APPENDIX 1

HERTFORDSHIRE COUNTY COUNCIL

CABINET
MONDAY, 17 OCTOBER 2011 AT 2.00 P.M.

LOCAL GOVERNMENT RESOURCE REVIEW: BUSINESS RATES RETENTION CONSULTATION

Report of the Director Resources & Performance

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Executive Member:- David Lloyd, Resources and Economic Well-Being

1. Purpose Of Report

1.1 To provide Cabinet with an overview of the Government's consultation on localising business rates and to enable Cabinet to agree the County Council's response to the consultation.

2. Summary

2.1 The consultation sets out proposals for a business rates retention scheme to replace the current local government finance system, under which business rates are distributed as part of formula grant. It also seeks views on options for enabling authorities to carry out Tax Increment Financing to fund infrastructure investment within the business rates retention scheme.

2.2 The Government will set out its detailed mechanism later this year following this consultation.

2.3 The Government intends to introduce the business rates retention scheme from 1 April 2013.

2.4 There are seven components to the proposed scheme:

- setting the baseline
- setting tariffs and top-ups
- the incentive effect
- a levy to recoup a share of 'disproportionate benefit'
- revaluation
- resetting the system
- pooling

2.5 Business will see no difference in the way they pay the tax, the way the tax is set or who is eligible for discount.

2.6 This authority is broadly supportive of the proposals but has a number of concerns in the following areas:

a) Stability / Certainty – it will be vital to reduce turbulence on the implementation of the new system given that authorities have already had to manage a range of changes in relation to inflation and demography. In particular there is a need for:
- maximum stability at outset (it is recommended that the 2012/13 Formula Grant is used as a baseline without any update / adjustments given that this is likely to introduce further uncertainty); and
- early announcement of baselines to provide certainty for medium-term financial planning.

b) Predictability – given that this will be essential for meaningful medium-term planning and investment. In this regard:
- resets should be infrequent in order to avoid significant turbulence;
- ministerial discretions / adjustments should be minimised; and
- there should be transparent operation of safety net criteria.

7. Simplicity – is important for understanding and engagement by all stakeholders. In particular the retention scheme should:
- be readily explained to citizens and businesses in ways that enhance understanding and build support for economic development activity; and
- minimise adjustments in pursuit of "fairness"; accepting an element of "rough justice" in interests of simplicity and explicability.

c) Incentivisation – the retention scheme must encourage investment / activity to grow the economy. In order to do this:
- starting forecasts for business rates in 2014/15 (and therefore amount 'set-aside') must be realistic and evidence-based;
- the levy must not be set so high as to discourage investment and (appropriate) risk-taking in pursuit of economic growth; and
- differential levy rates to encourage "pooling" is not appropriate (this should be local decision in response to local circumstances).

d) Volatility – mechanisms for dealing with this area should adopt localism principles and be kept simple. Specifically there is a need to:
- limit central government intervention to transparent operation of safety net criteria; and
- expect councils to deal with volatility through pooling and / or reserves, to suit their local circumstances.

e) New burdens – should be assessed through fair and mutually agreed methodology. Namely:

- calculation of additional / reduced burdens should be transparent and evidence-based; and
- the set-aside should be returned to local government through greater delegation of functions.

2.7 The deadline for commenting on the proposals presented in the consultation paper is 24 October 2011.

3. Recommendations

1. That Cabinet welcomes the re-localisation of business rates income and the incentivisation of local economic development activity; but notes the issues set out in paragraphs 2.6 and 6 of the report in relation to the detailed operation of the proposed system.

2. That Cabinet authorises the Director Resources & Performance, in consultation with the Executive Member for Resources and Economic Well-Being, to respond to the consultation.

4 Background

4.1 The consultation period runs until 24 October 2011. A consultation paper (detailing 33 questions) was published on 18 July followed by a series eight technical papers (detailing 63 questions) on 19 August. The Government will set out its detailed mechanism later this year following this consultation.

4.2 Under the existing arrangements, business rates income collected by billing authorities is pooled nationally by central government before being redistributed to local authorities on a per capita basis to fund a significant proportion of formula grant. The Government wants to change the current system by enabling councils to keep a share of the growth in business rates in their area. This will make councils less dependent on central government funding and give them a strong incentive to promote local business growth.

5. Key proposals

5.1 Billing authorities collect varying levels of business rate income. If all councils were allowed to keep all business rates generated in their areas, some areas would have a much larger amount than they need to deliver their services whilst some others would have much less than they need.

5.2 To ensure that no council is worse off at the outset, the Government will set a baseline position for 2013/14 for each local authority, using the 2012/13 formula grant allocations either unadjusted or adjusted for some limited technical updates.

5.3 Authorities like Hertfordshire whose business rates income is higher than their baseline position would pay the difference to central government in the form of a ‘tariff’. Those whose business rates are less than their baseline would receive the balance from central government in the form of a ‘top-up’ grant. The tariffs and top-up grants would be self funding.

5.4 The Government is seeking views on whether tariffs and top-ups should be increased each year to take account of the annual Retail Price Index (RPI) increase which is set nationally. The choice is to either uprate the year one tariff and top-up amounts to reflect movements in the RPI each year or fix the tariffs and top-ups as a cash amount that does not change in future years.

5.5 Where a group of local authorities have decided voluntarily to form a ‘pool’, then the pool would be treated as a single body for the purposes of tariffs and top-ups, which would be the sum of all tariffs or top-ups of the individual authorities.

5.6 Incentives may be offered to local authorities that form a pool by allowing them to retain a greater proportion of growth within the rates retention system or by offering additional incentives outside the system.

5.7 Measuring business rates - in order to calculate tariffs and top-up amounts, it will be necessary not only to establish the baseline, but also to have an agreed way of measuring each authority’s business rates income. There are a range of different options for carrying out an assessment of business rate income. It could be based on business rates income at a single point in time, or the average over a number of years.

5.8 There would be no cap on the amount of business rates growth an authority can benefit from under the rates retention system. However, to manage the possibility that some local authorities with high business rate tax bases could see disproportionate financial gains, and to make the system more sustainable in the long term, the Government would collect a levy recouping a share of disproportionate benefit; and use the proceeds to help manage large, unforeseen negative volatility in individual authorities’ budgets. Where local authorities come together to form pools, the pool would be treated as a single body for the purpose of the levy. But to incentivise authorities to pool, the Government will consider adjusting the levy arrangements to produce a positive outcome for pools.

5.9 For two-tier areas, there are two options for sharing business rates income between upper (county councils) and lower (district councils) tier authorities. The first is based on the national aggregate spending patterns in two-tier areas and the second is based on the local distribution of business rates.

5.10 In relation to the Government’s renewable energy commitment, the scheme will ensure that business rate revenues from new renewable energy projects are kept by the local authorities within the area of the project and that those revenues are discounted in the calculation of any levy that might be applied to growth in business rate revenues. This would mean that authorities would keep all of the business rates generated from new renewable projects. It is proposed that at least the greater proportion of this funding should go to the level of the local planning authority to maximise the community benefit.

5.11 Adjusting for revaluation - the tariff and top-up amounts for each authority would be adjusted when business rates are revalued; so that the sum of top-ups and tariffs is 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.

5.12 Resetting the system - to achieve a strong incentive effect, the tariff and top-up amounts will remain fixed. However, over time it is likely that resources will move away from changing levels of underlying need and, as a result, the Government would want to be able to 'reset the system'. The paper outlines two possible approaches to the reset period; not to set a fixed period for resets in advance; or set fixed periods for resets.

5.13 When undertaking a reset for need and resources either partial or full the paper proposes that it would be open to the Government to change the basis on which need was determined. Any reset could determine the assessment of need and resource, and, therefore, the distribution of business rates,on some other basis than formula grant if the Government agreed such an approach.

5.14 The New Burdens principle will continue to operate. For example, departments could pay a section 31 grant to local authorities to meet the costs of a new burden, before mainstreaming the funding into the business rates retention system or other funding streams, such as the current Local Services Support Grant.

5.15 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.

5.16 The Government is committed to continuing to fund the New Homes Bonus within a business rates retention system.

5.17 The Government is proposing that Tax Increment Financing (TIF) could operate within a business rates retention system. TIF is a way of funding infrastructure investment by borrowing against future business rates income. Following responses to this consultation, the Government will publish a technical paper setting out more detail on Tax Increment Financing.

5.18 The Government is proposing that police authorities will not be part of the business rates retention scheme in 2013/14 and 2014/15, and is posing a similar question regarding single purpose fire and rescue authorities. Rather than having their funding affected by fluctuations in business rate income in 2013/14 and 2014/15, they would receive guaranteed funding at the levels agreed in the 2010 Spending Review for these years.

6. Issues And Concerns

General

6.1 The timescale for implementing such a major change is short; it is essential that local authorities have the time to test robustly the final model since neither local nor central government can afford to get this reform wrong.

6.2 There is no correlation between assessment of need (spending pressures) and business rate growth.

Setting the baseline

6.3 The Government's proposal to update its forecast of national business rate figures in the 2010 Spending Review (2010 SR) in the autumn of 2012 will be a key consideration when setting the baseline, since authorities will benefit only to the extent business rates actually raised exceed the forecast level. Consequently, local government should be actively involved in the decision-making process in particular testing Government's forecast assumptions.

6.4 The Government's proposal is to retain the full proceeds of growth (as part of set-aside) above the 2010 SR national spending totals for 2013/14 and 2014/15. Set aside would be used to fund other grants to local government. This would operate to local government's disadvantage as it does not recognise the greater pressures arising from higher inflation over the 2010 SR period.

6.5 Single purpose fire and rescue authorities should be treated no differently to combined fire and rescue authorities. This means single purpose fire and rescue authorities should not be treated like police authorities who will receive guaranteed funding for 2013/14 and 2014/15.

Setting tariffs and top-ups

6.6 Tariffs and top-ups amounts should be fixed as a cash amount that does not change in future years. This would ensure tariff and top-up authorities are exposed to similar levels of risk in terms of managing fluctuations in business rates income.

The incentive effect

6.7 Restricting business rates growth to physical footprint does not encourage or reward knowledge or internet based growth. Some businesses and industries do not generate high levels of rate income, such as digital/hi-tech and advanced manufacturing micro-businesses.

6.8 Local authorities are only one part of the jigsaw that influences business success and growth.

A levy to recoup a share of 'disproportionate benefit'

6.9 The principle to collect a levy recouping a share of disproportionate benefit and use the proceeds to help manage large, unforeseen negative volatility in individual authorities' budgets is sound. However, this would have to be seen in the context of tariffs and top-ups. The Government acknowledges that it needs to discuss these issues further with the local government sector before reaching decisions about which tariff, top-up, levy and safety net options to adopt. Consequently, we look forward to participating in those discussions.

Resetting the system

6.10 Since there is no correlation between business rate growth and pressures on services, there could be serious funding problems if the time between resets is too great - a 10 year timescale is mentioned in the consultation paper.

Pooling

6.11 The principle is sound but it might prove difficult to achieve in practice.

Government's renewable energy commitment

6.12 Neither option reflects the role of upper tier authorities in planning and procuring waste plants generating renewable energy.

7. Financial implications

7.1 At this stage it is not possible to quantify the impact for Hertfordshire.

Background Information

Department for Local Government and Communities (DCLG):

- Main consultation document dated July 2011
- A Plain English Guide dated July 2011
- Technical papers dated August 2011

The main consultation paper and the series of eight technical papers can be accessed by clicking on the web link below.

http://www.communities.gov.uk/localgovernment/localgovernmentfinance/lgresourcereview/

Local Government Association:

- Briefing on Technical papers dated 22 August 2011