EXETER CITY COUNCIL

EXECUTIVE
4 OCTOBER 2011

GOVERNMENT CONSULTATION ON PROPOSALS FOR BUSINESS RATES RETENTION

1. PURPOSE OF THE REPORT

1.1 This report sets out the Government's consultation proposals for Business Rates Retention as part of the Local Government Resource Review and highlights the key issues to be considered.

2. BACKGROUND

2.1 Under existing arrangements, non-domestic rates (or business rates) revenue collected by local authorities is pooled for redistribution to local authorities in England as part of the overall local government finance settlement. This means that while local authorities have a vital role to play in supporting the local economy, there is limited direct fiscal incentive to do so.

2.2 On 18 July 2011, the Government published for consultation its proposals to allow councils to retain their locally-raised business rates as part of its wider Local Government Resource Review. This was followed up on the 19 August 2011 with the Government publishing eight technical papers which provide more details of their proposals. The Government are seeking responses to their consultation by 24 October 2011. The original consultation paper included 33 questions that the government was seeking responses to; the technical papers include an additional 63 questions.

3. OVERVIEW OF THE CURRENT SYSTEM

3.1 Under the current system, local government has three main sources of income: grants from central government; council tax; and other locally generated income (such as fees and charges for services). On average, councils receive 53 per cent of their income from central government grants, of which there are two types. Firstly there are 'specific grants', which may be ringfenced for specific purposes, or unringfenced. Secondly there is 'formula grant', which is an unringfenced revenue grant distributed to local authorities each year through the Local Government Finance Settlement. In the case of Exeter, formula grant is by far the most important of these grant streams.

3.2 Formula grant funds a wide range of local services, including children's services, adult social services, police, fire, highways maintenance, environmental, protective and cultural services. It includes funding from central government, known as 'Revenue Support Grant'; Police Grant from the Home Office; and National Non-Domestic Rates, commonly known as business rates. Business rates are collected by local authorities, paid into a central government pool and redistributed through the Local Government Finance Settlement. Billing authorities (district councils and unitary authorities) collect business rates from the occupiers of non-domestic properties - mainly businesses such as shops, offices, warehouses and factories. There are approximately 1.7 million properties liable for business rates in England. Each property has a rateable value which is assessed by the Valuation Office Agency on the basis of the annual rent that a tenant would be willing to pay for it on the open market. Every five years there is a revaluation to ensure a property's rateable value reflects changes to the property market.

3.3 The business rates owed are calculated as a function of the rateable value and a multiplier. The national multiplier currently stands at 43.3p in England. So a property with a rateable value of £100,000 would have an annual bill of £43,300. The multiplier is increased each year by the Retail Prices Index (RPI). The multiplier is also adjusted at each revaluation so that the overall tax yield remains the same in real terms before and after revaluation. There are a number of reliefs (with mandatory and discretionary elements) available to occupants to reduce their liability – for example reliefs for charities, community amateur sports clubs, certain businesses in rural areas and Small Business Rate Relief.

4. WHAT COULD THESE PROPOSALS MEAN FOR COUNCILS AND BUSINESSES?

4.1 The consultation seeks views on proposals to change the current system by enabling councils to keep a share of the growth in business rates in their area. The intended outcome is that this will make councils more financially independent from central government and give them a strong incentive to promote local business growth. This in turn could mean that the public will find their local council's budget is more strongly linked to local business growth. In general terms, the more new business premises are developed in an area, the more funding (outside of council tax, fees and charges) local councils could have to provide local services and investment, as well as having positive impacts on employment and the local economy more widely. The proposals include protections to ensure that local authorities are able to meet local service needs in their area.

4.2 Business rates payers see no change in the way in which their business rates bills are calculated. The Government is not proposing to change the way that properties are valued or business rates levels are set. However, it should mean that the rates businesses pay have more impact on local authority budgets in their local area, and that local authorities have more incentive to work closely with the Valuation Office Agency to ensure that all businesses in their area are valued correctly and are paying the right amount of tax.

4.3 Developers will find local authorities have greater incentives to grant planning permissions for appropriately-sited and well-planned non-residential development and go for growth. This is especially true of new renewable energy projects that start paying business rates from year one of the system, as councils would keep all of the business rates paid by such projects. Local authorities would 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.

4.4 Billing authorities (district councils, unitary authorities) would still bill and collect business rates, as now. However, instead of contributing all business rates into the central pool and receiving formula grant, under these proposals, some of the business rates would be retained locally. A baseline level of funding would be set so that at the start of the system, each Council's budget is equivalent to what it would have been under the current system. From then on the funding could increase if the business rates base in an area grows, but conversely could fall if the business rate base declines.

4.5 County councils will receive a share of business rates revenues from the districts in their area (and a top up from other areas if relevant), rather than receiving formula grant. As with billing authorities, their baseline level of funding would be set so that at the start of the system their budget is equivalent to what it would have been under the current system. Similarly their funding would grow if the business rates base in the area grows, but could fall if the business rates base declines.

4.6 It is proposed that the police and fire sectors will receive the level of funding for 2013/14 and 2014/15 that was agreed as part of the 2010 Spending Review and their funding will therefore not be affected by fluctuations in business rates in their areas. The way in which they are funded will be fully reviewed in time for changes to be made at the next Spending Review, from 2015/16.

5. PROPOSED SCHEME FOR BUSINESS RATES RETENTION

5.1 There are seven components to the proposed scheme:

5.1.1 Setting the Baseline

The Government will set out a baseline position in 2013/14 for each local authority. This will use the 2012/13 formula grant as a baseline, either unadjusted or with some limited technical updates.

5.1.2 Setting tariffs and top-ups

Authorities whose business rates income is higher than their baseline would pay the difference to government as a ‘tariff’. Those whose business rates are less than their baseline would receive the balance as a ‘top-up’. In future years, tariffs and top ups could either be up rated by the Retail Prices Index (RPI) to reflect the annual increase in the business rates multiplier or retained at their original year 1 amounts.

5.1.3 The incentive effect

The Government says that from ‘year one’ all local authorities would stand to benefit from retaining increases in business rates. This would provide an incentive for councils to engage with businesses in their area to maximize growth.

5.1.4 A levy to recoup a share of ‘disproportionate benefit’

The Government proposes to collect a levy from those councils with the highest business rates income. The consultation document says this can help with moderating the ‘gearing effect’ between different need to spend and ability to raise business rates. There are a number of ways in which this can be calculated:

- It could be based on the same rate for all authorities; this would be simple but would not deal with this gearing effect.
- It could be based on putting authorities in different bands.
- Finally; it could be based on revenue; so that if an authority grows its business rates income by 1% it would be allowed 1% growth in its baseline revenue. This percentage could be varied up or down; for example if it was 2% a high number of authorities would keep all their growth; or conversely if it was 0.5% there would be more of a levy income.

The proceeds of the levy could be used:

- To manage volatility in authorities’ business rates income, due to factors such as appeals and changes to properties or due to sudden changes in economic circumstances.
- To support authorities with low growth, through a ‘safety net’ mechanism. Access to this could be triggered if business rates fall by more than a certain percentage each year or if they drop by more than a certain percentage below the original baseline business rates.
- If there is sufficient income left there are a variety of other possible uses: including providing ongoing support to authorities which have experienced loss, top-up the growth reward for low business rates authorities, support expenditure on targeted projects to encourage growth, or redistribute in proportion to the baseline.

5.1.5 **Revaluation**

The tariff and top-up for each authority would be adjusted when business rates are revalued; so that the sum of top-ups and tariffs was the same after as before revaluation. The document does not propose any other changes to revaluation; so the multiplier would still fall to reflect any increase in overall taxbase. It is proposed that the impact of transitional relief allowed following revaluation is stripped out from the business rates retention scheme.

5.1.6 **Resetting the system**

The document says there are two possible approaches to resetting the underlying tariffs and top-ups:

- The Government could decide not to set a fixed period for resets; they say this will allow the incentives to remain in the system for longer.
- Alternatively there could be a fixed period for resets: the possibility of a ten year period is trailed, which would offer a strong incentive effect; alternatively a shorter reset period would allow a more frequent reassessment of spending needs. In addition resets could relate to the baseline position only or to the whole system, including the incentive growth.

5.1.7 **Pooling**

The Government proposes that local authorities could come together voluntarily to form a pool; the pool would be treated as a unit in the system, with a single tariff and top-up and a single levy. Pools could decide for themselves how they distribute business rates growth, including any levy proceeds, amongst their members. The Government wants to encourage pooling, subject to assurances on workability and governance and what would happen if pools dissolved. The Government suggests that in two tier areas it makes sense for districts to align with their counties; it is suggested that, if a district formed a pool outside its county area, it might still be required to pay a fixed proportion of its business rates to its county.

6. FURTHER INFORMATION COVERED IN THE CONSULTATION

6.1 **Police and Fire authorities**

The Government propose that police and fire authorities should, for 2013/14 and 2014/15, be funded without being impacted by the business rates retention scheme. Police and fire authorities will therefore continue to receive funding at the levels set in Spending Review 2010 for those years. Beyond that, there will be a full review of future funding arrangements, including the option that the police might receive all funding from the Home Office.

6.2 **Tax Increment Financing**

6.2.1 The Government is consulting on two options for how Tax Increment Financing (TIF) could operate within a business rates retention system. Under ‘Option 1’, local authorities would have full discretion to determine whether to invest in a TIF scheme. However, any additional business rates growth on top of the tariffs and top ups set in year one would be subject to the “disproportionate growth” levy and growth would also be taken into account in any future reset of tariffs and top ups. ‘Option 2’ proposes that additional business rates growth would not be subject to any levy or be taken into account in any reset of tariffs and top ups. However, schemes would require government control or approval in order to limit the number of schemes coming forward, with a view to ensuring that the levy pot was maintained at a level sufficient to manage volatilities. The Government also proposes that all uplift in business rate revenues within an Enterprise Zone would be retained by the Local Enterprise Partnership, and not subject to a levy or reassessment of tariffs or top ups. The Government will publish a detailed technical paper on TIF following the close of the consultation on business rates retention.

6.2.2 The Council will shortly be meeting with representatives from CLG to discuss the feasibility of piloting TIF within Exeter.

6.3 **New Homes Bonus**

The Government proposes to fund the New Homes Bonus from 2013/14 by fixing individual authorities' tariff and top up amounts at a level that would allow a sufficient sum to be top-sliced from the total business rates yield to fund the future cost of the bonus. To ensure that the tariffs and top ups can remain fixed; the Government would take out from 'year one' of the retention scheme the total required to fund the New Homes Bonus at its steady state. Since a significant amount of this pot may not be needed in the early years of the bonus scheme, the Government would return any surplus to local government each year. One option being considered for returning the surplus is to redistribute the amount to local authorities in proportion to their baselines.

6.4 **Business rates reliefs**

No changes to the current system of reliefs, including eligibility, are proposed. An allowance to cover the central government funding element of discretionary reliefs will be provided.

6.5 **Changes to collection and enforcement**

The Government proposes to:

- allow billing authorities to publish certain statutory information which accompanies business rates online, although they would be required to send out hard copies on request;
- operate multi-year billing for business rates; and
- clarify legislation on business rates refunds so that billing authorities can offset outstanding liabilities from previous years before offering refunds.

7. TECHNICAL PAPERS

7.1 Further details on the elements above are discussed in the series of further technical papers released in August. The eight 'Technical Papers' are as follows:

Technical Paper	Content
1) Establishing the baseline	How, technically, the government establishes the baselines and the implications of fixing them for a number of years between resets.
2) Measuring business rates	The issues associated with measuring business rates and options for doing so.
3) Dealing with non-billing authorities	The basis for funding police and fire authorities in 2013/14 and 2014/15 and, more widely, that for apportioning rates between authorities.
4) Business rates administration	The consequences for business rates administration of the scheme outlined in the consultation paper.
5) Tariff, top up and levy options	Options for the design of tariffs, top ups, the levy and the use of levy income.
6) Volatility	Causes and the options for dealing with it.

7) Revaluation and transition	The practicalities of assessing business rate income following a revaluation. It will also consider the implications of the transition scheme – and in particular, how this affects business rate administration and the payments made between authorities.
8) Renewable energy	Definitions of renewable energy, the treatment of rates from renewable sources for the purposes of tariffs, top ups and levies, and their distribution between the tiers.

8. THE KEY ISSUES

8.1 There are a number of key issues that need to be considered before making a response to the consultation papers. The key issues for Exeter include:

- Determining how the split of the baseline will be determined between county and district councils and how the benefits of any growth will be apportioned in future years (both within and outside of any pooling arrangements) i.e. using a fixed national share or individual shares and the percentages used to determine the shares. For example, within Devon (but excluding Plymouth and Torbay) the estimated business rates yield for 2011/12 is £207.3 million of which Exeter will contribute £67.9 million (33%). If the split is determined using a fixed national percentage then Exeter's share of the baseline will be only about £7.5 million. Conversely if the split is determined using individual share, Exeter would keep 33% of its individual tax yield i.e. £22.4 million. It would therefore seem that from Exeter's individual point of view it should favour this latter option.

- Considering what local pooling arrangements might be available and whether they will be advantageous to Exeter, including the incentives that might be required to encourage pooling.

- The relationship between the New Homes Bonus Scheme and top-ups and tariffs, given the implications for national control totals.

- The implications of potential changes to how the level of need is assessed (and therefore the tariff and top-up) from 2013/14 onwards.

9. THE COUNCIL'S RESPONSE

9.1 In general the Council should support the principle of the Government carrying out a consultation on the proposals for retention of business rates. The City Council has an excellent track record in achieving business rates growth in the City and in theory it therefore should gain from the introduction of a new finance system based upon the retention of local business rates. However it will need to be satisfied that any proposed new system is both fair and gives all Councils greater freedom and incentive to encourage growth in local areas.

9.2 The consultation paper including all the technical papers is by its very nature extremely complex. Whilst some commentators including the Local Government Association have already prepared a briefing and highlighted some of the key issues to be aware of, their advice can at best only be of a very general nature.

9.3 The Council has received a specific proposal from an independent external provider to do some more detailed analysis and modelling support to finance officers within Devon in relation to the current business rates retention proposals. The analysis would provide forecasts of the key variables that will determine future resource levels under a business rates retention scheme and it would also consider the implications of the upper and lower tier split and the preferred position for individual authorities. If this proposal was taken up by all of the 8 district councils in Devon some of the work required and costs could be shared. It is estimated that the cost of this work would be £26,850 (£3,350 per authority). If the Council is to make a detailed and considered response to the consultation it will need to commission external support work. We have approached the other Councils within the proposal to see if there is any interest in commissioning some jointly funded external work. To date we have received a positive response from 4 other interested parties.

10. RECOMMENDATIONS

It is recommended that: -

10.1 The Council seeks to commission some jointly funded external support work and submits a response to the consultation before the due date.

10.2 The Government is informed that the Council does not support the approach of using a fixed national percentage for determining either the baseline or future growth.

10.3 Any proposed new scheme based upon retention of business rates has sufficient incentive to reward funding based upon growth in local areas.

HEAD OF TREASURY SERVICES

CORPORATE SERVICES DIRECTORATE

Local Government (Access to Information) Act 1985 (as amended)
Background papers used in compiling this report:

The government consultation document is at
http://www.communities.gov.uk/publications/localgovernment/resourcereviewbusinessrates
The LGA Briefing on this document is at
http://www.lga.gov.uk/lga/tio/19377920