAL THIRD PARTY PAYMENTS (Total of lines 54 to 59)	**32,837,051**	**17,952,773**	**533,691**	**14,350,588**
61 Total Transfer Payments (Discretionary)	5,231,882	1,140,734	304,292	3,770,751
62 Expenditure on Management and Support Services	6,000,194	1,002,602	0	5,013,487
63 TOTAL Part B (Total of lines 29, 37, 53, 60, 61 & 62)	**68,855,619**	**23,400,210**	**2,540,147**	**42,915,254**

Subjective Analysis Return (SAR)

- The **SAR** collates authorities' break down of running costs into categories for "Social Care", "Police", and "All other services" and assigns categories to components of the ACA:
  - "Repairs, Alterations and Maintenance of Buildings" will vary with the RCA
  - "Agency Staff" will vary with local labour costs i.e. the LCA,
  - "Equipment, Furniture & Materials" will reflect local market size and therefore Remoteness
  - "Energy costs" are unlikely to vary between LAs given regulation and the scale of suppliers
- MHCLG will publish a technical paper later this year that will outline the approach to weights using SAR in more detail.