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To: County Council – 24<sup>th</sup> March 2016

Subject: Business Rate Retention & School Funding Reform

Classification: Unrestricted

**Summary:**

This report, together with a presentation on the day, explores the major implications of the announcement in the Autumn Statement of changes to local government funding arrangements over the next 4 years through 100% business rate retention. The report discusses how the new arrangements will differ from existing arrangements, and the possible options for further devolution of responsibilities to local government. Kent County Council has an opportunity to influence and subsequently change the business rate retention proposals as they emerge. This report and presentation are aimed at raising awareness and prompting debate to help shape our contribution towards the development of the new arrangements both through representative working groups and consultation anticipated over the next few months (and years).

Reforms to the funding formula for schools are also being consulted on. This is a welcome opportunity to address the long-standing inconsistencies in funding per pupil across the Country and specifically the relative under-funding of Kent Schools. This report, together with a presentation on the day, highlights the aims of the reforms and the principles being consulted on.

**1. Introduction**

- 1.1 In the Autumn Statement in November the Government confirmed that by the end of the current Parliament local government will retain 100% of business rate revenues to fund local services. They say this move would allow local authorities to retain direct control over an anticipated £26bn from business rates revenues, approximately £13bn of which is currently pooled centrally before being redistributed to local authorities in the form of un-ring-fenced grants, principally the Revenue Support Grant (RSG). The total Business Rate tax base for Kent is £550m. In advance of the new arrangements the existing Revenue Support Grant will be phased out and the new arrangements will require the transfer of approximately £13bn of new responsibilities. The presentation on the day will provide a more detailed explanation of this significant issue.
- 1.2 The system of tariffs and top-ups which redistributes business rates proceeds from high wealth/low needs areas to low wealth/high needs areas will need to be reviewed. This will be a hugely important factor in the distribution mechanism, and again, will be covered in more detail in the presentation at this Council meeting.

- 1.3 Local authorities will also have the ability to reduce rates in order to attract new businesses. Elected Mayors (for those areas that have created combined authorities) would have the ability to levy a premium on business rates to pay for new infrastructure provided this levy is supported by the Local Enterprise Partnership.
- 1.4 The methodology to be used in Business Rate devolution is not yet established and we have an opportunity to influence this. Central government are expecting all sectors of local government to come up with fair and sensible proposals to allocate the devolved Business Rates. Quoting from the published minutes of the LGA Councillors' Forum on 21st January, "The Secretary of State [Greg Clark, MP] invited the LGA and councillors to propose how they would manage the retention of business rates, seeking agreement on this with the intention of recommending the proposals to government. If no proposals were made, the Secretary of State would produce a plan."
- 1.5 There are far more unknowns than knowns about the new arrangements and all manner of practical considerations which we can only speculate about at this stage. These include (amongst many other issues):
- Which additional functions will be devolved to local authorities
  - How the needs led baseline will be set in order to inform tariffs and top-ups
  - How business rates revenues will be split in two tier areas
  - How business rate reductions will operate
  - How the unpredictable volatility in business rates (e.g. when businesses open/ cease or move between areas) proceeds at a local level may or may not be cushioned
  - Impact of revaluations and outstanding appeals

These issues will be discussed further in the presentation to County Council on 24<sup>th</sup> March.

- 1.6 In March the Government also announced a consultation on reforms to the funding formula for schools. Under the current system, funding per pupil is severely inconsistent across local authorities for a range of historical reasons.
- 1.7 Central Government has stated that the aim of these reforms is to tackle the wide variation in funding per pupil between local authorities and individual schools with similar needs. The consultation proposes three fundamental principles:
- i) DSG funding should be allocated fairly and straight to the frontline
  - ii) Funding should be matched to need so that the higher the need the greater the funding
  - iii) Transition to the new system should be manageable

These principles will also be explored further in the presentation on 24<sup>th</sup> March.

## **2. Business Rates Framework**

- 2.1 The current legislative framework for universal business rates was introduced in 1990. It replaced the previous system of non-domestic rates which were controlled and set by individual local authorities. By law all of the proceeds from business rates have to be used to fund local services.
- 2.2 Business rates are a tax levied on all commercial properties. Business rates are based on a rateable value (assumed market rental set by the Valuation Office Agency) multiplied by national multiplier (rate in the £ set by government), less any business rate relief (determined by the local council). Rateable values are reassessed every 5 years, although the review scheduled for 2015 has been deferred until 2017.
- 2.3 Business rates for most properties are collected by local councils, districts in two tier areas. Properties for major transport, utility and telecommunications undertakings and cross-country pipelines are on a separate central list and collected directly by Government.

## **3. The Current Local Government Funding Arrangements**

- 3.1 The current arrangements were introduced in 2013/14 and allow local authorities to retain 50% of the business rates raised locally (in Kent and other two-tier areas this is split: 40% to Districts, 9% to Counties and 1% to Fire Authorities, where they are separate). The remaining 50% (approximately £13bn) is pooled centrally and redistributed to local authorities in the form of un-ring-fenced grants, principally the Revenue Support Grant (RSG). This redistribution is intended to transfer resources from high wealth/low needs areas to low wealth/high needs areas. This principle of redistribution has underpinned local authority funding for a very long time.
- 3.2 A number of specific ring-fenced grants are also allocated to local authorities to manage on behalf of central government. These funds have to be spent in accordance with the conditions applied to the individual grants. By far the most significant of these specific grants is the Dedicated Schools Grant (DSG) which funds schools' delegated budgets and a limited range of local authority for schools/individual children. The potential changes to DSG are considered later in this report. A full list of all un-ring-fenced and ring-fenced grants was included as an appendix to the County Council budget paper in February.
- 3.3 The presentation to County Council will provide a pictorial representation and detailed explanation of how the current system works. This will provide a reasonable exemplar of how the new arrangements might work through 100% business rate retention adjusted by tariffs and top-ups.

#### 4. The New Arrangements for Local Authority Funding

4.1 Table 1 below sets out the illustrative core spending power over the next four years for Kent County Council, as set out in the Final Settlement on 8th February 2016. This shows the £5.7m Transition Grant that we will receive in each of 2016/17 and 2017/18. The expansion of the Better Care Fund, which starts in 2017/18 but really ramps up in 2018/19, is welcomed and we do not anticipate the transfer of any additional responsibilities to come alongside this, other than to continue to strive for better integration with Health. These figures do not include the full devolution of business rates.

Table 1

	2015-16 £ millions	2016-17 £ millions	2017-18 £ millions	2018-19 £ millions	2019-20 £ millions
Settlement Funding Assessment	340.0	283.4	241.8	218.2	195.8
Council Tax of which:	549.0	577.2	609.7	644.6	682.2
<i>Council Tax Requirement excluding parish precepts (including base growth and levels increasing by CPI)</i>	549.0	566.0	586.3	608.0	631.1
<i>Additional revenue from referendum principle for social care</i>	-	11.2	23.3	36.6	51.1
Improved Better Care Fund	-	-	0.3	17.5	33.7
New Homes Bonus	7.9	9.3	9.4	5.9	5.6
Transition Grant	-	5.7	5.7	-	-
<b>Core Spending Power</b>	<b>896.9</b>	<b>875.5</b>	<b>866.8</b>	<b>886.2</b>	<b>917.3</b>
Change over the Spending Review period (£ millions)					20.4
Change over the Spending Review period (% change)					2.3%

4.2 Central Government offered the option of a four-year settlement in the Provisional Settlement announcement on 17<sup>th</sup> December, to provide funding certainty and stability for local authorities. We will decide over the coming weeks whether or not to take up the offer of a four-year settlement.

4.3 As can be seen from Table 1 above, we have an indicative resource allocation for the next four years. The transition grant was introduced as a temporary funding stream pending a needs-led assessment of funding distribution. It is likely that that full needs-led basis of funding will be introduced alongside full devolution of business rates. This leaves 2018/19 figures in question.

4.4 What happens beyond 2019/20 will be very much dependent on business rate growth and how that pans out across the Country. The presentation to County Council will give some 'what if' scenarios and will highlight the main opportunities and risks. The obvious opportunities are the potential for growth in the Thames Gateway and Thanet. A couple of more obvious risks would be the cost of the new devolved responsibilities exceeding devolved funding and how those areas of the Country that do not see Business Rate growth are financially supported through top-up arrangements.

- 4.5 Allowing local authorities to retain 100% of business rates will not replace the RSG which is being phased out. Local authorities will have to find alternative sources of funding to replace the RSG being lost or reduce spending.
- 4.6 When the new arrangements are introduced, the additional business rate revenues will be matched by the devolution of additional responsibilities. Much of the debate will revolve around which responsibilities should be devolved to local authorities. The Spending Review suggested these could include the administration of housing benefits for pensioners, attendance allowance (payments to people aged 65 or over with mental or physical disabilities to help with personal care), and public health. The Spending Review confirmed that the government will consult on the devolution of these and other additional responsibilities during 2016. It is essential that consultation about these responsibilities is concluded before a debate about needs-led baseline which would be needed to inform redistribution through tariffs and top-ups. For example, the needs-led baseline would need some different factors included if public health was devolved, compared to those that would be needed if responsibility for the Care Act was devolved.
- 4.7 However, it is important not to focus purely on the new devolved responsibilities, but also the core services that need to be part-funded by the Business Rates. These include social care, maintaining the road network, and the mortgage that we have taken out to fund school places and roads. The presentation to Members will suggest some key factors that need to be considered in the needs-led formula, such as the differing impact of an ageing population in shire counties compared to inner cities.
- 4.8 Another important aspect of the devolution discussion is whether there is any correlation between the additional responsibilities and business rates. There is a significant risk that these prove to be incompatible and authorities with the most scope to raise additional business rates are not the same as those authorities with the highest spending on the additional devolved responsibilities. Whilst there is a clear correlation between a property based tax such as business rates and infrastructure and/or services which benefit the whole community, the link is less clear for services provided to individual residents such as social care, health or welfare services. Local authorities could find that demand-led functions are devolved (with a trajectory of rising demand) which cannot be matched by local business rates receipts.
- 4.9 To mitigate this risk there will need to be a debate about the needs-led baseline used to determine tariffs and top-ups. **This is a real opportunity to influence the debate and it is essential that the County Council engages fully in this debate to ensure our needs are fully reflected (we have long argued that previous redistribution mechanisms favoured metropolitan cities, especially Inner London).** The debate will also need to consider how often baselines should be reset.

## 5. Schools Funding

- 5.1 The Government has announced the first of two stages of consultation about improvements to the schools funding arrangements through the Dedicated Schools Grant (DSG). The first stage concerns the fundamental principles upon which DSG should be based, the second stage (date as yet unknown) will relate to the formula methodology and weightings used to determine individual authority allocations.
- 5.2 DSG is a specific government grant established in 2006/07. Effectively it took the decision over how much to spend on schools and school related services out of the hands of local authorities (previously funding for schools had been part of the overall Formula Grant and local authorities determined how much was spent on schools). However, the way DSG has evolved has meant that by and large the amount each authority receives per pupil is still inextricably linked to their decisions about spending and delegation levels taken by individual authorities prior to 2006/07.
- 5.3 In 2013/14 new arrangements for the calculation of DSG were introduced which allocated funding into three blocks: schools, early years and high needs. Nationally, the schools block ranges from £4,166 per pupil to £8,587 per pupil; Kent's rate per pupil is £4,383 and the national average is £4,636. More background information on this will be included in the presentation to County Council.
- 5.4 There have been a number of attempts over the years to address the inconsistency in school funding between local authorities, including in the early 2000s when the changes drove numerous schools into deficit. In 2015/16 an additional £390m was allocated to boost 69 of the least fairly funded areas in the country. Despite the figures outlined in paragraph 5.3 above, Kent was not one of the 69 authorities receiving additional funding.
- 5.5 The F40, which represents forty of the the lowest funded education authorities in England, has said that the consultation "signals an end to the current unfair system, which has lasted for decades" and that the reforms "will ensure every school and local area, no matter where they are in the country, is funded fairly – according to pupil need rather than the oddities of history."
- 5.6 The recently launched consultation proposes that the move to a national formula would happen in 2019/20, with the schools block ring-fenced in the meantime and a new local authority services block created from 2017/18. The high needs block will also be ring-fenced and the early years block will be reviewed "later in the year".
- 5.7 The consultation proposes three fundamental principles:
  - i) DSG funding should be allocated fairly and straight to the frontline
  - ii) Funding should be matched to need so that the higher the need the greater the funding
  - iii) Transition to the new system should be manageable

5.8 Government has stated that its aim from the reforms is to tackle the wide variation in funding per pupil between local authorities and individual schools with similar needs. Ultimately the aim is to develop a single national formula for schools, removing the role of local authorities from determining school funding. Funding for pupils with high needs would continue to be allocated at authority level with local authorities deciding on local levels of provision and special needs support for individual children and young people.

## **6. Conclusions**

6.1 The underlying principle of 100% business rate retention seems sound. The local government funding system has become ever more complex and as a consequence ever more opaque. It was built on the principle of needs-led redistribution of resources. It is essential that the County Council fully engages in the development of appropriate needs led redistribution under the new arrangements, however, it is also essential that we know which functions will be devolved in order to properly assess needs. If the intention of 100% business rate retention is to empower and encourage local authorities to promote business growth there is a risk that this could prove incompatible with a needs led redistribution. This risk needs to be carefully managed.

6.2 We will also need to be aware the extent to which the new system is subject to central control or whether it will be accompanied by genuine devolution leaving local authorities responsible to find local solutions to local issues within the resources. There is a risk that without some central controls and needs led redistribution it could cause a greater divide between wealthier and poorer areas. However, as already identify these controls and redistribution can themselves cause complexity and lack of focus on outcomes.

6.3 We need to respond to the consultation on schools funding to clearly set out our expectations of the changes to the Dedicated Schools Grant.

## **7. Recommendations**

### **Recommendations:**

Members are asked to note this report and the presentations on the day and discuss how the Council can best influence the outcomes of what will be a hugely significant change to local government funding.

## **8. Background Documents**

- 8.1 The Chancellor of the Exchequer's Spending Review and Autumn Statement on 25<sup>th</sup> November 2015

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/479749/52229\\_Blue\\_Book\\_PU1865\\_Web\\_Accessible.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479749/52229_Blue_Book_PU1865_Web_Accessible.pdf)

- 8.2 The provisional Local Government Finance Settlement 2016-17 announced on 17th December 2015

<https://www.gov.uk/government/collections/provisional-local-government-finance-settlement-england-2016-to-2017>

- 8.3. The final Local Government Finance Settlement 2016-17 announced on 8<sup>th</sup> February 2016

<https://www.gov.uk/government/collections/final-local-government-finance-settlement-england-2016-to-2017>

- 8.4 KCC's Medium Term Financial Plan 2016-19

[http://www.kent.gov.uk/\\_data/assets/pdf\\_file/0008/52991/Draft-medium-term-financial-plan-2016-19.pdf](http://www.kent.gov.uk/_data/assets/pdf_file/0008/52991/Draft-medium-term-financial-plan-2016-19.pdf)

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