Family and Childcare Trust

A short introduction to early years funding reform

How does early years funding currently work?

Free early education is funded by the Government through the Dedicated Schools Grant (DSG). Each local authority receives an annual grant consisting of an early years block, a schools block and a high needs block. Local authorities can move funding from one block to another but the grant as a whole must be spent on early education and school places. The National Audit Office estimated that in 2015/16 the Government allocated £2.7 billion to local authorities through the DSG for free early education for two, three and four year olds.[1]

Local authorities fund early years providers using a local funding formula, which must meet guidelines set by the Department for Education. The formula consists of an hourly ‘base rate’ with one or more supplements: local authorities must use a supplement for deprivation but may also add optional supplements for factors such as flexibility and quality. The amount of funding each provider receives depends on the number of children they care for and the amount of funding allocated to each child through the formula.

What’s wrong with the current system?

Early years funding allocations from central to local government through the DSG have not been based on a formula but rather have followed historical precedent. As a result, significant variation has developed over time in the amount of funding each local authority receives and many areas with similar levels of need receive different amounts of funding per child. For example, at the moment Coventry receives an average of £3.51 per hour per child compared to £5.02 in Birmingham.

At a local level, local authorities often offer different base rates and supplements for different types of provider, so funding arrangements can be complex.[2] In some cases, this variation reflects different costs for different types of providers; for example, nursery provision in schools must be teacher-led but PVI (private, voluntary and independent) provision often is not, but there are also instances in which there is little clear explanation for variations in funding for different providers.

These issues mean that the current system is failing to align resources with need. In 2012, the National Audit Office found that only 20 per cent of the differences in funding allocations between local authority areas could be explained by known factors such as variations in local wages or other costs.[3]

What is the Government proposing?

There are three key elements to the Government’s proposals, which are set out in a consultation that closes on 22 September. At a **national level**, the Department for Education proposes to introduce a new formula to decide funding for each local authority. The new formula is based on a standard hourly rate per child and an ‘additional needs’ factor based on the proportion of children eligible for free school meals or with additional SEN or language needs. This amount is then weighted taking into account variations in local staff and provider operating costs.

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[1] National Audit Office (2016) *Entitlement to free early education and childcare*

[2] The Family and Childcare Trust recently published a report examining the structure of local funding formulas, which can be read here.

[3] National Audit Office (2012) *Delivering the free entitlement to education for three- and four-year-olds*

The national funding formula would be implemented alongside an increase in funding for free early education. Estimates published by the Department suggest that funding for the free offer will rise by around 6.5 per cent in cash terms and three quarters of local authorities would gain funding. For those local authorities that lose funding, the Department proposes a transitional period of two years during which year on year reductions would be capped at five per cent, and no local authority will lose more than 10 per cent of its current funding.

At a **local level**, the Government proposes to simplify funding by requiring local authorities to use one 'universal' funding rate for all providers. Supplements would only be allowed for a prescribed list and the value of individual supplements would be limited to ten per cent of the base rate.

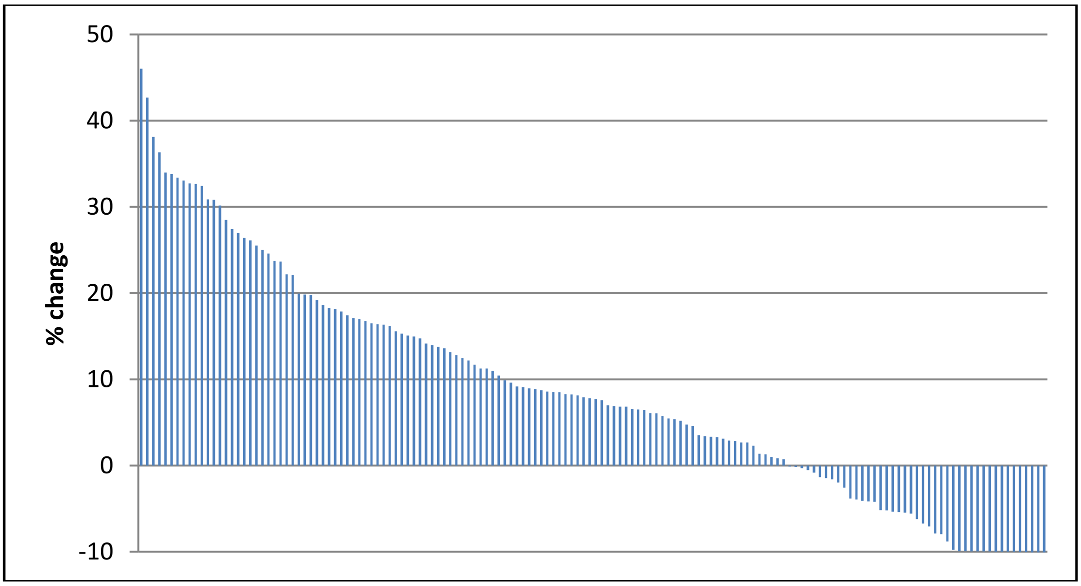
Local authorities would also be asked to limit any funding they retain centrally from the early years block of the DSG (to administer the free offer and support providers) to five per cent to ensure that as much funding as possible reaches providers directly. The consultation also proposes to remove the current 'minimum funding guarantee' which ensures that no provider sees a decline in its funding rate of more than 1.5 per cent year on year, so there would be no cap on reductions in future.

Finally, the consultation includes proposals to improve access to **inclusive provision** in the early years by creating a new Disability Access Fund payment – a lump sum that all providers caring for a child eligible for Disability Living Allowance would receive each year along the lines of the Early Years Pupil Premium – and encouraging all local authorities to establish a separate inclusion fund to support providers.

Who will benefit from the proposals?

We have examined how funding will change for individual local authorities and providers after the transitional period to understand the long-term impact of the proposals. Figure 1 shows how funding will change for each local authority. Whilst the 10 per cent cap creates a floor limiting funding reductions, there is no upper limit and **most areas stand to gain significantly in cash terms**.

Figure 1: Change in funding by local authority

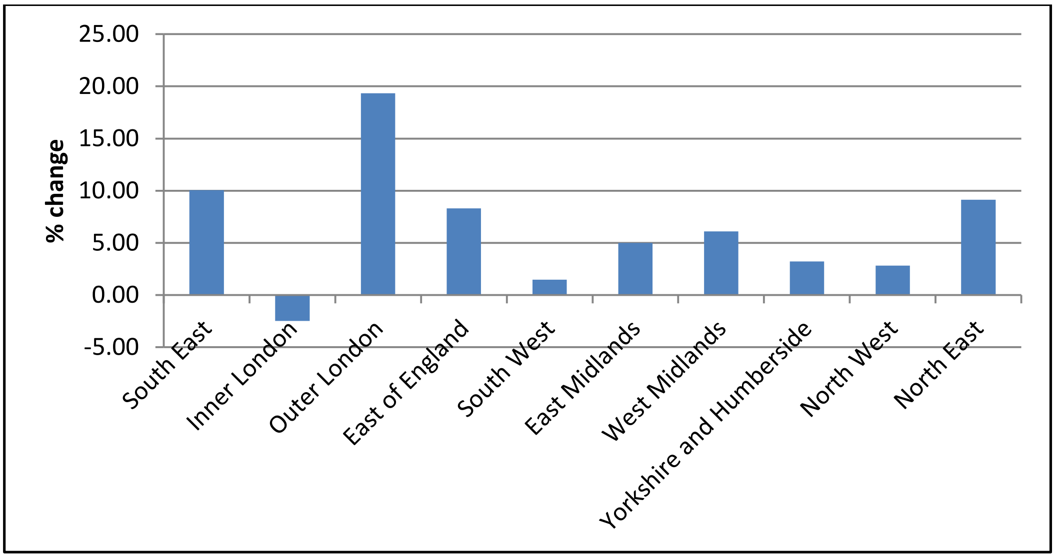


Source: Family and Childcare Trust calculations using Department for Education (2016) Early Years Block National Funding Formula - Illustrative Impact on LAs

The big **regional** winner from the proposals will be **outer London** with a rise in cash funding of almost 20 per cent. Other regions will see a more modest rise in funding (figure 2). Only inner

London will see a fall in cash funding of -2.5 per cent. Within these regional changes, individual local authorities will see dramatically different changes to their budgets. Yorkshire and Humberside will see little change in funding overall but dramatic changes to budgets among individual local authorities. For example, Leeds would receive a cash increase of 20 per cent whilst nearby Bradford would see funding fall by 10 per cent.

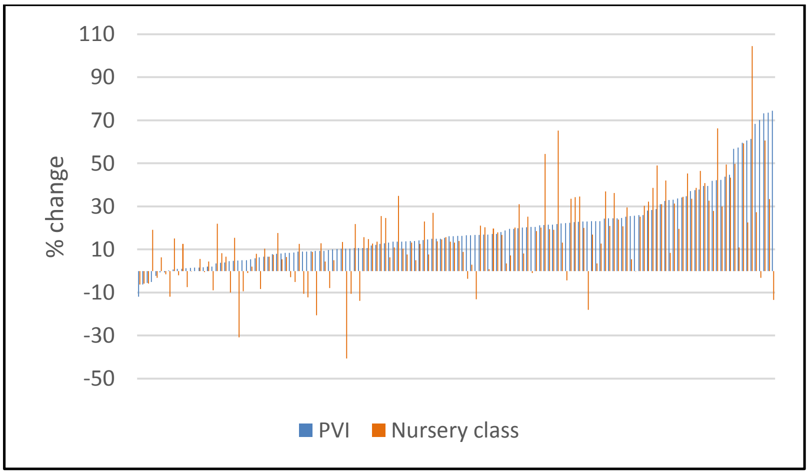
Figure 2: Change in funding by region



Source: Family and Childcare Trust calculations using Department for Education (2016) Early Years Block National Funding Formula - Illustrative Impact on LAs

Most early years providers would also benefit from the proposals. **Private and voluntary providers** in many areas would receive a 'double dividend' as the local authority receives an increase in funding and the introduction of a universal funding formula means that PVI settings receive an increased share of funding. Overall, the Department estimates that 88 per cent of PVI providers and 78 per cent of maintained providers will be better off in cash terms once the changes are fully implemented. However, it is worth noting that a small number of PVI and maintained settings will face significant funding reductions. Figure 3 shows the estimated gain or loss for PVI and maintained settings in each local authority once transitional protections are removed.

Figure 3: Percentage change in cash funding per hour for PVI and nursery class settings by local authority[4]



[4] We have removed two local authorities – Harrow and Kensington and Chelsea – which are outliers with a potential percentage change for PVI settings of over 100 per cent.

Source: Family and Childcare Trust calculations using Department for Education (2016) Illustrative LA allocations under early years national funding formula and Department for Education (2015) Early Years Funding Tool 2015/16

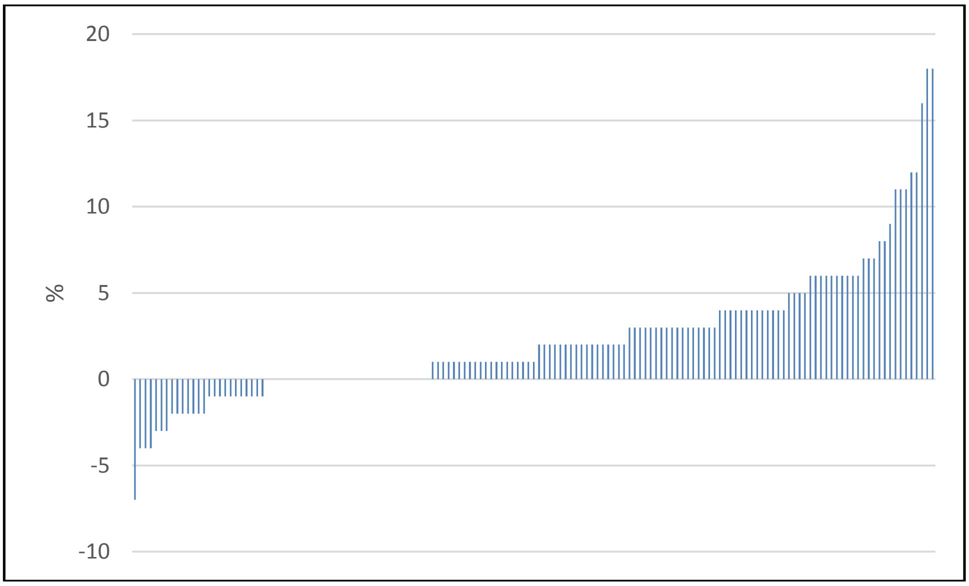
Who will lose out?

The group of providers most likely to lose funding will be **maintained services**. As figure 4 shows, a small proportion of local authorities offer rates that favour PVI providers whilst a majority currently favour maintained settings. A universal base rate means that these imbalances would be largely smoothed out but this will result in sharp funding cuts for some maintained providers.

Children from disadvantaged backgrounds are more likely to attend free early education in a maintained setting, so these settings are still likely to receive a greater share of funding overall through the additional deprivation supplement. However, the ten per cent cap on supplements is lower than the current value of supplements in many areas (in 2015/16 the average value of the deprivation supplement was 15 per cent of the base rate) so maintained settings would benefit less from this additional funding than in the past.

Overall, we estimate that up to £60 million will be 'transferred' from maintained to PVI providers as a result of the universal base rate.[5] Around a fifth of maintain providers would lose funding – many significantly – but the majority of both maintained and PVI providers would gain funding; however, maintained providers would receive a lower share of the pot.

Figure 4: Spending imbalance between PVI and maintained settings (positive figures favour maintained settings)[6]



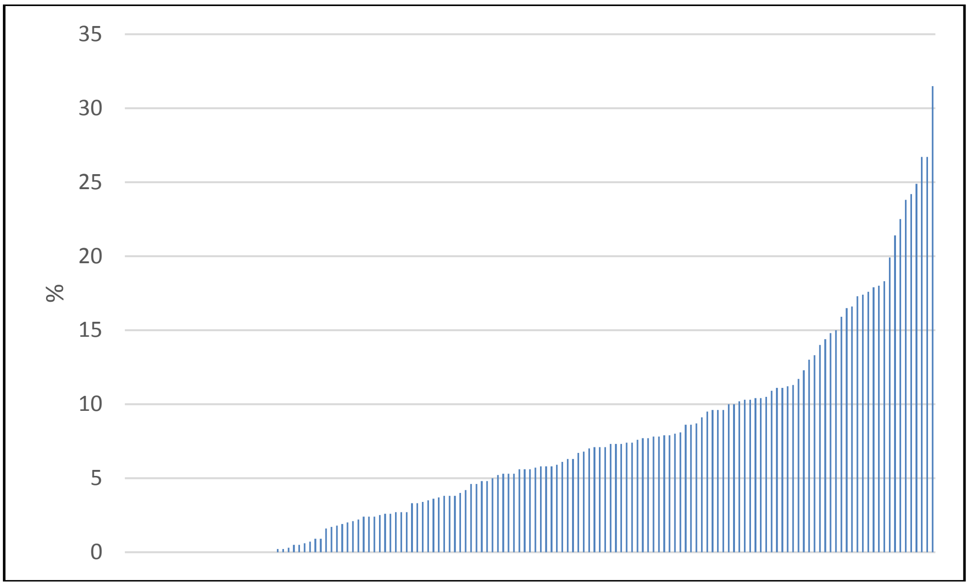
Source: Department for Education (2015) Early Years Funding Tool 2015/16

Local authorities may also lose funding as a result of the five per cent on funding that they can retain. Figure 5 sets out what percentage of the early years block of the DSG local authorities

[5] This estimate is calculated by comparing the amount of funding maintained settings would receive if they received the same share of future funding as at present compared to the amount of funding if this funding was distributed equally among settings through a universal formula. The estimate does not take account of the value of supplements so is likely to over-estimate the transferred funding modestly.
[6] Figure 4 shows the percentage of 'excess' funding maintained providers in each local authority receive compared to the percentage of children that attend free early education in maintained settings (i.e., if 50 per cent of children attend in maintained settings but these settings receive 55 per cent of the funding available, the imbalance is five per cent).

retained in 2015/16.[7] We estimate that 75 local authorities would lose up to £83 million in total. In addition to administration costs and support for providers, this funding may be used for a range of purposes, such as targeted support for maintained and voluntary settings, support for families and children at risk, quality incentives and to develop free places where there are shortages.

Figure 5: Percentage of early years block of DSG centrally retained by local authorities



Source: Department for Education (2015) Early Years Funding Tool 2015/16

The **region** that will clearly lose as a result of the proposals is **inner London**, where 12 out of 14 local authorities will lose an average of five per cent of their funding (Greenwich and Lewisham are the exception and will gain 27 and 25 per cent respectively, illustrating how disparate settlements for neighbouring local authorities will be). Inner London already has serious sufficiency problems, with take-up of the two and three year old offer of 53 and 83 per cent compared to 68 and 94 per cent in England.[8]

Is this the right approach?

Early years funding had become so distorted that reform to put funding on a more rational basis will inevitably create disruption. There are a number of positive aspects to the Government's proposals, including a significant increase in funding for most areas and welcome steps to invest in inclusion. However, the approach set out carries some significant risks.

The proposed **removal of the minimum funding guarantee** could mean steep declines in funding for many providers. Consequences could include a declining number of free places, lower quality as pressures on wages bite and even in some cases service closures. Of course, the opposite is also true in many of those areas that gain funding, where providers will have new opportunities to invest in services.

As a whole, the proposals are not progressive in targeting the most disadvantaged children. Overall, 63 per cent of children in the **most deprived** decile attend free early education in a maintained setting compared to 17 per cent in the least deprived decile.[9] Redistributing funding from maintained providers to PVI providers must therefore be considered carefully. It would be

[7] Twenty eight local authorities reported they did not retain any of the grant, which means that early years administration and support is funded from elsewhere in the local authority budget or that these local authorities submitted incomplete data.
[8] Department for Education (2016) *Education provision: children under 5 years of age, January 2016*
[9] NAO (2016)

better as far as possible to raise funding for PVI settings to the level of their maintained equivalents rather than redistribute funding from one type of setting to another.

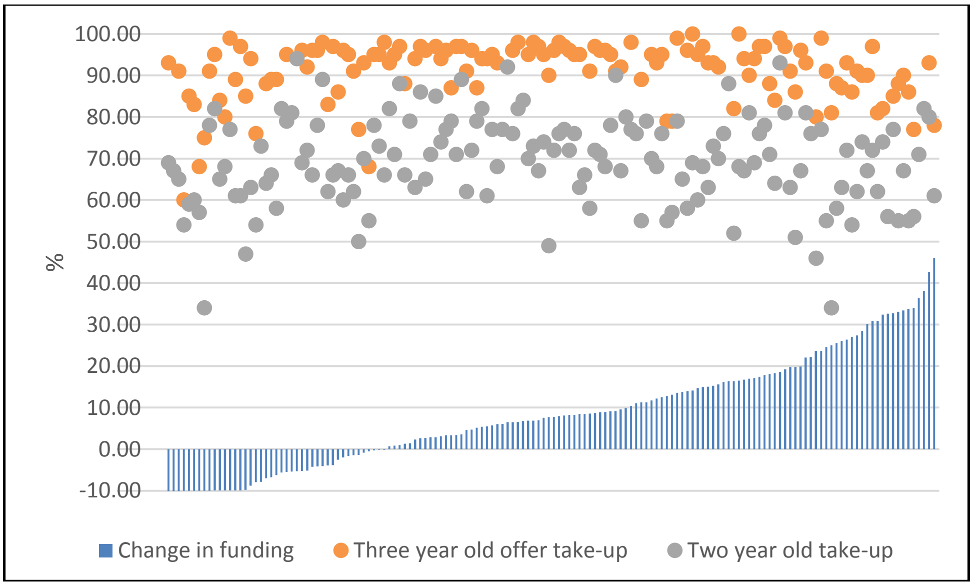
There are also risks in equalising funding between PVI and maintained settings without **equalising standards**. Maintained providers must adhere to the school admission code, which means they must prioritise those with the highest needs, implement more stringent inclusion policies for children with SEND and meet higher staff qualification requirements. All of these duties carry additional costs, but it is not clear how these costs have informed funding reform.

The opportunity to raise quality in PVI settings through new investment is also not mentioned in the consultation; for example, a graduate funding supplement is not on the list of allowable hourly supplements. There are large variations across local authority areas in the proportion of children receiving graduate-led care and in the proportion of settings with 'Good' or 'Outstanding' Ofsted grades. Rising funding is an opportunity to raise standards where quality falls short that should not be missed.

The cap on early years DSG funding that can be retained by **local authorities** would compound funding challenges for local authorities already managing steep budget reductions (in fact, local authorities are currently spending £233 million more on free early education than the Government allocates).[10] Centrally retained funding is often used to support local early intervention strategies, increase the proportion of qualified staff and graduates in settings and develop new places to address gaps in provision. The cap would put at risk the important strategic role local authorities play in improving quality and children's outcomes, particularly for those who are otherwise poorly served by the local early years market.

Finally, no consideration has been given in the new funding arrangements to the funding needed to address **gaps in sufficiency**, either in the number of free childcare places or the quality of places offered. Figure 6 shows the change in funding for each local authority along with take-up of the free offer. As the chart indicates, there is no correlation between sufficiency problems and the proposed redistribution of funding.

Figure 6: Indicative allocations by local authority and childcare sufficiency



Source: Department for Education (2016) Education provision: children under 5 years of age, January 2016; Department for Education (2016) Early Years Block National Funding Formula - Illustrative Impact on LAs

[10] NAO (2016)

How can the Government get it right?

There are good reasons to be cautious about the long-term impact of the Government's proposals. The key question for providers will be whether funding rises in real terms once new cost pressures such as the National Living Wage, pension auto-enrolment and the impact of the 30 hour offer are taken into account. The picture for many providers could be less positive than the headline hourly allocations suggest.

Second, the Government has not proposed any structural changes that will ensure future allocations keep pace with changes in provider costs. It is to be expected that the early years budget will be settled each spending review period. However, the funding settlement for the early years must be informed by a credible assessment of the cost of delivering childcare, particularly as quality standards rise and demand for flexible services increases.

The Family and Childcare Trust has recommended that local authorities are given a statutory responsibility to collect data on the cost of delivering childcare and the Government in turn establishes an independent advisory body to make recommendations on funding allocations. This would help to restore trust between providers and the Government and put funding on a sustainable footing in future.

In the short term, we think there are five steps the Department for Education should take to manage early years funding reform in a way that minimises unnecessary disruption and works for as many providers and ultimately families as possible.

First, the Department should **slow down** the speed of reform and target investment at those areas and providers with the greatest quality and sufficiency challenges. There is no reason to impose deep funding cuts in some areas and extraordinary gains in others over a two year period. This will lead on one hand to unnecessary disruption in those areas losing funding and on the other to waste as other areas receive a windfall.

The Department should **extend the transitional period** and implement a 'pace of change' policy by retaining the 1.5 per cent minimum funding guarantee so that the sustainability of services is not threatened and funding increases can be invested sensibly. A proportion of funding should also be linked to the sufficiency challenges each local authority faces and could be conditional on a credible sufficiency action plan.

Second, local authorities must retain the flexibility to invest early years funding to meet **local priorities** through centrally retained funding and well-designed supplements. The consequence of the proposed approach will be that it is much more difficult for local authorities to invest in **early intervention** to benefit the most disadvantaged children. A balance between ensuring funding reaches providers and enabling early intervention can be achieved by allowing local authorities flexibility alongside clear guidance on acceptable uses of supplements and centrally retained spending.

Third, equal funding for PVI and maintained settings should mean **equalising quality, access and inclusion requirements** . If funding is not linked to higher standards, the proposals could simply lead to a perverse outcome where new funding is pumped into free provision with no meaningful impact on the quality of services or outcomes for children.

Fourth, whilst **additional support for inclusion** is welcome, the requirement for local authorities to operate an inclusion fund should be put on a statutory basis to ensure a concrete improvement in practice. Key principles can be set out in the annual statutory guidance for early years providers. This would not constrain local flexibility but would mean that both early years providers and parents know what to expect in future.

Finally, the Government and Greater London Authority must work together to find solutions for **inner London**. Many areas in London stand to lose out even as children are already being denied their entitlement to free early education. In this context, it is hard to argue that inner London boroughs are over-funded. However, funding alone is not the answer in London, where shortages of appropriate buildings will make delivery difficult without creative solutions such as freeing up publicly owned buildings for nursery provision.