Report to the Cabinet

Epping Forest
District Council

Report Reference: C-036-2011/12
Date of meeting: 24 October 2011

Portfolio: **Finance & Economic Development.**

Subject: **Government Consultation – Local Government Resource Review: Proposals for Business Rates Retention.**

Responsible Officer: **Rob Pavey** **(01992 564211).**

Democratic Services: **Gary Woodhall** **(01992 564470).**

Recommendations/Decisions Required:

(1) That the proposals for Business Rates Retention be noted; and

(2) That the Cabinet approves and amends where necessary the proposed responses to the consultation set out in Appendix 1.

Executive Summary:

On 18 July 2011, the Government published its 'Local Government Resource Review' consultation paper. The review proposes that the current local government finance system, under which the Government distributes Business Rates to Local Authorities, is replaced. The proposed reform would allow Local Authorities to keep a share of the growth in local Business Rate income to incentivise them to promote business growth. They would also bear the impact of any reduction in Business Rates. Following the publication of the consultation paper, the Government released eight technical papers on 19 August which aimed to provide more detail on the proposed reform. The deadline for responses to the consultation is 24 October 2011 with the Government aiming for legislation to be in place by April 2013.

The proposed responses to the consultation have been prepared following discussions with other Essex authorities and after considering the views expressed in responses from the Society of County Treasurers and the Society of District Council Treasurers.

Reasons for Proposed Decisions:

The consultation contains a number of inter-related options, which make it difficult to predict with any confidence the likely impact on this Council. However, within the broad principals of the scheme there are clearly aspects that would either be more favourable or more detrimental to this Council. Therefore it is important to respond to the consultation to seek the best possible outcome for this Council.

Other Options for Action:

Members could decide not to respond to the consultation.

Report:

1. Currently, local authorities collect around £19 billion in business rates annually, which are pooled centrally by the Government and redistributed back to local authorities according to a complex formula. On average, councils receive 53% of their income from central

government grants, of which there are two types. Firstly, there are specific grants which are generally ring fenced for particular purposes and secondly there is a formula grant which is unringfenced revenue distributed through the Local Government Finance Settlement. Redistributed Business Rates are a large component of this Formula Grant. Epping Forest District Council currently collects around £31m in Business Rates annually and receives back £5.6m.

2. The proposals will see changes to the way Business Rates are distributed, rather than to the system of Business Rate taxation itself. Businesses will see no difference in the way they pay tax or the way the tax is set. The Rate setting powers will remain under the control of Government and the revaluation process will be unchanged.

3. The Government argues that enabling councils to keep a share of the growth in their Business Rates will make councils more financially independent and give them a strong incentive to promote local business growth. It is also argued that members of the general public will find their local council's budget is more strongly linked to local business growth as the more new businesses there are, the more funding the Council has for services. Business rate payers should see that their rates paid will have more impact on the local spending in the area and developers will find councils have greater incentives to grant planning permissions for appropriately sited and well –planned non-residential development, especially those related to new renewable energy projects as councils retain all this additional income. Whilst this is welcomed, renewable projects have relatively low rateable values, as little as 1/40th of an equivalent sized retail or warehouse development. This means the retained income with these projects would be relatively modest. Local authorities will also be able to choose to borrow against future growth in business rates, through Tax Increment Financing schemes, to help fund the provision of infrastructure. County Councils will receive a share of business rates from their districts, including a share in the income growth or loss if the income falls. It is suggested that Counties may wish to look at pooling arrangements with local districts to make decisions about the distribution of funding locally.

4. Billing Authorities, such as Epping Forest District Council, will still bill and collect Business Rates. But as stated previously, instead of contributing all business rates into the central pool and receiving formula grant, under these proposals, some of the Business Rates will be retained locally. Our baseline of funding would be set so that at the start of the system, our funding (or needs) would be calculated by reference to the 2012-13 Formula Grant. From then on our funding will grow if the Business Rates in our district grows, but could fall if our Business Rates base declines.

5. The Consultation Paper goes on to describe its proposals for how the scheme will work and was supplemented by technical papers issued in August. There are seven components to the scheme. Component 1 is concerned with setting the baseline for the scheme. To establish a fair starting point for all local authorities and ensure that no-one loses out at the outset of the system a baseline position will be set for all local authorities, within the overall expenditure control totals of the 2010 Spending Review. This will involve a re-balancing of resources at the outset of the scheme with some authorities paying a 'tariff' to Government and some receiving a 'top-up' from Government. This is in effect an assessment of the level of funding against the amount of Business Rates collected. Those authorities with Business Rates in excess of their funding will pay a tariff and those authorities with business rates yield below their baseline would receive a top-up. The tariffs and top-ups form Component 2 of the system. It is anticipated that Epping Forest District Council will be in receipt of a top up.

6. The Spending Review 2010 set out the expenditure control totals for local government over the four-year period 2011-12 to 2014-15. The Government expects that Business Rates revenues in England up to 2014-15 will be greater than the expenditure control totals. Forecast Business Rates levels above the limits will be set aside and directed to local government grants. These other grants include the New Homes Bonus. This interaction with the New Homes Bonus will be discussed later.

7. Under the proposed scheme, individual local authorities' baselines will ultimately be set by reference to the government's calculation of Forecast National Business Rates for 2013-14 and 2014-15. This will necessarily involve estimates being made by Government. The resulting yield, adjusted for mandatory reliefs and other items, will form the national baseline, from which individual billing authority's baselines will be derived from the use of proportionate shares. Once set the proportionate share remains fixed until a reset of the system takes place.

8. A billing authority's proportionate share would be its individual business rates income expressed as a percentage of the aggregate of all authorities. In two-tier areas there would be a further apportionment between districts and counties, which will be discussed later. Individual authority business rates would be calculated using each authority's gross yield, adjusted for any additional income and allowable deductions such as mandatory and discretionary reliefs and other items.

9. The baseline calculation is critical to each authority as this would be fixed until any future reset. The principle around establishing the baselines is to establish a fair starting point for growth and ensuring that resources keep pace with spending needs. This then depends on accurate forecasting by Government of forecast national business rates and inflation. It is not clear how Government intends to deal with any discrepancies between estimates and final totals. As the baseline determines the level of tariff or top-up for each authority which is then fixed, the baseline level is fundamental. In addition, there is a significant decision to be made about whether the tariffs and top-ups should be index linked. Those contributing a tariff would probably support a level fixed at the outset of the scheme whilst those receiving a top-up would want the amount to be index linked.

10. There are implications with the fixing of the baseline until any future reset. Firstly, the authority would be vulnerable to the effects of reductions in the rateable values set by the Valuation Office Agency subsequent to appeals by ratepayers. These reductions would be offset against any future growth in income and to which the Council has no control. This makes predicting future income difficult. Also, the baseline takes account of the reliefs granted by the authority at the start of the scheme, such as for mandatory reliefs for charitable and empty properties. However, should a large assessment become eligible for such a relief after the baseline then this would be offset against any future growth in income. The Government is attempting to mitigate against some of these risks through a levy discussed in Component 4, which is intended to act as a potential safety net.

11. Component 3 of the scheme relates to what is termed 'the incentive effect'. In future years, local authorities would keep a significant proportion of increases in their Business Rates. Authorities whose Business Rates grew would retain a significant proportion of that growth in revenues, while those whose rates declined or grew at a lower rate would have lower or negative growth.

12. Component 4 relates to a levy recouping a share of disproportionate benefit. To manage the possibility that some local authorities with high business rate taxbases could see disproportionate financial gains, government would recoup a share of disproportionate benefit through a levy. The proceeds from the levy would be used to manage significant financial volatility in individual business rates and so ensure stability in the system. Depending on the amounts raised, resources could also be redistributed to authorities with lower growth, or to fund regeneration schemes, in areas with high growth potential. There are two main reasons for this significant volatility. Firstly, as discussed previously, rates income can vary year-on-year because of appeals and physical changes to properties. This does place a greater onus on the Valuation Office Agency to get valuations right first time so that reductions upon appeals are minimised. Only recently, a large number of schools within the district have received rateable valuation reductions of around 10%. These reductions would in the future be offset against growth levels. Secondly, there can be a sudden change in local economic circumstances, such as through the closure or relocation of a large business.

13. The Review proposes that a proportion of the levy pot is used to protect the spending power of authorities who are less able to respond and have low growth making it difficult to fund the service needs of their area. Based on a percentage amount to be defined, this safety net could offer short-term protection against major drops in income so that local authorities have time to adjust budgets and also long –term protection against drops in income that actually fall below the baseline.

14. Although this would provide assurances for authorities that there income cannot fall below a certain position and would help ensure spending is provided on services rather than offsetting risk, there is a trade-off between the level of protection and the incentive effect. This is a major challenge for the Review to get this balance right – the stronger the protection, the less the incentive effect.

15. Component 5 is concerned with adjustments for revaluation. The system would be adjusted to take account of changes in the distribution of Business Rates yield resulting from five yearly revaluations, while ensuring that the incentive to promote physical growth in the Business Rates base remained in place for all authorities. This means that as the Business Rate taxbase goes up, the nationally-set multiplier goes down. The impact of the lowering of the multiplier has a variable effect on local rates yield and historic evidence shows this could lead to considerable change in the local Business Rates income following a revaluation, even if the local taxbase has stayed constant or even grown. To address this risk, the Government proposes to adjust each authority's top up or tariff, following a revaluation, to ensure that retained income is the same after revaluation as immediately before.

16. Component 6 concerns the ability of Government to reset the system if it was felt that resources no longer met service pressures within individual local authority areas. The longer the period between resets, the greater the incentive effect and level of certainty for local authorities about the funding system. If reset periods are too short, new developments may not be completed and begin generating Business Rates in time for the local authority at all. There are two possible approaches to the reset period. Firstly, it could decide not to set a fixed period for resets in advance, but instead take an objective assessment of resources against changing levels of need to judge whether a reset was necessary. The Review argues this strengthens the incentive effect, but it does add an element of uncertainty to long-term planning. Alternatively, the Government could set a fixed period for resets which would provide that certainty and the length of time involved would have an effect on incentive i.e. a longer term would offer a strong incentive for long-term growth whilst a shorter term would offer more frequent reassessment of spending needs. Interestingly, it is proposed that it would be open to Government to change the basis on which need was determined.

17. Before moving on to Component 7 which describes the potential for pooling arrangements it is worth looking at how non-billing authorities (county councils, police and single purpose fire and rescue authorities) would be funded under the scheme. The Review proposes that the incentive for growth should apply equally to counties and districts in two tier areas to reflect levers for growth. To achieve this, a fixed percentage of all Business Rates income collected by districts will be paid to the county either on the basis of fixed national shares or individually-tailored shares which would itself be based on each district council's Business Rates as a proportion of the county total.

18. The Review argues that police authorities have more limited levers to influence growth and therefore proposes that they will receive a fixed sum of forecast national Business Rates for 2013-14 and 2014-15. The Government will review police authority funding beyond this period. The Review also proposes that county fire authorities should be funded in the same way as other county services, through a percentage share of retained Business Rates and any tariff or top up. The Review asks for views on whether single purpose fire authorities should be funded in the same way as county fire authorities or through fixed funding allocations as for police authorities. The Government intends to also fully review the way fire and rescue authorities are funded after 2014-15.

19. Component 7 suggests that local authorities, such as those in local enterprise partnerships, or districts and counties, could choose to form voluntary pools within the system, allowing them to share the benefits of growth and smooth the impact of volatility over a wider economic area. There would be a single tariff or top up for the pool which would be the sum of all tariffs or top ups for the individual authorities. In addition there would be a single levy for the pool calculated on the aggregate income and growth for all the authorities rather than individually. Pools would be able to decide for themselves how they distribute revenues, including any levy proceeds, amongst their members.

20. The Review argues that pooling has two potential benefits. Firstly, it could enable groups of local authorities to make additional increases in growth through collaborative effort by taking advantage of economic efficiencies and working across natural economic geographies. Secondly, pooling could also help local authorities to manage volatility by sharing fluctuations in their budgets across wider economic boundaries. However, despite the potential benefits there are practical challenges including getting the geographies right and the reliance on significant co-operation between member authorities to ensure the workability and stability of the pool. Other requirements to be met would be agreeing to each member's tariff contribution or top-up entitlement; agreeing each member's contribution to the levy which in effect determines how the proceeds of growth are shared; agreeing how the proceeds of growth should be spent and how to deal with the failure to agree on any issue

21. Nevertheless the Government wishes to encourage pooling based on them being voluntary, having assurances around governance and workability prior to Government approval and in the event that the pool dissolved the members would return to their original tariff, top up and levy amounts. In addition, the Government wishes to require that pooling arrangements do not separate districts from their counties as it could mean that districts could, for example promote growth in another county, which could result in a lower level of funding for its own county which would still need to provide the same level of upper tier service in that area.

22. The Government is considering offering further incentive to encourage the formation of pools such as by allowing them to retain a greater proportion of growth within the rates retention system, or by offering additional incentives outside the system.

23. The future interaction with the New Homes Bonus is important. The Bonus is based on the additional Council Tax raised for new homes and properties brought back into use, with an additional amount for affordable homes, for the following six years to ensure that the economic benefits of growth are returned to the local area. The DCLG has set aside almost £1bn over the current Spending Review period to fund the scheme, including nearly £200m in 2011-12 in year 1 and £250m for each of the following three years. Under the current local government finance system, funding beyond those levels is due to come from the formula grant i.e. centrally pooled business rates.

24. The Government is to fund the New Homes Bonus within the Business Rates retention system by fixing individual authorities' tariffs and top up amounts at a level which leaves a sufficient sum aside to fund the future cost of the New Homes Bonus. This requires making a judgement, at the start of the rates retention scheme, about the likely sum needed to fund future New Homes Bonus payments, which would need to take into account the latest housing growth projections and the potential level of central support available. To ensure that the tariffs and top-ups are able to remain fixed, it will be necessary to take out the total required to fund the Bonus at its steady state. The consultation recognises that particularly in the early years, a significant amount of the pot will not be needed and the Government has committed to ensure that this is refunded in full each year to local government, possibly by redistributing the amount in proportion to each local authority's baseline. However, because the Bonus will be effectively funded from the estimated future increased income in Business Rates, Local Government is not receiving its full reward for both Council Tax and Business Rates growth.

25. The Review introduces proposals to implement Tax Increment Financing (TIF) which would allow local authorities to borrow for capital projects against future predicted increases in Business Rates growth, provided that they can afford to service the borrowing costs out of revenue resources, subject to the normal operation of the prudential borrowing system. Such borrowing needs certainty for local authorities and developers about future tax revenue and guarantees that they will remain within the authority. The Review proposes two ways in which TIF schemes could come forward under the Business Rates retention system. The first option would allow local authorities to determine for themselves whether to invest in a TIF scheme, but would not exempt revenues from the risks of the impact of the retention scheme such as a potential loss of a share of revenue to the levy or resets in the system. It is suggested that this risk could be mitigated by using all growth across their area, not just development unlocked by TIF infrastructure, and by pooling across a wider area. Option 2 would involve stronger government controls on the ability to bring forward such a scheme but would guarantee revenues, without the risk of loss to the levy and reset process. This option offers a guarantee that Business Rates growth in an area could be used to secure debt and was free from the levy and resets. However, this would also mean that there would be less money in the levy pot to manage volatilities and potentially less resources available for any necessary reset. The Review argues therefore that government control or approval would be required to limit the number of schemes coming forward, which is a more centralised approach and against the principles of the Business Rates retention scheme.

26. Business Rates collected from renewable energy projects will be retained in full by the relevant local authorities. They will be disregarded in any reset of tariffs and top-ups and in the calculation of any levy. ‘New project’ means one that enters the valuation list after 1 April 2013 when the retention scheme comes into effect. The projects will be based on defined eligible renewable energy technologies. The preferred option within the Review for the allocation of the additional revenue in two-tier areas is a simple process of the local planning authority retaining the full amount. Alternatively, similar arrangements to the New Homes Bonus could be introduced, where in two-tier areas, the lower tier received 80% of the bonus, whilst 20% goes to the upper tier.

27. In considering the response to the consultation there are key areas to highlight:

(a) It is disappointing that the funding for New Homes Bonus is intended to come from the proceeds of Business Rates growth so that Local Government will not receive the full proceeds from both schemes.

(b) There are still so many variables relating to the scheme that this has made modelling very difficult. The DCLG produced an interactive calculator but this did not allow for future projections so has not been useful.

(c) The Baseline is critical to the fairness of the scheme but it appears that it will be based on estimates and the mechanism for resolving imbalances is not clear. It could have significant consequences if unfair for tariffs and top ups.

(d) The establishment of a ‘Levy’ and ‘Safety Net’ are sensible provisions but the balance needs to be right to retain the incentive effect.

(e) Pooling could be an option but is unclear how many would be adopted given the many practical considerations.

(f) There is not necessarily a direct relationship between economic growth and Business Rate income growth. Recent economic growth has seen the emergence of internet based companies which require little or no business premises compared with traditional industries, such as manufacturing which are on the decline, and therefore the growth in Business Rates will not correspond to growth in the economy. In addition, with the current economic situation, many businesses may be under-utilising their premises and any economic growth will be

absorbed within their current set-up and there will be no growth in Business Rates income. There may be the need for an additional indicator to more accurately align any economic growth such as levels of Corporation Tax income or unemployment.

28. Attached to this report is Appendix 1 which provides responses to the questions asked in the main consultation paper.

Resource Implications:

Attached as Appendix 2 is a report from LGFutures which examines the potential impact of business rates retention for the Essex region. This report was jointly commissioned by the Essex Authorities (apart from Maldon DC). The key points from the report are:

1. EFDC, in common with most Essex districts, will be a “top up” rather than a “tariff” authority.

2. The projections for income in the model are greater than those currently included in the Medium Term Financial Strategy (MTFS), although this is seen as providing some comfort on the figures in the MTFS rather than an opportunity to increase them.

3. As a “top up” authority EFDC should support the use of the RPI to inflate top up payments.

4. EFDC would benefit if it was possible to agree an Essex wide pool.

Legal and Governance Implications:

What is being proposed is a radical change to the current system of funding and new legislation will be required. Governance arrangements for any pools will need to be carefully considered.

Safer, Cleaner, Greener Implications:

There are no environmental implications.

Consultation Undertaken:

The draft response has been formulated following consultation with other Essex authorities and various professional associations.

Background Papers:

Local Government Resource Review: Proposals for Business Rates Retention – Consultation and technical papers

Impact Assessments:

<u>Risk Management</u>
Responding to the consultation is one of the few steps the Council can take to attempt to reduce the risks associated with a major change to the system for financing local authorities.

<u>Equality and Diversity</u>

Did the initial assessment of the proposals contained in this report for relevance to the Council’s general equality duties, reveal any potentially adverse equality implications?	No
Where equality implications were identified through the initial assessment process, has a formal Equality Impact Assessment been undertaken?	No

What equality implications were identified through the Equality Impact Assessment process?
N/A

How have the equality implications identified through the Equality Impact Assessment been addressed in this report in order to avoid discrimination against any particular group?
N/A