REPORT TO:	Corporate Policy & Performance Board
DATE:	3rd January 2012
REPORTING OFFICER:	Operational Director – Finance
PORTFOLIO:	Resources
SUBJECT:	Local Government Resource Review Proposals for Business Rates Retention
WARD(S):	Borough-wide

1.0 PURPOSE OF REPORT

1.1 To inform the Board of the Government's proposals for Business Rates Retention as part of the Local Government Resources Review and the potential financial implications for the Council.

2.0 RECOMMENDED: That

(1) the report and potential financial implications for the Council, be noted; and

(2) the Board be kept up to date with developments.

3.0 BACKGROUND

3.1 The Government's Local Government Resource Review will make fundamental changes to the funding of local government and will have a significant impact upon the future resources available to the Council.

3.2 The Government undertook a consultation which ended on 24th October 2011 in relation to the proposals for Business Rates Retention as part of the Resource Review. Halton's response to the consultation was approved by Executive Board on 13th October 2011 and Halton also contributed to a joint response by the Liverpool City Region.

3.3 Eight technical papers were published as part of the consultation, providing further details of the proposals. The consultation also sets out how Tax Increment Financing (TIF) and the New Homes Bonus might work within the proposed Business Rates Retention system.

3.4 In 2011/12 business rates contributed 76% of the total national Formula Grant provided to Council's, with the balance met by Revenue Support Grant. Business rates are currently collected by councils and paid over into a national pool from which they are re-distributed as part of formula grant on a per capita basis. The Government's proposals are that from 2013/14 formula grant will be fully funded from business rates with the removal of revenue support grant.

4.0 PROPOSALS FOR THE RETENTION OF BUSINESS RATES

4.1 The consultation does not propose any changes to the current business rates payment mechanism ie. rateable values will continue to be set by the Valuation Office Agency and the rate in the pound will still be set by Government. Therefore the charges levied for business rates will continue to remain outside the Council's control and will not be localised.

4.2 The changes proposed by the Government relate instead to the "re-distribution" of business rates. The proposals are a fundamental change to the funding of local government. There was a risk that business rates could be fully localised, which would have had a major impact upon Halton's future funding. However, the Government has acknowledged that this would have brought too much volatility in the funding of local government services, and instead has proposed a system with effect from 1st April 2013 whereby councils will retain additional revenues from business rates above a Government-determined baseline.

4.3 The new re-distribution system will be based upon "tariffs" and "top-ups" to ensure no council is better or worse off from the start. Halton, along with all the Liverpool City Region councils, is a net receiver under the current national pool arrangements. In 2010/11 Halton received £64m of formula grant. This comprised £8m of revenue support grant and £56m of re-distributed business rates. However, Halton only paid over £44m into the national business rates pool relating to the business rates collected in the Borough.

4.4 Therefore, under the proposals Halton would receive a top-up grant in addition to the business rates collected locally. This is intended to ensure councils are protected at 2012/13 funding levels. Going forward, the system will operate on a "risk and reward" basis whereby councils will be allowed to retain growth in business rates (reward), but will also lose resources if business rates decline (risk).

4.5 The Government's stated aim for the changes is to incentivise councils to encourage economic growth and regeneration in their areas as they will in future benefit from increases in local business rate yields. The change to the system should not affect businesses as the mechanics of the current system will remain unchanged.

4.6 There are further implications as to how this new system will work within the Localism Bill currently before Parliament. In the Bill, there are local freedoms to offer business rate discounts and reliefs. The potential impact of this is that wealthier councils will be able to offer discounts/incentives to businesses to relocate from poorer tax base councils who cannot afford to offer such discounts.

5.0 POTENTIAL IMPLICATIONS FOR HALTON

5.1 There are a number of key issues and financial risks for Halton associated with the proposed changes, as follows;

(i) the basis used by the Government to determine the baseline position and how much top-up grant is likely to be received, are critical;

(ii) how the baseline and top-up grants are likely to change in future years, as this may result in the value of Halton's resource base diminishing over time compared to the increasing cost of providing services, resulting in either an increase in council tax or reduction in services;

(iii) if total business rates income exceeds the Comprehensive Spending Review national control totals then the excess income will be used by government to fund other grants, whereas under the current system all business rates must be re-distributed to councils;

(iv) if business rates income reduces in future there is a danger that the safety net mechanism may be insufficient to compensate councils.

5.2 There are seven components of the consultation which are outlined in Appendix 1, along with an indication of the potential implications for Halton within each component.

6.0 POLICY AND OTHER IMPLICATIONS

6.1 None.

7.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

7.1 There are no direct implications, however, the Local Government Resource Review will have a fundamental impact upon the Council's future funding and therefore upon the delivery and achievement of all the Council's priorities.

8.0 RISK ANALYSIS

8.1 The impact upon the Council's future funding is difficult to ascertain with any certainty at this stage. The Council is however drawing upon technical support and briefings provided by Sigoma, Local Government Association, and other bodies as well as liaising closely with colleagues in the Liverpool City Region, in order to establish the best options for Halton within each area of the Government's consultation.

9.0 EQUALITY AND DIVERSITY ISSUES

9.1 None.

10.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1072

Document	Place of Inspection	Contact Officer
Local Government Resource Review: Proposals for Business Rates Retention Consultation	Financial Management Division Kingsway House Widnes	Ed Dawson Divisional Manager Financial Management
Technical Papers 1-8 • Establishing the Baseline • Measuring Business Rates • Non-billing Authorities • Business Rates Administration • Tariff, Top-Up and Levy Options • Volatility • Revaluation and Transition • Renewable Energy	Financial Management Division Kingsway House Widnes	Ed Dawson Divisional Manager Financial Management

APPENDIX 1

COMPONENTS OF THE BUSINESS RATES CONSULTATION

There are seven components of the Business Rate consultation and a summary of each is provided below along with an indication of the potential implications and consultation response for Halton.

1. SETTING THE BASELINE

Funding Baseline

The consultation proposed the establishment of a fair starting point for all councils to ensure that no-one loses out at the outset of the scheme.

It would appear that the 2012/13 funding levels for councils will be considered as the base on which to implement the review. Such a base position will still lock-in significant business rates for Halton funded through the national pool arrangements, which would in future be classed as a "top-up" grant.

The Government proposed two options for setting the funding baseline;

- Option 1: adjust actual 2012/13 formula grant allocations in proportion to the sum of local government control totals as per the Comprehensive Spending Review (CSR) 2010.

- Option 2: apply the 2012/13 formula grant process to the sum of local government control totals as per CSR 2010 and at the same time make technical updates to the formula.

Halton favours option 1, as it would provide stability and simplicity at such a volatile period in terms of council funding. If option two was applied there would be a greater risk that the baseline may reduce resulting in less funding being made available to Halton.

For either option Government will need to decide whether to use 2012/13 formula grant before or after floor damping. Floor damping is a self-funding mechanism within formula grant which protects councils' year-on-year funding from dropping below a certain percentage. The 2012/13 indicative formula grant allocations show that Halton is protected by £2.649m of damping, which represents 4.3% of the formula grant allocation.

It is essential that the baseline should be based on the damped allocation of 2012/13 formula grant. The removal of damping will be costly to Halton; it would also go against the proposal to establish a fair starting point meaning that floor authorities would be at a disadvantage at the commencement of the scheme.

Business Rate Baseline

It is very important that Government measures fairly the business rates starting position, as the suggestion in the consultation was that it will be fixed for many years (possibly ten years). A council's business rates baseline will be set in proportion to the national business rates baseline. In order to calculate the national business rates baseline Government will forecast 2013/14 and 2014/15 national business rates based on the actual national non-domestic multiplier for 2013/14 and an estimated multiplier for 2014/15.

The consultation explained that, to avoid putting its deficit reduction programme at risk, the Government will set-aside from the forecast national business rates the sum needed to ensure that the business rates retention scheme operates within the expenditure control totals for 2013/14 and 2014/15. Further adjustments will be made to remove sums to fund the future cost of the New Homes Bonus Scheme, police authorities and, possibly, single purpose fire and rescue authorities to arrive at the national business rates baseline.

In order to arrive at an individual council's baseline figure the national baseline will be apportioned between billing authorities on the basis of proportionate shares. Proportionate shares will be calculated as an individual council's business rates income expressed as a percentage of the aggregate of all billing authorities business rates income. There are two options for measuring individual business rates;

- Option 1: using a spot assessment based on one particular day, or;
- Option 2: an average of a council's business rates income over two or three years.

Halton has argued that the proportionate share should be calculated as an average over three years, as this will smooth out any shocks in business rates yield felt by any individual council. An average should produce a lower proportionate share for Halton, whilst a spot assessment would increase the proportionate share. This is due to Halton's business rate contribution to the national pool growing gradually over the past three years.

2. TARIFFS AND TOP-UP GRANTS

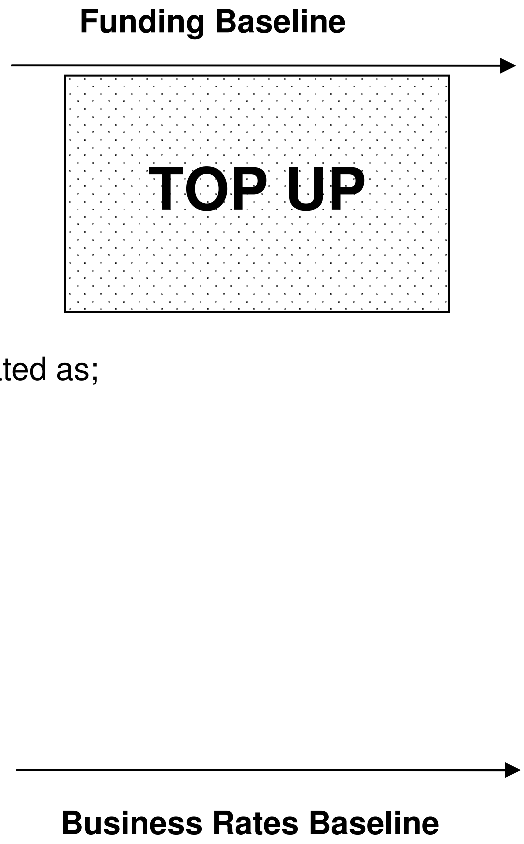
Setting Tariffs and Top-Up Grants

In order to achieve a fair starting position the Government would calculate a tariff or top-up grant amount for each council. The general rules would be;

- Those councils with a business rates baseline in excess of their baseline level of funding would pay a tariff to Government;

- Those councils with a business rates baseline below their funding baseline would receive a top-up grant from Government.

The tariff and top-up grants would be self-financing and remain fixed year-on-year until a reset was undertaken. Halton will be a top-up grant council. The top-up grant can be illustrated as;



The Council's consultation response was centred upon ensuring the top-up grant amount for Halton is as large as possible. In order to do this the Council would need a high funding baseline and low business rates baseline. Removing damping and calculating the business rates baseline with technical changes, will have the effect of lowering the funding baseline. Calculating the business rates baseline using a future spot assessment will increase the business rates baseline

<u>Fixing Tariffs and Top Ups</u>

Whilst the Government would fix both the tariff and top-up grants until any reset is undertaken, there are two options in the consultation to either;

- Uprate the year-one tariff and top-up grant amounts by the Retail Price Index (RPI) each year, to reflect the annual RPI increase in the nationally set business rates multiplier, or;

- Retain the year-one cash amounts and do not uprate them by RPI.

It is crucial to Halton that top-up grants are increased by RPI year-on-year. The approach to fixing tariff and top ups in cash terms would place the top-up grant councils in a much weaker position than the tariff councils. Tariff councils would gain in an RPI increase to business rates income whilst the tariff that is apportioned amongst top-up grant councils would not be increased. Government state that they want a fair starting point for all councils, but that position starts to erode in year 2 if tariff councils gain from an increase to RPI and top-up grant councils do not.

Based on a forecast of the top-up grant that Halton would receive at the commencement of business rates retention scheme, it is estimated that Halton could lose £1.9m in the first three years of the scheme if RPI is not applied to both tariff and top-up grants. The result of this loss of funding would add 1.4% per annum to council tax to continue funding the cost of services at existing levels.

3. THE INCENTIVE EFFECT

The consultation stated “This incentive effect is at the heart of the changes that business rates retention is aiming to deliver – shifting from the allocation of local government funding solely on the basis of a central government assessment of need and resources to future increases in funding being on the basis of local economic growth.”

Halton maintains that protection should be evident in any funding system which ensures that councils have the funding available to keep pace with the cost they incur in providing services. Incentivising growth cannot be seen as a priority over protecting local needs.

Halton argues that the incentive effect will not work as described, as it does not take into account the advantage some councils have of increasing their business rate base due to their geographical location. Whereas there are councils who would need to invest additional resources to see the same growth, if any at all.

A council can keep a significant proportion of the additional business rates it generates, but it must also work hard to retain the businesses it has, as any loss of business rates will directly affect the revenues of the council. Furthermore, councils will be liable for failure to bill and collect business rates, therefore, a poor collection rate will result in a potential debt liability to the council.

4. A LEVY RECOUPING A SHARE OF DISPROPORTIONATE BENEFIT

To manage the possibility that some councils with high business rate taxbases could see disproportionate financial gains, Government would recoup a share of disproportionate benefit through a levy. The proceeds would be used to fund a "safety net" which would manage significant negative volatility in individual councils' business rates and so ensure stability in the system.

Halton agrees with the introduction of a levy on disproportionate benefit. If councils are to be funded wholly by business rates then there needs to be adequate resources to fund councils facing reductions to their income.

The way in which the levy is designed can have a positive impact upon moderating a "gearing effect" caused by the uneven distribution of business rate bases and the different spending needs of councils. As an example, in a council with a business rates base of £100m and a total budget requirement of £50m, a 5% increase in business rates income will result in a 10% increase in revenue. For another, with a different business rates base (£10m) and the same budget requirement (£50m), the same 5% increase in business rates income would only produce a 1% increase in revenue.

There are three proposed options as to how a levy could be calculated, which are summarised below;

- Option 1: Flat Rate Levy - levy based on pence in the pound with the same rate for all councils.

The flat rate levy is opposed by Halton as it takes a too simplistic approach. The disadvantage is that it does not deal with the gearing effect described above and would therefore result in councils with a high tax base and low need benefiting more from the same levels of growth than councils with a low taxbase and high need.

- Option 2: Banded Levy - levy based on pence in the pound but introduce a "banding approach".

This would assign councils into different bands, with different levy rates depending on their levels of gearing. Councils with higher gearing levels would hand over a greater percentage of their retained income to fund the safety net. The disadvantage with this option is that it could develop into a complicated system with many bands which will always have 'cliff edges', with some councils falling just above or below a band boundary.

- Option 3: Proportional Levy - an individual levy rate for each council to allow the retention of growth in an equivalent proportion to its baseline revenue. For example a 1% growth in business rates income would allow councils to retain up to 1% growth in their baseline funding. There is flexibility in the option as the ratio could be altered with a 1% growth in business rates income resulting in councils retaining up to 0.5% or 2% growth in their baseline funding.

Halton favours the proportional levy rate as opposed to options 1 and 2. We have asked for a smaller levy ratio to be applied so that it protects the growth in business rates for top-up grant councils, whilst also creating a larger levy pot to protect against future volatility in the system. It would help the gearing effect and offer a more equal incentive for all authorities. The optimum levy ratio for Halton which would protect future growth whilst also ensuring a large levy pot would be 1% growth in business rates income resulting in a 0.75% increase in baseline funding.

It is important that the Government recognise the gearing effect where large tax base councils can gain significant resources compared to low tax base councils such as Halton, for the same increase in business rates base.

The proceeds of the levy will be used to fund councils (by way of a safety net) suffering from volatile changes i.e. losses in tax base. It should be noted that renewable energy projects are proposed to be excluded from any levy calculations.

Halton has called for the safety net to protect councils whose funding falls from one year to the next and also if their funding was to drop below their baseline position regardless of the percentage drop. Halton also argues for the safety net to provide an absolute guarantee of support rather than financial assistance being scaled back if there is insufficient funding in the levy pot. We would not want inconsistencies in the system from one year to the next due to the lack of funding in the levy pot. There needs to be fairness and equality throughout the system.

5. ADJUSTING FOR REVALUATION

It is important that financial gains or losses as a result of revaluation are removed from the system. Revaluations will continue every five years by the Valuation Office Agency and a scheme of transitional relief would remain.

It is proposed that the tariff or top-up grant of each council is adjusted at revaluation, so that the sum of each council's retained business rates and tariff or top-up adjustment is the same after revaluation as immediately before.

Having made adjustments to tariffs and top-ups to protect against the impact of revaluation the consultation proposes that there will be no further adjustments to reflect subsequent appeals against the rating list. The proposal is that the impact of any appeals will be treated as part of the normal volatility of the system.

Halton has disagreed with the proposed treatment of appeals against the rating list. It is unfair that the system will protect councils at only the first stage of the revaluation process. Councils will be at risk of genuine growth in business rate income being diluted by downward revaluation appeals.

6. RESETTING THE SYSTEM

The Government would have the option of resetting the system if it was felt that resources no longer met changing service pressures sufficiently within individual council areas.

The Government is considering that a reset would be in many years time (10 years), and that any reset may only be partial (linked to original baseline), and may not consider needs. This is a major concern for Halton and the Liverpool City Region as councils could be tied into assessed relative need resources at 2012/13 levels for more than 10 years, and the gap between resources and relative needs will grow.
Therefore, a system of full resets on a more regular resetting would be more appropriate and should be aligned to multi-year local government finance settlements, comprehensive spending reviews or revaluations of the rating system.

7. POOLING

A group of councils, such as the Liverpool City Region, can voluntarily form a "pool" to share the risk and rewards. This option has some merits in that it reduces the financial risk of localised business losses for individual councils and allows a sub-regional strategic assessment of where businesses are best located rather than financially motivated competition. However, it must be recognised that this approach does reduce the financial reward for the best performing councils in any pool, as the rewards (like the risks) are shared.