Examining the Potential Impact of Business Rates Retention for the Essex Region:

Executive Summary

September 2011

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The Business Rates Retention Scheme

1. The government's stated aim through business rates retention is to provide a greater incentive to local authorities to increase NDR revenues. This incentive would be created through proposals that would allow authorities to retain an element of any increased revenues due to growth in NDR revenues.

2. The complex nature of local government finance, the need for some element of funding stability, and, in particular, the variation between local authorities in terms of the amount of business rates retained locally, means that the proposed scheme, whilst simple in principle, will require a number of features to provide sufficient incentives to all authorities and protect those that are not able to increase NDR revenues or may have one-off reductions in the amount of NDR collected.

3. The key features of this system are as follows:

- Local authorities will still need to operate within the existing NDR system. They will not have control over how the level of tax is determined for ratepayers i.e. the rateable value of properties or the national multiplier (the rate of tax).
- Each local authority will be provided with an initial baseline level of funding - this is known as its **'needs baseline'**. Local authorities' needs baselines will be based upon the 2012/13 Formula Grant allocation (with adjustments for the 2013/14 control totals and possibly other changes to the formula and underlying data). The needs baseline is effectively the starting point for the rates retention system.
- Not all growth in NDR receipts will be distributed to local authorities – sufficient resources to fund the **New Homes Bonus** scheme will be retained centrally. There will also be deductions for **Police authorities**, where funding will continue (at least in the short term) to be provided through a formulae-based grant (and potentially for single purpose Fire and Rescue authorities, depending upon the option chosen from the consultation).
- An additional amount will also need to be removed from the system in 2013/14. This represents the difference in funding for local authorities between 2013/14 and 2014/15. It is necessary to remove this amount, as the baselines need to be based upon the lowest funding point (i.e. in 2014/15). The government plans to distribute the amount removed from the baseline to local authorities in 2013/14 as section 31 grant, using authorities' needs baselines as the basis for apportionment. This funding will be known as the **'2013/14 adjustment grant'.**
- A system of '**tariffs'** and '**top ups'** will be introduced, in order to allow for the fact that authorities have significantly different capacities to generate NDR income, depending upon their NDR taxbase. A tariff will be paid by an authority to

government where their NDR income exceeds their needs baseline. A top up will be received by authorities from government where their NDR income is below their needs baseline. Tariff/top up amounts could be **(i) indexed to RPI** or **(ii) fixed** as a cash amount.

- There will be a '**reset mechanism'**, designed to keep resources broadly in line with need. Without resets, there is the potential for authorities' levels of need (based upon population and socio-economic factors, for example), to become significantly higher or lower than the amount that is being received through rates retention. Each year between resets, individual authorities will either pay the same tariff or receive the same top up. Resets could be **(i) partial** (where authorities benefit from growth in business rates obtained before the reset) or **(ii) full** (authorities only benefit from any growth in their local business rates obtained in the time period between two resets).
- There will be a **'safety net'** for payments to local authorities experiencing negative volatility in business rate income. There could be **(i) an 'annual' safety net** (where income in any year declines by more than a set percentage when compared to the previous year's income) or **(ii) a 'baseline' safety net** (where income in any year declines by more than a set percentage below the baseline funding level).
- A **'levy'** system will scale back the amount of resources that are retained locally (and this may be linked to the size of authorities' NDR base). Three options have been put forward for how a levy could be calculated: **(i) Flat rate levy**, such that an authority pays x pence of every pound of business rate growth into the levy pot, **(ii) Banded levy**, where authorities would be grouped into bands based on their gearing ratios, with the levy being higher for those authorities in bands with higher levels of gearing or (iii) **Proportional levy**, with each authority being assigned an individual levy rate, set such that a 1% increase in an authority's business rates would result in a fixed percentage increase in its retained income.

Methodology

4. In order to forecast resources at a local authority level, it is first necessary to determine national level figures for the amount of funding that local authorities would be expected to receive and estimate the level of NDR income that will be collected nationally. The majority of these figures can be derived from figures provided by CLG within Spending Review 2010, with adjustments then being made in order for the rates retention scheme to work in practice i.e. for New Homes Bonus and the 2013/14 adjustment grant.

Projecting Individual Local Authority Resources

5. In arriving at forecasts at an individual local authority level, there are three key areas for consideration:

- Determining the starting point for local authorities within the system i.e. the starting level of need and the amount of NDR resources retained locally.

- Assumptions regarding the specific CLG options that could be chosen from the consultation.
- Assumptions regarding the level of NDR change at a local level.

6. The starting point for each local authority was determined by translating the national level figures to an individual local authority level. This required an assumption regarding the amount of resources that district councils would retain/how much would be passed to the county council. The CLG option to use a fixed national split, based on actual expenditure, was used in the first instance. The table below shows the top up/tariff status of the individual authorities within the region:

Table 1 Top up/tariff status, based on the starting NDR and Needs baselines

	Needs Baseline £m	NDR Baseline £m	NDR as a % of Need	Status
Essex	221.121	302.584	137%	Tariff
Southend-on-Sea	49.891	34.223	69%	Top up
Thurrock	48.520	78.335	161%	Tariff
Basildon	8.829	6.391	72%	Top up
Braintree	5.673	3.311	58%	Top up
Brentwood	2.847	2.499	88%	Top up
Castle Point	3.498	1.200	34%	Top up
Chelmsford	5.638	6.163	109%	Tariff
Colchester	7.138	4.765	67%	Top up
Epping Forest	5.481	2.746	50%	Top up
Harlow	4.774	3.758	79%	Top up
Maldon	2.483	1.072	43%	Top up
Rochford	2.760	1.257	46%	Top up
Tendring	8.208	2.167	26%	Top up
Uttlesford	2.350	3.200	136%	Tariff

7. In order to present the analysis in a logical manner, an initial scenario was determined based on assumptions on how the levy, tariff/top up and the safety net were determined. Within the initial scenario, the following assumptions were made:

- Inflating the tariff/top up amount by RPI
- A proportional levy (using a 1:1 ratio)
- NDR growth based on historic growth patterns

8. This "initial scenario" provided an initial five-year resource forecast for the Essex authorities. The forecast showed the following resource projection:

Table 2 – Five-year resource projection for retained income using the initial scenario

Local Authority	2012/13* £m	2013/14 £m	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m
Essex	260.332	260.689	248.872	251.100	257.640	267.356
Southend-on-Sea	58.738	58.669	55.843	56.174	57.463	59.456
Thurrock	57.124	57.542	55.316	56.203	58.072	60.673
Basildon	10.395	10.413	9.945	10.038	10.304	10.698
Braintree	6.680	6.685	6.378	6.431	6.595	6.839
Brentwood	3.351	3.354	3.199	3.225	3.306	3.428
Castle Point	4.118	4.110	3.909	3.929	4.016	4.151
Chelmsford	6.637	6.638	6.328	6.376	6.532	6.769
Colchester	8.404	8.368	7.937	7.956	8.110	8.363
Epping Forest	6.453	6.450	6.144	6.185	6.332	6.557
Harlow	5.620	5.656	5.431	5.511	5.688	5.936
Maldon	2.923	2.926	2.792	2.816	2.888	2.996
Rochford	3.249	3.247	3.092	3.113	3.186	3.298
Tendring	9.663	9.699	9.284	9.394	9.667	10.061
Uttlesford	2.767	2.756	2.615	2.623	2.675	2.759
Total	**446.454**	**447.202**	**427.085**	**431.074**	**442.474**	**459.340**
Percentage change (year on year)		0.2%	-4.5%	0.9%	2.6%	3.8%
Percentage change overall		0.2%	-4.3%	-3.4%	-0.9%	2.9%

**Provisional Formula Grant allocations for 2012/13*

Sensitivity Analysis

9. In order to test the implications of different assumptions around NDR growth and the options that CLG could decide to use within the scheme, further resource forecasts were made based on alternative scenarios.

10. Firstly, the six permutations in relation to setting the top up/tariff amount (indexed to RPI/fixed) and the levy (flat rate/banded/proportional) were considered. The resulting resource projections are shown in the table below.

Table 3 Forecast retained income resources for 2017/18 under the six permutations, in relation to the determination of the top up/tariff amount and the calculation of the levy

	Fixed & Flat £m	Fixed & Banded £m	Fixed and Proportional £m	RPI & Flat £m	RPI & Banded £m	RPI and Proportional £m
Essex	252.755	271.735	267.356	266.342	267.660	267.356
Southend-on-Sea	53.149	56.408	56.408	59.456	59.456	59.456
Thurrock	58.33	64.217	60.673	60.150	61.464	60.673
Basildon	9.526	10.223	10.223	10.622	10.698	10.698
Braintree	6.027	6.380	6.380	6.808	6.839	6.839
Brentwood	3.103	3.360	3.360	3.414	3.428	3.428
Castle Point	3.601	3.704	3.704	4.151	4.151	4.151
Chelmsford	6.256	6.627	6.769	6.753	6.765	6.769
Colchester	7.519	7.901	7.901	8.363	8.363	8.363
Epping Forest	5.753	6.024	6.024	6.552	6.557	6.557
Harlow	5.256	5.739	5.739	5.819	5.936	5.936
Maldon	2.602	2.721	2.721	2.981	2.996	2.996
Rochford	2.883	3.006	3.006	3.298	3.298	3.298
Tendring	8.546	8.885	8.885	9.933	10.061	10.061
Uttlesford	2.637	2.810	2.847	2.759	2.759	2.759
Total	**427.943**	**459.740**	**451.996**	**457.401**	**460.431**	**459.340**

11. The following conclusions were drawn regarding the six permutations:

- For top up authorities, the options to uprate the top up/tariff by RPI provides the highest forecasts. This is because the top up is an income source to these authorities (i.e. to supplement NDR revenues) and therefore increasing this by RPI increases the value of the top up year on year. Whilst the figures for 2017/18 are the only ones shown, the same conclusions would hold for each year.
- For top up authorities that are not expecting taxbase growth, all three options in relation to the levy give the same resource forecast. This is due to the levy only operating on resources increases above RPI, and, as the top up authorities will not have any growth above RPI (as the only growth is at RPI), no levy applies.
- For top up authorities that are expecting growth, the proportional or banded options provide the highest resource forecasts, as, under these options, no levy is applied, whereas the flat rate levy option is paid by all authorities i.e. both top up and tariff authorities.
- The flat rate levy and a fixed top up/tariff is the worst case scenario for all authorities. This is because (i) it applies a levy on the total NDR income increase i.e. the increase due to the increase in the multiplier (through RPI) and any growth

to the taxbase and (ii) the rate at which we have assumed the levy to be (i.e. 50%) is higher than the rate that has been applied though the banded or proportional options. Under these options, the top up authorities pay no levy on growth and tariff authorities pay a levy rate that is less than 50% (varying on an individual authority basis).

12. Using the initial scenario, assumptions in relation to the top up/tariff, the levy and the safety net, three additional scenarios were modelled based on different NDR growth rates. The outcome of this analysis is shown in the table below:

Table 4 – Variation in total funding between 2013/14 and 2017/18 using three NDR growth scenarios

Local Authority	-0.25% Growth £m	Zero Growth £m	+0.25% Growth £m
Essex	(12.813)	1,276.499	9.470
Southend-on-Sea	(1.453)	288.013	1.471
Thurrock	(3.295)	280.098	2.077
Basildon	(0.270)	50.968	0.273
Braintree	(0.139)	32.752	0.142
Brentwood	(0.107)	16.433	0.106
Castle Point	(0.051)	20.192	0.051
Chelmsford	(0.263)	32.546	0.241
Colchester	(0.204)	41.206	0.205
Epping Forest	(0.117)	31.644	0.117
Harlow	(0.158)	27.557	0.160
Maldon	(0.046)	14.334	0.046
Rochford	(0.055)	15.933	0.053
Tendring	(0.090)	47.381	0.092
Uttlesford	(0.137)	13.565	0.100
TOTAL	**(19.198)**	**2,189.121**	**14.604**

13. The table shows total resources of £2,189m for zero growth. A group-wide reduction in growth of 0.25% results in a reduction of funding to the group of £19.2m, whereas the same 0.25% increase, results in funding increasing by £14.6m. The difference between the level of decrease and increase is due to the levy that would act on any increased resources for tariff authorities.

14. The final variable to be considered was the amount of resources that districts retain locally i.e. the district/county split. The following three options were considered:

- **Fixed National Share version 1 –** this share (88.7% to county councils and 11.3% to districts) is based on net current expenditure by county and district councils.

- **Fixed National Share version 2 –** this share (82.5% to county councils and 17.5% to districts) is based on net current expenditure by county and district councils, excluding Dedicated Schools Grant.
- **Individual Shares –** using local business rates distribution.

15. The overall funding change (i.e. 2013/14 to 2017/18) is shown in the table below. The figures show the increase or decrease in resources compared to the initial scenario i.e. the fixed national split (1), which includes DSG within county-level expenditure.

Table 5 – Net change in total funding 2013/14 to 2017/18, compared to the initial scenario of fixed national splits, including DSG

	Fixed National incl. DSG	Fixed National excl. DSG	Individual Shares
Local Authority	£m	£m	£m
Essex	1,285.657	0.000	0.000
Southend-on-Sea	287.605	0.000	0.000
Thurrock	287.806	0.000	0.000
Basildon	51.562	0.164	0.164
Braintree	33.026	0.098	(0.041)
Brentwood	16.522	0.010	(0.034)
Castle Point	20.073	(0.042)	0.057
Chelmsford	32.643	0.000	0.000
Colchester	40.475	(0.259)	(0.052)
Epping Forest	31.682	0.014	(0.009)
Harlow	28.400	0.178	(0.100)
Maldon	14.464	0.046	(0.064)
Rochford	15.939	0.003	(0.003)
Tendring	48.504	0.399	(0.375)
Uttlesford	13.354	(0.074)	0.036
Total	**2,207.712**	**0.537**	**-0.421**

16. The following observations can be drawn from the tables above:

- The fixed national splits excluding DSG option provides the highest forecast overall (+£0.537m). The difference between the forecasts is due to different tariff levels applying to the NDR growth within the county i.e. depending on whether districts have more or less of the NDR.
- For the county council, the change in the county/district split has no impact on the forecast level of resources received under the initial scenario. This is due to the county remaining a tariff under all three options (and therefore the levy reduces the amount of resources received, due to NDR growth, by the same amount under all three scenarios).

- There is no impact for Chelmsford, which remains a tariff authority under all three options and has positive growth. These characteristics therefore mean that its proportional levy will adjust upwards or downwards, in order that a 1% growth in NDR only equals a 1% growth in resources, irrespective of the actual size of the NDR taxbase.
- For both top up and tariff authorities with negative NDR growth, reducing their share of the taxbase is favourable. For top up authorities, this is because a greater proportion of resources is paid through the top up, which is not subject to decline (unlike the taxbase). For tariff authorities, this is because the amount that is expected to be raised (prior to the tariff) is lower, and therefore the percentage of income lost due to negative NDR growth, is a lower cash amount.

Pooling

17. The government proposes to allow authorities to voluntarily form a business rates retention pool. This would require tariffs/top-ups to be combined and an overall levy to be determined for the pool authorities. The distribution of resources within the pool would be determined locally. As outlined in the main consultation paper, a single tariff or top up would be set for a pool, calculated as the sum of its individual members' tariffs and top ups.

18. The consultation paper raises the possible issue of incentives being given to authorities that form pools e.g. by allowing a greater proportion of resources to be retained or by allowing additional incentives outside of the system. The paper does not provide any examples as to how this incentive would operate.

19. Based on feedback from the 13 commissioning authorities, the following three pooling scenarios were considered:

- For all 15 authorities
- For the districts and county only
- 4 sub-pools i.e.
    - Heart of Essex – Chelmsford, Brentwood and Maldon
    - Haven Gateway – Braintree, Tendring and Colchester
    - West Essex – Epping Forest, Uttlesford, Harlow
    - Thames Gateway – Basildon, Castle Point, Rochford, Southend and Thurrock

20. In order to determine the implications of the pool, the total level of resources for the 15 authorities in an individual context, against resources as a pool, were compared for each of the three scenarios above.

21. Using the initial scenario, it was also assumed that the funding received by the pool is distributed to all authorities based upon their share of the previous year's funding i.e. the

funding levels in 2012/13 are used to determine individual authorities' respective share of the pool.

Pooling Scenario 1 – all 15 authorities

22. The potential change in projected resources for all 15 authorities entering into a pooling arrangement are shown in the table below.

Table 6 – Gain/(loss) in funding under pooling, compared to individual resource forecasts, using the initial scenario (for all 15 authorities)

	2013/14	2014/15	2015/16	2016/17	2017/18	Total
Local Authority	£m	£m	£m	£m	£m	£m
Essex	0.213	0.445	0.697	0.973	1.273	3.601
Southend-on-Sea	0.198	0.410	0.639	0.887	1.154	3.287
Thurrock	(0.293)	(0.610)	(0.952)	(1.325)	(1.729)	(4.908)
Basildon	0.005	0.010	0.015	0.022	0.028	0.080
Braintree	0.009	0.019	0.029	0.041	0.053	0.150
Brentwood	0.005	0.011	0.017	0.023	0.030	0.085
Castle Point	0.017	0.035	0.054	0.075	0.098	0.279
Chelmsford	0.014	0.028	0.044	0.061	0.080	0.227
Colchester	0.053	0.111	0.172	0.238	0.309	0.882
Epping Forest	0.017	0.036	0.057	0.079	0.102	0.292
Harlow	(0.023)	(0.048)	(0.075)	(0.105)	(0.137)	(0.389)
Maldon	0.004	0.007	0.012	0.016	0.021	0.059
Rochford	0.009	0.019	0.030	0.042	0.054	0.155
Tendring	(0.014)	(0.030)	(0.048)	(0.068)	(0.090)	(0.249)
Uttlesford	0.016	0.034	0.053	0.073	0.095	0.272
TOTAL	**0.230**	**0.477**	**0.743**	**1.032**	**1.343**	**3.823**

23. From the table above, the following conclusions can be drawn:

- Of the fifteen authorities, three would see a reduction in funding.
- The three authorities that see a reduction have the highest historic NDR growth rates. The reduction to their respective funding forecasts would therefore be expected (as they pool resources with authorities with lower historic NDR growth).
- For the group overall, there is an increase in the resource forecast of £3.823m over the five-year period. This is due to the growth in NDR income of the group being subject to a lower level tariff under the proportional system than if calculated for individual authorities.

24. It would also be possible to assume a different split in resources locally, e.g. provide each authority with the resources it would have received under an individual approach and then share the proceeds of the financial benefit of pooling.

25. The size of the possible benefits of pooling would be increased if CLG decided to provide a further incentive for authorities to pool. It was determined that there would be an increase of £8.120m between 2013/14 and 2017/18, if CLG reduced the levy for pooled authorities by using a 1:1.2 ratio for NDR growth to resources growth, rather than the current ratio of 1:1.

Pooling Scenario 2 - For the districts and county only

26. Using the initial scenario again, the implications of pooling have also been assessed for a group containing the county and districts only. The total gain, due to pooling for this group was projected to be £0.883m between 2013/14 and 2017/18.

Pooling Scenario 3 – Four sub-pools

27. Using the initial scenario again, the implications of pooling have also been assessed for the four sub-pools.

Pool 1: Heart of Essex – Chelmsford, Brentwood and Maldon

Pool 2: Haven Gateway – Braintree, Tendring and Colchester

Pool 3: West Essex – Epping Forest, Uttlesford, Harlow

Pool 4: Thames Gateway – Basildon, Castle Point, Rochford, Southend and Thurrock

28. Essex CC also asked that it would like to identify not only the benefits of pooling, but also the level of additional resources that each pool would raise due to NDR growth from increases to its NDR taxbase.

29. The table below shows the net change in resources for each of the four pools under pooling arrangements.

Table 7 – The net change in resources for the four sub-pools 2013/13 to 2017/18

Local Authority	2013/14 £m	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	Total £m
Pool 1: Heart of Essex	0.001	0.001	0.002	0.002	0.003	0.009
Pool 2: Haven Gateway	0.000	0.000	0.000	0.000	0.000	0.000
Pool 3: West Essex	0.000	0.000	0.000	0.000	0.000	0.000
Pool 4: Thames Gateway	0.235	0.489	0.763	1.061	1.382	3.929

Resources within each pool due to NDR growth

30. The level of resources raised by each pool from NDR growth was determined. It was identified that the overall gain due to NDR growth for the region would be £21.998m using the four pool scenario (including £9.159m outside of the four pools that the county would receive). The main reasons for this growth, however, are the growth achieved by Thurrock (and the benefit of pooling via the Thames Gateway group) and the gain made by the county council outside of the pool (as a result of receiving 88.7% of individual authorities' growth).

31. The table below splits the county council growth across the four pools, based on the growth achieved by the districts within each pool. The county share of growth (the £9.159m) has been distributed according to the NDR growth achieved by the districts in each pool.

Table 8 – The increase in resources due to NDR growth for the four sub-pools (with Essex CC growth apportioned across the pools)

Local Authority	2013/14 £m	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	Total £m
Pool 1: Heart of Essex	0.109	0.230	0.356	0.488	0.630	1.807
Pool 2: Haven Gateway	0.170	0.352	0.551	0.776	1.022	2.877
Pool 3: West Essex	0.224	0.460	0.719	0.996	1.294	3.694
Pool 4: Thames Gateway	0.817	1.698	2.646	3.676	4.784	13.621
Total	**1.320**	**2.741**	**4.273**	**5.936**	**7.730**	**21.998**

Next Steps

32. This report provides the Essex authorities with information to assist in:

- Informing medium term financial planning scenarios.
- Responding to the consultation paper and the questions in the eight technical papers.

33. The original consultation paper included 33 questions that the government were seeking responses to and the technical papers include an additional 63 questions. The deadline to respond to both consultation papers is 24 October 2011.

34. LG Futures will be providing the Essex authorities with a list of potential areas where they may be common ground within Essex, in order to assist them in submitting a joint response.

35. Once authorities have had the opportunity to consider this report, other areas that we could potentially provide support on to take this work forward, if required, include:

- **Assistance with individual local authority responses.** Individual authorities may also want to respond to the consultation in order to attempt to influence the final design of the scheme. LG Futures is able to assist individual authorities through either drafting responses on behalf of the authority or reviewing drafted responses.
- **Presenting information to officers and Members.** Due to the complexity of the business rates retention scheme and the potential difference between NDR income collected and the amount that is retained, it is important that there is a clear understanding of the scheme locally. LG Futures is able to assist local authorities in explaining the scheme and the potential implications locally, if required. This includes our attending meetings to offer support/advice or preparing and delivering a presentation regarding the scheme and its potential implications locally.
- **Further scenario analysis.** We have presented a range of potential scenarios within this report. We could also run further possible scenarios; for example, using individual authorities' own local projections for NDR growth.
- **Further detailed modelling.** Following CLG's decisions regarding the options chosen, it will be possible to update the resource projections included within this report. Using our funding model, with further detail being available about the final design of the scheme and any additional information that may emerge in relation to NDR growth and RPI, LG Futures will subsequently be able to assist local authorities in updating their medium term financial planning figures.