CABINET	Agenda Item 94 Brighton & Hove City Council

Subject:		**Local Government Resource Review: Proposals for Business Rates Retention and Government Consultation Paper**	
Date of Meeting:		**13 October 2011**	
Report of:		**Director of Finance**	
Lead Cabinet Member:		**Cabinet Member for Finance & Central Services**	
Contact Officer:	**Name:**	**Mark Ireland**	**Tel: 29-1240**
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Key Decision:	**Yes**	**Forward Plan No: CAB 23935**	
Ward(s) affected:		**All**	

FOR GENERAL RELEASE

1. SUMMARY AND POLICY CONTEXT:

1.1 The Department for Communities & Local Government (CLG) published in July a consultation paper setting out proposals for local authorities to retain locally collected business rates and provide financial incentives for authorities to improve their local economy. The deadline for responding to the consultation paper is 24 October 2011. In late August a further 8 technical consultation papers were published covering detailed aspects of how the new system of local authority funding might operate.

1.2 This report sets out the main proposals covered in the consultation paper and the key technical issues for the council. The proposals make fundamental changes to the future funding of all local authorities and to the risks to resource levels faced by each authority from 1 April 2013. For Brighton & Hove the proposals have significant implications for about £100m per annum future funding. The consultation paper and associated technical papers pose 96 separate questions many of a purely technical nature and there is not time to go through each question in detail. Cabinet are therefore asked to agree that a technical response to the consultation is prepared by the Director of Finance based on the key issues identified in the body of this report.

1.3 In summary it is considered that the proposals should be opposed in principle by the council for the following reasons:

- they transfer too much financial risk to Brighton & Hove City Council relative to the levers available at a local level to influence business rates growth;
- the likelihood of Brighton & Hove not exceeding national growth targets is high meaning that the council will lose further funding under this scheme and have to reduce spending as a result;
- the scheme is complex to understand and financial planning will be difficult given uncertainty over a number of key variables within in the system (for example levels of inflation, growth forecasts and the scope for Ministerial discretion);

- Brighton & Hove City Council would need to increase the levels of reserves held to cope with the level of risk being transferred and the financial planning uncertainties;
- there is the potential for significant adverse consequences from the behaviours that this will drive for individual local authorities.

1.4 It is recognised that CLG is highly likely to proceed with these reforms and therefore as well as providing an overarching response the council will make specific representations on key elements of the proposals to ensure that if implemented, the council has attempted to safeguard its financial position as much as possible.

2. RECOMMENDATIONS:

2.1 That Cabinet notes the proposals set out in the consultation paper and the potential implications for the council as known at this time.

2.2 That Cabinet agrees that the Director of Finance responds to the consultation document opposing the proposals in principle and providing technical responses to the questions raised in the consultation paper based on the key issues set out in paragraphs 3.10, 3.12, 3.15, 3.17, 3.19, 3.21, 3.23 and 3.24 in the body of the report.

3. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

3.1 The last fundamental change to local government finance occurred on the 1 April 1993 when the council tax system was introduced. Since that time many changes have been made to the way Government revenue support grants are calculated and distributed between local authorities. Currently the council receives £112m Formula Grant to help fund General Fund services in 2011/12 but this is forecast to reduce to £87m by 2014/15 based on the Spending Review undertaken by the Government last year. The council is forecast to receive £11m funding protection from the adverse changes to the way in which grant has been calculated in recent years through floor damping grant in 2012/13. In 2012/13 floor damping grant is due to be received by 49 councils with education and social care responsibilities and will be paid for by the other councils with the same responsibilities. What happens to floor damping grant in the new system will be of critical importance to the council.

3.2 Currently, councils in England collect some £19 billion of business rates each year. This cash is paid over to the national Treasury and redistributed to councils according to a complex formula. There is absolutely no link between the amount of business rates collected locally and the amount received locally through the formula. The Government is determined to repatriate business rates so local councils can share in the benefit of a growing local economy and are incentivised to support local growth. However they will only be able to keep a share of additional income over and above nationally set growth targets which are not yet specified. Business rate income is much more volatile than council tax income and can be strongly influenced by national and international economic conditions. This means that councils also take the risk of business rate income falling below the nationally set growth targets which would result in less funding and less money available to spend on local services. There will be new safety net mechanisms and councils will be allowed to spread the volatility risk by pooling with other local authorities should they wish to do so.

3.3 The Government does not propose to allow local councils to generate additional resources by increasing the business rate poundage beyond inflation. However, councils will be given powers to set a lower rate if they can afford to do so. The setting of individual business rateable values and the determination of appeals is undertaken by the Valuation Office (VO) and is completely outside the control of local councils. The business rates paid by an individual business are calculated by multiplying the property's rateable value by the national uniform rate poundage set by the Government. Legislation restricts the maximum annual increase to inflation as measured by the retail price index (RPI). For small businesses the rate poundage is set at a lower level. Not all businesses pay the full business rate as they can qualify for rate reliefs such as charities who receive 80% mandatory relief. The VO carry out a national revaluation every 5 years and the next revaluation is in 2015. Transitional arrangements are put in place to smooth out any big increases or decreases in rates caused by the revaluation. How to cope with the impact of revaluations fairly within the new system adds greatly to its complexity.

3.4 The Government has promised to establish a fair starting point for all local authorities to ensure no-one loses out at the outset of the system. Effectively this means that the new system will have to initially mirror resource distribution under the current system also adding considerable layers of complexity.

Issues guiding the response to the consultation

3.5 The response will be guided by the potential impact of the proposals on the resources of the council and the new risks faced by the council. In the first year it will be important that the starting point of the new system is as beneficial to the council as possible i.e. the business rates baseline is set as low as possible to maximise future gains and the baseline funding set as high as possible to protect existing funding levels.

3.6 Making judgements about what would be most beneficial to the council once the system is operational is much more difficult as it would require, amongst other things, forecasts to be made about future levels of inflation and growth in the local economy.

Components of the business rates retention scheme

3.7 The following paragraphs very briefly set out the 7 proposed components of the business rate retention scheme and the key issues for the council. The components are:

- Component 1 – Setting the baseline.
- Component 2 – Setting tariffs and top ups.
- Component 3 – The incentive effect.
- Component 4 – A levy recouping a share of disproportionate benefit.
- Component 5 – Adjusting for revaluation.
- Component 6 – Resetting the system.
- Component 7 – Pooling.

3.8 Appendix 1 sets out the money flows between the Government, the council and potentially the Police and Fire authorities under the current and proposed systems. The proposed system will increase the number of individual transactions but it is impossible at this stage to assess whether there will be an overall positive or negative impact on the cash flow of the council.

Component 1 – Setting the baseline

3.9 A business rates baseline needs to be set from which future changes in business rates income can be measured. It will be critically important that this baseline is set at a fair level for the council.

3.10 Key issues:

- The Government proposes to set the baseline taking into account their forecasts of future business rate growth over and above inflation. Thus the Treasury could keep some growth although the amount will not be known until this time next year. It is recommended that the response should point out that a fair new system should allow local government to retain the full proceeds of business rate growth above inflation.
- The last national revaluation took effect from 1 April 2010 and by the time the baseline is set it is likely that many appeals by local businesses will not have been processed by the VO. Any successful appeals processed after the baseline has been set will reduce the level of resources available to the council. It is therefore recommended that the response should propose that appropriate adjustments are made for successful rating appeals to ensure that the council is not unfairly penalised for decisions that are completely outside its control.

Component 2 – Setting tariffs and top ups

3.11 The funding baseline will be closely aligned to the amount of grant each council receives through Formula Grant. In simple terms if the amount of business rates collected locally exceeds the funding baseline then the council will pay a tariff to the Government and if it is less then the council will receive a top up. On the basis of current figures it is likely the council will receive a small top up. Once set the tariffs or top ups will remain fixed for a period of time until the system is reset.

3.12 Key issues:

- Although the proposals indicate that floor damping grant will form part of the funding baseline this will be strongly opposed by the majority of councils who are not at the floor. The resource implications for the council are hugely significant as the indicative floor damping grant for 2012/13 is over £11m. A list of the 49 authorities with education and social care responsibilities due to receive floor damping grant in 2011/12 is given in appendix 2. It is therefore recommended that lobbying is undertaken with these authorities for the inclusion of floor damping grant within the funding baseline.
- There are options within the proposals to make some further data and methodology changes to the grant formulae that could be reflected in the funding baseline. Specifically mentioned are possible changes to the concessionary travel formulae. It is impossible to quantify what impact any changes might have on the council but any gains will be offset by an equal and opposite reduction in floor damping grant. In previous responses the council has set out many fundamental reservations about the way in which the current grant formula operates and these cannot be overcome by the sorts of changes proposed and in any case cannot reflect the 2011 Census data which will not be available in time. It is therefore recommended that the response opposes any further updating of the grant formula.
- There are options to increase the top up and tariff payments annually by inflation as measured by the Retail Price Index (RPI) or to leave them fixed. As the council is likely to receive a top up payment it is recommended that support is given to annual inflation uplifts.

Component 3 – The incentive effect

3.13 The proposals allow individual councils to keep a proportion of any increase in business rates above the forecast increase made by the Government. The higher the proportion the greater the incentive to generate more businesses within the local economy but the higher the financial risk to the council if increases are not achieved. There are many options within the consultation proposals which impact on the level of the incentive.

3.14 The Local Government Association (LGA) has undertaken an analysis of returns on business rate collection covering the period 2005/06 to 2009/10 for each local authority to estimate the underlying growth excluding the impact of revaluations. The following table shows that the underlying growth figures for Brighton & Hove are well below the national average although part of the explanation may be high numbers of successful rating appeals. Therefore on a historical basis the council has potentially less to gain from the retention of business rates. Officers will continue to research and collect other data in time for the response submission that could support the point that business growth does not necessarily equate to business rates growth.

TABLE 1: Historical estimated underlying business rate growth (LGA)				
Year	**Brighton & Hove**	**East Sussex**	**West Sussex**	**England**
2006/07	-0.05%	+2.70%	+3.57%	+3.75%
2007/08	+0.56%	+1.22%	-0.56%	-0.70%
2008/09	+8.10%	+6.11%	+9.16%	+10.18%
2009/10	-0.15%	+1.80%	+2.06%	+1.41%
Average	+2.06%	+2.98%	+3.53%	+3.60%

3.15 Key issue:

- On the basis that historically business rate growth rates have been well below the national average and there is limited scope for the city to expand, it is recommended that the response to the consultation favours options which limit the incentive effect. This will reduce the exposure of the council to risk if growth rates are lower.

Component 4 – A levy recouping a share of disproportionate benefit

3.16 The consultation papers sets out proposals to charge a levy on councils that would otherwise receive a disproportionate benefit from an increase in local business rates. This levy is likely to impact upon councils whose business rate income is very large where a relatively small increase in rates creates a big increase in resources for that council or where the growth in business rate income is exceptional. It is proposed that the levy will be used to provide protection for councils with falling business rates income in the short term.

3.17 Key issues:

- It seems fair to design a levy to protect councils with high spending needs but with a low business rates baseline. The council may also need protection on occasion from the levy pool having had falling income in both 2006/07 and 2009/10. It is therefore recommended that strong support is given in the response to the principle of a levy.
- It is completely unclear from the consultation how the timing of payments to and from the levy pool will work in practice. It will be essential to have reasonable certainty over resource levels in time for the budget setting process but it appears from the proposals that payments to and support from the levy pool will only be know up to 6 months after the financial year has ended when the business rate returns have been independently audited. CLG should be asked to clarify this timetable.

Component 5 – Adjusting for revaluation

3.18 The rateable values of all businesses in England are reviewed by the VO every 5 years. The overall financial impact of the revaluation is neutral so if the national rateable value goes up then the national rate poundage goes down proportionately and vice versa. However, the picture for individual businesses can be very different depending on the area in which they are located and the type of business they operate. There are very complex transitional arrangements for individual businesses that phase in both increases and reductions in rates payments over a 5 year period. The next revaluation is in 2015 and the proposals try to exclude the impact of revaluations on the retention scheme by complicated adjustments.

3.19 Key issues:

- Under previous revaluations improving economic conditions in Brighton & Hove have resulted in local rateable values rising by more than the national average so local businesses have on average ended up paying more in business rates. Under the proposed system all this additional income will be discounted so the council will not receive any of it. Although adjusting the system so that the council could benefit from some of this income would be hard to do it is recommended that CLG be asked to develop an option to allow councils to keep some of this income.
- Increases in rating valuations inevitably lead to higher numbers of appeals and potentially higher numbers of successful appeals which under the proposed system become a financial risk for the council even though it can do nothing to influence the process. It is therefore recommended that the response asks CLG to discount successful rating appeals from the retention calculations.

Component 6 – Resetting the system

3.20 The Government proposes to reset the system periodically to reflect changes in the relative needs of different authorities. The more frequently this happens the greater uncertainty there is in future resource levels and the lower the incentive to grow the local economy. However, infrequent resets would particularly penalise those authorities with rapidly growing spending needs.

3.21 Key issues:

- The council has previously lobbied on the serious short-comings of the current models for assessing needs and therefore it is recommended that the response should support the development of a completely new model of needs assessment by an independent body.
- On the basis that the council probably has less to lose in a reset it is recommended that the response should favour more frequent resets to enable resource distribution to more closely reflect needs. CLG should also be asked to set out more clearly the trigger points for a reset so it is not left purely to ministerial discretion.

- Any reset could result in significant changes to resource distribution between authorities. Therefore the response should also ask CLG to set out what protection mechanisms might be put in place to help those authorities to plan for a significant loss of resources.

Component 7 – Pooling

3.22 Business rates income is much harder to predict and much more volatile than council tax income as it can go down as well as up. The council is forecast to receive about £95m in business rates in 2011/12 but the actual amount may vary by several million. The proposals allow councils to spread their business rate income risk by pooling income with other authorities. This will need formal arrangements to be put in place to determine the shares of any gains or losses between the authorities within the pool. A view on how business rates income will change in other potential pooling authorities is therefore critical. The table below draws again on the LGA analysis and compares the average change in business rates income over the period 2005/06 to 2009/10 for neighbouring district councils.

TABLE 2 - Historical estimated underlying business rate growth (LGA)		
Council	**2005/06 to 2009/10 growth**	**National Ranking**
Brighton & Hove	+2.06%	299
Adur	+2.02%	302
Arun	+2.75%	253
Chichester	+3.11%	215
Crawley	+4.05%	110
Eastbourne	+3.02%	224
Hastings	+2.42%	272
Horsham	+2.94%	234
Lewes	+1.97%	305
Mid-Sussex	+3.31%	192
Rother	+2.48%	268
Wealden	+4.34%	83
Worthing	+3.72%	137

3.23 Key issue:

- The Government is thinking about giving additional incentives for authorities to work together in pooling arrangements. On the basis that there should be a level playing field for all authorities it is recommended that the response should support the same incentives being applied to all possible working arrangements.

Other issues raised by the business rate retention proposals

3.24 There are a number of other issues raised by the consultation that do not fall directly within the components of the new system. These are:

- Business growth and job and wealth creation does not always equate to growth in business rates which is driven by rents payable on space occupied. Growth in service sector businesses or knowledge/technology based industries will have a much lower impact on business rates growth than, for example, a new supermarket.
- The response should also point out that the proposals provide greater incentives to develop “Greenfield” sites over the redevelopment of existing sites that are already generating business rates.
- The incentives that it places on individual authorities to compete for businesses in their area may have adverse consequences.
- The interaction between Tax Incremental Financing (TIF – the use of future additional business rate income streams generated by a new project to fund some of the debt financing costs associated with the project capital investment costs) and the business rates retention proposals have not been well developed. The business rate retention proposals provide far too little certainty about future income streams to justify any significant new borrowing particularly because some or all of this income may be lost at a reset. It is therefore recommended that the response should support the treatment of TIF schemes outside the retention proposals and that changes to the business rates within the defined boundary of a TIF project should be ring-fenced – this will mean that Government approval will be needed before any TIF scheme can proceed.
- Although CLG have provided an interactive calculator as part of the technical papers it is very difficult to work out how to populate it with meaningful data. The response should therefore ask for CLG to provide exemplifications of key data for each local authority.
- The proposals consider various options for the treatment of Police and Fire authorities. On the basis that these services have no impact on local business rates growth and their inclusion adds to the complexity of the system it is recommended that these authorities are funded entirely from Government grant.
- There are potentially alternative mechanisms for incentivising local authorities to support business growth which are less complex and transfer less financial risk, for example a model based on similar principles to the former Local Authority Business Growth Incentive Scheme (LABGI) or the New Homes Bonus

3.25 In the light of the proposals officers will need to review the current Business Rate Collection System to see whether it is “fit for new purpose” and what changes and improvements could be made. Although business rates collection rates for Brighton & Hove are currently comparable to authorities with similar characteristics, for 2013/14 and beyond the way the council collects business rates also needs to be reviewed to see whether changes and new investment might generate higher collection rates.

4. COMMUNITY ENGAGEMENT AND CONSULTATION

4.1 Presentations on the proposals and the consultation have been made to the cross political party Budget Review Group who will also see the final response before it is sent to CLG.

5. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

5.1 The business rate retention proposals will have implications for the level of resources received by the council from 2013/14 onwards. Possible implications arising from the proposals are contained within the body of the report and these will become clearer as the proposals are developed by the Government. However, firm figures will not be known until November / December 2012 when the provisional Government Settlement is due that. In addition officers will have to develop new models to forecast local business rates income over the medium term. All significant developments will be reported to Members through the regular budget reports.

Finance Officer Consulted: Mark Ireland Date: 29/09/11

Legal Implications:

5.2 Cabinet have the requisite authority to agree the recommendations at paragraph 2 of this report, as the body responsible for formulating and implementing the council's budget.

5.3 Any changes which the Government propose to make to the system of non-domestic rate collection will require fresh legislation to revoke or amend the existing statutory scheme set out in Part III of the Local Government Finance Act 1998.

Lawyer Consulted: Oliver Dixon Date: 29/09/11

Equalities Implications:

5.4 There are no direct equalities implications arising from the report.

Sustainability Implications:

5.5 There are no direct sustainability implications arising from the report.

Crime & Disorder Implications:

5.6 There are no direct crime and disorder implications arising from the report.

Risk and Opportunity Management Implications:

5.7 The proposals set out in the consultation paper pose significant additional financial risks to the council as set out in the body of the report.

Public Health Implications:

5.8 There are no direct public health implications arising from the report.

Corporate / Citywide Implications:

5.9 The funding of Police and Fire services across the city will also be affected by the proposals set out in the consultation and those authorities have the opportunity to respond separately to the consultation.

6. EVALUATION OF ANY ALTERNATIVE OPTION(S):

6.1 The report sets out the key issues and explains the reasoning why certain responses are proposed to be made in keeping with the overall objective to protect and minimise risk to future funding sources of the council.

7. REASONS FOR REPORT RECOMMENDATIONS

7.1 The consultation requires responses to be received by 24 October 2011 and given the potential significance of the proposals to the future finances of the council the recommendations ask Cabinet to give a clear steer to the response from the council so that the response deadline can be achieved.

SUPPORTING DOCUMENTATION

Appendices:

1. Cash-flows under the current and proposed systems

2. List of authorities with Education and Social Care responsibilities due to receive floor damping grant in 2012/13

Documents in Members' Rooms

None.

Background Documents

1. The Government consultation document can be found on the CLG website at:

   http://www.communities.gov.uk/publications/localgovernment/resourcereviewbusinessrates