Report to the Finance, Performance and Resources Select Committee

Title:	Business Rates Retention - Change Implications
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Purpose of Agenda Item

This report is for information, and is intended to inform the committee of the current operation, and upcoming changes to Business Rates Retention. Business Rates is a key funding stream all local authorities. Within the report the place of Business Rates within the wider system of Local Government funding will be discussed, along with the risks and uncertainties relating to the future of Business Rates Retention.

Background

Business Rates are property-based tax paid on non-domestic properties. Properties are independently valued by the Valuation Office Agency (VOA) and Business Rates charged on this basis. Billing and collection of Business Rates is undertaken by District and Unitary Councils.

The current Local Government Business Rates Retention scheme was introduced in 2013-14, and forms part of the wider Local Government funding settlement. As such it is not practical to consider Business Rates Retention separately from the wider funding system within which the policy operates.

There are 3 key points to be aware of in relation to Business Rates Retention system;

- The total funding available to Local Government is set through Spending Reviews and allocated through the Local Government Settlement on the basis of ‘relative need’. Locally retained Business Rates are a part of this funding of ‘relative needs’;
- Baselines for local shares of Business Rates were set when the system was introduced, and have not been revised since. This allows some local growth to be retained locally;
- The whole system of funding Local Government is under review, including Business Rates and new methodologies will directly impact the level of funding received by Local Authorities through various funding streams, including Business Rates.

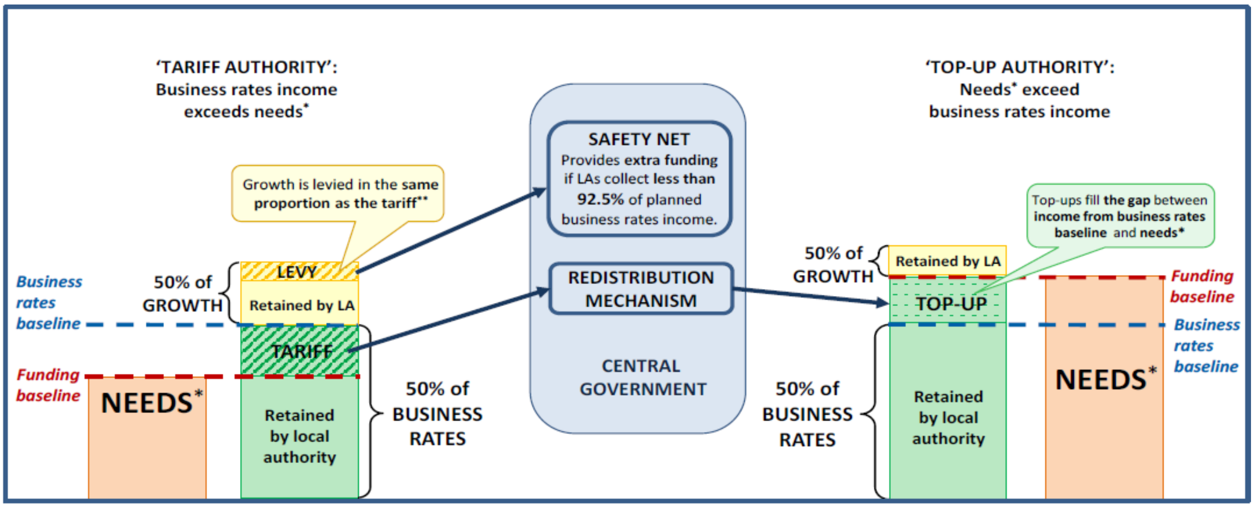
<u>The current Business Rates Retention system</u>

At the point of implementation a ‘Business Rates baseline’ was calculated for each authority based on actual 2011/12 and 2012/13 Business Rate receipts. Of this baseline value 50% was returned to Central Government, and the other 50% was split between District and County Councils and the Fire and Rescue Service, with 40% retained by Districts**, 9% by County Councils** and 1% by Fire and Rescue. This split was used to calculate the ‘Business Rates Baseline’ for all authorities.

In 2013/14 an initial ‘Settlement Funding Allocation’ was calculated for each Local Authority based on the ‘relative need’ formula calculations at that time. This mechanism distributes the quantum of funding agreed in Comprehensive Spending Reviews on the basis of ‘relative need’, and will only provide full funding for the levels of need calculated if the amount agreed in the Spending Review is sufficient for this purpose. This ‘Settlement Funding Allocation’ was funded by both ‘Revenue Support Grant’ (RSG) and locally Retained Business Rates.

The proportion of the ‘Settlement Funding Allocation’ funded by Business Rates is known as the ‘baseline funding level’. If the ‘Business Rates Baseline’ (the authorities share of the baseline Business Rates receipts) is greater than the ‘baseline funding level’ (the funding requirement from Business Rates) an authority has to pay a ‘tariff’ to Central Government to reduce receipts retained to the level of the ‘baseline funding level’. Where the ‘Business Rates Baseline’ is less than the ‘baseline funding level’ the Government pays a ‘Top-up Grant’ to the authority to ensure funding is received to the value of the ‘baseline funding level’.

The diagram below shows the operation of Business Rates Retention for both ‘tariff’ and ‘top-up’ authorities, and the interaction with Central Government;



<u>Risk and reward within the Business Rates Retention system</u>

Business Rates income is not a fixed annual amount. As businesses move between areas, expand, build new properties, convert existing properties to business usage, or potentially fail and leave empty properties the amount of Business Rates billed and collected locally will change. The scheme was designed to both incentivise Business Rates Growth and protect against significant losses in Business Rates income.

Local Authorities can retain up to 50% of 'additional revenue' generated through growth, with the balance paid to Central Government in the form of a 'levy' payment. Tariff authorities are subject to a levy on their share of growth, which is in proportion to their tariff, whilst top-up authorities are not subject to a levy on retained growth. The receipts from these levies on growth are then used to fund a 'safety net' for any authorities whose Business Rates receipts fall below 92.5% of their 'baseline funding level'.

As part of the Local Government Settlement 'baseline funding levels' and Business Rates payable are increased by the Retail Prices Index (RPI) each year. In 2020-21 this inflation uplift will change to the Consumer Prices Index (CPI).

In order to recognise that not all business properties can easily be identified to a single billing authority there are both 'local lists', which contain all the business properties easily identifiable to a particular billing authority, and a 'central list' which includes geographically distributed properties and assets (often, but not exclusively, networks covering a significant geography such as Electricity distribution networks, telecoms infrastructure, large pipelines etc.). Business Rates from this 'central list' are billed and the income retained by Central Government.

It should be noted that risk profiles for authorities differ on the basis of the make-up of the businesses operating within their boundaries. In authorities where there are a small number of very significant business, which might reflect more than 10% of Business Rates receipts, the failure or relocation of one such business could trigger the safety net in its own right. For authorities without such sizeable rate payers this risk is far lower, and would require significant economic events to receipts sufficiently to trigger the safety net.

<u>Business Rate pools</u>

Business Rate pools are a mechanism which allow the pooling of risk and reward across geographies. By creating a pool, a number of authorities can essentially be treated as a single authority for the purposes of Tariffs, top-ups and levies. In practice pools have largely been used to maximise the local retention of growth, where a number of authorities subject to levies on growth pool with a top-up authority to reduce the levy rate.

In Buckinghamshire there has been a pool in recent years between the County Council, the Fire and Rescue Service, Aylesbury Vale, Chiltern and South Bucks District Councils, with the County Council being the most significant top-up authority. The combined effect of this pool was to reduce the levy rate on growth on District Council shares from 50% to 8%. This resulted in a reduction in levies paid to Central Government across the pool, and this gain was shared on an agreed basis across the participants in the pool.

<u>The future of Business Rates retention in Local Government</u>

In 2015 it was announced that Local Government would collectively retain 100% of business rates by the end of the parliament. This would include the removal of Revenue Support Grant and Public health Grant, and their inclusion in the Business Rates Retention scheme. This further retention of Business Rates would not be additional resource to Local Government, rather there would be additional responsibilities transferred to Local Government which would match the additional funding available from the additional locally retained Business Rates.

Following this it was announced in February 2016 that a ‘Fair Funding Review’ would be undertaken to revise the mechanism through which ‘relative need’, and hence future ‘baseline funding levels’ are calculated.

In the Local Government Finance Settlement 2018/19 it was announced that the government aimed to implement ‘at least 75%’ Business Rates Retention by 2020-21, a year later than originally planned. Fundamental to this remained the transfer of other grants, including Revenue Support Grant, and additional responsibilities, which would be funded by the additional retained Business Rates.

There has been much debate as to which responsibilities are best suited to funding from Business Rates, as it would be perverse for any responsibility where demand increased in times of economic downturn to be funded from an income source which reduced at such times. At present it appears that finding appropriate responsibilities to be funded from Business rates is the most significant reason why ambitions have been scaled back from 100% retention to 75%. It is suggested that transferring Revenue Support Grant into Business Rates Retention almost achieves 75% in its own right.

There are currently a number of ongoing trials of both 75% and 100% Business Rate retention. The outcomes of these trials are being used to inform the design of the future Business Rates Retention system.

One of the design principles of the initial scheme, which has been retained under the proposals being developed for 75% Business Rates Retention is that there will be a full reset of baselines in 2020-21. The mechanism for this is currently under discussion and consultation across the sector. However it is likely that a full reset this will see all growth retained to date removed from individual authorities and redistributed on the basis of ‘relative need’ when revised baselines are set.

The mechanism for calculating Business Rate growth is complex, as growth could be significant but then be reduced by factors beyond the authority’s control, such as revaluations or the loss of significant businesses. Options are currently being explored to ensure that growth is suitably calculated and rewarded.

Additionally there are discussions as to how resets should work in future, with full and partial reset being considered. The challenge with full resets is that there is an incentive to deliver growth just after a reset as it will be retained for the maximum time until the next reset. There is little incentive to deliver growth in the year preceding a reset as only one year benefit will be retained.

Partial resets are under consideration, which would see some growth retained beyond a reset. These partially address the issues of there being more and less advantageous times for growth, but do not fully recycle national levels of growth into the funding system.

The period of these resets is also a matter for discussion and agreement. The more frequent they are the less growth will be retained before it is redistributed through a reset. Alternatively the longer the period between resets the greater the divergence between real need, assessed ‘relative need’ and retained business rates. As such if an authority experiences a greater growth in demand than in Retained Business Rates it could be left unable to fund essential services to its residents for a significant period, and then experience a sudden jump in funding at the reset when ‘relative need’ and ‘baseline funding’ are realigned.

In addition there are some authorities, who by their very nature have significantly more opportunity to grow business rates than others. For example, the City of London is inherently attractive to businesses for its international profile, whilst rural Cornwall has a different appeal, and different infrastructure challenges in attracting businesses. We do not believe that Buckinghamshire is an outlier in this sense, however local opportunities and challenges need to be fully understood

As part of the proposed change, the splits between tiers of local government are under review. Currently upper tier authorities (without Fire) retain 9% of the total growth in business rates, whilst District Councils retain 40%. With the transfer of additional responsibilities, the understanding gathered through 6 years of operating the current policy, and the output of the various Rate Retention trials a new split is being sought. Counties have long argued that growth in local businesses places additional burdens on the infrastructure they are responsible for providing, and that the current splits do not reflect this new burden. Since the new Buckinghamshire Unitary Council will be in place when this reform comes into operation tier splits will no longer be a relevant concern.

As an authority we are actively engaged with discussions and developments of the new methodologies. We have represented our views through our MP’s, in our own responses to Government consultations and through representative group such as the Society of County Treasurers and the LGA. We share similar concerns to our other County Colleagues, especially with the relationship between demand growth in statutory services and the potential for growth in Business Rates receipts. We will continue to be engaged in this process to deliver the best outcomes for Buckinghamshire are fully represented.

The Business Rates Retention position for Buckinghamshire

The initial calculation of Business rates to be retained within the County of Buckinghamshire saw both the County Council and Bucks Fire and Rescue falling into the category of ‘top-up’ authorities, and all District Councils falling into the category of ‘tariff’ authorities. The table below shows each authorities ‘Business Rates baseline’ and the value of Tariff / top-up at the inception of the scheme.

Authority	Business Rates Baseline £m's	(Tariff) / Top-up £m's
Buckinghamshire	14.644	24.237
Aylesbury Vale	18.901	-15.422
Chiltern	7.908	-6.603
South Bucks	11.477	-10.511
Wycombe	26.799	-23.875
Buckinghamshire Fire	2.999	1.496
TOTAL	**82.728**	**-30.678**

Overall £56.4m of the 50% of Business Rates from the Buckinghamshire ‘local share’ were returned to Central Government through ‘tariffs’ on the District Councils, and £25.7m of this was then returned through ‘top-up grants’ to the County Council and the Fire and Rescue Service, resulting in a net £30.7m of the 50% local share returning to Central Government as part of the design of the system.

Over the period since the implementation of the current Business Rates Retention model there has be some growth in Business Rates in Buckinghamshire. The pooling arrangements discussed above were implemented in 2017/18 and 2018/19, and have delivered additional retained growth of approximately £500kfor the County Council in each of these years through the reduction of levies on growth for the ‘tariff’ authorities.

In 2019-20 all authorities in Buckinghamshire are piloting 75% Business Rates Retention. As previously stated this gives a modelled financial benefit of approximately £7.0m in 2019-20, shared across the councils involved. This benefit is being used to ensure sustainability and to support future economic growth. As it is only a one-off benefit it is difficult to make significant impact in supporting service sustainability given the ongoing service demand and cost pressures experienced across Social Care services. A significant proportion of the County Council gain is being put into a specific reserve to cover Unitary transitional costs.

Looking forward, there will be a new Unitary authority for Buckinghamshire in 2020, therefore there will be no tier split under the new arrangements. This will simplify the system locally and mean that all growth is retained by the new authority, and decisions on the use of any gains will be made at a county-wide level. However this simplification will not increase the financial benefit beyond that already delivered through pooling, and will not provide any mitigation of the risks described below.

Risks and uncertainties

As identified above, there are a number of significant uncertainties around the whole of the Local Government funding system, and to focus on Business Rates alone would underplay some of the larger risks in this arena.

Focussing solely on Business Rates Retention, there will be a benefit from an increased level of local growth being retained locally; however there are risks in relation to likely future growth levels. The biggest current risk is the reset of baselines, which will see accumulated growth returned and redistributed through the top-up and tariff mechanism. This is due to be implemented in 2020. The new mechanism of rewarding growth has yet to be defined, however there are concerns that this mechanism may be retrospective, and see receipt of the benefit of growth delayed by 1 or potentially 2 years. Added to this is uncertainty regarding the periods between baseline resets. Longer periods mean that locally generated growth is retained for longer, but shorted means that those authorities whose growth has been shower than their increase in need will have to wait longer for this to be rebalanced.

Allied to this is the likelihood of growth given current economic factors. Primary within this are the impacts of Brexit, which could see an economic slowdown, and significantly lower business growth levels, reduced inward investment, or even a reduction in Business Rates receipts, which may trigger the safety net for some authorities.

Additionally we are currently witnessing a national slow-down on the High Street, and a move to more online businesses. These online businesses often have small or no business premises, and hence do not pay Business Rates. This shift presents a risk to future growth levels in Business Rates. This is especially pertinent at a time when both local and national investment in Broadband is making it easier for online businesses to operate from any location.

Proposals for a safety net under the revised Business Rates retention systems are under development, so this risk will be mitigated to some extent, however reductions to resources at a time when need is increasing may require difficult decisions to be made.

Considering the wider funding system in which Business Rates Retention sits, there are significant uncertainties which will come into effect from April 2020, namely;

- The Spending Review 2019, which will define the total resource level available for distribution through the relative needs formula, and which will then impact on tariffs and top-ups;
- The Fair Funding Review, which will redefine and recalculate the assessment of ‘relative need’ for all authorities in England, and will also impact on tariff and top-ups;

- Any transitional arrangements to mitigate shocks to the funding system are currently unclear. Whilst our financial planning assumptions are prudent, there may be material variances to our estimates;
- Timelines for publication of the results of these reviews are very tight, and we may not know what our future funding levels are until late in our Medium Term Financial Planning process, potentially resulting in urgent and difficult decisions being required. This does not support proper and robust planning, or a longer-term strategic view in the decision-making process;
- The future of Social Care, our largest and most risky areas of expenditure, is also unclear. The Government has recognised these pressures in recent years, with the Adult Social Care Precept, the Better Care Fund and a number of other one-off grants to support these growing expenditure areas. However the futures of these are uncertain beyond 2020, and the funding for Social Care pressures through the updated relative needs calculation will change as a result of the Fair Funding review.
- The Green Paper on Social Care continues to be delayed. This may redefine how and what Social care is to be delivered, and impact both on level of relative need and the allocation of funding across authorities providing Social Care.

Summary

Whilst the opportunity to retain more growth in Business Rates is appreciated by the authority, this in its own right is not a mechanism to address the significant service demand and cost pressures which we are currently experiencing.

There remains significant risk in delivering Business Rate growth in the future. These are risks which are largely beyond our control as they reflect national and global economic trends and decisions.

Whilst there is risk in changes to Business Rates Retention, there is also reward in the form of greater local retention of Business Rate growth.

However, on balance the risk associated with the wider changes to Local Government funding from the Fair Funding review, the Comprehensive Spending Review and developments in Social Care policy present by far the bigger risk to Local Government funding.

Key issues

The key issues identified within this report are as follows;

- More Business Rates will be retained locally by Local Government, however this will be balanced by additional responsibilities, so does not reflect additional funding for current pressures;
- A higher proportion of Business Rates growth will be retained locally after the system is reformed;
- There is a risk that wider economic impacts will reduce the levels of Business Rates growth in the short to medium-term;
- Changes to the wider Local Government funding system may impact negatively on the level of Business Rates retained locally;
- The current level of uncertainty with regards funding beyond 2019-20 may have already hampered investment to support growth and resulted in sub-optimal decision-making;

Resource implications

This topic is fundamentally about the financial resources available to the authority, and the new Buckinghamshire Council which will be formed as the new system comes into force. At present we are actively engaged in monitoring the proposals as they develop, and in responding with our concerns, observations and comments to Government consultations as they are published.

The changes to the system will need to be understood and quantified, however this will be considered as part of the Medium Term Financial Strategy.

Next steps

As this report reflects developments in Central Government policy there are no decisions to be made by the County Council.

Our next steps consist of continued monitoring of developments in this area, lobbying through MP's and sector representative groups, and responding to Government consultations relating to the above matters.

In creating a Medium Term Financial Plan beyond 2020 we will review the best evidence available at the time and make estimates of the impact of the changes relating to Business Rates Retention and on our overall funding levels and inform decision-makers accordingly.