

## Early Learning and Childcare Funding Rate 2022-23

Report by Fiona Robertson Executive Director Children, Young People and Partnerships

### Report for Decision

#### 1 Recommendations

Council is recommended to:

- a. Maintain the current 2 year old rate of £6.90, whilst increasing the 3-5 year old rate from £5.71 to £6.42 for both funded providers and childminders delivering Early Learning and Childcare (ELC).
- b. Backdate the increase in 3-5s rate to August 2022.
- c. Give delegated authority to the Executive Director (*Children, Young People and Partnerships*) to write to the Scottish Government (SG), on behalf of Council, to seek clarity on future funding and assurance that the SG will provide the necessary funds to allow Midlothian to pay funded providers a sustainable rate.
- d. Review the funding rates for 2023/24 once the funding allocation from the Scottish Government is confirmed.

#### 2 Purpose of Report/Executive Summary

Following the Council Briefing on 14 November 2022, this report seeks a decision to maintain the current rate paid to partner providers for 2 year olds, whilst applying an increase to the 3-5 year old funding rate from August 2022 for the 2022/23 financial year, which can be funded from existing carry-forward. With the Scottish Government's (SG) funding methodology for ELC for 2023/24 onwards unavailable and the 2022/23 funding gap estimated to be circa £11.084m, it is recommended that the future rate be determined once the SG's funding settlement is known.

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### 3 Background

#### 3.1 When to increase the rate

In 2022 Ipsos MORI carried out a survey of the cost to provider settings and childminders of delivering early learning and childcare. The funding rate discussed below has been calculated on the basis of coming into effect from August 2022. It has been extrapolated from the results of the survey using inflation estimates since March 2022, as the survey was carried out before the cost of living crisis became as apparent and inflation, and hence wage pressures, escalated.

#### 3.2 Whether to have separate rate for settings and childminders

Midlothian currently pays the same funding rate to settings and childminders (CM). With the very direct relationship between the funding rate and childminders' incomes, allied to the small number of funded ELC hours currently delivered by CM, continuing to pay childminders the same rate as settings would not incur significant additional expenditure for the council. An increase in the funding rate may lead to an increase in the number of active childminders, broadening the choice and flexibility of ELC available to parents.

#### 3.3 What to increase the rate(s) to

Following the inflationary adjustment to the costs established by the survey and an allowance for Return on Investment (ROI), a new sustainable rate for 3-5 year olds has been calculated<sup>1</sup>.

The Care Inspectorate staff to child ratio for 2 year olds is 1:5, whereas for 3-5 year olds it is 1:8. This means that 2 year olds require 60% more staff than 3-5 year olds, and staffing constitutes nearly three quarters of providers' operating costs. To account for this, Midlothian currently applies a 21% adjustment to the 3-5s rate. This is significantly higher than Edinburgh City (7%) and Scottish Borders (5%). Therefore, it is recommended to increase the 3-5s rate £6.42, while holding the 2s rate at current levels (£6.90). This would make both rates comparable to those approved at Edinburgh City. Applying this increases from August 2022 to March 2023 will incur an additional funding requirement of circa £411k in financial year 2022/23.

	<b>Current</b>	<b>Proposed</b>	<b>% diff</b>
2 year olds	£6.90	<b>£6.90</b>	-
3-5 year olds	£5.71	<b>£6.42</b>	12.40%
<b>Total additional cost (Aug 22 - Mar 23)</b>	<b>£411,118</b>		

<sup>1</sup> Methodology was discussed in the Council briefing on 14 November and provided in [Appendix A](#).

### 3.4 Benchmarking

The table below presents the local benchmarking comparisons. The rates presented by Edinburgh City Council (from August 2022) and Scottish Borders Council (SBC, backdated to August 2021) do not include meals. If we add 40p onto these figures (as an assumption) then it is clear that the Midlothian proposal is almost identical to Edinburgh City and less than SBC and West Lothian (from August 2020) for 3-5 year olds. This table also provides the proportion of ELC places delivered by funded providers in these neighbouring authorities. We are aligned with the proportion of funded providers for Edinburgh City and SBC, who have both increased their rate.

LA	2s	3-5s	Notes	Proportion
<b>Midlothian (current)</b>	<b>6.90</b>	<b>5.71</b>	<b>Includes meals top-up</b>	<b>37%</b>
<b>Midlothian (proposed)</b>	<b>6.90</b>	<b>6.42</b>	<b>Includes meals top-up</b>	<b>37%</b>
Edinburgh	6.48	6.03	Plus £3.10 per meal	41.3% (NDNA)
Borders	6.55	6.21	Does not include meals	37% (NDNA)
West Lothian	6.80	6.80	Settings, includes meals	9.5% April 2020
West Lothian	6.30	6.30	Childminders, includes meals	0.6% April 2020

### 3.5 Funding

The Scottish Government provides ring-fenced funding for the implementation of the expansion from 600 to 1140 hours of funded ELC, initially increasing year on year until full implementation from August 2021. The rest of the cost of the Early Years' Service is met by the allocation of funds from the Revenue Support Grant from Scottish Government and the council's other funding sources. The multi-year funding for 1140 hours is presented below, showing a £1.7m reduction in ring fenced revenue funding from 21-22 to 22-23.

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Multi-year Ring fenced funding	£1.475m	£6.942m	£11.725m	£13.125m	£11.411m	TBC

The 26 May 2022 letter (see Appendices) from Alison Cumming, Director of ELC at the Scottish Government to local authorities advised;

*“2022-23 represents an interim year for ELC funding. The ELC Specific Revenue Grant will remain ring-fenced in the next financial year while we work together to agree the annual quantum for 2023-24 onwards, taking into account changing costs and population figures.”*

*“Councils will work with partners, on the basis of the available evidence and within the funding envelope available for ELC, to uplift rates for 2022-23 to ensure that they reflect the costs of delivery (including inflationary increases), provide scope for reinvestment (reflecting a measure of profit in a private sector setting or surplus in a third sector organisation) and enable delivery of the Real Living Wage commitment. The level of change in rates in 2022-23 will reflect evidence about local needs and circumstances, and will be determined through robust and transparent processes that are supported by local engagement. Rates must be affordable for local authorities within their overall ELC budget.”*

The additional funding requirement for an increase in the sustainable rate for financial year 2022/23, will be met by the early years carry forward.

### **3.6 Future years**

The use of the carry-forward noted above is a one-off and not recurring position. The May 2022 letter also confirms that the Scottish Government intends to adopt a new funding methodology for ELC for 2023/24 onwards. However, we do not have details of what this method will be or whether it will result in an increase or decrease to the funding allocated to Midlothian.

With the increase to the real Living Wage announced in September 2022, and circumstances that are unknown, such as details of the proposal to cap gas and electricity costs to businesses, the continued impact of the war in Ukraine, and the final budget position of the UK Government, the proposed rate will need to be reviewed for the 2023/24 budget. However, with uncertainties around the funding methodology and the allocated budget to Midlothian, it would be prudent to determine the future rate once these uncertainties are resolved.

To support the future budgeting activity, we recommend that delegated authority is given to the Executive Director (*Children, Young People and Partnerships*) to write to the Scottish Government, on behalf of the council, to seek clarity on future funding and assurance that the SG will provide the necessary funds to allow Midlothian to pay funded providers a sustainable rate.

As an overview, any review of the rate must be sustainable for authorities in terms of the budgets available and will have to take account of the following considerations:

- The rate does not have a detrimental effect on the local authority's ability to continue to pay for the service in the long-term.
- The wider package of 'in-kind benefits', which are separate to the sustainable rate, available to the funded provider as part of their contract with the local authority.
- The rate does not need to be cross-subsidised by parents and carers through charges for non-funded hours.

### **3.7 Risks**

The information provided in this paper recognises that while we must calculate a sustainable rate for our funded providers, the application of that rate must be affordable for the authority. With budget shortfalls and funding uncertainty, it is necessary to consider the implications associated with increasing and not increasing the rate.

#### **Risks if the rate IS increased:**

- Irrespective of the rate chosen, there will be an increased cost to the authority.
- While an increase may be funded by underspend in the short-term, there are significant unknowns about the Scottish Government's future funding methodology and allocation. This may lead to an even larger funding gap.
- Other local authorities have reported using their reserves to fund the sustainable rate increases. This is not financially sustainable practice.

**Risks if the rate is NOT increased:**

- Neighbouring authorities with the same proportion of funded providers have increased their rates. Not doing so will lead to reputational damage and potential scrutiny from the SG.
- Funded providers are required to pay the real Living Wage. If they do not have the financial support to do so, they may have to withdraw from partnership as they will not meet the National Standard.
- Analysis has shown that costs are increasing for our funded providers; not supporting our partners may lead to a loss of local businesses and associated employment, direct and indirect.
- The local authority does not currently have the physical capacity or infrastructure to be able to mitigate against the risk of losing our partner providers.
- If we lose some of our funded providers, there will be cost implications associated with increasing and transforming our learning estate to create a suitable early year's environment.
- Losing funded providers will impact upon the council's ability to provide parents with choice, flexibility and affordability for funded ELC, three of the four tenets of 1140 hours.

## **4 Report Implications (Resource, Digital and Risk)**

### **4.1 Resource**

If Council decides to approve an increase in the funding rate for 3-5 year olds, the additional funding requirement of circa £411k for financial year 2022/23 will be met by the early years carry forward, although it is important to note that this is a one-off and not recurring position. Budgets for future years will be set taking account of the revised rate.

#### **4.2.1 Digital**

There are no digital implications arising from this report.

#### **4.2.2 Risk**

There are two interconnected risks addressed by this report. The council has a legislative duty to provide ELC places to eligible children. If the ELC funding rate to funded providers is set too low, providers may be unsustainable and capacity will reduce, thereby the council's ability to meet its duty will be at risk. The council may either fail to meet this duty or will incur additional costs while seeking to provide substitute places through other routes. This risk must be balanced against the budgetary pressure upon the council. While the authority has an obligation to provide a sustainable rate to the funded providers, it needs to be affordable. As stated by the Scottish Government 'the rate does not have a detrimental effect on the local authority's ability to continue to pay for the service in the long-term'.

### **4.3 Ensuring Equalities (if required a separate IIA must be completed)**

An Integrated Impact Assessment was carried out on the potential impact of setting rates that are not sustainable to either providers or to the council. It identified that setting the rate(s) too high would negatively impact upon other services provided by the council, though which groups might be affected would be determined by how the budget was balanced. Setting the rate(s) too low would disproportionately negatively impact young people and children, women (particularly female single parents and the predominantly female workforce in the ELC sector), people with a disability and those vulnerable to falling into poverty. A reduction in settings and flexibility may increase travel distances for parents and carers, potentially increasing CO2 and particulate emissions.

### **4.4 Additional Report Implications (See Appendix A)**

**See Appendix B**

## APPENDIX A – Sustainable Rate Methodology

On behalf of local authorities, CoSLA commissioned IPSOS MORI to conduct a survey of the costs incurred by funded providers to deliver childcare. The survey was carried out in February and March 2022. The data produced was at Regional Improvement Collaborative (RIC) level. Midlothian is a member of the South East Improvement Collaborative (SEIC), along with East Lothian, Edinburgh, Fife and Scottish Borders councils.

The Scottish Government states in the guidance for setting sustainable rates that:

*Local authorities must act transparently, regardless of the process chosen, and make available details of the process.*

The current rate was an estimate calculated by SG in 2018 for the rate in 2020, using data collected through an IPSOS MORI survey carried out in 2016. There have been significant unforeseeable events causing upward pressures on salaries, utilities etc. (pandemic, labour market competition, Russia's invasion of Ukraine and the cost of living crisis) since that time. The 2022 IPSOS MORI survey shows that costs are now above Midlothian's current funding rate.

The SG estimate of the hourly rate for 2020 did not include payment for meals. As a result, Midlothian added a 40 pence per hour top-up to the hourly rate to cover meals. The 2022 IPSOS MORI cost data includes the costs associated with providing meals, therefore, the sustainable rate calculated from it includes meals.

Angus Council provided a detailed breakdown of how it calculated its sustainable rate, extrapolating the IPSOS MORI survey data using publically available statistical information on increases in costs and applying a factor to account for the different staff-to-child ratios between three to five year olds and two year olds. For almost all cost elements it used the mean costs found by the survey rather than median or a percentile. It then applied an 8% Return on Investment (ROI) (discussed later).

The Angus method has been applied to the SEIC data provided to Midlothian by IPSOS MORI. In order to make these costs reflect current economic conditions, we made the following adjustments:

<b>Cost adjustment</b>	<b>Adjusted by</b>	<b>Proportion of costs</b>
Staff costs aligned to real Living Wage (rLW) April 2022	rLW	72%
Utilities	Ofgem	2%
Other costs, where appropriate	CPIH	26%
<b>TOTAL</b>		<b>100%</b>

Following the inflationary adjustment to the costs, an 8% Return on Investment (ROI) rate is applied to produce a new sustainable rate for 3-5s.

## **Return on Investment**

The cost per hour used to calculate the sustainable rate proposed was the mean (average) cost figure found by the IPSOS MORI survey. This means around half of providers will experience higher costs than the mean funding rate calculated from the survey<sup>2</sup>. Clearly, therefore, if the council were to set the sustainable rate at this cost per hour half of the providers would either need to charge parents more for unfunded hours in order to meet the funding shortfall, or could be unsustainable and ultimately close. This could have a significant impact upon children and families and the council's ability to meet its legislative duty.

Providers do not operate solely to break even however, an ROI rate of 8% has been applied to the cost per hour. As stated in the IPSOS MORI paper "private companies are unlikely to continue to operate if they are not generating a profit in addition to their costs, although actual/desired profit margins will vary widely". This is also acknowledged by SG in the guidance:

*"Ensuring a sustainable rate in the current economic climate is challenging. For private and third sector providers, this means an adequate return on investment and being able to recruit and retain staff. For local authorities, it means that the service reflects high quality ELC provision and affordability."*

Due to the variability of costs discussed above, only providers with costs matching the mean figure will have an 8% ROI rate if the sustainable rate is set as proposed. Around half of providers will be above this figure and around half will have a lower rate, with some potentially making a loss. As well as the mean cost figures, the IPSOS MORI survey provided 80<sup>th</sup> percentile cost figures. The 80<sup>th</sup> percentile is where the cost per hour of delivering childcare at 80% of providers will be less than this figure and they will make, to a greater or lesser degree, a profit, and at 20% it costs more and they will make a loss.

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<sup>2</sup> Assuming that the providers who completed the survey are representative of all providers



## **APPENDIX B – Report Implications**

### **A.1 Key Priorities within the Single Midlothian Plan**

- Individuals and communities have improved health and learning outcomes

### **A.2 Key Drivers for Change**

**Key drivers addressed in this report:**

- Holistic Working**
- Hub and Spoke**
- Modern**
- Sustainable**
- Transformational**
- Preventative**
- Asset-based**
- Continuous Improvement**
- One size fits one**
- None of the above**

### **A.3 Key Delivery Streams**

**Key delivery streams addressed in this report:**

- One Council Working with you, for you**
- Preventative and Sustainable**
- Efficient and Modern**
- Innovative and Ambitious**
- None of the above**

### **A.4 Delivering Best Value**

This report has been considered from a Best Value perspective, to maintain a sustainable position for our providers and support quality provision of ELC in line with the National Standard, enabling the council to meet its statutory duty and delivering flexibility and choice to parents and carers.

### **A.5 Involving Communities and Other Stakeholders**

The development of this rate has been driven by the needs of our community, and will be delivered in partnership with funded providers.

## **A.6 Impact on Performance and Outcomes**

The sustainable rate is required to ensure that the authority has the capacity and resource to effectively delivery 1140 hours to our children, meeting the council's statutory duty.

## **A.7 Adopting a Preventative Approach**

Providing a rate that is sustainable is, by its very nature, preventative. The provision of high quality ELC for eligible children is also preventative in terms of supporting the development of children, improving attainment and learning outcomes.

## **A.8 Supporting Sustainable Development**

Not applicable.