Agenda Item No. 5

Meeting of the Cabinet – 13th October 2011

Report of the Director of Corporate Resources

Local Government Resource Review: Proposals for Business Rates Retention - Consultation

Purpose of Report

1. To inform members of the Government's proposals for local business rates retention, and seek approval for a response to the consultation.

Background

2. The main outcome of the Local Government Resource Review is a proposal to allow authorities to retain any increases (and bear the burden of any losses) in Business Rate yield, compared with the current system where all Business Rates are pooled and redistributed as part of Formula Grant. It is intended to incentivise Councils to encourage local economic growth, and reward them when that growth materialises.

3. Central Government would continue to set the Business Rate poundage, and the current system of reliefs etc. would be maintained – so that businesses would see no difference in the amount they pay.

4. The Government recognises that simply allowing each authority to keep all rates collected would be unfair given that there is no direct relationship between rateable value and spending needs. Instead there would be a system of "tariffs and top-ups" whereby high resource / low need authorities would pay a tariff to the Government, and high need / low resource authorities would receive a top-up. These tariffs and top-ups would be based on the current difference between each authority's formula grant and the amount it collects in business rates. The amount of business rates collected less tariff or plus top-up would replace formula grant, which would cease.

5. So, at the start of the new system, the resources received by each authority would not be dissimilar to those which would have been received under the current system. However, as the tariffs and top-ups will be fixed for several years, any increase in business rates would remain with individual authorities. Likewise any reduction would fall on individual authorities. This would include the impact of any appeals and other losses in collection, which are currently pooled. There would therefore be a direct impact of business rates collection activity on authorities' overall resources.

6. There would be some further adjustments in the new system in that authorities with very high increases in rates yield would pay a "levy" which might help fund significant losses by other authorities. The system could be reset periodically to bring needs and resources back into line.

7. The broad principles of the proposed system are set out in a main consultation document, with a further 8 technical papers setting out more detail with further consultation questions. The deadline for response is 24th October.

8. The proposed responses to the main consultation questions are set out in Appendix A, and reflect our main concerns that:

- The proposals effectively lock in the damping from the current Formula Grant, which amounts to almost £6m for Dudley in 2012/13. This damping is the result of previous reviews of the underlying formula on which the grant is based, the results of which have been phased in to protect losers from the changes, at the expense of gainers who have had their increases "damped".
- The new system will be more complex than the existing system and will lead to additional uncertainty and risk in forecasting resources.
- Whilst the system would need to be reset periodically to ensure fairness and equalisation of need / resources, this would make it too difficult and risky to enter into the large long term regeneration investment projects that it is theoretically intended to promote.

9. It is proposed that the Treasurer be authorised, in consultation with the Cabinet Member for Finance, to respond to the questions in the technical papers - to be consistent with the responses to the main questions where relevant.

Finance

10. The new system will have a significant and ongoing impact on the level and potential volatility of Council's General Fund Revenue resources.

Law

11. The Council's budget setting process is governed by the Local Government Finance Acts 1988 and 1992 and the Local Government Act 2003.

Equality Impact

12. These proposals have no direct implications for the Council's commitment to equality and diversity.

13. With regard to Children and Young People:

- The proposals in this report have no specific implications for children and young people.

- There has been no specific involvement of children and young people in developing the proposals in this report.

Recommendations

14. That Cabinet:

(a) Approves the response to the main consultation questions, as set out in Appendix A.

(b) Authorises the Treasurer, in consultation with the Cabinet Member for Finance, to respond to the questions in the technical papers - to be consistent with the responses to the main questions where relevant.

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List of Background Papers

Local Government Resource Review: Proposals for Business Rates Retention – Consultation Paper & Technical Papers (DCLG)

Appendix A

The main consultation paper includes 33 questions, reproduced below with proposed responses. The sections in italics are to assist with understanding the questions and responses and will be removed when the final response to DCLG is made. For full details of the proposals see the consultation paper (click here)

Consultation Question	Response
Chapter 3: A scheme for rate retention	
Component 1: Setting the baseline	
Q1: What do you think that the Government should consider in setting the baseline? *This is effectively the measure of need net of local resources (council tax) for each authority at the outset of the new scheme and is crucial to the resources that will be available until the next "reset".*	Any system of Local Government funding allocation should primarily be based on fairness (e.g. assessment of levels of need and deprivation), i.e. equalisation between Councils to reflect differing underlying levels of need and resources.
Q2: Do you agree with the proposal to use 2012-13 formula grant as the basis for constructing the baseline? If so, which of the two options at paragraphs 3.13 and 3.14 do you prefer and why? *2012/13 formula grant includes a "damping" element which reduces Dudley's funding by almost £6m compared with what the underlying formula says we should receive.*	If 2012/13 formula grant is used as the basis for constructing the baseline, provision must be made in the new funding system for the existing damping to unwind over a reasonable period, rather than fossilise the current levels of damping which would be unreasonable and contrary to the overriding principle of equalisation.
Component 2: Setting the tariffs and top ups	
Q3: Do you agree with this proposed component of tariff and top up amounts as a way of re-balancing the system in year one? *This is the means by which equalisation would be achieved under the new system. Dudley would receive a top-up.*	Yes in principle, but these should not be fixed – in order to allow the unwinding of damping. The adjustments to achieve this could be set in advance, so it would not create any more complexity or uncertainty. We envisage that the redistributional impact of any future resets would have to be phased in using some form of damping of tariffs and top-ups (see Q16), so there is no reason this could not apply on the introduction of the new system.

Consultation Question	Response
Q4: Which option for setting the fixed tariff and top up amounts do you prefer and why? *The options are to fix the cash amounts or to uplift them by RPI.*	Tariffs and top-ups should increase by RPI, both as a matter of logical principle, and to protect authorities with low rateable values.
Component 3: The incentive effect	
Q5: Do you agree that the incentive effect would work as described? *i.e. the incentive to promote economic growth*	The system would need to be reset periodically to reflect the overarching principle of fairness through equalisation of need / resources. However, this would make it too difficult and risky to enter into the large long term regeneration investment projects. At the same time, the risk, uncertainty, and complexity arising from the new system would add to the pressures being faced by authorities at a time of already reducing resources. This would increase the amount authorities would need to hold in reserves in mitigation, and other things being equal would reduce the amount available for spend on services – including regeneration activity.
Component 4: A levy recouping a share of disproportionate benefit	
Q6: Do you agree with our proposal for a levy on disproportionate benefit, and why?	Yes, to restrain such disproportionate benefit, and to generate resources to protect other authorities from losses.
Q7: Which option for calculating the levy do you prefer and why? *3 options are suggested: a flat rate for all authorities; banding of rates, or individual rates based on total baseline revenue. A flat rate would mean all authorities with rates growth paid a levy. Individual rates would mean only those with relatively high growth and/or a high base paid a levy, so that a 1% increase in business rates would give each authority the same % maximum increase in total funding. Banding would be a compromise between the two, but might cause issues for authorities near the “edges” of bands.*	Individual rates, so that each authority has an equal incentive to promote growth.
Q8: What preference do you have for the size of the levy?	In the interests of stability, the levy should be maximised to ensure adequate resources are available to protect authorities with large / unexpected losses in rateable value.

Consultation Question	Response
Q9: Do you agree with this approach to deliver the Renewable Energy commitment? *The proposal is to encourage renewable energy projects by excluding these from the levy.*	The incentive for renewable energy projects needs to be weighed against the reduction in support available for councils suffering disproportionate losses of business rates income.
Q10: Do you agree that the levy pot should fund a safety net to protect local authorities: i) whose funding falls by more than a fixed percentage compared with the previous year (protection from large year to year changes); or ii) whose funding falls by more than a fixed percentage below their baseline position (the rates income floor)?	Yes. The protection should also be guaranteed and ongoing (regardless of the amount available from the levy) so that all authorities can at least plan for a minimum level of funding.
Q11: What should be the balance between offering strong protections and strongly incentivising growth?	In the interests of stability and predictability, the balance should be strongly in favour of protection.
Q12: Which of the options for using any additional levy proceeds, above those required to fund the safety net, are you attracted to and why? *These are: provide ongoing support for ongoing losses; allocate to all authorities not paying the levy; support areas of low growth or target on specific projects.*	There should be ongoing support for ongoing losses as a matter of principle. No strong views on other options.
Q13: Are there any other ways you think we should consider using the levy proceeds?	No
Component 5: Adjusting for revaluation	
Q14: Do you agree with the proposal to readjust the tariff and top up of each authority at each revaluation to maintain the incentive to promote physical growth and manage volatility in budgets? *This would avoid windfall gains and losses from revaluation.*	Yes
Q15: Do you agree with this overall approach to managing transitional relief? *Transitional relief is the method protecting losers from revaluations by phasing in both gains and losses over a number of years. The proposal is to continue to manage the costs of transitional relief centrally, so there would be no impact on authorities.*	Yes

Consultation Question	Response
Component 6: Resetting the system	
Q16: Do you agree that the system should include the capacity to reset tariff and top up levels for changing levels of service need over time?	Yes, given the overarching principle of equalisation and fairness – though this would make it too difficult and risky to enter into large long term regeneration investment projects. This highlights the inherent tension in the proposed system. We presume that the redistributional impact of any reset would be phased in, to avoid instability and the additional risks this would create.
Q17: Should the timings of reset be fixed or subject to government decision?	Fixed in the interest of predictability.
Q18: If fixed, what timescale do you think is appropriate?	No strong view.
Q19: What are the advantages and disadvantages of both partial and full resets? Which do you prefer? *A partial reset would leave growth in business rates with authorities, so would effectively adjust only for need.*	In principle the system should be reset in full to maximise fairness through equalisation of need / resources.
Q20: Do you agree that we should retain flexibility on whether a reset involves a new basis for assessing need? *i.e. not necessarily a "formula grant" type basis*	Yes, the most appropriate basis for assessing need at the time should be used.
Component 7: Pooling *It is proposed that authorities should be able to voluntarily form a self-managed pool with a single tariff / top-up and levy.*	
Q21: Do you agree that pooling should be subject to the three criteria listed at paragraph 3.50 and why? *The criteria are: (i) voluntary; (ii) subject to assurances around governance and workability; (iii) if dissolved, members would revert to individual arrangements.*	Yes.
Q22: What assurances on workability and governance should be required?	There would as a minimum need to be a commitment for a number of years, and "rules" covering every foreseeable eventuality agreed at the outset.

Consultation Question	Response
Q23: How should pooling in two tier areas be managed? Should districts be permitted to form pools outside their county area subject to the consent of the county or should there be a fourth criterion stating that there should always be alignment?	Not applicable.
Q24: Should there be further incentives for groups of authorities forming pools and if so, what would form the most effective incentive?	No, as this would reduce resources available to other authorities and might encourage pooling where not appropriate or practical.
Impact on non-billing authorities	
Q25: Do you agree with these approaches to non-billing authorities? *The proposal includes the effective exclusion Police and Fire authorities from the impacts of the new system, pending a major review of their funding, to be implemented fro 2015/16.*	N/A
Chapter 4: Interactions with existing policies and commitments	
New Homes Bonus	
Q26: Do you agree this overall approach to funding the New Homes Bonus within the rates retention system? *The proposal is to effectively earmark the same level of resources for this scheme as would have been the case under the current system.*	Yes
Q27. What do you think the mechanism for refunding surplus funding to local government should be? *As a result of fixing tariffs and top-ups, more funding would be earmarked in the early years of the scheme than is actually needed. It is suggested that this might be proportionate to baseline funding.*	Proportionate to baseline funding would be the simplest approach, albeit a further complexity of the proposed system.

Consultation Question	Response
Business rates relief	
Q28: Do you agree that the current system of business rates reliefs should be maintained? *i.e mandatory and discretionary reliefs*	Yes
Chapter 5: Supporting local economic growth through new instruments	
Q29: Which approach to Tax Increment Financing do you prefer and why? *Option 1 is to have no special treatment. Option 2 is to "ring-fence" from the rest of the system, so would not be subject to the levy or re-setting, but this would require Govt. control to limit its impact.*	The uncertainty caused by resetting (see Q16) is such that authorities would only be able to undertake major long term projects with the security of Option 2.
Q30: Which approach do you consider will enable local authorities and developers to take maximum advantage of Tax Increment Financing?	As question 29.
Q31: Would the risks to revenues from the levy and reset in option 1 limit the appetite for authorities to securitise growth revenues?	Yes.
Q32: Do you agree that pooling could mitigate this risk?	No, as pools would still be subject to re-sets.
Q33: Do you agree that central government would need to limit the numbers of projects in option 2? How best might this work in practice?	Yes. Though not ideal, a fair bidding system would need to be implemented.