Special Cabinet – 12 October 2011

Local Government Resource Review – Proposals for Business Rates Retention: Draft Consultation Response

Portfolio: **Councillor Towe – Finance and Personnel**

Service: **Finance – council wide**

Wards: **All**

Key decision: **No**

Forward plan: **No**

1.0 Summary of the report

1.1 To inform Cabinet of the Government's proposals in relation to business rate retention and provide a draft consultation response to the main document.

2.0 Recommendations

Cabinet are requested to:

2.1 Note the proposed changes in relation to business rates scheme.

2.2 Consider the draft response and propose any changes.

2.3 Note and approve the draft response to the main consultation as set out in **Appendix 1** and delegate responsibility to the Chief Finance Officer in consultation with the Portfolio Holder for Finance and Personnel to finalise the responses which are required to be returned by 24 October 2011. This would include any additional responses to the 8 technical papers published last month which are currently being worked on.

3.0 Report detail

3.1 <u>Current system of redistribution of NNDR</u>

Business rates is almost entirely out of the control of local authorities, as it is collected locally but pooled by central Government, and then redistributed to authorities as part of the annual formula grant settlement. The redistribution is via a complex set of calculations that attempt to take into account an authorities' relative need (spending pressures) and resources (council tax and fees). The formula grant contains two elements: redistributed National Non-Domestic Rates (NNDR), commonly known as business rates, and revenue support grant (RSG).

3.2 <u>Why the Change?</u>

The consultation states that "the current system means:

- that local authorities do not have any financial incentive to promote business growth in their area, as they will not receive any of the business rates receipts from new development.
- that this dependence on central government funding also means there is a greater incentive to design services in order to secure government funding, rather than to respond to local communities' needs or align spending with citizens' service preferences; councils may feel they can generate better results for their area by lobbying government for more resources or demonstrating their need, rather than driving cost efficiencies or investing in local growth".

Therefore the Government wants to change the current system by enabling councils to keep a share of the growth in business rates in their area. "This will make councils more financially independent from central government and give them a strong incentive to promote local business growth".

3.3 <u>The proposals for change</u>

The proposals do not affect businesses. Rate setting powers will remain under the control of central Government who will set the multiplier. The revaluation process will also remain unchanged.

The consultation seeks views on the Government's proposals to change the way business rates are distributed to local government by introducing local retention of business rates. This includes the proposal for local authorities to retain any increases (and bear the burden of the loss) in business rate yield.

The following section summarises the main changes:

- The Government recognises that some local authorities collect business rates in excess of their current formula grant funding whilst others collect amounts below their formula grant funding. Therefore it cannot allow all authorities to retain purely its own business rates, as some authorities (such as Walsall) would receive extremely large reductions in resources. As such, there will need to be a re-balancing in the first year of operation.
- Government therefore will set a baseline sum of money (expected to be set at the Formula Grant 2012/13 level adjusted for 2013/14 and 2014/15 spending control totals) for each authority for 2013/14, which is effectively an assessment of the level of funding against which to compare the amount of business rates the authority collects. This baseline will form the minimum funding each authority will receive from local retention of business rates and formula grant.
- Local authorities will retain their business rates income, *less* a tariff payable back to Government (where business rates collected is in excess of the Baseline set, generally a high resource / low need authority) or *plus* a top-up grant (where business rates income collected is below the baseline, generally a low resource/high need authority). This is in contrast to the current system whereby all income collected is given back to central Government and pooled and used in part to fund formula grant.

- The system is expected to be self-funding.
- Those experiencing growth will receive a financial incentive as they will be allowed to keep a "substantial" proportion of their business rate income growth above the baseline.
- The document states that there would be no fixed limit on the amount of business rates growth an authority can benefit from under the new system. The more any authority grows its business rates base, the better off it will become.
- However, in recognition that some authorities with high business rate taxbases may see disproportionate (term yet to be defined) financial gains, Government will claw back some of this disproportionate growth (by imposing a levy) to provide funding for particular issues, such as negative volatility in other authorities' budgets (i.e arising from business closures or relocations). This is intended to provide a safety net for those areas suffering either a decline or with lower growth potential.
- Depending on the amounts raised, the proceeds could also be redistributed to fund schemes, for example, for regeneration, in areas with high growth potential.
- There will be a mechanism to reset the system if resources no longer meet need/pressures.
- There is an option for voluntary pooling arrangements by local authorities, to potentially share the benefits of growth or manage the impact of volatility.

3.4 <u>Key Issues</u>

Walsall's main focus needs to be on balancing the risks and rewards of the new system. The higher the level of growth which is retained will result in fewer funds available to fund the safety net - the need to protect the baseline v retaining proportionate growth. Walsall's draft response to the consultation is currently aimed at lobbying the Government to provide sufficient protection arrangements for council's such as Walsall with a relatively low tax-base and high need. Cabinet are asked to comment on the responses in this respect.

Walsall would receive a top-up grant given that we currently receive more in grant than we actually collect from local business rates. Walsall is expected to collect £68.5m in local business rates in 2011/12 for paying over to the central pool. In return we will receive £104.7m as part of our 2011/12 Formula Grant. This means that we are currently expecting to receive £36.2m more revenue than actually collected.

Walsall strongly supports a needs based system of redistribution of funds and would seek to ensure there are sufficient protection arrangements in place including a safety net to protect us from volatile business rate yields. Growth within Walsall from 2005-2009 has been -0.3%. If yields fall we will lose resources. Our focus is to maintain a minimum level of resources and protection against a decline whilst allowing for some retention of growth.

It is not clear if the top up or tariff will be index linked. Walsall would expect to benefit from indexation as a top-up authority. This is because as a receiver of top up grant, we would receive an RPI linked increase in our grant each year, and therefore an increase in cash terms.

The baseline is currently expected to be set using 2012/13 formula grant adjusted for 2013/14 control totals. Walsall's provisional grant for 2012/13 is already damped by £3.8m, therefore if the grant was distributed purely based on need, we would receive additional resources equal to this amount. Continuing to include this in any new system of distribution perpetuates this inequity.

If the business sector does grow, it is not clear whether the Government will allow us to keep growth without cuts to other grants or shifting other burdens to local authorities.

Detail on how the scheme will work in practice in terms of how the baseline, levy, top-up, tariff, etc is to be calculated is not yet available therefore a detailed assessment cannot be made until this and the Governments business rate yield forecast is published.

The Government intends that local authorities' funding from business rates should be managed within the control totals set out in the 2010 Spending Review. Government will estimate business rate growth for all and individual authorities however we have not yet received these estimates. It further proposes that amounts of forecast national business rates for 2013/14 and 2014/15, above the spending review 2010 control controls will be "set aside" and may be used to fund other grants to local Government. Until we receive these figures, it is extremely difficult to forecast the impact on Walsall and if indeed we gain or lose.

New Homes Bonus is currently fully funded from an un-ringfenced grant (S31). For 2012/13, the current arrangements are expected to continue. From 2013/14, any growth is expected to be funded from business rate growth i.e. adjustments to the national baseline, and therefore effectively it will be top-sliced.

We do know that any growth in Enterprise Zones is excluded and authorities can retain the full growth in these areas.

4.0 Council priorities

4.1 The ability to financial plan into the medium to long term provides council's with a level of certainty which allows them to then forward plan to deliver council priorities. The new system adds a further level of uncertainty to an already complex mechanism for distributing local government funding.

5.0 Risk management

5.1 The proposals replace one complex mechanism of resource distribution with another and introduce further uncertainty into funding arrangements. There is an ongoing risk to the finances of the council should the allocation of resources change as part of these proposals. Such risks will be robustly managed within the council's medium term financial strategy and plan.

6.0 Financial implications

6.1 Due to the many variables still to be decided upon it is not possible to calculate the full extent of any financial implications. Government are stating that no Council should be any worse off than its current formula grant allocations. Once further information is known a report will be sent to Cabinet on the expected financial implications for Walsall.

7.0 Legal

7.1 There are no direct implications.

8. Property implications

8.1 There are no direct implications.

9.0 Staffing implications

9.1 There are no direct implications.

10.0 Equality implications

10.1 There are no direct implications.

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11.0 Consultation

11.1 A response to the 96 consultation questions is required by 24 October 2011.

Background papers:

CLG Local Government Resource Review: Proposals for Business Rates Retention
LG Futures: Briefing note on CLG proposal document
CLG Local Government Review: Technical Papers
LG Futures: Summary of the Technical Papers

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James T. Walsh Assistant Director - Finance (Chief Finance Officer) 4 October 2011	Councillor C. Towe Portfolio holder Finance and Personnel 4 October 2011

Appendix 1

Main Consultation Document

The words in italics are to assist with understanding the questions and responses and will be removed when the final response to DCLG is made**.**

Q1: What do you think that the Government should consider in setting the baseline?
This is effectively the measure of need net of local resources (council tax) for each authority at the outset of the new scheme and is crucial to the resources that will be available until the next "reset"

Removing the damping from current FG before the baseline is set, to more closely match need versus resources.

The ability of each council to raise income via council tax and fees – i.e. deprived areas such as Walsall have a more limited ability to raise income in this way, therefore protecting the baseline amount of formula grant (and having it un-damped) is essential.

Ensuring funding reductions for 13/14 are no more than already set out in the SR.

Q2: Do you agree with the proposal to use 2012-13 formula grant as the basis for constructing the baseline? If so, which of the two options at paragraphs 3.13 and 3.14 do you prefer and why?
2012/13 formula grant includes a "damping" element which reduces Walsall's funding by £3.8m compared with what the underlying formula says we should receive.

Only if damping is removed or transitionally removed.

Q3: Do you agree with this proposed component of tariff and top up amounts as a way of re-balancing the system in year one?
This is the means by which equalisation would be achieved under the new system. Walsall *would receive a top-up.*

Yes as it maintains a strong link between need and offers some protection from deprived, low growth areas, with relative high resource needs, but lower ability to raise or grow business rate and other external finance.

Q4: Which option for setting the fixed tariff and top up amounts do you prefer and why?
The options are to fix the cash amounts or to uplift them by RPI.

Option one - to uprate the year one tariff and top up amounts by the Retail Prices Index (RPI) – is our preferred approach. This offers greater protection to authorities with low taxbases.

Q5: Do you agree that the incentive effect would work as described?
i.e. the incentive to promote economic growth

We believe there is already a strong incentive to promote growth – to stimulate the local economy, improve residents standard of living and get people into work.

The greater the complexity and therefore potential uncertainty around funding levels arising from the system will make financial planning more difficult, leading potentially to more caution around committing expenditure on larger scale more risky projects and therefore could act as a disincentive..

However, we agree with attempts to allow us to retain a proportion of business growth, whilst ensuring that adequate arrangements are in place to protect the council should rates decline for reasons unconnected to the underlying business rate base.

Q6: Do you agree with our proposal for a levy on disproportionate benefit, and why?

Yes, in order to maintain the balance between ability to grow and maintaining protection arrangements for those less able to. Additionally, this will allow targeted funding for other growth initiatives nationwide.

Q7: Which option for calculating the levy do you prefer and why?
3 options are suggested: a flat rate for all authorities; banding of rates, or individual rates based on total baseline revenue. A flat rate would mean all authorities with rates growth paid a levy. Individual rates would mean only those with relatively high growth and/or a high base paid a levy, so that a 1% increase in business rates would give each authority the same % maximum increase in total funding. Banding would be a compromise between the two, but might cause issues for authorities near the "edges" of bands.

The third option is preferred, creating an individual levy rate for each local authority, to allow the retention of growth in an equivalent proportion to its baseline revenue. This would deal with the gearing effect.

Q8: What preference do you have for the size of the levy?

Until we see the business rate growth predictions and our baselines, this is difficult to say. We would want sufficient size of levy to support the safety net for councils less able to grow. Therefore, in principle, a substantial levy. Setting the levy at a higher level would involve a reduced transfer of risks (as well as of rewards), but the protection that could be afforded by the levy pot would be commensurately greater.

Q9: Do you agree with this approach to deliver the Renewable Energy commitment?
The proposal is to encourage renewable energy projects by excluding these from the levy.

As long as this does not reduce the funding available for protection arrangements,

Q10: Do you agree that the levy pot should fund a safety net to protect local authorities:

i) **whose funding falls by more than a fixed percentage compared with the previous year (protection from large year to year changes);**

ii) **or ii) whose funding falls by more than a fixed percentage below their baseline position (the rates income floor)?**

Yes we agree with the principle of a levy to fund a safety net. The safety net should be set such that there is a minimum funding stream available to all authorities and therefore reduced fluctuations in overall funding and greater certainty in financial planning.

Q11: What should be the balance between offering strong protections and strongly incentivising growth?

Sufficient protection to high need/low taxbase authorities to ensure a minimum level of funding is guaranteed and avoiding large year on year changes to funding. Therefore balance should be to offer protection.

Q12: Which of the options for using any additional levy proceeds, above those required to fund the safety net, are you attracted to and why?
These are: provide ongoing support for ongoing losses; allocate to all authorities not paying the levy; support areas of low growth or target on specific projects.

We prefer option 1 – provide ongoing support to authorities that have experienced significant losses that take more than one year to recover from

Q13: Are there any other ways you think we should consider using the levy proceeds?

Depending on the total size of the levy pot, supporting revenue expenditure in areas of lower growth or target expenditure on projects to unlock growth and prosperity, and/or hold some levy money back in higher growth years to ensure sufficient funding for the safety net in lower growth years.

Q14: Do you agree with the proposal to readjust the tariff and top up of each authority at each revaluation to maintain the incentive to promote physical growth and manage volatility in budgets?
This would avoid windfall gains and losses from revaluation.

Yes. It removes added potential volatility which is outside the authorities control. It puts the emphasis on physical growth (growing the tax base).

Q15: Do you agree with this overall approach to managing transitional relief?
Transitional relief is the method protecting losers from revaluations by phasing in both gains and losses over a number of years. The proposal is to continue to manage the costs of transitional relief centrally, so there would be no impact on authorities.

Yes this appears a fair process.

Q16: Do you agree that the system should include the capacity to reset tariff and top up levels for changing levels of service need over time?

Yes this would seem reasonable.

Q17: Should the timings of resets be fixed or subject to government decision?

They should be sufficient to allow local authorities to plan and have some certainty about funding, balanced with the ability to implement growth initiatives. If the latter is proposed (government decision), then a 2 to 3 year lead in period should be allowed in terms of the impact so councils can plan.

Q18: If fixed, what timescale do you think is appropriate?

See above.

Q19: What are the advantages and disadvantages of both partial and full resets? Which do you prefer?

A partial reset provides authorities who achieved the growth with the benefit, however this could lead to large funding swings for those unable to grow, unless protection arrangements avoid this.

How would a full reset be undertaken and would this be proportionate to the baseline, in which case areas of high growth could see significant swings in funding, a clear disincentive.

Q20: Do you agree that we should retain flexibility on whether a reset involves a new basis for assessing need?
i.e. not necessarily a "formula grant" type basis.

In either case, the basis of need should not be the sole perogative of central Government, but should be a transparent process at minimum agreed with local authorities. If need is to be used, then artificial arrangements such as damping, which move us away from that basis, are unhelpful and should be removed.

Q21: Do you agree that pooling should be subject to the three criteria listed at paragraph 3.50 and why?
The criteria are: (i) voluntary; (ii) subject to assurances around governance and workability; (iii) if dissolved, members would revert to individual arrangements.

Yes these seem reasonable.

Q22: What assurances on workability and governance should be required?

Clear rules of engagement and disengagement, set out up front, would be required.

Q23: How should pooling in two tier areas be managed? Should districts be permitted to form pools outside their county area subject to the consent of the county or should there be a fourth criterion stating that there should always be alignment?

We do not propose to respond to this.

Q24: Should there be further incentives for groups of authorities forming pools and, if so, what would form the most effective incentive?

Not at the detriment of other authorities. Pooling should only be undertaken if there is a clear practical reason for doing so. Further incentives may encourage pooling where it is not appropriate.

Q25: Do you agree with these approaches to non-billing authorities?
The proposal includes the effective exclusion Police and Fire authorities from the impacts of the new system, pending a major review of their funding, to be implemented fro 2015/16.

No strong views.

Q26: Do you agree this overall approach to funding the New Homes Bonus within the rates retention system?
The proposal is to effectively earmark the same level of resources for this scheme as would have been the case under the current system.

This depends on how the adjustment to the baseline is calculated.

Potentially, this may remove funds from our FG that is not proportionate to any gain in NHB grant. Additionally as the national control totals are fixed, growth in NHB will be offset by reductions in FG/business rates.

Q27: What do you think the mechanism for refunding surplus funding to local government should be?
As a result of fixing tariffs and top-ups, more funding would be earmarked in the early years of the scheme than is actually needed. It is suggested that this might be proportionate to baseline funding.

This appears the simplest method.

Q28: Do you agree that the current system of business rates reliefs should be maintained?
i.e mandatory and discretionary reliefs.

In principle, yes.

Q29: Which approach to Tax Increment Financing do you prefer and why?
Option 1 is to have no special treatment. Option 2 is to "ring-fence" from the rest of the system, so would not be subject to the levy or re-setting, but this would require Govt. control to limit its impact.

Option 2 appears the most workable and offers a guarantee that revenue to fund the prudential borrowing is secure. This is dependent on the "defined period of time" being set out and link to the asset life and borrowing period.

Q30: Which approach do you consider will enable local authorities and developers to take maximum advantage of Tax Increment Financing?

See response to Q29.

Q31: Would the risks to revenues from the levy and reset in option 1 limit the appetite for authorities to securitise growth revenues?

Yes

Q32: Do you agree that pooling could mitigate this risk?

No.

Q33: Do you agree that central government would need to limit the numbers of projects in option 2? How best might this work in practice?

Yes, some control would be needed to ensure the level of business rates available to support the safety net is sufficient. More detail on the bidding system would be required to comment further.