Department for Education

An early years national funding formula

And changes to the way the three- and four-year-old entitlements to childcare are funded

Government consultation

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Foreword

This Government is committed to extending the free entitlement to childcare from 15 to 30 hours a week for working parents. This will reduce the cost of childcare for working families and break down the barriers to work, so that parents who want to return to work or work more hours can do so. This ambitious expansion of our free childcare programme is supported by an investment of over £1 billion more per year by 2019-20.

To deliver the extended 30-hour entitlement, and ensure that all children can continue to benefit from high quality early education, we need to get the funding right and ensure that early years providers are funded on a fair and sustainable basis. We have committed to increasing the average hourly rate paid to providers for delivering the entitlements and the £1 billion extra annual funding includes £300 million per year for a significant uplift to government funding rates.

But more funding, even if it is at record levels, is only part of the answer. Equally important is how that funding is used. We must ensure that funding is distributed fairly and transparently across the country. We must also ensure that funding reaches providers and gives them incentives to deliver both the existing 15-hour entitlement and the extended 30-hour entitlement for working parents, on a sustainable basis. For these reasons we committed in the Autumn Statement to introduce an early years national funding formula to ensure that funding is fairly allocated.

We need a strong and sustainable early years funding system that is fair, transparent and maximises funding to providers. We need it to target additional funding to children who require extra support so they can benefit fully from opportunities for early education. The current system is driven by historical precedent and not by the costs of providing childcare that meets the needs of children in different areas. Only with significant change can we establish a system that supports the delivery of the Government's ambitious agenda for the early years and enables the successful delivery of our Manifesto commitment.

We now have a unique opportunity to revise our approach. Our seminal *Cost of Childcare Review* gave us an opportunity to listen to the sector and a strong foundation of evidence on which to base our proposals. The extension of the free entitlement to 30 hours together with the significant injection of new government investment provides a compelling reason to start now.

Early years providers have been asking for clarity on the funding rates they will receive for delivering 30 hours of free childcare. Now is the time to offer them, as well as local authorities and parents, the certainty they need to plan ahead. Our proposals, together with our additional investment in the early years, will see the large majority of local authorities, and the vast majority of providers, seeing increases in their hourly funding rates.

The proposals presented here are ambitious and historic. I recognise this and I look forward to hearing the opinions and views of interested parties from across the early years sector – from childcare providers and local authorities to representative organisations and parents. It is clear that changes to each level of the funding system are needed to underpin a long term shift in the childcare market as it moves toward delivering 30 hours of free childcare for the benefit of working parents.

I believe our final set of proposals, refined by your views during this consultation, should deliver a funding system which is fair for children, parents, providers and local authorities. As we develop and then implement our final proposals, we will monitor and review the impact closely to ensure that providers are receiving sufficient funding to enable them to deliver 30 hours of free childcare and to thrive and grow. We all want to enable all children, whatever their background and individual needs, to access the high quality early education they deserve.

Rt. Hon Justine Greening MP

Executive Summary

The Case for Change

1. To implement 30 hours of free childcare, we need early years providers to deliver enough free childcare places to meet the needs of the nearly 400,000 families who will be eligible from September 2017. They cannot be compelled to do so and funding is our principal means of incentivising them.
2. These providers however also currently deliver 'non-funded' hours which parents pay for at market rates. To deliver successfully our manifesto commitment, we need to persuade significant numbers of providers to switch parent-paid hours for government-funded hours. As market rates exceed government funding rates, this is a significant challenge which we can only meet if we can distribute our early years budget as effectively and fairly as possible.
3. The current early years funding system is manifestly not capable of doing this. The principal problem is the way in which the Government allocates funding to local authorities based on historic council expenditure. This leads to significant variations in funding for local authorities which correlate neither with provider costs nor market prices. They are therefore impossible to justify or explain.
4. There are also problems with the way in which some local authorities distribute their government allocations to providers. Some councils retain far too much of their allocation as 'central spend'. Others unfairly differentiate the funding rates that they pay to different types of providers which leads to a non-level playing field between those from the maintained sector and those from the private/voluntary sector. This matters to 30 hours delivery, as the majority of 30 hours places will need to be delivered by the private/voluntary sector.
5. These problems at both the national and local level mean that the funding levels that different providers receive for delivering the same entitlement vary considerably and not necessarily for good reasons. Funding levels should be determined by relative costs of delivery (and influenced by market prices in local markets). Instead they are driven by historic spending patterns and widely varied / unpredictable council decisions.
6. This is neither fair nor efficient, and investing the additional £1bn of early years funding in the same way will simply exacerbate this inefficiency and inequity. It will also jeopardise manifesto delivery because it will not incentivise sufficient numbers of providers to deliver 30 hours of free childcare.

The Early Years National Funding Formula

7. To create a strong and sustainable early years funding system that is fair and transparent we propose to introduce an early years national funding formula.The formula will allocate funding for the three- and four-year-old entitlement, both the existing universal 15 hour entitlement and the new 30 hour entitlement for working parents, on a formulaic basis for the first time. It will commence, for the existing 15 hours, in April 2017 alongside the funding rate uplift announced in the last Spending Review; and for the additional 15 hours, in September 2017, when 30 hours of free childcare is implemented nationally.

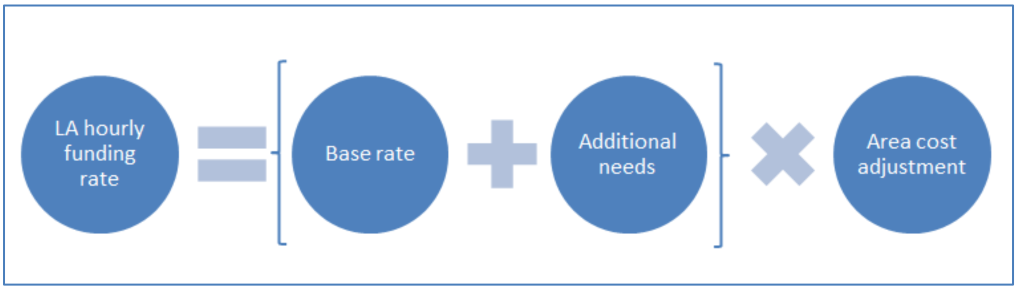
8. Our proposed formula has been designed to allocate funding fairly, efficiently and transparently in order to give local authorities the funding they need to ensure that sufficient numbers of providers are willing and able to deliver 30 hours of free childcare on a sustainable basis. It features three funding factors that determine the funding per child that each local authority receives:

   i) a universal base rate of funding for each child;

   ii) an additional needs factor, reflecting the extra costs of supporting children with additional needs to achieve good early learning and development outcomes; and

   iii) an area cost adjustment, reflecting the different costs of providing childcare in different areas of the country.

9. The early years national funding formula will therefore be constituted as follows:



10. The base rate will allocate the majority (89.5%) of all early years formula funding. The remainder will flow through the additional needs factor which ensures that each local authority's funding allocation reflects their proportion of children with additional needs and the extra costs of meeting these needs. It will be based on the three metrics that we believe to be the best available proxies for additional needs in the early years and are weighted to balance the different aspects of additional needs:

a) Free School Meal eligibility, which we propose to weight to 8%;

b) English as an Additional Language, which we propose to weight to 1.5%; and

c) Disability Living Allowance, which we propose to weight to 1%.

11. The area cost adjustment reflects cost differentials between local areas particularly in terms of the staff costs which are the main cost driver for childcare providers. We propose to use an area cost adjustment based primarily on the general labour market measure, but adjusted for relative nursery premises costs (based on rateable values).

12. This fair formula, combined with record levels of investment, means that most local areas will gain funding: when the formula is implemented in full, our proposals see 112 local authorities (75%) gain funding on their hourly rate. For the remaining areas that need to make savings, we propose to provide stability by limiting their reductions through building a funding floor into the formula. We propose that no local authority should face a reduction in its hourly funding rate of more than 10% against its 2016-17 baseline as a result of introducing the formula.

Amending the Local Authority Funding Role

13. The formula will deliver a significant improvement to the way in which the national early years budget is allocated to local authorities. But this cannot, in and of itself, ensure that providers themselves receive the funding they need to deliver 30 hours of free childcare. To do this, we also need to improve the way in which local authorities distribute funding to their local providers with a focus on three key changes.

14. First we will tackle excessive local authority central spend by implementing a 'high minimum threshold' on the proportion of government early years funding that local authorities must pass on to providers. This will be set at 93% in 2017-18 and 95% thereafter. This will reduce central spend for those councils with excessively high current levels, thus ensuring that the vast majority of the record investment in the early years is passed onto providers.

15. Secondly, we will make local authority funding formulae fairer to different types of providers by requiring local authorities to use a 'universal base rate' of funding for all providers from 2019-20 at the latest. This means that, all else being equal, a child in a private or voluntary setting will receive the same level of 'per child' funding as a child in a nursery class in a primary school.

16. Thirdly, we will reduce the variation in local formulae so that the system is simpler and clearer for providers. To do so, we will reduce the use of local authority funding supplements by limiting the types of supplements that can be used. In future, these will be limited to key drivers of local cost such as deprivation or

rurality, and key policy objectives such as 30 hours delivery. We also propose to consult on a cap, of 10%, on the amount of funding that can flow through these supplements.

Managing the Transition

17. The changes we are proposing will, rightly, see new levels of funding across the country as funding is better matched to need. We want underfunded areas and providers to benefit and receive gains as soon as possible so that they can deliver 30 hours of childcare and improve outcomes for children and families. We recognise though that our proposed changes are ambitious, and that in a minority of cases some savings will be needed. We therefore wish to ensure a manageable transition.

18. We intend to phase in funding changes gradually so that early years providers and local authorities have time to plan how to make the best use of their new levels of funding. We propose to put in place a range of measures to minimise turbulence, help with transition and support 30 hours delivery. These complement the 10% funding floor that we are proposing in our national formulae and which will limit the overall reductions that individual local authorities may face.

19. In designing a transition arrangement for early years funding, not only do we need to deliver both fairness and stability, but we also need to ensure enough funding gets to every area, including those which have been underfunded in the past, to enable and incentivise delivery of the manifesto commitment to 30 hours of free childcare. We therefore need to balance a desire to increase funding to underfunded areas as fast as possible, so that early years providers in those areas remain viable and choose to deliver the manifesto commitment, against a desire to keep the transition manageable, and maintain childcare sufficiency for the minority of areas that do need to make savings.

20. The implications for early years providers have therefore been central to the design of our transition arrangements even though these arrangements apply to local authorities. In addition to our proposal to limit the total reduction in the hourly rates that a local authority can face to 10%, we propose to protect local authorities on an annual basis as they transition to their new funding rates.

21. We therefore propose to cap local authorities' reductions in their hourly rates to 5% in 2017-18 and 2018-19. With the additional government investment of £1 billion per year, we can make swift early progress in raising funding levels in historically underfunded areas. Our ambition is that all local authorities should be 'on formula' by 2019-20.

22. We also need to consider transition in the context of the proposed changes to the local authority funding role. A significant minority of local authorities have high levels of early years central spend. Our proposal is that, once fully implemented,

95% of early years funding allocated to local authorities will be passed directly to providers. This will benefit providers in local authorities with high central spend that will need to reduce. Such authorities will instead need to pass more resource to the front line. We recognise however that moving directly to 95% may be challenging for some areas. We therefore propose to transition the policy, starting at 93% in 2017-18 and moving to 95% by 2018-19. This policy provides a firm guarantee of funding to the front line, and as such we propose it will replace the minimum funding guarantee for the early years, as it becomes unnecessary.

23. We also recognise that for some local authorities, moving to a universal 'per child' base rate of funding to providers will be a significant change. We therefore propose to allow local authorities until 2019-20 to implement this while encouraging them to do so sooner if possible, and monitoring their progress.

Support for Children with Special Educational Needs

24. We know that the current funding system does not serve the needs of children with special educational needs and disabilities (SEND) consistently well. We are determined, in rolling out 30 hours of childcare, to tackle this so that families and children with SEND can access and benefit from the free early education and childcare that they are entitled to.

25. We therefore propose to introduce disability access funding to ensure that providers will automatically receive additional funding for every child in their setting in receipt of disability living allowance. We will also encourage all local authorities to build on existing best practice by creating SEN Inclusion Funds to provide additional top up funding to providers to improve outcomes for children with special educational needs.

26. These measures will help providers by making it easier for them to access additional funding to support children with SEND. In turn they will help families by securing better access to the free entitlement and improved outcomes for their children.

The Impact of our Proposals

27. Alongside the consultation document, we have published a table showing how our proposed formulae would impact on local authorities' funding allocations. We have also published the indicative average hourly funding rates that providers might expect to receive in each local area to deliver the entitlements for 3- and 4-year-olds. This is to help them plan ahead for the introduction of 30 hours of childcare from September 2017.

28. We have committed to uplift the average early years funding rate to an average of £4.88 per hour, and the vast majority of areas will therefore see increases in

funding. There is currently wide historic variation in early years funding rates from central to local government, from £3.24 to £9.17 per hour. Our funding formula will instead allocate funding according to the relative costs of meeting the needs of children in each local area. The proposed formula would result in more generous per-hour funding for 112 local authorities and less generous per-hour funding for 38.

29. Local authorities that gain and local authorities that face reductions are spread across the country. Many of the authorities who stand to see reductions are those with higher reported levels of central spend (or top-slicing).

30. The expected impact on providers is even more positive. Our analysis shows that indicatively, and dependent on local authority funding decisions, private and voluntary providers in 132 local authorities will gain funding and in only 18, will they face reductions. Providers will benefit from both our new funding formula but also from the proposed 95% pass-through which means that local authority reductions often do not translate into reductions for providers.

Introduction

31. All three- and four-year-olds are entitled to 15 hours of free early education a week and 95% of them were taking up funded provision in January 2016. These children receive their early education from a professional sector that is characterised by high quality provision, with 86% of settings rated ‘good’ or ‘outstanding’ by Ofsted[1]. The sector is diverse with a wide range of different types of providers, including private providers, voluntary providers, schools, childminders, and independent providers – all with a variety of operating practice.

32. Government policy on early education has always focused on social justice and equality of opportunity. We know that high quality childcare improves children’s long-term educational outcomes and helps close the gap in attainment between the most disadvantaged children and their peers. We know it improves their overall life chances. That is why, in the last Parliament, we extended our offer of 15 hours of free childcare to the 40% most disadvantaged two-year-olds. It is also why we introduced the Early Years Pupil Premium for disadvantaged three- and four-year-olds.

33. The funding system must work so all parents can find affordable and high quality childcare for their three- or four-year-old child, whatever their choice of provider and whatever the individual needs of their child. It must make a reality of the Government’s 2015 Manifesto commitment to double the free childcare available to three- and four-year olds of working families. This aims to reduce the cost of childcare for families, breaking down the barriers to work, so that parents who want to return to work or increase their hours can do so.

34. Getting the funding right is fundamental to achieving our objectives. The 2015 Spending Review announced that we will be investing an extra £1 billion in free childcare each year by 2019-20. Funding for the free entitlements will be at the highest level ever – rising by 38% over this Parliament to £3.9 billion.

35. This significant investment was informed by rich and sophisticated analysis of provider costs, so we can be confident that our spending decisions provide a sustainable childcare funding rate. We published this evidence in full in November – the first comprehensive study in England of the costs of providing childcare, which the National Audit Office recognised as “*thorough and wide-ranging*”.

36. We are committed to increasing the average hourly rate of funding paid to providers. The extra £1 billion we will be investing in childcare each year by 2019-20 includes £300 million per year specifically to increase the average hourly funding rates for the two-, three- and four-year-old entitlements. The national average hourly rate for two-year-olds will rise from £5.09 to £5.39. The equivalent

[1] Childcare inspection and outcomes, providers and places: period ending 31 March 2016. https://www.gov.uk/government/statistics/childcare-providers-and-inspections-as-at-31-march-2016

rate for three- and four-year-olds, including funding for the Early Years Pupil Premium, will rise from £4.56 to £4.88. For more detail as to how the £4.88 figure is comprised, please see the Annex.

37. This significant new investment has been welcomed by the sector:

"We are pleased the Government has listened to our campaigning for better levels of funding.....Despite the tough fiscal climate, the childcare sector is receiving more money. This is a welcome step." National Day Nurseries Association (NDNA)	"The announcement of an additional £300 million to increase the average hourly rate for providers is also welcome, as is the introduction of a national early years funding formula." Local Government Association
"The Government's commitment to uplift the funding level for the free entitlement is good news for childcare providers." Professional Association for Childcare and Early Years (PACEY)	"We welcome the Government's decision to prioritise its ambitious childcare plans and the resulting increases in the hourly rates for two-, three- and four-year-olds." Family and Childcare Trust

38. To make sure providers have sufficient funding to deliver the 30-hour entitlement, we must have a fresh approach to *how* that money is distributed. It is therefore absolutely vital that we allocate the record level of government investment fairly and efficiently.

39. Providers have raised concerns about early years funding for some time. We have listened and seek to address these concerns. We intend that all providers should receive a sustainable rate of funding to deliver the high quality early education that we all want for our children.

40. We are seeking to change the early years funding system to support a vibrant and efficient childcare market in which providers can thrive, grow and invest in their futures. Our proposals would see three quarters of local authorities, and the great majority of providers seeing increases in their average hourly funding rates. A minority of local authorities would see reductions in their funding rates but our proposal for a funding floor means that these cannot exceed 10%. In addition, Part 4 of this document sets out our proposed arrangements to ensure that the

transition to these new funding rates is manageable with annual reductions limited to 5%.

41. To deliver these ambitions, we propose major changes to the early years funding system:

    A. at the national level, the early years funding that is distributed from central government to local authorities; and

    B. the local level arrangements that local authorities use to distribute that funding to childcare providers on the front line.

    Changes at both levels are essential if we are to achieve a fair, sustainable and effective early years funding system.

42. We recognise our proposals present an ambitious and historic set of changes, which must work for a childcare market characterised by a large number of small, single site providers and a wide range of different types of providers from nurseries to childminders. They must also work for different parts of the country and for children with different needs. We acknowledge that our commitment to providing 30 hours of free childcare will see the Government becoming an ever larger purchaser of childcare hours, with implications for providers. Crucially, we cannot require anyone to deliver the free entitlements so we are determined to deliver a funding system that properly incentivises and rewards providers who choose to do so.

43. Whatever their size, we know that childcare providers are passionate believers in early education and that the vast majority provide consistently good outcomes for their children. The *Cost of Childcare Review* gave us a real insight into the childcare market, and we want this consultation to add even more. So please do respond and help us to understand the impact of our proposals.

44. We want providers to thrive and grow. Their innovation can deliver the flexible, affordable and high quality childcare that parents seek. As we develop and then implement our final proposals, we will monitor and review the impact closely to ensure that the funding system incentivises high quality providers, including new entrants to the market, to deliver 30 hours of free childcare for working parents.

45. This document complements our consultation on the childcare free entitlement delivery model, which closed on 6 June[2]. We will publish the Government response to that consultation in the autumn and it will cover the wider local authority role in the early years and regulations under the Childcare Act. It will set out final proposals on delivering flexible childcare, improving access to provision for children with special educational needs and disabilities, and around information to parents on their local childcare offer.

[2] Consultation hosted at: https://consult.education.gov.uk/early-years-funding/childcare-free-entitlement

Our proposals at a glance

Part 1: National funding to local authorities

- Hourly funding rates (national average) will increase from £4.56 to £4.88 for three- and four-year olds (including average Early Years Pupil Premium spend) and from £5.09 to £5.39 for two-year olds.
- A new early years national funding formula would allocate funding to local authorities for the existing 15-hour entitlement for all three- and four-year-olds and the additional 15 hours for three- and four-year children of eligible working parents.
- The formula would include factors for additional needs and an area cost adjustment to reflect variations in local costs.
- While the majority of local authorities would see increases in their hourly funding rates, we would set a funding floor to ensure that no authority could see a reduction of more than -10% once the formula is fully implemented.
- We would also use transitional protections (Part 4) to ensure that no local authority could see an annual reduction in their hourly funding rates of more than -5% in any year.
- We propose all local authorities should be funded by the early years national funding formula, without any transitional protections, by 2019-20.

Part 2: Local funding from local authorities to providers

- We would require that all local authorities pass 93% in 2017-18 then 95% in 2018-19 of early years funding to providers. This would maximise funding to childcare providers.
- Local authorities would use a universal base rate to fund providers for each hour of the free entitlement, by no later than 2019-20. This would bring about greater equality in funding between different types of provider.
- There would be supplementary funding for maintained nursery schools for at least two years to keep their transition to a universal base rate manageable.
- There would be a limited set of permitted funding supplements, limited to those which reflect drivers of cost and incentivise providers to meet the needs of parents. These supplements would be capped at 10% of the hourly funding rate.

Part 3: Meeting children’s additional needs

- There would be a new Disability Access Fund to support disabled children to access the free entitlements.
- Local inclusion funds for children with special educational needs would support providers in driving outcomes for these children.
- The Early Years Pupil Premium will continue.

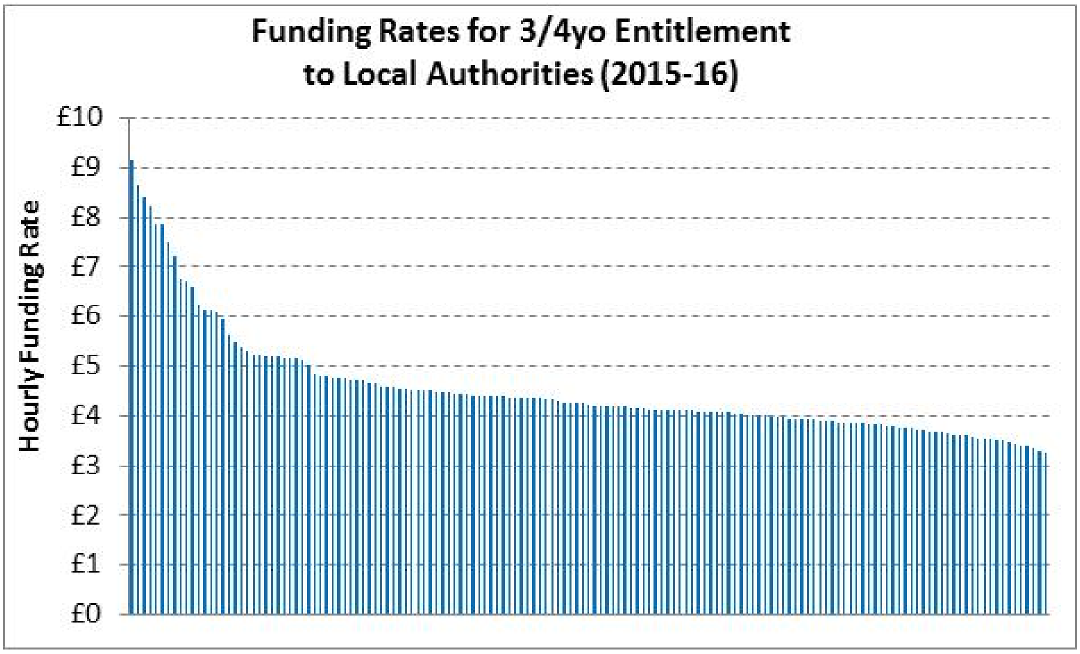
The case for change

This section explains why we think we need to change the way the three-and four- year-old free entitlements are funded.

A. Funding from central government to local authorities

46. The funding rates for each local authority should reflect the local costs of providing childcare that meets the needs of children in that area. The current early years funding system for three- and four-year olds has, however, significant and unjustified variation between local authority funding rates. Funding rates are not based on relative costs or child characteristics in different local areas, but rather on historic spending patterns sometimes determined decades ago.

47. The variation of current funding is demonstrated in the chart below. This shows that the highest hourly funding rate[3] for a local authority is almost three times the lowest.

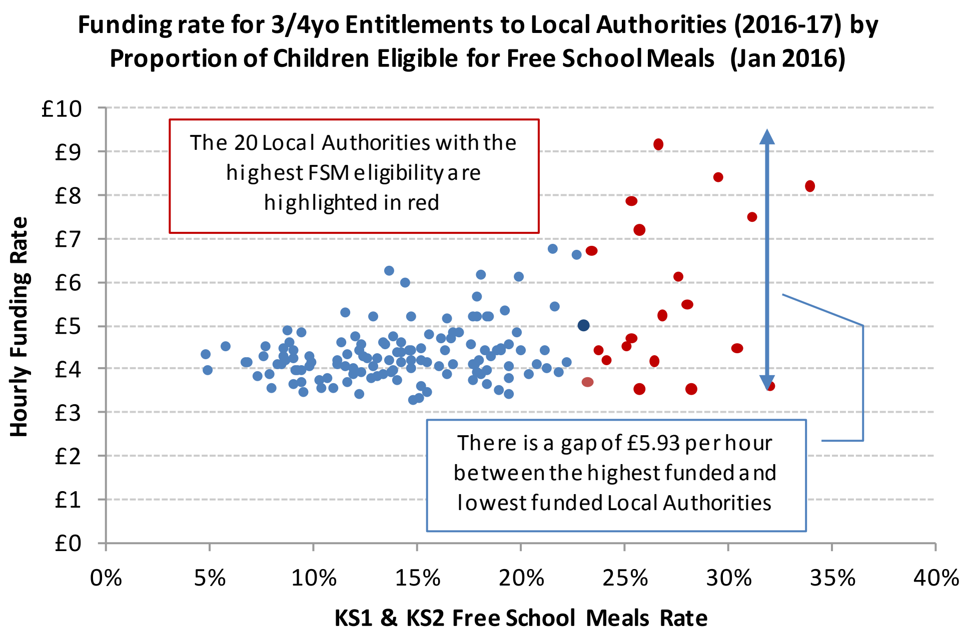


48. There is of course no reason why funding rates should be equal across the country. The costs of providing childcare that meets the needs of local children can vary significantly between areas, for example due to differences in wages and premises costs, as well as the characteristics of children themselves. The current distribution of funding cannot however be explained by these variables alone. For example, while Stoke-on Trent and Sandwell have similar characteristics,

[3] In this section, references to funding rates are those rates allocated from DfE to local authorities. These rates have not been adjusted to reflect planned patterns of spend as reported by local authorities following the baselines exercise run by the Education Funding Agency, and can therefore differ from the hourly rates published in the data tables accompanying this consultation.

Sandwell currently receives an hourly funding rate of £3.71 from central government compared to £5.00 in Stoke-on-Trent.

49. The chart below shows how current funding rates for three- and four-year-olds vary by eligibility for Free School Meals (a measure of disadvantage). There is no clear relationship between the two but there is considerable variation in funding rates for local authorities with similar levels of disadvantage. In the twenty most deprived local authorities, funding rates range from £3.54 to £9.17.



50. So if we compared Liverpool and Middlesbrough, two local authorities with high levels of deprivation, we would see that Liverpool receives an hourly funding rate of £5.24 compared to £3.62 in Middlesbrough. Similarly, Sunderland is currently funded by the Government at £5.39 per hour whereas Darlington is funded at £3.92.

51. These funding disparities between local authorities have inevitable knock-on consequences for the funding rates that early years providers receive in their locality. Indeed providers who operate in neighbouring local authorities can find that their funding rates vary significantly between the two for no apparent reason.

52. Of course where providers are currently underfunded, they will find it harder to operate a necessary and healthy surplus to invest in their staff and children's outcomes. Some may have been forced to increase costs to parents for non-entitlement hours. In contrast, evidence and feedback from the sector tells us that better funded providers may have operated less efficiently, not representing good value for money for parents or the taxpayer.

53. The unjustified disparities in the amount of funding that local authorities are currently allocated has skewed local childcare markets. If we continue to distribute

resources in this way then this distortionary effect will simply be exacerbated as the Government funds a greater proportion of childcare hours upon the roll-out of 30 hours of free childcare. This explains why organisations representing the early years sector have been calling for changes to the national early years funding system:

The introduction of a national early years funding formula [is welcome]. In the past, providers in some areas have been underfunded due to the wide variation in rates paid by central Government. Local Government Association January 2016	We call on any incoming Government to… Overhaul the free early education funding formula for three- and four-year-olds to make it more responsive to social factors. Family & Childcare Trust Childcare Costs Survey 2015
The next Government should… Implement a national funding formula for schools and early years, so local authorities are funded on a consistent level per child. NDNA Annual Nursery Survey 2015	It is… imperative that the DfE develop a national fair funding formula for nursery education. An Early Years Place for All - National Association of Head Teachers, October 2015

54. It is essential that we change the national funding system to address the historic imbalance between the funding rates that different local authorities receive. Only if we put the national funding system onto a fairer basis will we be able to ensure that every local authority is able to pay its providers a sustainable funding rate, and incentivise their local childcare market to respond to parental demand for 30 hours of free childcare.

B. Funding from local authorities to providers

55. Local authorities have an important ongoing role in delivering free early education, including their legal duty to secure sufficient early education places free of charge for three- and four-year olds. They work with a wide range of providers in their area to secure sufficient places for all parents who want to take up their child's entitlement to early education.

56. Although there are around 150 local funding models, this system delivers very high take-up with 93% of three-year olds and 97% of four-year olds receiving funded

early education[4]. Local authorities have led these programmes to ensure three- and four-year olds can access their free entitlement. They provide assistance to providers looking to set up or expand their provision, and help to improve the quality of that provision. We also recognise the very hard work that local authority teams have carried out to drive take up of free places for disadvantaged two-year olds. Local authorities remain best placed to oversee the provision of free entitlement places in highly localised and complex childcare markets.

57. This does not however mean that local funding systems work as well as they could, and the unfairness in the national funding system, as described earlier, can then be exacerbated by local funding decisions. For example, the hourly rates which local authorities pay to their providers can be substantially lower than those allocated by central government. There is thus a strong and pressing need to balance the important role that local authorities play in delivering the free entitlements, with ensuring that they maximise the amount of funding that actually reaches providers.

Funding retained by local authorities for central spending

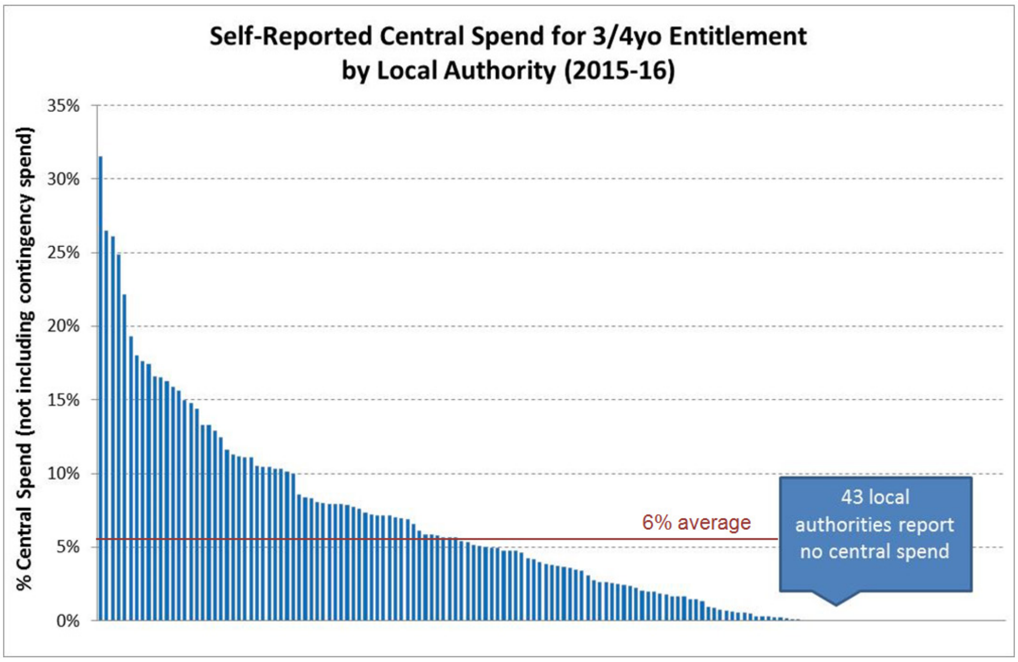
58. Under the current system, some local authorities retain significant amounts of funding centrally. Conversely, many local authorities are delivering their statutory duties within very efficient operating models. Their models ensure they can pass the vast majority of central government funding to childcare providers working on the front line.

59. The National Audit Office reported[5] significant differences in the amount that local authorities hold back centrally around the country: *"In 2015-16, 105 local authorities (out of 152) planned to spend up to 10% of the early years component on central services; 34 between 10% and 20%; and the remainder planned to spend over 20%."*

60. While these retention rates may reflect local priorities, we do not have evidence that higher rates of central spend drive a greater sufficiency of places or higher quality delivery. The chart below illustrates further the significant variation in the proportion of funding that local authorities planned to retain in 2015-16:

[4] Statistical First Release 23/2016, 30 June 2016: Provision for children under five years of age in England, January 2016 https://www.gov.uk/government/statistics/education-provision-children-under-5-years-of-age-january-2016

[5] Report by the Comptroller and Auditor General (Department for Education) Entitlement to free early education and childcare, 2 March 2016 https://www.nao.org.uk/wp-content/uploads/2016/03/Entitlement-to-free-early-education-and-childcare-Summary.pdf



61. Some retention of central spend is clearly justifiable and appropriate. We recognise, for example, that local authorities need to administer the entitlements. We also know that some of the variation in local authorities' central spend reflects differences in how they channel funding for training and improvement to their local childcare providers. Local authorities with low central spend channel such resource via the core hourly rate they pay to providers. Providers can then choose whether to buy services offered by their local authority or to purchase it elsewhere. For their part, local authorities are permitted to impose reasonable charges to cover the costs of services they provide, and many do so.

62. The proportion of government funding held back centrally by local authorities clearly affects the amount of money that can be passed onto providers. All things being equal, providers in areas of high central spending receive less funding to provide high quality early education for their children. For example, one London Borough reports (via Section 251 data returns) that it pays providers £2.05 less per hour (around 30% less) than the amount it is allocated by Government.

63. In contrast, many boroughs have low, or very low, reported levels of central spend, meaning that providers already receive the vast majority of the full hourly rate allocated by central government.

64. In order for the childcare market to thrive and be sustainable, and also to deliver good value to the taxpayer, we need to ensure that funding allocated by central government is passed through to providers. This is the best way to ensure that our high level of investment in childcare will enable providers to offer the free entitlements, including 30 hours to working families. We must make it economically viable and attractive for existing providers and new entrants, whether

they are childminders, schools, charitable or private nurseries, to flourish and expand in all areas of the country.

How funding is distributed to providers

65. Local authorities are responsible for distributing their early years funding from central government to providers through their early years single funding formulae. This means that local authorities have the flexibility to decide the hourly rates that providers receive and as a result, there are very different formulae in use across the country.

66. Some of these differences are rational reactions to specific market conditions. For example, some rural authorities pay extra funding to small village providers whose viability might otherwise be under threat. Others are used justifiably to incentivise provider behaviour, such as offering flexible childcare.

67. However, some of the differences in local funding formulae seem much less justifiable. For example, different types of provider can often be funded at very different rates without a clear justification of why this is the case. In some localities, this favours the maintained sector and in others, it favours the private, voluntary and maintained sector.

68. Our Cost of Childcare Review, however, found that costs are broadly similar between the main types of early years provider. For example, the representative hourly cost (at average adult to staff ratios) for children aged three and four was £4.25 in private settings and £4.37 in primary schools with nursery provision. As the requirements of these providers, and the quality of the early education they provide, should be the same everywhere, we do not think that there should be such significant funding rate differentials between them.

How funding is used by providers

69. As is the case for local authorities, we know that many providers of early education use their funding, and other income streams, efficiently. Excellent practice exists which keeps quality high for children, rewards staff and keeps costs low for parents. Some providers, organisations and local authorities have discovered ways to share this practice.

70. We know that the financial landscape is changing rapidly for all providers and this could have an impact on their business sustainability. The changing landscape includes:

    - uncertainty about parental take up of the additional 15 hours;
    - the changes to the funding system we propose here (which may change a major (guaranteed) income stream for providers); and
    - cost pressures for example the National Living Wage and ‘pension auto enrolment’.

To recognise the effect of the National Living Wage on firms across the nation, the Government is introducing a number of steps to mitigate the costs to business. This includes cuts to Corporation Tax, reforms to business rates and increases in the Employment Allowance.

71. The childcare market is highly complex, localised and fragmented. It comprises a wide range of different types of providers, many of which are small, single-site organisations, with different business models. We want all providers to thrive and have the confidence to plan for the future. Our proposals aim to put in place the foundation for that to happen.

Our approach to funding reform

This section explains the principles that underpin the specific proposals set out in this consultation document.

72. As set out in the previous section, there is an overwhelming case for changing the early years funding system so that it supports better our key overarching policy objectives in the early years. These are to:

    - ensure that there continue to be sufficient childcare places as we expand the free entitlement;
    - enable all children to benefit from high quality provision;
    - ensure that the specific needs of individual children are met; and
    - deliver affordable and flexible childcare that meets the needs of working parents; and

73. In developing the proposals in this consultation, that respond to the strong case for change, we have borne in mind a number of important principles. These are to:

    i) maximise funding to the front line i.e. to early years providers;
    ii) allocate funding fairly to local authorities and to different types of provider;
    iii) distribute funding efficiently and effectively to ensure value for money;
    iv) allocate funding transparently so local authorities and providers can understand how their funding rates were derived;
    v) target effectively additional funding at those children who need it; and
    vi) allow adequate time to transition to the new funding arrangements.

74. These five principles are explained in more detail below.

Maximising funding to the front line

75. As discussed in the last chapter, the proportion of government funding held back centrally by local authorities affects the amount of money that can be passed onto providers. Providers in areas of high central spend currently receive less funding to provide high quality early education for children.

76. In order for this market to thrive and be sustainable, and also to deliver good value to the taxpayer, we need to ensure that as much funding as possible allocated by central government is passed through to providers. This is the best way to ensure our record level of investment in childcare will allow providers to offer sufficient high quality places for all eligible children

Allocating funding fairly to local authorities and providers

77. The Government's additional £1 billion annual investment will help to ensure the market continues to grow in response to parental demand for 30 hours. Additional funding is of course critical, but we must also ensure that it is distributed fairly. This means allocating funding on the basis of objective measures of the costs of meeting the needs of children in different local areas.

78. This will ensure that all providers, regardless of their type or location, can be paid a sustainable funding rate which incentivises them to deliver the free entitlements, enables them to thrive and grow, and encourages new providers to enter the market for the first time. It does not mean that everyone will receive the same funding rate, but it does mean that differences are rooted in evidence and are justifiable.

Distributing funding efficiently and effectively

79. The free entitlement is the same across the country and local authorities and providers should receive the right amount of funding to deliver it. Over-funding some while under-funding others is not only unfair, it is also inefficient and a poor use of public money.

80. One aspect of this is being clear about what government funding is for. It is intended to deliver 15 or 30 hours a week of free early education and childcare. It is not intended to fund the cost of consumables (such as drinks, meals and nappies) or additional services (such as baby yoga, music lessons and trips).

81. Providers are free to charge parents for such discretionary items provided they are not compulsory. So, for example, paying for additional services must not be a condition of taking up a free publicly-funded place.

Allocate funding transparently

82. It is important that funding is transparent so that local authorities and providers can understand why they have received the funding they have been allocated. Such transparency, including setting out any justifiable variations in funding levels between different areas and different providers, is key to demonstrating the fairness of the funding system. Transparency is also important to ensure that providers have confidence to enable them to plan their businesses on a secure and understandable footing.

Targeting additional funding at children who need it

83. We want to ensure that disabled children and children with special educational needs (SEN) receive the additional resources they need to access and benefit

from the free entitlements. We know however, from the Parliamentary Inquiry Into Childcare for Disabled Children[6] and our engagement with the sector through our recent consultation on the delivery of 30 hours free childcare, that this does not happen consistently at present.

84. Where a childcare setting takes more disabled children and children with SEN, its costs are likely to be higher than those of a comparable setting with fewer such children. In order to meet the needs of these children, local authorities are able to use funding from the high needs block of the Dedicated Schools Grant as well as their early years funding. Some early years practitioners, however, report difficulties in accessing funding for these children. Furthermore recent research by Isos Partnership[7] found that there was a lack of clarity as to who was responsible for making sure that additional funding was available for children with SEN.

85. In reforming the early years funding system, we are therefore determined to ensure that our funding system enables and incentivises local authorities and providers to meet better the needs of disabled children and children with SEN.

Allowing adequate time for transition

86. While we want to move quickly towards an improved funding system, it is also important that we avoid excessive turbulence as we do so. We want to make sure that local authorities and providers have time to plan for, and adapt to, their new funding rates and we have therefore developed an appropriate set of transition arrangements. These are set out in Part 4 of this document and will help to ensure smooth delivery of the free entitlements, including 30 hours of free childcare, at a time of considerable change

[6] Parliamentary Inquiry into childcare for disabled children
http://www.cafamily.org.uk/media/775031/parliamentary_inquiry_into_childcare_web.pdf
[7] Funding for young people with special educational needs
https://www.gov.uk/government/publications/funding-for-young-people-with-special-educational-needs

Our proposals: Part 1: Funding from central government to local authorities

This section explains our proposed changes to the way funding from the Government is allocated to local authorities. We'll explain each element of the early years national funding formula we have designed and we ask for your views on each of these.

87. Wide variations in the hourly rate of funding for each child are not well correlated with differences in the costs of providing childcare in different localities (such as differences in labour costs) or in the proportion of children requiring additional support to attain an equivalent level of development to their peers.

88. We are committed to putting the distribution of the Government's increased investment in childcare onto a fair, simple, transparent and evidence-based footing. This is essential to ensure that local authorities can pay their local childcare providers a sustainable rate of funding, attracting new providers into the market. Such funding will enable existing providers to continue improving quality and growing their business in response to parental demand for 30 hours of free childcare. That is why we propose an early years national funding formula.

An early years national funding formula

89. The formula will apply to both the existing 15-hour entitlement for all three- and four-year-olds and to the additional 15 hours for children of working parents. For each local authority, the hourly rate of funding will be the same for both the existing 15-hour entitlement for all three- and four-year-olds and to the additional 15 hours for children of working parents. Similarly, local authorities will be expected to pass the same rates of funding to providers for the existing 15 hours and the additional 15 hours.

90. In line with the existing 15-hour entitlement for all three- and four-year-olds, funding for the additional 15 hours for children of working parents from September 2017 will be provided on the number of children who actually take up the free entitlement (a 'participation' basis) from the outset, rather than the number of possible places a setting could provide (not on a 'place' basis).

Funding floor to limit any overall reductions

91. The changes we are proposing will, rightly, see new levels of funding across the country as funding is better matched to need. We want underfunded areas and providers to benefit and receive gains as soon as possible so that they can deliver 30 hours of childcare and improve outcomes for children and families. Our

proposals result in three quarters of local authorities seeing increases in their hourly funding rates.

92. We intend to limit the impact of our changes in the minority of cases where savings are needed. In order to provide stability for local authorities and providers, we are proposing to limit reductions by building a floor into the formula.

93. We propose that no local authority should face a reduction in its hourly funding rate of greater than 10% against its 2016-17 baseline[8] as a result of introducing the formula. This funding floor will limit the overall reductions that individual local authorities may face.

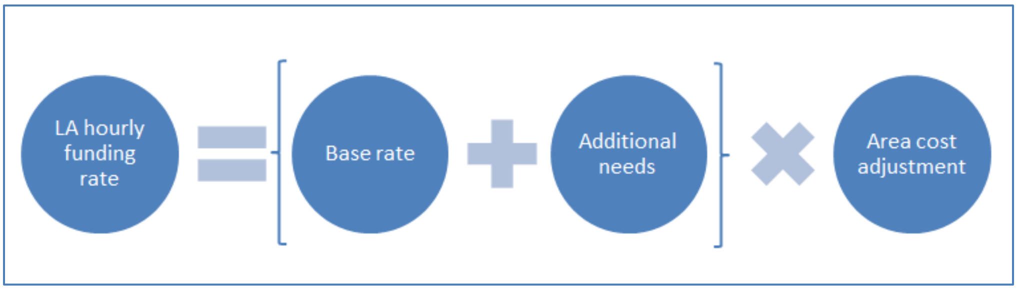
Funding factors within the early years national funding formula

94. Our proposals are designed to ensure that the funding a local authority receives is based on robust evidence on the costs of providing childcare and meeting the needs of children in a local area, relative to the costs of provision in other areas.

95. Our proposed formula is designed to be simple and transparent, focussed on the key drivers of cost variation. We do not want to over-complicate the formula with a multitude of factors which only have marginal impact.

96. We have drawn on evidence from the *Cost of Childcare Review*[9] to identify the key drivers of cost variation. Based on this evidence, we propose to include these three factors within the formula:

   1. *A universal base rate of funding for each child*.
   2. *An additional needs factor*, reflecting the extra costs of supporting children with additional needs to achieve good early learning and development outcomes.
   3. *An area cost adjustment*, reflecting the different costs of providing childcare in different areas of the country.



[8] As mentioned in the schools National Funding Formula consultation in February (https://consult.education.gov.uk/funding-policy-unit/schools-national-funding-formula) we carried out an exercise to 're-baseline' the four blocks of the DSG for each local authority. This is to ensure that that each block aligns with the pattern of each authority's spending in 2016-17, rather than how the Government allocated the funding to them.

[9] Review of Childcare Costs https://www.gov.uk/Government/publications/review-of-childcare-costs

Questions:

- Should there be an early years national funding formula (to distribute money from central government to each local authority)?
- To what extent do you agree with the proposed funding floor limit, so that no local authority would face a reduction in its hourly funding rate of greater than 10%?

97. Each of the three proposed factors is explained below. We intend that the factors act as proxy measures for the drivers of additional costs in each local authority. We welcome your views on these factors, bearing in mind that they all must be sufficiently robust and objective to underpin funding allocations.

A universal base rate of funding for each child

98. The universal base rate is designed to fund the core costs of childcare provision which do not vary by local area.

99. The *Cost of Childcare Review* took a bottom-up approach to analysing the cost of a unit of childcare for different types of providers in England. The analysis found that the costs of providing childcare are broadly comparable for a private nursery, a charitable pre-school or a school nursery class. It found far greater cost variations between providers of the same type (depending upon business practices adopted, size of setting, etc.) than across provider types.

100. In light of the Review findings, we propose to set a universal base rate of funding for each child, which is not differentiated depending on the makeup of provider types within a local authority.

101. We propose that 89.5% of the total funding for three- and four-year olds will be channelled through this base rate. We consider this is the appropriate level to ensure sufficient basic funding for each child, while also ensuring adequate levels of funding are channelled to those with additional needs.

Questions:

Considering a universal base rate of funding which does not vary by local area...

- Should a universal base rate be included in the early years national funding formula?
- Is 89.5% of overall funding the right amount to channel through this factor?

2. An additional needs factor

102. We want to ensure local authorities are able to fund childcare providers for the additional costs of providing quality early education for children with additional needs. This Government is committed to narrowing the gap in attainment between the most disadvantaged children and their peers, and to ensure that children with special education needs and disabilities benefit equally to all other children from the free entitlement offer. Our early years national funding formula must therefore recognise the additional costs to providers of supporting such children to achieve good early learning and development outcomes.

103. We therefore propose an additional needs factor to channel a substantial portion of the funding towards local authorities with a higher relative proportion of children with additional needs. There are three elements to this factor:

2a) Socio-economically disadvantaged children

104. We have secured year-on-year reductions in the gap in attainment between the most disadvantaged children and their peers, which has narrowed from 19.0 percentage points in 2013 to 17.7 percentage points in 2015. There is further to go. Ofsted data from 2015 shows that 78% of providers on the Early Years Register in the most deprived areas were rated “good” or “outstanding” compared to 88% of providers in the least deprived areas.

105. The Government already provides additional funding for the most disadvantaged three- and four-year olds through the Early Years Pupil Premium (EYPP). The EYPP will continue as a separate funding stream i.e. distinct from the early years national funding formula.

2b) Special educational needs and disabilities

106. Research suggests a correlation between deprivation and the incidence of special educational needs and disabilities.[10] The Government’s early years funding is designed to support local authorities and providers to meet the additional costs of providing early education for children receiving SEN support.

107. The Government also provides over £5 billion of funding to support children with high needs to access learning from the ages of 0-25. The bulk of this funding is within local authorities’ high needs budgets and can be used across the full age range, including early years.

108. Local authorities are responsible for using their early years and high needs funding to ensure that each child receives support appropriate to their individual needs. We are determined to ensure that our funding system incentivises local authorities and providers to better meet the individual needs of the youngest children. More

[10] Funding for young people with special educational needs
https://www.gov.uk/government/publications/funding-for-young-people-with-special-educational-needs

details of our proposals can be found in Part 3: Meeting the needs of disabled children and children with SEN.

109. We have already consulted on changes to the distribution of high needs funding to local authorities, and later this year will consult further, before introducing a national funding formula for high needs. We would encourage early years practitioners with an interest in special educational needs and disabilities to respond to that consultation in due course.

2c) Children with English as an Additional Language

110. There is a significant difference in attainment in the Early Years Foundation Stage Profile between children with English as an additional language (EAL) and those without. Children without EAL are more likely than pupils with EAL to get the expected levels in all their early learning goals (67% and 56% respectively). Supporting children with EAL can lead to additional costs for childcare providers. We therefore propose targeting additional resource to those children to help them achieve good outcomes.

Funding metrics and weightings for additional needs

111. We propose that funding channelled through the additional needs factor should be based on a basket of metrics. This would consist of:

   a. *Free School Meal (FSM) eligibility for Key Stage 1 and 2 children*
   We consider that the proportion of children in a local area receiving free school meals is the best proxy measure for the additional costs of providing childcare for children with disadvantage and low-level special educational needs (the incidence of the latter is correlated with deprivation). As there is no FSM data for children in the early years, we are using data for Key Stage 1 and 2 as the best proxy. **We propose that 8% of the total formula funding should be directed according to this metric.**

   b. *Disability Living Allowance (DLA)*
   This is a proxy measure for children with SEND, recommended in the Isos Partnership[11] report. **We propose that 1% of the total formula should be directed according to this metric.**

   c. *English as an additional language (EAL)*
   This is a proxy measure of the costs of additional support for children who do not have English as a first language. We propose using data about EAL prevalence at Key Stages 1 and 2 as a proxy for the prevalence in early years because there is no EAL metric for under-fives. **We propose that 1.5% of total formula funding should be directed according to this metric.**

[11] Funding for young people with special educational needs
https://www.gov.uk/government/publications/funding-for-young-people-with-special-educational-needs

112. We welcome your views on whether these are the best metrics for ensuring that more money reaches local authorities where the incidence of children with additional needs is greater. We aim to reflect the extra costs associated with narrowing the gap in outcomes and supporting such children's early education.

Questions:

Considering an additional needs factor...

- Should an additional needs factor be included in the early years national funding formula?
- Do we propose the correct basket of metrics?
- Do we propose the correct weightings for each metric?

3. An area cost adjustment

113. We know, from the findings of the *Cost of Childcare Review*, that staff costs make up the vast bulk of overall costs for all types provider. These costs are known to vary, sometimes considerably, between local areas and we want to acknowledge this variation.

114. We also recognise that nursery premises costs vary across the country, and often make up a significant proportion of nursery outgoings. Such recognition is particularly important as we roll out the offer to 30 hours of free childcare, through what is substantially a private and voluntary market, which needs to finance premises. This is very different from education for children aged 5-15.

115. We therefore propose to introduce an area cost adjustment that accounts for variations in both staff and premises costs (for more information, see the technical note that accompanies this consultation). The area cost adjustment will be applied as a multiplier of both the universal base rate and the additional needs factor. This will ensure that both the universal and the additional costs of provision in a local area are increased where staffing and/or premises costs are relatively higher than elsewhere.

116. For each local authority, our area cost adjustment is derived by appropriately weighting data from two sources: information on staffing costs, and information on nursery premises costs.

117. For staffing costs, variations in average early years wage costs correlate well to the general labour market. This correlation is stronger than to teachers' pay scales. We therefore propose to base the element for staff costs on the General Labour Market measure.

118. For premises costs, we intend to base our measure on the rateable values of nursery premises, reflecting the fact that rates are a good proxy for premises costs.

119. Combining staffing and premises factors results in an area cost adjustment that provides each local authority with a score from 1 to 1.9. This means a local authority with a General Labour Market score of 1 (Shropshire) would receive the universal base rate for each child and additional needs funding. A local authority with a score of 1.9 (Hammersmith and Fulham) would have its universal base rate and additional needs funding multiplied by 1.9.

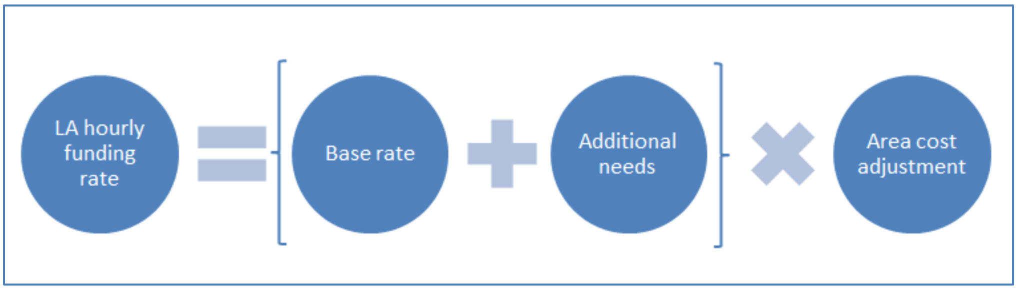
Questions:

Considering an area cost adjustment...

- Should the early years national funding formula include an area cost adjustment?
- Should that adjustment be based on staff costs (based on the General Labour Market measure) and on nursery premises costs (based on rateable values)?

Combining the factors to create an early years national funding formula

120. The base rate, additional needs and area cost adjustment factors are combined, such that the hourly rate of funding a local authority receives for each child is calculated as:



121. This formula is then used to calculate the hourly rate of funding for each three- and four-year old taking up the Government's offer of 15 or 30 hours of free childcare each week. The hourly rate is multiplied by the predicted total number of hours taken[12] to calculate each local authority allocation.

[12] Funding allocations in 2017-18 for the core 15 hours offer will continue to be based on 5/12th of January 2017 child numbers (to cover the April 2017 to August 2017 period) and 7/12th of the January 2018 child numbers (to cover the September 2017 to March 2018 period), to acknowledge any in-year growth in child numbers. For the additional hours, we intend final funding allocations for 2017-18 to be based on child numbers recorded at the January 2018 census.

Funding formula for two-year olds

122. Funding for the most disadvantaged two-year olds is already allocated on a fair and formulaic basis and is not covered by these proposals. However, the Government has already committed to uplift the average two-year old funding rate from £5.09 to £5.39.

123. To implement this, we are minded to retain the current two-year old formula and use the additional funding secured at the Spending Review to uplift all local authority allocations based upon this. This will be a fair way to allocate additional funds that preserves stability in a programme which has only quite recently started to bed in.

A technical note on the Dedicated Schools Grant

124. As part of looking at the way in which the Dedicated Schools Grant funding is allocated in the future, we propose funding through the early years block should be:

    - Capped at 15 hours for all three- and four-year olds.
    - Capped at 30 hours for three- and four-year old children of eligible working parents.

125. This will be true for all children taking up the free entitlements, whether they are in a maintained or non-maintained setting.

126. The indicative allocations accompanying this consultation are based on current practice (as set out in the Dedicated Schools Grant pupil number information for the schools block and early years block[13]). Subject to the outcome of consultation responses, revised funding allocations would reflect the capping levels set out above.

Questions:

To implement the increased hourly rate for the two-year old free entitlement...

- Should we retain the current two-year-old funding formula?
- Should we use the additional funding secured at the spending review to uplift local authorities' allocations based upon this?

Considering the Dedicated Schools Grant…

- Should the free entitlement be capped at 30 hours for children of eligible working parents and 15 hours for all other children?

[13] Dedicated schools grant (DSG): https://www.gov.uk/government/publications/dedicated-schools-grant-dsg-2016-to-2017

Our proposals: Part 2: Local authority funding to providers

This section explains our proposed changes to the way funding from local authorities is allocated to childcare providers. We'll propose a limit to the amount of funding local authorities should hold back for central services and suggest changes to the way the remaining money is allocated to providers. We ask for your views on each idea.

127. We believe our proposals for an early years national funding formula, set out above, would ensure early years funding is distributed fairly between local authorities. Combined with the substantial funding increase announced in the Spending Review, our proposals would mean that every local authority will have sufficient funding to deliver 30 hours free childcare for working families and to maintain high take-up of our existing offer of the 15-hour entitlement.

128. However, young children and families across the country will only benefit from more high quality childcare if local authorities distribute the increased funding efficiently and fairly between local childcare providers. Ensuring local authorities pay a sustainable funding rate is key to enabling existing providers to thrive. It is also important in attracting new providers into the market that are passionate about giving young children from all backgrounds the best possible start in life.

129. Our proposals to put the national funding system onto a fairer footing are necessary but not sufficient. At present, there is currently great inconsistency in the proportion of funding local authorities pass on to providers. A young child's education is often also funded at very different rates depending upon whether they attend a school or a private or voluntary provider. A fairer, more consistent local funding system is essential.

130. We therefore propose to introduce complementary local funding changes alongside our early years national funding formula. We seek to strike the right balance between ensuring local authorities have enough discretion to secure sufficient childcare for parents locally, while ensuring the system is fair, transparent and consistent across local authorities.

131. Through local funding change, we aim to maximise funding to providers and 'level the playing field' between types of provider. We would also like to achieve effective use of funding supplements to provide incentives for delivery of wider objectives (such as 30 hours of free childcare) and facilitate the spread of high quality practice. Our proposals in each of these areas are set out below.

Maximising funding to providers

132. At present, local authorities have wide discretion over the amount of early years funding they retain to resource their central early years functions.

133. As we set out in paragraphs 58-64, if we are to ensure that all providers receive a sustainable funding rate, we must maximise the funding which local authorities pass to providers and limit the funding which local authorities retain centrally.

134. We therefore propose to set a high minimum percentage of early years funding that local authorities must pass through to providers (high pass-through). This will ensure that the vast majority of early years funding is passed to providers and not retained, for example, to pay more than is reasonable for central services.

135. In line with our funding objective to maximise funding to the front line, we expect that local authorities will increasingly build funding for training and improvement support into the core hourly funding rate which they pay to providers. In exchange, providers who choose to use local authority training and support services would be increasingly expected to pay a charge to enable the local authority to recover its costs.

136. We propose that the level of the high pass-through should be set at 95%. Average central spend for three- and four-year olds is currently 6%, and we therefore believe that a 95% pass-through is a realistic and appropriate level. This will balance the risk of insufficient funding to providers against immediate reductions to in-kind support services before buy-back[14] models become established.

137. We want to avoid the loss of a skilled local authority workforce and to allow time for the buy-back model of services to grow. For this reason we do not propose to introduce a 95% pass-through straight away – rather we propose 93% in 2017-18, rising to 95% in 2018-19. We consider that it is reasonable to increase the level of the pass-through over time, as providers become more accustomed to buying back services. (Please see Part 4: Transitions to the new funding arrangements for more information).

138. The high pass-through includes all funding passed directly to providers. This means not only the base rate and supplements, but also other funding direct to providers, principally for SEND. Part 3: Meeting the needs of disabled children and children with SEN sets out further details of SEND funding, the inclusion fund and Disability Access Fund.

[14] By buy-back models, we mean local authorities providing training, support or specialist services. Childcare providers can *choose* whether to buy these services offered, rather than the local authority building the cost of these services into a provider's hourly rate. See paragraph 61.

Contingency funds

139. We recognise that it is reasonable for local authorities to hold back contingency funds for in-year demographic growth and this should be counted in the high pass-through rate, because the money is eventually shared with providers. However, many local authorities operate without holding back any contingency funds. We therefore expect the minimum necessary level of contingency funding to be held back in order to maximise the hourly rate going to providers.

140. We do not anticipate local authorities will need to set aside significant contingency funds for the take up of the additional 15 hours. This is because, for the additional hours, we intend final funding allocations for 2017-18 to be based on child numbers recorded at the January 2018 census. This means that funding in 2017-18 will be based on timely data, and will allow for growth in take-up over the autumn term 2017. (Funding allocations for the core 15 hours offer will continue to be based on child numbers on a 5/12 – 7/12 basis to acknowledge any in-year growth in child numbers).

Questions:

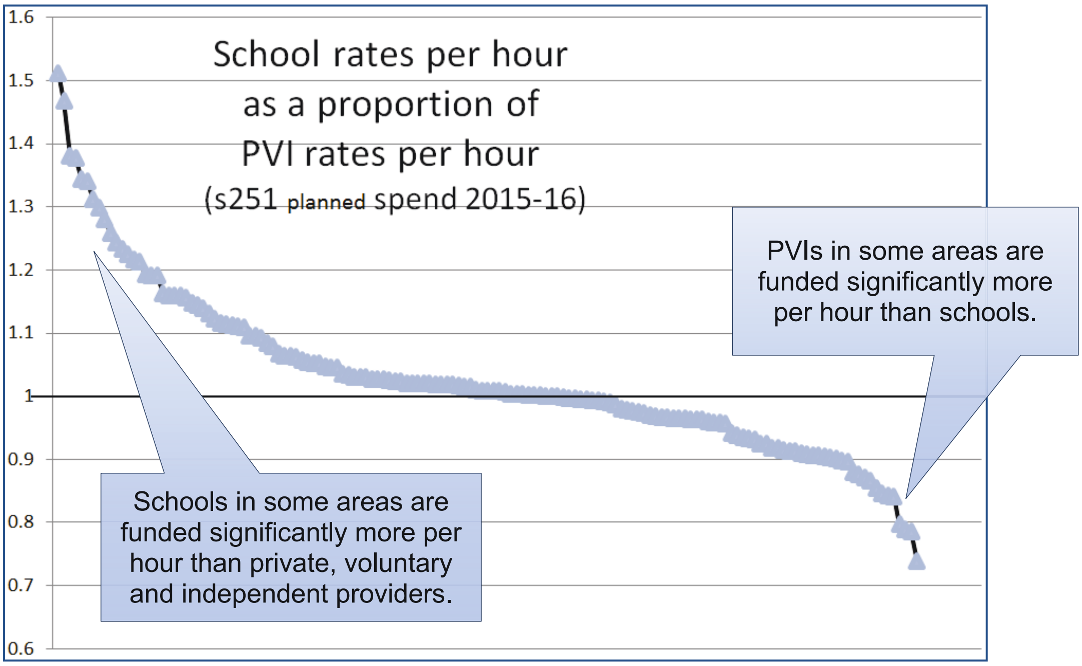
- Should Government set the proportion of early years funding that must be passed on to providers?
- Do you think that 95% is the correct minimum proportion of the money that should be passed from local authorities to providers?

Levelling the playing field between different providers

141. Local authorities are required to set a base rate of funding within their local early years single funding formulae. Currently, they have discretion to set a higher base rate for providers that have unavoidable additional costs. Local authorities also have discretion to pay providers a lump sum to top-up their base rate.

142. The *Cost of Childcare Review*[15] found greater cost variations between providers of the same type than across provider types (depending upon business practices adopted, size of setting and so on). The Review analysis indicated that the costs of providing childcare are broadly comparable for a school nursery class, a private nursery or a charitable pre-school. Yet we know significant disparity in relative funding exists – as this diagram illustrates:

[15] Review of Childcare Costs https://www.gov.uk/Government/publications/review-of-childcare-costs



143. In light of these findings, it cannot be fair that in some local authorities a child's early education is funded at a lower level simply because of the type of setting they attend. In August 2015, Ofsted's Early Education report advised parents: "Every type of provider now has high levels of performance nationally".

144. Nor is it right to give some providers a competitive advantage by funding them at a higher rate to deliver the same entitlement, while other providers receive a lower rate which constrains their ability to improve or expand their offer.

145. We therefore propose that all local authorities should be required to set a universal base rate in their local single funding formulae; i.e. a base rate which is the same for all types of provider.

146. This approach will ensure that no child is disadvantaged in terms of the funding available to support their early education, by the type of childcare setting which they attend. Please see Part 4: Transitions to new funding arrangements for more information on this approach being implemented by no later than 2019-20. As described in the next paragraph, we want to minimise disruption and reassure maintained nursery schools on their position. In order to do this, the Government will provide supplementary funding for maintained nursery schools for at least two years.

Question:

- Should local authorities be required to give the same universal hourly base rate to all childcare providers in their area?

The Universal base rate and maintained nursery schools

147. Maintained nursery schools (MNS) have a well-deserved reputation for providing high quality early years education and childcare. In March 2016, of 406 MNSs inspected, 60% were rated as outstanding by Ofsted (compared with 17% nursery / preschools and 13% childminders) and 39% rated as good (compared with 73% nursery / preschools and 70% childminders)[16]. The majority of them are based in disadvantaged areas, and they therefore make valuable contributions to the improvement of the life chances of the children who live there.

148. We know that MNS continue to thrive where they have evolved to meet the changing needs of parents, including offering more flexible provision; acting as a hub for their local community by providing other services for children and families; and leading the drive for increased quality in their local areas. The Government wants to support maintained nursery schools that work in this way and to ensure that the important contribution they make to the early years sector, and the life chances of young children in disadvantaged areas, continues to grow.

149. Maintained nursery schools are of course schools and as such, bear costs over and above other providers because of their structure. We want to minimise disruption and reassure maintained nursery schools on their position. In order to do this, the Government proposes to provide supplementary funding for maintained nursery schools for at least two years (please see the Annex for more information). This additional funding takes account of maintained nursery schools' current costs and will provide much needed stability to the nursery school sector while they explore how to become more sustainable in the longer term, including exploiting scope for efficiencies. We will consult on further detail in due course.

Effective use of funding supplements and incentives

150. As well as the base rate, local authority funding formulae use funding 'supplements' which are additional amounts for extra need or to reflect key policy objectives. Local authorities must include a deprivation factor in their formula for the three- and four-year-old entitlement, but the use of other supplements is discretionary.

151. Funding supplements can play an important role in local funding allocations. We therefore propose that local authorities can continue to use them to supplement their universal base rate and channel additional funding to providers for particular purposes. Whilst we want to end arbitrary and unjustified differences in the funding rates paid to different providers, it is important that the funding system builds

[16] Ofsted inspection statistics: https://www.gov.uk/government/collections/maintained-schools-and-academies-inspections-and-outcomes-official-statistics

incentives for providers to support wider outcomes for children and recognises where they bear additional costs as a result.

152. It is also essential that local authorities retain some discretion in this area to enable them to respond to market conditions locally. For example, they might wish to particularly encourage flexibility, if there is a need among local parents, or they may wish to ensure providers deliver the additional 15 hours entitlement, if demand outstrips supply locally.

153. We want to ensure effective use of local funding supplements and incentives which are focussed on genuine cost drivers and act to promote our core objectives. We also want providers to be able to understand clearly why they receive the funding rate they do and why this might differ from that of other providers.

154. We therefore propose to restrict the use of supplements within local authorities early years single funding formulae to a limited set of possible supplements. Please note that the permitted supplements do not include reference to special educational needs and disabilities as we have additional proposals to improve services in this area (Part 3: Meeting the needs of disabled children and children with SEN).

155. The key cost drivers we have identified relevant to the limited set of supplements are:

a. *Deprivation*: reflecting the higher costs of providing quality early education for children from backgrounds of socio-economic disadvantage.

b. *Rurality / sparsity:* recognising that lack of scale economies may lead to higher costs to providers operating in very small settings, and that these may be unavoidable in sparsely populated rural areas with limited demand.

156. We believe local authorities need scope to build in incentives to the set of supplements to support these wider outcomes.

c. *Flexibility:* we want providers to offer flexible childcare which fits around parents’ working patterns, and therefore believe local authorities should be able to encourage provision of a ‘stretched offer’ including holiday care, ‘wraparound’ to extend the day or out-of-hours provision.

d. *Efficiency*: local authorities should be able to encourage providers to exploit the considerable scope for efficiencies identified in the *Cost of Childcare Review*, to improve the sustainability of their businesses and ensure childcare is provided at good value to parents and the taxpayer.

e. *Delivery of the additional 15 hours free childcare*: whilst childcare providers will be under strong market incentives to expand their offer, we want to ensure that local authorities have maximum levers to encourage childcare providers to offer the additional 15 hours free childcare for three- and four-year olds of working parents, alongside the existing 15 hour entitlements.

Question:

- Should local authorities be able to use funding supplements?

157. Funding supplements are important to help pay for increased provider cost drivers, and also drive provider behaviour. However, significant use of supplements comes at the detriment of reducing the universal base rate, which may risk the viability of some providers. We therefore propose to cap the amount of funding that can flow through funding supplements. This would mean guaranteeing a minimum basic level of funding for all providers, including those who are not receiving any supplements.

158. The level of funding supplements used by local authorities currently varies considerably from nothing, through to over 50% in one local authority. However, the average (median) use of supplements is around 10%. We are therefore minded to introduce a supplement cap of 10%, but would be interested in views on the level of the cap.

Questions:

- Should there be a cap on the proportion of funding that is channelled through supplements?
- If you agree that there should be cap on the proportion of funding that is channeled through supplements, should the cap be set at 10%?

The proposed set of supplements

a. Deprivation

159. Currently local authorities are required to include a deprivation supplement in their funding formulae; across the country this carries about 4% of funding. Local authorities use a variety of metrics at the moment to allocate funding through the deprivation supplement. The majority use the 'income deprivation affecting children index' dataset (IDACI), which is an area-based measure. Others use rates of free school meals, the Index of Multiple Deprivation, ACORN or a combination.

160. Such variation within the metrics used – and so variations in the amounts of funding being channelled through this factor – are often due to the way in which deprivation manifests locally; for example whether in ‘pockets’ or spread more uniformly across the authority.

161. We propose that the deprivation factor should continue to be a mandatory factor in local formulae. We propose that it is the only mandatory factor within this set of possible supplements – all the others are optional. The reason is a considerable portion of funds at national level are being channelled for additional needs through the relevant factor in the formula (see paragraphs 102-112). It is therefore appropriate that extra funding should be given in turn to providers which care for those children.

162. We propose that local authorities should be able to continue to use their own choice of metric for allocating deprivation funding. This will allow local authorities the flexibility to determine the best measures in accordance with local circumstances. Likewise local authorities should retain discretion over the amount of funding to direct through this supplement. Allowing this discretion reduces local fluctuations and turbulence thus giving providers more funding stability.

b. Rurality / Sparsity

163. Childcare providers in rural areas do not necessarily bear higher costs than those in urban areas where there is sufficient local demand for them to operate at a scale. However, we recognise that in some very sparsely populated areas, childcare providers may be delivering an important service to a very small number of local families.

164. We want to encourage providers to exploit the potential to operate as efficiently as possible and to support the sustainability of their businesses and ensure maximum value to parents and the taxpayer. However, we recognise that the scope for efficiencies is likely to be more limited for very small-scale providers because they have less ability to exploit economies of scale and reduce under-occupancy.

165. Where a childcare provider faces higher costs from operating at very small scale in sparsely populated areas – where that setting provides an important service to local families with no alternative source of childcare provision – we propose that local authorities should have the discretion to offer a funding supplement to maintain the provider’s viability.

166. Only a small number of local authorities currently route funding according to sparsity or rurality. Some choose to top up the hourly rate for ‘sparse’ providers, while others offer a lump sum. We propose that local authorities should be able to choose the amount of funding to channel through this supplement, and that they should be able to determine the most appropriate metric for allocation of the funding, as appropriate for local circumstances.

167. The only limitation we intend to place is that funding should be allocated for sparsity as *judged by distance*. It would be up to local authorities to decide exactly how to frame this. For example, it could be done as the distance from the next nearest provider, or the next nearest provider of a similar type. We also intend that local authorities should have discretion in how far the distance should be. We consider that local authorities will be best placed to judge what is most appropriate in their locality. This supplement would be optional.

c. Flexibility

168. As we set out in the Case for Change, there is potentially a huge economic prize from enabling parents to play a fuller role in the economy. We know that more flexible childcare provision will be critical to allow parents to take advantage of 30 hours free childcare in a way that fits around their working lives. Our funding system should support delivery of flexible childcare provision that matches parental working patterns.

169. This does not mean that sessional providers, who are only able to offer three hours a day during term time, cannot play a part in delivering 30 hours free childcare. Rather, it means that all childcare providers can think innovatively and creatively to meet the needs of parents in their community.

170. For sessional providers that cannot offer full day-care alone, working in partnership with other local childcare providers will be key to providing 'wraparound' care which extends the day. Indeed holiday childcare can stretch the offer over the full year. For full day-care providers, improving the flexibility of their offer is likely to mean removing restrictions on parents who want to compress their free childcare into two or three days of the week or extend it over the full year.

171. The Department is at present running a project to understand how schools can work in partnership with other providers, such as private nurseries and childminders, to overcome barriers to delivering high quality, flexible childcare that meets the needs of working parents. We will disseminate practical guidance and tools in the autumn.

172. Local authorities have a wide range of tools for promoting and supporting childcare providers to offer more flexible provision. We have just completed a consultation on non-funding proposals for encouraging more flexible childcare, including through identifying and removing any barriers to flexible provision. However, we also want to ensure that local authorities have discretion to include funding incentives for providers to offer greater flexibility.

173. For example, a flexibility supplement could help local authorities to support growth in the childminder segment of their local childcare market. Alternatively, a flexibility supplement could reflect a local authority's definition for flexibility – perhaps within the year (e.g. offering more than 38 weeks in the year to enable provision outside

school term time), within the day (e.g. offering provision early in the morning or later in the evening) or an offer of a choice of days.

174. Parental working patterns and the type of demand for childcare varies from area to area, and the extent to which the local market has developed to offer more flexible childcare varies. We therefore consider it appropriate for local authorities to retain discretion over what kind of flexibility they wish to promote, and the amounts of funding they wish to channel through this supplement. This supplement would be optional.

d. Efficiency

175. We want to work with the sector to help providers operate as efficiently as possible and to handle any cost pressures, including the National Living Wage. Operating efficiently will be important for providers themselves, and it will be key to deliver good value for money for both parents and the taxpayer.

176. We have ‘front loaded’ the increase in our national average funding rate to give providers the resources they might need to quickly develop their business models.

177. We are minded to include the option for local authorities to reward and recognise providers who make optimum use of their income to provide high quality childcare, to invest in their workforce and to develop and share strong business models with other providers.

178. We welcome your views on whether a supplement to recognise and reward such behaviours would be valuable in your local area, and if so how it might be designed.

e. Delivery of the additional 15 hours free childcare

179. Our overarching objective is to ensure that the childcare market offers sufficient high quality places and delivers 30 hours from September 2017, as well as continuing to deliver the 15 hour offer for all three- and four-year olds, and for the most disadvantaged two-year olds.

180. From September 2017, childcare providers will of course be under strong market incentives to expand their offer to 30 hours free childcare, whether alone or in partnership with wraparound providers. However, additional incentives may be needed.

181. We therefore propose that local authorities should have discretion to pay a supplement to settings which participate in delivering 30 hours free childcare. This could, for example, be a ‘growth’ or ‘new places’ supplement to offer additional money for new capacity where it is genuinely required to meet parental demand, while protecting existing places.

182. We welcome your views on how such a supplement might be designed. We would particularly welcome your views on how this supplement could be delivered without creating a disadvantage to providers who choose to, or whose capacity is limited to, offering only the existing 15-hour free entitlement. We would not expect such a supplement to be implemented if it led to providers declining to offer the existing 15-hour free entitlement.

Quality

183. Please note we are minded not to retain a quality supplement. We recognise that funding is an important element of improving quality, however good quality provision should be expected of all providers in the sector. Quality is an expectation of government and parents, rather than an optional extra. This should not only be guaranteed by the use of supplements.

184. The Government recognises that investment has an important part to play in achieving continued improvements in the quality of the early years, has committed over £1 billion more per year by 2019-20 and is creating a system where funding is more fairly distributed across the country. We know that good quality childcare has the most significant impact on those from disadvantaged homes. Therefore it is really important that additional funding is targeted at those areas and children who need it most, and this is why we propose to retain the mandatory deprivation supplement.

Questions:

- Should the following supplements be permitted?
  Deprivation, sparsity / rural areas, flexibility, efficiency, additional 15 hours
- When using funding supplements, should local authorities have discretion over the metrics they use and the amount of money channeled through each one?
- If you agree that efficiency / additional 15 hours should be included in the set of supplements, do you have a suggestion of how should it be designed?
- If you think any additional supplements should be permitted which are not mentioned here, please set out what they are and why you believe they should be included.

How our proposals on funding reform link to the consultation on *'Self-sufficient local Government: 100% Business Rates Retention*[17]*'*

185. The Government has committed to increase the proportion of business rates revenues that councils retain locally from 50% to 100% by the end of the Parliament. This will give local government control of up to an additional £12.5 billion of revenue from business rates to spend on local services. In order to ensure that the reforms are fiscally neutral, councils will gain new responsibilities including funding responsibility for some areas currently funded through central government grant., .

186. A consultation is now live to seek views on rolling existing grants to local authorities into the business rates retention system, and on devolving further functions to local government, to match their increased funding from business rates.

187. The grant provided to fund early years and childcare provision is provided to English local authorities to fulfil their duties under sections 6, 7, 7A, 9A, 12 and 13 of the Childcare Act 2006 and under regulations that will be made pursuant to section 2(1) of the Childcare Act 2016. It is currently part of the Dedicated Schools Grant.

188. We would like to reassure readers of this consultation that any consideration of this grant for devolution would take place after successful delivery and establishment of the manifesto commitment to 30 hours free childcare from September 2017.

[17] Consultation published 5 July 2016, hosted at: https://www.gov.uk/Government/consultations/self-sufficient-local-Government-100-business-rates-retention

Our proposals: Part 3: Meeting the needs of disabled children and children with special educational needs

This section explains our proposals for the way funding might support disabled children and children with special education needs to access their free entitlement. We ask your views on the funding barriers that exist at the moment and our proposals for different ways to allocating funding.

189. The Government is clear that all children should be able to access their entitlement to childcare and that no child should have access to their entitlements restricted or denied because of special educational needs or a disability. We recognise that there are issues with the way the funding system currently works to support disabled children and children with SEN. Building on our consultation on the childcare free entitlement delivery model[18], in this consultation we are proposing two different models for allocating additional funding to help to address the funding barriers that currently exist.

190. While this consultation focuses on changes to the early years funding system, the Government is also clear further action is required beyond funding to ensure that disabled children and children with SEN are supported to access the free entitlement and develop during their early years. This includes the following areas:

- The local authority role in delivering SEND support in the early years.
- Early Implementer and Early Innovator areas will be testing innovative ways of providing flexible childcare for parents of children with SEND from September 2016.
- We are developing a workforce strategy in 2016 which will set out how the Government will help to remove barriers to attracting, recruiting and retaining staff. As part of this, we plan to look at what more can be done to support practitioners to access SEND training and qualifications.

Supporting disabled children to access the free entitlement

191. The Childcare Act 2006 and Childcare Act 2016 make clear that if children meet the eligibility requirements for the free entitlements, the local authority must secure a place for them. If a disabled child wishes to take up the free entitlements, additional needs must not be a barrier to doing so. The Equality Act 2010 ensures local authorities and all early years settings must not discriminate against, harass or victimise disabled children and must make reasonable adjustments for them.

[18] Consultation hosted at: https://consult.education.gov.uk/early-years-funding/childcare-free-entitlement

192. In practice however we know that the experience for parents of disabled children can feel different; The *Parliamentary Inquiry into Childcare for Disabled Children*[19] published in July 2014 reported widespread barriers to offering inclusive childcare. This included a lack of confidence and understanding about reasonable adjustments and a lack of funding for resources and physical adaptations, amongst other factors. 41% of parent carers who responded to the inquiry said their children did not access the full 15 hours of the free entitlement for early education for three and four year olds.

193. While early years settings are under clear legal obligations to make reasonable adjustments to support disabled children to access their entitlement, we recognise that this can put additional cost pressures on providers. Local authorities should support settings to provide childcare to disabled children through use of the high needs block within the Dedicated Schools Grant. While the Government is clear that the high needs block is for children aged 0-25 years, we believe that the introduction of additional targeted Disability Access Funding will support providers to make initial reasonable adjustments and build the capacity of the setting to support disabled children.

194. The total additional funding available for this new approach is £12.5 million per year. We propose that the targeted Disability Access Funding would be paid to all providers for each child in receipt of Disability Living Allowance (DLA) taking up a place in their setting. We propose that this would be paid to the provider as a total annual sum rather than an increase on the hourly rate.

195. To ensure that this new approach is implemented as simply as possible, we propose building on the existing model of the EYPP. This would mean that the local authority would receive the additional targeted Disability Access Funding as a ring fenced amount and they would be responsible for passing a total amount directly through to providers for each eligible child.

196. Once the additional funding is allocated to an early years setting, the provider will be responsible for making decisions about how the funding should be deployed, for example to target one child's specific needs, to improve the setting for a cohort of children or to increase the setting's capacity to take more disabled children. Over time we will be interested in developing an evidence base of how this additional funding is used to best effect.

197. The Early Years Disability Access Funding is not intended to cover the total costs of providing childcare for a disabled child in receipt of DLA. Providers will still be required to support all children within their setting as per their duties under The Early Years Foundation Stage (EYFS) and Equality Act 2010, and work with their

[19] Parliamentary Inquiry into childcare for disabled children
http://www.cafamily.org.uk/media/775031/parliamentary_inquiry_into_childcare_web.pdf

local authority when additional support is required. The local authority can use funds from its high needs budget, funded from the Dedicated Schools Grant, or from other appropriate budgets – for example, if the child has health or social care needs indicated by an education, health and care assessment. Local authorities should develop clear expectations of the circumstances in which additional funding will be made available to support settings to provide childcare to disabled children. These should be developed with providers, and communicated to parents (for example through the published local offer of SEN services and provision).

Questions:

- Should there be a Disability Access Fund to support disabled children to access their free entitlement?
- Should eligibility for the Disability Access Fund be children aged 3 or 4 which are a) taking up their free entitlement and b) in receipt of Disability Living Allowance?
- When it comes to delivering the funding for the Disability Access Fund, is the most appropriate way the existing framework of the Early Years Pupil Premium?

Funding proposals to support children with special educational needs in the early years

198. High quality childcare in the early years has a significant impact on outcomes for children, and these experiences are even more important for children with special educational needs (SEN) in their earliest years where early identification and early intervention can have a positive impact on life chances and outcomes. While overall the quality of early years provision is improving and the number of children achieving a good level of development is rising, in 2015, the Early Years Foundation Stage Profile results[20] showed that the gap between children with SEN and other children achieving a Good Level of Development has widened from 47.1 percentage points in 2014 to 50.4 percentage points in 2015.

199. The Government recognises that the funding system has a role in improving this practice and in 2015 the Department commissioned Isos Partnership to research and report on the current SEN funding arrangements and practice in the early years, school and further education systems. Their research report: *Research on funding for young people with special educational needs*[21] was published in July 2015 and reported that it was difficult for providers to fully fund the existing 15-

[20] Early years foundation stage profile results: 2014 to 2015
https://www.gov.uk/government/statistics/early-years-foundation-stage-profile-results-2014-to-2015
[21] Funding for young people with special educational needs
https://www.gov.uk/government/publications/funding-for-young-people-with-special-educational-needs

hour free entitlement for children with SEN due to lack of clarity about who was responsible for paying for the additional SEN support. The report also showed the importance of flexibility for early years SEN funding to fit with the make-up of the local sector and to target support and resources effectively.

200. We agree that the current funding system in the early years lacks the necessary structure and transparency to ensure that children with SEN receive the support that they need to develop while taking up the free entitlement. The school funding system has long had a 'notional SEN budget' to give schools some indication of the resource they have to support children with SEN, but this has not been replicated in the early years. It is important to recognise that the early years market is extremely diverse in the types and size of providers delivering free entitlement places and Isos found that the creation of a notional SEN budget for early years settings would not be the right approach.

201. The lack of a clear funding route to support children with SEN has led to a fragmented picture, with inconsistencies on which additional costs early years settings are expected to meet to support children with SEN and how additional funding can be accessed. We know some local authorities have established clear processes for allocating additional funding to providers to support them in meeting their duties to support children with SEN under the EYFS and Code of SEND Code of Practice, and that this works well. However while we recognise there are many examples of good practice, this is variable and the national picture is fragmented.

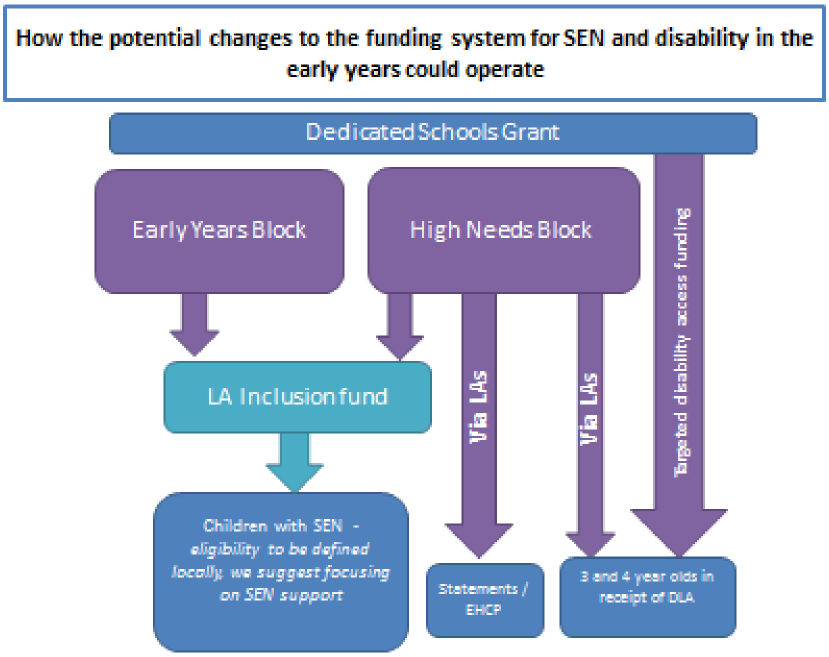
Inclusion fund for children with SEN in the early years

202. A common feature of local authorities and providers that are delivering effective support for children with SEN is a strategic and clear approach on how funding is allocated to meet additional needs. We want to build on this best practice and are proposing in this consultation that all local authorities should set up an inclusion fund in their local funding systems. We believe such a structure will support local authorities to work with individual providers to resource support for the needs of individual children with SEN. It will also enable local authorities to carry out an effective strategic role in their local area to increase the capacity of their childcare market so that it appropriately supports and develops children with SEN in the early years. We believe that an aspect of the local funding system dedicated to supporting children with SEN will help local authorities in developing their plans for strategically commissioning services as required under the Children and Families Act 2014.

203. To establish an inclusion fund we propose that local authorities should pool an amount of funding from either one or both of their early years and high needs allocations from the Dedicated Schools Grant. Over the course of the financial year we would expect local authorities to use the fund to facilitate discussions with their providers about the needs of children with SEN taking up the free

entitlements. We would expect local authorities to pass the majority of the funding through to providers in the form of 'top ups' on a case by case basis.

204. Where local authorities wish to use part of their inclusion fund to support local services, for example specialist services, we believe that they must continue to be able to do so. Some of these services may be delivered by local authorities to providers free at the point of use. Where this is the case we are minded that such services would <u>not</u> be considered as part of the 95% of funding which must be passed through to providers, although we welcome views on this. Local authorities may wish to move to offering more of these specialist services with a charge to providers ('buy-back' models).



Case Study: Early years inclusion funding – City of York

To respond to growing demand for support for children with special educational needs and in pre-school settings, the City of York undertook research and presented the evidence of the need for a new approach to the schools forum. School leaders agreed to invest funding from the schools block to support an increase to the early years inclusion fund to support children with special educational needs, who did not need an Education, Health and Care Plan or Statement of special educational needs, in pre-school settings (including maintained nurseries).

This fund was established in July 2011 and the increase agreed by the Schools Forum took effect from April 2015. The research carried out by City of York showed that by the end of 2013, almost 80 children with special educational needs in over 40 settings had been supported.

An evaluation reported that the early years inclusion fund had led to better identification of need, pupils making better progress, and better transition planning with schools. Staff in pre-school settings reported that the support available had improved their confidence and skills in supporting children with special educational needs. This in turn has meant that all pre-school settings are fully inclusive, improving parental confidence, and reducing demand for places in the city's enhanced resource nursery.

Eligibility for support via an inclusion fund

205. We believe that a local inclusion fund could help early years settings and local authorities to work together to identify children with SEN in the early years and to ensure that the appropriate support is in place to best support child development.

206. The early years census shows that in 2016 6.0% of three- and four-year olds taking up funded early education had special educational needs. Breaking this down, 0.7% had Education, Health and Care Plans or Statements of SEN, and 5.3% were in receipt of SEN support.[22]

207. In most local authorities children with an Education, Health and Care Plan or Statement receive additional funding via the high needs block to fund provision set out in their Education, Health and Care Plan. However the approach to funding for children with SEN Support is currently inconsistent, unclear, and in some cases does not have a place in local funding systems.

208. The proposed inclusion fund model is not a national structure or funding stream. We believe that local authorities know the needs of their local population and they are best placed to identify which children they wish to support via an inclusion fund. However in doing so, we suggest that particular consideration is given to children who receive SEN Support. We believe that the targeting of the inclusion fund should be considered in consultation with early years providers, SEN specialists and parents in the local area.

Transparency

209. We believe that increased transparency around local authorities' funding systems for children with SEN in the early years will help support effective discussions with parents and providers about how additional resource and support can be accessed. We would therefore expect the inclusion fund to directly link with each local authority's published 'Local Offer' and be allocated clearly and transparently so it is easily understood by parents and providers.

[22] SEN Support is a graduated approach to supporting children with SEN and is set out in detail in the 0-25 SEND Code of Practice
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/398815/SEND_Code_of_Practice_January_2015.pdf

210. This transparency will support local authorities to be clear with their early years providers what support they are expected to deliver for children with SEN as part of their allocated base rate funding. Local authorities will also need to be clear to providers on how and when they can seek further support from the local authority inclusion fund. We will consider in future whether it would be helpful to collect specific details of the inclusion fund in the information local authorities provide to central government on how the Dedicated Schools Grant is spent.

Questions:

- To what extent do you agree that a lack of clarity on how parents / childcare providers can access financial support results in children with special educational needs not receiving appropriate support? (We mean children who do not already have an Education, Health and Care Plan)

When it comes to establishing an inclusion fund...

- Should local authorities be required to establish an inclusion fund?
- Would an inclusion fund help improve the supply of appropriate support children receive when in an early years setting?

- If you envisage any barriers, arising from existing practice or future proposals, to introducing a new requirement on local authorities to establish an inclusion fund, please tell us what they are and how they might be overcome.

When it comes to the SEN inclusion fund, should local authorities be responsible for deciding...

- The children for which the inclusion fund is used?
- The value of the fund?
- The process of allocating the funding?

- Where specialist SEN or SEND services are delivered free at the point of use, should they be considered as funding passed directly to providers for the purposes of the 95% high pass-through?

Our proposals: Part 4: Transition to the new funding arrangements

This section explains our proposals to keep the transition to a new funding system manageable and to make sure there is stability by significantly limiting reductions in local authority funding rates. We ask whether you agree or disagree with these arrangements. Separately, we ask for your ideas for helping childcare providers to have strong, efficient and sustainable business models in place to help their stability in times of change.

Proposed transitions

211. We recognise our proposals present an ambitious and historic set of changes, which are needed to underpin a long term shift in the childcare market as it moves toward delivering 30 hours of free childcare. Our proposals will, rightly, see new levels of funding across the country as funding is better matched to need. We want underfunded areas and providers to benefit and receive gains as soon as possible so that they can deliver 30 hours of childcare and improve outcomes for children and families. In the minority of cases where local authorities will have to make savings, we want the transition to be manageable.

212. We therefore want to phase in funding changes, while monitoring and reviewing the impact closely. This will offer early years providers and local authorities time to plan how to make the best use of their new levels of funding. We are proposing to put in place a range of measures to minimise turbulence, help with transition and support 30 hours delivery.

Funding floor to limit any overall reductions

213. In order to provide stability for local authorities and providers, we are proposing to limit reductions by building a floor into the formula. We propose that no local authority should face a reduction in its hourly funding rate of greater than 10% against its 2016-17 baseline as a result of introducing the formula. This funding floor will limit the overall reductions that individual local authorities may face.

Early years national funding formula protections

214. But we need to go further. In designing a transition arrangement for early years, not only do we need to deliver both fairness and stability, but we also need to ensure enough funding gets to every area, including those which have been underfunded in the past, to support delivery of the manifesto commitment to 30 hours of free childcare. We therefore need to balance a desire to increase funding to underfunded areas as fast as possible, so that early years providers in those areas remain viable and choose to deliver the manifesto commitment, against a

desire to keep the transition manageable, and maintain childcare sufficiency for the minority of areas that do need to make savings.

215. The implications for early years providers have therefore been central to the design of our transition arrangements even though these arrangements primarily apply to local authorities. In addition to our proposal to limit the total reduction in the hourly rates that a local authority can face to 10%, we propose to protect local authorities on an annual basis as they transition to their new funding rates.

216. We therefore propose to limit local authorities' reductions in their hourly rates at 5% in 2017-18 and 5% in 2018-19. With the additional government investment of £1 billion per year in the early years, we can make swift early progress in raising funding levels in historically underfunded areas. Our ambition is that all local authorities should be 'on formula' by 2019-20.

Question:

- To what extent do you agree with the transition approach proposed for the Early Years National Funding Formula (money distributed from Government to local authorities)?

Introduction of high pass-through from local authorities to providers

217. We also need to consider transition in the context of the proposed changes to the local authority funding role. A significant minority of local authorities have high levels of early years central spend. Our proposal is that, once fully implemented, 95% of early years funding allocated to local authorities will be passed directly to providers. This will benefit providers in local authorities currently having high central spend that will need to reduce. Such authorities will instead need to pass more resource to the front line.

218. We recognise however that moving directly to 95% may be disruptive for some areas. We therefore propose to transition the policy, starting at 93% in 2017-18 and moving to 95% by 2018-19.

Question:

- To what extent do you agree with the transition approach proposed for the high pass-through of early years funding from local authorities to providers?

219. Our high pass-through policy provides a firm guarantee of funding to the front line, and as such we propose to remove the Minimum Funding Guarantee for the early years, as it becomes unnecessary.

Question:

- To what extent do you agree that our proposals on the high pass-through of funding from local authorities to childcare providers makes the existing Minimum Funding Guarantee for the early years unnecessary?

Introduction of universal 'per child' base rates

220. We have proposed requiring all local authorities to move to a universal 'per child' base rate of funding that to 'levels the playing field' between different types of providers, and funds all types of provider on a consistent basis. We recognise, however, that for some areas and provider types, this will be a significant change. We therefore propose to allow local authorities until 2019-20 to implement a universal 'per child' base rate, while pushing them to do so sooner if possible, and monitoring their progress.

Question:

- To what extent do you agree with the transition approach proposed for introducing the universal base rate for all providers in a local authority area?

Equalities Assessment

This very short section asks for your help identifying any impacts of our proposals on people with protected characteristics that we have not identified.

221. We are publishing this as a separate document.

Question:

- Please provide any representations / evidence on the impact of our proposals for the purposes of the Public Sector Equality Duty (Equality Act 2010). The protected characteristics are: age; disability; gender reassignment; pregnancy and maternity; race (including ethnicity); religion or belief; sex and sexual orientation.

The impact of our proposals

This section does not ask questions. It explains what our modelling shows would be the impact of all the proposed changes, if they we implemented. We talk about the impact on local authorities and on childcare providers.

The impact on local authorities

222. Alongside this document, we are publishing tables showing how our proposals impact local authorities, and how the allocations are constructed from the component formula factors. The tables show, for each local authority, what would happen under the proposed early years national funding formula if child numbers and characteristics stayed exactly as they were in 2016-17. The tables show the expected impact in 2017-18 as well as the effect when the formula is implemented in full – i.e. without transitional protections.

223. Our new investment means that most areas will gain funding: when the formula is implemented in full, our proposals see 112 local authorities (75%) gaining funding on their hourly rate[23].

224. We recognise the need to provide stability for those 38 local authorities that have been historically overfunded relative to the cost of delivering childcare. We will limit any reductions by building a funding floor into the formula. This means that there are no reductions on hourly rate greater than -5% in 2017-18 and that when local authorities reach formula endpoint, their overall reductions do not exceed -10% on their baseline hourly rate. When the formula is implemented in full, 20 local authorities will face reductions of less than 5% on their hourly rate; the remaining 18 no more than 10% (due to our funding floor).

225. Local authorities that gain and local authorities that face reductions are spread across the country. Many of the authorities who stand to see reductions are those with higher reported levels of central spend. This means that in many cases, these reductions will not be transmitted onto providers who should be financially incentivised to deliver 30 hours of free childcare. We are also confident that all councils will have sufficient funding to continue to fulfil their statutory duties.

226. We do however recognise that, even with the transition arrangements set out in Part 4, we will need to work closely with local authorities over the next year to ensure successful implementation from September 2017. In doing so, we will clearly wish to pay particular attention to the small number who may need additional help to overcome particular localised childcare sufficiency challenges.

[23] Funding changes are based on a comparison between baseline hourly rates and final allocation Local Authority rates, with final allocation MNS rates included.

The impact on providers

227. The published tables also provide data on the indicative average hourly rates that providers might expect to receive in 2017-18 in each local authority area to deliver the entitlements for three- and four-year olds. These provider figures cannot show what every early years provider will receive but give an indication based on implementation of our proposals for both national funding to local authorities, as well as the way councils discharge their funding role locally.

228. While these figures are likely to be somewhat different from the final rates that providers receive, we have published them so that providers can make initial plans for 2017-18, and crucially plan their engagement in delivery of 30 hours of free childcare. We appreciate that some providers may, of course, need to revise these plans in light of final funding rates which will be confirmed by local authorities in early 2017, following local consultation. But we believe that these rates provide a good planning assumption for providers to use right away.

229. We have calculated these indicative average provider figures for 2017-18 by assuming implementation of our proposals as described in this document. In determining these figures it has been necessary to make certain assumptions about how local authorities deliver their early years funding role. Local authorities will continue to have a degree of autonomy in funding early years providers, which will necessarily give rise to justified variation in funding rates between one provider and another.

230. Our calculations of indicative average hourly rates make the following assumptions about how local authorities will interpret and implement early years funding reform in 2017-18.

- We are not able to model exactly how local authorities will move toward a universal base rate (a base rate which is the same for all types of provider) by 2019-20. Instead, we assume that a universal base rate is implemented straight away. If it is not, then relative funding rates between particular types of provider in an authority (i.e. schools and private/voluntary providers) might be expected to be higher or lower in 2017-18 depending on how quickly local authorities move from their current position to a universal base rate.
- We have assumed a provider receives an average amount of funding from supplements. Some providers may meet a greater number of local criteria for supplements than other providers. Such providers might expect to receive a higher funding rate than the average for providers in the authority. Conversely, providers meeting fewer local criteria for supplements might expect to receive lower funding rates than the average. Our proposed 10% supplement cap would, however, act to limit this effect, giving providers meeting fewer criteria for supplements some protection against receiving funding rates significantly below the average.

- As discussed in paragraphs 139 and 140, we recognise that some local authorities hold back contingency funds for in-year demographic growth. We have assumed that, where current practice suggests it, local authorities will continue to hold back a small amount of contingency funding, with the consequent effect of somewhat reducing their hourly rate to providers.
- Our indicative average hourly rates have primarily been designed with private and voluntary providers (including childminders) and schools in mind. As described in paragraph 147, maintained nursery schools bear costs over and above other providers, because of their structure. The Government will provide supplementary funding of £55 million a year to local authorities for maintained nursery schools for at least two years. As such, for at least two years, local authorities will continue to have the autonomy, should they wish to, to fund maintained nursery schools at a different rate to maintain their stability. This means that the indicative average hourly rates for providers we have published are unlikely to be relevant to most maintained nursery schools. Instead, a reasonable planning assumption might be for continuation of similar funding levels.

231. Based on these assumptions, the impact on providers is broadly very positive. This positive picture is due to both the significant additional government investment of £300 million to uplift the funding rate, as well as the proposals in this document which have been designed to maximise funding to the front line and to provide a sustainable funding rate. Providers will benefit from both the early years national funding formula itself but also from the proposed high pass-through. This means that local authority reductions often do not translate into reductions for providers.

232. Overall, indicatively, and dependent on local authority funding decisions, private and voluntary providers in 131 local authorities (88%) will gain funding, and schools in 114 authorities (78%) will gain funding. This is based on comparing the illustrative average provider funding rates, in our published tables, with current funding rates reported by local authorities and published in our early years funding benchmarking tool[24].

233. The vast majority of providers will see funding increases: we anticipate a 16% indicative average increase to private and voluntary providers, and a 14% indicative average increase to schools. This will enable providers to deliver the free entitlements, both the existing 15-hour entitlement for all three- and four-year-olds and the extended 30-hour entitlement for three- and four-year-olds of working parents, on a sustainable basis.

[24] Early Years Benchmarking Tool https://www.gov.uk/government/publications/early-years-benchmarking-tool

Timetable for consultation, Government response, and local authority determination of local formulae

234. This consultation will close on Thursday 22 September 2016. The Government's response will then be published in the Autumn. We will aim to announce local authority allocations at the same time as the response to allow authorities to go out to consultation on their proposed local formulas.

235. New funding arrangements will commence for the existing 15-hour entitlement in April 2017 alongside the funding rate uplift, and for the additional 15 hours in September 2017 when the 30-hour entitlement is implemented nationally.

236. We recognise announcement of the outcome of consultation in the Autumn will set a challenging timetable for local authorities to determine their funding approach; consult with their providers; discuss with schools forums; engage local democratic processes as needed; and announce funding rates well in advance of the financial year beginning in April 2017. To help make this manageable:

- We would urge local authorities to start discussions with their providers as soon as possible about what our proposals might mean to the local early years single funding formulae. While it is clearly not possible for local authorities to draw up final proposals until after the Government response to consultation, preliminary planning and provider discussions are likely to expedite the production of final local proposals and enable providers to be informed of their final rates as soon as possible.

- While schools forums need to be consulted on local early years single funding formulae, they do not hold a veto. As such, we would expect schools forums to engage with local authorities in a timely way without creating undue delay.

237. We also recognise that relatively late confirmation of final funding rates may create planning challenges for providers, including around their engagement with 30 hours of free childcare. To mitigate this, as discussed in the last section, the data tables published alongside this document provide indicative average hourly rates that providers might expect to receive in each area to deliver the entitlements for three- and four-year-olds.

238. These provider figures cannot show what every early years provider will receive but give an indication based on implementation of our proposals for both national funding to local authorities, as well as the way councils discharge their funding role locally. As such, we would expect providers to be able to start to plan now for their engagement in delivery of 30 hours of free childcare.

239. Looking forward, we will monitor and review the impact of our proposals closely to ensure that the funding system enables local authorities and providers to implement 30 hours of free childcare in a sustainable way.

How to respond

240. You can reply to this consultation online at: https://consult.education.gov.uk/early-years-funding/eynff

241. Consultation opens: Thursday 11 August

 Last date for responses, at midnight: Thursday 22 September

242. If you have any enquiries or questions about the consultation, please contact the Early Years Funding Team at: EarlyYearsFundingReform.CONSULTATION@education.gsi.gov.uk

 We can only accept your consultation response via the online survey, above. Please do not submit your response to this inbox.

243. If, for accessibility reasons, e-mail is your only means of submitting a response, then of course we will take your answers into account during our analysis. However, we're afraid we cannot include such response in our analysis statistics.

244. Similarly, if it is essential for your accessibility, we are able to accept hard copy responses at:

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Annex: The £4.88 Average Hourly Funding Rate

Following the Cost of Childcare Review, the Government committed to deliver a new national average funding rate of £4.88 for three- and four-year olds, including the Early Years Pupil Premium (EYPP). This annex shows how the £4.88 is comprised.

Component 1: Early years national funding formula

1. As explained at paragraphs 120-121, the formula calculates the hourly rate each local authority receives for each child, based on a base rate, factors for additional needs and an area cost adjustment. The hourly rate is then multiplied by the number of hours taken to calculate each local authority allocation.

Component 2: Maintained nursery schools

2. As set out in paragraph 149, we want to minimise disruption and reassure maintained nursery schools on their position.
3. In order to do this, the Government will provide supplementary funding of £55 million a year to local authorities for maintained nursery schools for at least two years. This additional funding takes account of maintained nursery schools' current costs and will provide much needed stability to the nursery school sector while they explore how to become more sustainable in the longer term, including exploiting scope for efficiencies.

Component 3: Quality and expertise

4. The Government wants to fully utilise the quality and expertise that exists in the system, and give additional support to disadvantaged areas. Therefore we have set aside £5 million a year for this purpose. More details about this funding will be announced in due course.

Component 4: Early Years Pupil Premium

5. The Early Years Pupil Premium was introduced in April 2015 and we are committed to maintaining it at £302 per eligible child per year (pro-rata for children who access less than the full 15-hour early years entitlement). This funding will continue to be channelled through the Dedicated Schools Grant, but will remain outside the early years national funding formula.

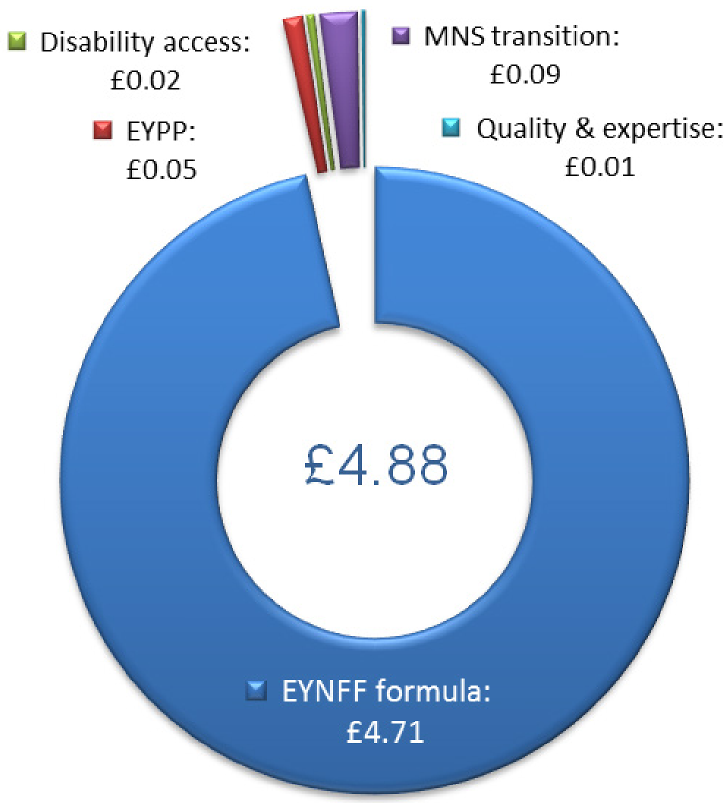
Component 5: Disability Access Funding

6. As explained at paragraphs 191-197, we believe that the introduction of additional targeted Disability Access Funding will support providers to make initial

reasonable adjustments and build the capacity of the setting to support disabled children. The total additional funding available for this new approach is £12.5 million per year. We propose that the targeted Disability Access Fund will be paid to all providers for each child in receipt of Disability Living Allowance taking up a place in their setting.

The £4.88 Funding Rate

7. This diagram illustrates what makes up the £4.88 national average funding rate. The figures given are the equivalent hourly rate for all three- and four-year old children, rather than the rates applying to, for example, an individual child eligible for the EYPP or the Disability Access Fund.



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