

DERBYSHIRE COUNTY COUNCIL

CABINET

25 April 2017

Report of the Director of Finance

100% BUSINESS RATES RETENTION CONSULTATION
(STRATEGIC POLICY, ECONOMIC DEVELOPMENT AND STRATEGY)

1 Purpose of the Report

To note the details of the Government's consultation *100% Business Rates Retention: Further consultation on the design of the reformed system* and approve the Council's response.

2 Information and Analysis

Background

In October 2015 the Government committed that local government should retain 100% of business rates raised locally. To ensure the reforms are fiscally neutral, some existing Government grants will be replaced by additional retained business rates. Subject to Parliamentary approval, the Government aim to introduce the new system for the financial year 2019-20.

In July 2016, the Government published a consultation seeking to identify some of the issues that should be kept in mind when designing the reforms. A summary of responses and Government response to the consultation was published alongside this consultation.

Alongside the consultation on the approach to the Business Rates Retention Reforms in 2016, the Government also published a call for evidence on the Fair Funding Review. The Government are expected to publish a summary of the responses to the call for evidence and consultation paper, seeking views on the broad approach and cost drivers that could form part of a new relative needs formula.

Devolution of responsibilities

The Government has announced that Revenue Support Grant, Rural Services Delivery Grant, the Public Health Grant and the Greater London Authority Transport Grant will be funded through retained business rates. However,

they have confirmed that the devolution of Attendance Allowance funding is no longer being considered as a part of the Business Rates Retention reforms.

These announcements are said to account for around half of the additional retained business rates that Government estimate will be available to local government at the point at which the reformed system is introduced. The Government will continue to explore with local government the issues raised by respondents in relation to the remaining responsibilities identified within the summer consultation and as well as other options identified by local government in their response to that consultation.

Consultation

Resets

The Government believe that the 100% Business Rates Retention scheme will look very similar to the current model; where there is a discrepancy between need and collected business rates, it will be redistributed between individual authorities through a system of tariffs and top-ups. The safety net, which protects authorities whose rates fall below a set percentage their funding baseline, will also continue. A full reset was intended for 2020, and then fixed every 10 years.

Tariffs and top-ups will continue to be fixed (only increasing annually by inflation) to maintain local authorities' incentive to grow. However, when income and needs diverge to the point where local services cannot be funded the system can be recalculated and therefore reset.

How the system is reset, and how frequently it is reset, does not require legislation. Therefore the Local Government Finance Bill does not make reference to resets. However, this consultation further examines where the right balance between incentive to grow and changing need sits.

Based on feedback, the Government considers that partial resets with a five year reset period would help provide this balance. This consultation therefore requests further feedback on how this could work in practice.

Under this proposition, business rates baselines would be set for every local authority for a period of five years, with top-ups and tariffs set to that level.

Any growth in business rates income that a local authority achieves during this five year period would be retained by the local authority, over and above their business rates baseline in the years up to the point of reset.

At the point of a reset, business rates baselines would be recalculated, allowing a proportion of growth achieved by an authority to be retained. The other portion of growth would go back into the pot to be redistributed as required. Baseline funding levels (along with top ups and tariffs) would then

be set for the next five year period to take account of an updated assessment of relative need.

If a local authority's business rates income has declined over the five year period, the partial reset will be the opportunity to reset the authority's baseline, and aim to bring funding back to baseline levels. In other words, whilst at a reset, authorities will be allowed to retain a proportion of growth achieved in the previous period. They will not be expected to continue to bear a proportion of any loss.

The Government recognises that resetting the needs formula every five years could result in significant changes of income for some local authorities, so they intend to explore the introduction of transitional arrangements after a reset. Any transitional arrangements would be expected to unwind over time, ideally within a reset period (e.g. a maximum of four years).

This partial reset would aim to bring the amount available for redistribution back to the same amount as at year one plus inflation. Government are continuing to model what this would mean in terms of the proportion of growth that authorities could retain at a partial reset. This is dependent on how much growth in business rates income is achieved, as well as how we measure growth over the five year period.

There is a relationship between the amount of growth authorities are able to retain at a reset and the amount available to bring all authorities back to baseline funding levels. For example, ensuring that authorities that have seen a decline in business rates income do not have to bear a proportion of that loss over a reset will impact on the ability to set a fixed proportion of growth that can be retained at a reset.

Under partial resets, growth over the reset period will need to be calculated and a proportion retained by the local authority.

The Government believe the method for measuring growth will need to ensure the growth incentive remains, is simple and transparent and does not provide perverse incentives which rewards annual volatility in income.

Factors to consider when calculating 'growth' at a reset, include:

- The baseline against which growth is to be measured;
- Whether to measure growth in real or nominal terms;
- Whether to measure growth at a single point in time, or whether to measure growth as an average over several years (and if so, how many);
- What proportion of growth to allow authorities to retain that have achieved growth over the reset period.

Business rates pooling

The Government wants to continue to encourage and reward pooling under the scheme but believes the current voluntary approach can incentivise the wrong behaviours – leading in some areas to local authorities being excluded from pools due to their being perceived as ‘high risk’. In addition, the removal of the levy from the new scheme means that the rewards for pooling are reduced.

Through the current Local Government Finance Bill, the Government is broadening the powers of the Secretary of State to designate pools of authorities. The Bill removes the requirement for local authority consent, but introduces a requirement to consult with affected local authorities.

A pool of authorities will, in effect, be treated as one authority under this approach. The pool will be treated as one entity for setting top-ups and tariffs, as well as safety net payments.

Some of the rewards the Government intend to explore for pools of authorities include:

- Offering up additional growth incentives – including the ability for the pool to set their own local growth zone, as set out below;
- The option of retaining additional growth in business rates income through a reset of the wider system;
- A different level of safety net, to provide additional support to those authorities willing to be ambitious in their plans for growth;
- Different or additional responsibilities to be funded through BRR that would be better exercised at a larger geographical area.

Local Growth Zones

The Government is introducing a new power through the Local Government Finance Bill, which will allow local authorities themselves to establish growth areas (within parameters to be set by government, to help manage the impact on the system as a whole). Local authorities will then be able to keep a proportion of growth in business rates income from that area outside the rates retention system for a specified number of years – i.e. this growth would remain outside the ‘reset’ system.

Once the parameters around the size and operation of a local growth zone have been set by Government, it will be for pools of local authorities to set up and define the relevant area.

Specific parameters will be part of the discussions for each pool, with further detail on these to be set out in secondary legislation. These could include some or all of:

- The proportion of growth retained in the local growth areas;
- The rateable value of hereditaments in the geographical areas to be designated and/or the proportion of the total business rates income that could be covered by the local growth areas;
- The number of years for which the local growth areas would exist;
- Definitions about the geographical areas;
- A connection to investment from the local authority in the local growth areas;
- The purposes for which growth in business rates income from the local growth areas could be used.

Appeals

The Government recognises the challenges that local authorities have faced under the current approach to managing appeals. To help local authorities manage the risk and income volatility associated with appeals, the Local Government Finance Bill includes a new provision for “loss payments”.

This provision will allow the Government to make a payment in connection with a reduction in a local authorities income that results from an alteration of the authority’s local rating list relating to ‘valuation errors’ in the compiled local ratings list. They do not intend for this payment approach to be made for other changes to ratings lists, such as those resulting from later physical changes to a property.

Further work will consider when loss payments should commence, including how this relates to the business rates revaluation timetable. The Government expect to continue funding ‘loss payments’ through a ‘top slice’. However, the top slice will be held and distributed centrally rather than a share being held by each local authority.

The detail about how loss payments are calculated and made will be set out in further proposals later in the year.

Tier Splits

The Government intends to continue to set ‘tier splits’ between different tiers of authority i.e. the percentage of business rates income that each tier of authority would get.

The level at which they set tier splits can affect the ‘gearing’ of two tier authorities. Gearing refers to the amount of local business rates that a council is able to raise, compared to the amount it is assessed to ‘need’ as its baseline funding level.

The more highly geared an authority, the greater level of reward they can achieve from changes in their business rates income, but the authority would also carry a greater level of risk. The lower geared an authority, the more

difficult it is to achieve significant reward in their business rates income, but they also carry a much lower level of risk.

The current 80/20 (lower tier authorities receiving 80% with upper tiers set at 20%) split means that district councils always collect a greater amount in business rates than they require to meet their baseline funding levels resulting in all districts being required to pay a tariff. For the same reason, shire counties are inevitably top up authorities and therefore lower geared.

The Government's intention is therefore to use tier splits to help manage the level of risk and reward open to councils in multi-tier areas, recognising in particular:

- The importance of providing stability of funding for adult social care services;
- The ability of different tiers to influence growth;
- The services devolved to different tiers.

Some responses to the July 2016 consultation on the scheme suggested that two tier areas should be able to determine their own tier splits for the area. This would mean, for example, the relevant county council and district councils across the county area working together to agree the right tier splits for their area. The Government is interested to hear views on this approach.

Pilots

The Government has announced pilots of the scheme in several local authorities in England to start in April 2017. They are interested in testing aspects of the system in areas not covered by devolution deals, including two-tier areas from April 2018. All councils will be free to apply to participate in these pilots, and the Government invites them to do so. The Government has already held discussions about the 2018-19 pilots with several councils and will be publishing more information shortly.

Safety Net

The Government is using the Local Government Finance Bill to make a minor change to correct an anomaly in the timing of safety net calculations and payments, in response to concerns raised by the local government sector. This will allow them to define the detail about the timing of calculations and payments in secondary legislation. The Government intends to consult later this year to ensure the changes support local government accounting practices.

The current safety net under the current scheme is predominantly funded via the levy on growth. The levy is to be abolished under the revised scheme so Government expect to fund a future safety net through a top slice to the overall quantum, using the same approach as for loss payments. This means that the safety net will continue to be funded through the overall scheme.

The Government say that, based on engagement with the local government sector, opinion is that the safety net should continue to function as a 'simple' safety net whereby local authorities bear some of the risk but will receive help when business rates income reduces below a certain level. This is the safety net that currently operates under the existing scheme, which has a threshold of 92.5% of baseline funding levels. The Government expects to raise this threshold for the revised scheme, to reflect the increased proportion of local government funding at stake. The pilots for 2017-18 will be trialling a safety net set at 97% of baseline funding level.

Central List

The Government believes that the core purpose of the central list will be, as now, to provide a home for hereditaments which by their nature are not suitable for being assessed on a local rating list. Such hereditaments are likely to be those spanning several local rating list areas and not primarily located in one list.

Ahead of the introduction of the revised scheme, the Government intends to set out a clear statement of policy for which properties and ratepayers should be assessed to the central list.

In order to do this, and to refresh the central list, the Government is taking powers through the Local Government Finance Bill to improve the operation of the central rating list and make it more responsive to changes.

Specifically they will move the operation of the central list from regulations to direction making powers including retrospective powers to update the list to reflect changes to ratepayers and properties. This will ensure they can keep properties on the central list following changes. They will also introduce charitable relief and empty property relief to the central list to ensure any central list properties entitled to these reliefs are treated fairly.

Following feedback from local government, the Government does not intend at this point to introduce area lists.

Ahead of the introduction of the scheme, the Government will consult with ratepayers and local government upon:

- The details of the central list policy;
- How it will undertake a review of the central list ahead of the revised scheme a way which supports the set-up of the reformed system whilst continuing to support the existing system; and
- How it will then maintain the practical application of the central list policy.

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity, human resources, environmental, health, property, transport and social value considerations.

4 Background Papers

100% Business Rates Retention: Further consultation on the design of the reformed system – Department for Communities and Local Government

5 Key Decision

No.

6 Is it necessary to waive the call-in period?

No.

7 Officer's Recommendation

That Cabinet:

- i. Notes the details of the consultation;
- ii. Approves the Council's response set out in Appendix One.

PETER HANDFORD

Director of Finance

Council Response

The Council welcomes the opportunity to respond to this latest consultation in respect of 100% business rates retention. The Council has set out below its responses to the consultation questions.

The Council finds it difficult to respond to the issues raised as we do not yet understand the financial implications of the proposals. We understand that detailed exemplifications are not expected to be published until Summer 2018. However, the Council appreciates that there are decisions to be made before the proposed final scheme design is published, together with the exemplifications.

We have raised our concerns regarding tier splits in response to Question 5 below, however we would like to reiterate further points. The increasing cost pressures associated with delivering adult social care services over the medium term is well documented. The Council has identified cost pressures for adult social care of £11-£12m per annum up to 2020-21. The Fair Funding Review needs to address this issue and examine appropriate cost drivers to ensure that the distribution of funding recognises this need. Therefore, it is essential that the tier splits recognise the pressure of delivering adult social care services for upper tier authorities.

The Council strongly objects to the suggestion that two tier areas should be able to determine their own tier splits. The Council considers that the majority of local authorities would prefer to see the tier split determined by secondary legislation from the outset of the 100% Business Rates Retention Scheme.

Q1: What are your views on the proposed approach to partial resets?

In its response to last summer's consultation, the Council stated that it recognised that such a system provides an incentive for growth. In practice, the proposals set out seem reasonable and provide both an incentive for growth balanced with a need for maintaining growth. However, we are concerned about the transitional arrangements that are being proposed. The Council's preference is that any 'unwinding' is dealt with during a reset period. We are particularly concerned that this mechanism is stemming back to the damping mechanism that was prevalent in the previous Formula Funding model. At the time of the transition to the new BRRS, the Council had £9m of 'damped' funding that was irrecoverable at that time. We would not want to see a mechanism that penalises authorities.

Q2: What are your views on how we should measure growth in business rates income over a reset period?

In order for the incentive to be high, we would suggest that 50% of growth is allowed to be retained.

Q3: What are your views on the Government's plans for pooling and local growth zones under the 100% Business Rates Retention system?

The Council would like to see more details of how the proposals would operate. Under the 100% BRRS, the Council has always assumed that business rates pooling would cease as there would be no levy mechanism under the revised scheme. Therefore, we would need to examine how the proposal to retain additional growth when resetting the income will affect the reset.

The Council has further concerns regarding the proposal. These are:

- How will the different level of safety net be funded? Will this be a top-slice from the overall scheme?
- The proposal refers to "different or additional responsibilities to be funded through Business Rates Retention that would be better exercised at a larger geographical area." The Council would like to know the details of these additional responsibilities.

Q4: How can we best approach moving to a centrally managed appeals risk system?

Whilst the Council is affected by the accounting treatment of appeals, we consider that billing authorities are best placed to provide any proposals for implementing a centrally managed appeals risk system.

Q5: What should our approach be to tier splits?

As a shire county, the Council is pleased to see that the consultation document recognises, amongst other things, "the importance of providing stability of funding for adult social care services". The Business Rates Retention Scheme (BRRS) working groups have analysed the impact of 'gearing' under the current scheme. Low gearing authorities (such as the Council) have highlighted the challenges faced in making significant increases to their budgets through business rates growth.

The Council would like to see some exemplifications regarding any proposed tier splits before it can comment further on the proposals. The current splits under the existing scheme do not appear to be appropriate, however, the Council cannot comment further without a detailed examination of what the potential outcome might be.

The Council considers that the proposal for two-tier areas to determine their own splits would be unworkable. The Council would prefer the splits to be determined and set out in legislation at the commencement of the scheme. The local government finance system requires certainty to be built into it. The local government sector will not want to see a further level of bureaucracy in the system.

Q6: What are your views on proposals for a future safety net under the 100% Business Rates Retention system?

The Council agrees with the proposals set out in the paper. It is hoped that the 100% business rates retention pilots will throw out any anomalies in trialling a safety net at 97% which can then be used to determine an appropriate safety net level prior to full implementation of the scheme.

The Council is aware that the working groups have considered a number of issues regarding the safety net. In the context of the safety net, the Council prefers simplicity over complexity.

Q7: What are your views on our proposals for the central list?

The Council agrees with the proposed approach for central lists.