From:	Paul Carter, Leader of the Council John Simmonds, Cabinet Member for Finance & Procurement and Deputy Leader Andy Wood, Corporate Director of Finance & Procurement
To:	Policy & Resources Committee 8th September 2016
Subject:	**Business Rate Devolution Consultation**
Classification:	**Unrestricted**

Summary:
The government launched a consultation paper "Self-sufficient local government: 100% Business Rates Retention" on 5th July. This consultation deals with the legal aspects of the proposed devolution of all the proceeds from local business rates to local authorities, as announced in the Autumn Budget 2015 and Queen's Speech 2016. It is anticipated that a bill will go before parliament in this session.

At the same time the government also launched a separate call for evidence paper on Needs and Redistribution to help reset the existing distribution of funding through baselines and tariffs/top-ups. This redistribution aspect is vitally important but does not require primary legislation.

This reports sets out the main issues in both the consultation paper and the call for evidence together with KCC's initial assessment. KCC's final response will be reported to Cabinet on 26th September and submitted that day (the deadline for responses)

Recommendation(s):
Policy and Resources Committee is asked to NOTE the report and make recommendations on any aspects which should be considered to be included in the formal response to the consultation and call for evidence papers.

1. Introduction

1.1 The current arrangements for local government finance were introduced in 2013. These allow for 50% of business rates to be retained locally (subject to tariffs and top-ups which perpetuate the national pattern of redistribution under previous grant regimes). The remaining 50% is pooled nationally and allocated via revenue support grant (RSG) and other grants to fund local authority services (details of which grants are funded from the central share have not been made available).

1.2 The current arrangements are incredibly complex and have been comprehensively explained in KCC's Medium Term Financial Plan (MTFP) documents. Significant changes to local authority funding arrangements were previously made in 2006 and 2011. This illustrates that local authority funding reviews are commonplace and can be fast moving.

1.3 The biggest challenges under the current arrangements are the significant reductions in RSG which have been made since 2013 (and are planned up to 2019-20), and the level of financial risk that councils face due to business rate appeals and avoidance. In two tier areas the upper tier authority is largely immune from volatility in business rates as they receive a small share of the local yield (18%/20%) and receive a large top-up based on historic baseline grants.

1.4 The distribution of RSG was altered in 2016-17 with reductions made pro rata to a combination of historic grant and council tax income (previously reductions had been pro rata to individual elements within RSG). This change was announced in December 2015 with no prior consultation or notification and had a significant detrimental impact on KCC's grant settlement (and those for other shire areas). We have consistently challenged the RSG distribution on the basis it inadequately reflects needs in shire areas and we opposed the late changes introduced for 2016-17 as a further retrograde step.

1.5 The government's intention to allow local authorities to keep 100% of the local business rates and to scrap core grants was first announced at the Conservative Party conference in 2015. It was subsequently confirmed in the Autumn Budget Statement in November 2015 and included in Queen's Speech in March 2016.

2. Essential Features of New Proposals

2.1 The use of property based taxes to fund local services dates back to medieval times. In Kent we have one of the best documented examples where landowners on Romney Marsh paid a local tax to fund the maintenance of sea defences and land drainage. This local tax was in force from 1252 to 1932. Business rates were used more widely as the basis of Elizabethan Poor Laws and provided revenue for municipal corporations established in the 19th century.

2.2 The concept of redistributing business rate income via a block grant mechanism is more recent, having been introduced in 1929. This was the start of the trend throughout the 20th century of increasing centralisation of business rates. This culminated with the introduction of National Non Domestic Rates in 1991 which put in place national arrangements for the first time with all yields pooled and redistributed via block grant. Only recently has this trend started to reverse through the un-ring-fencing of grants and local retention. The latest retention proposals should continue and extend this de-centralisation.

2.3 Under the proposed new arrangements individual authorities would retain all the proceeds from local business rates. It is estimated this will amount to an extra £12.5bn by 2020. It is clear that the government intends this will come with matching new responsibilities i.e. existing spending, and thus will not compensate for planned RSG reductions up to 2019-20. The consultation makes no reference to how the other local authority grants (unspecified) currently funded from the 50% central share of business rates will be treated following 100% local retention.

2.4 It is clear that under the new arrangements individual authorities will not necessarily keep all the business rates raised in their local area and a system of redistribution based on tariffs and top-ups will continue. Effectively this means that 100% retention means local authorities retain 100% of any growth in the tax base (or suffer from any decline), rather than retaining 100% of the yield. The baseline for these tariffs and top-ups will need to be agreed as part of the new arrangements. The existing baseline for the current 50% retention will also be reviewed as part of the new arrangements (but this does not require primary legislation and hence is covered in a separate call for evidence and later consultation). The baseline for the newly devolved responsibilities will need to be established once the areas for further devolution have been agreed.

2.5 The devolution aspects of the new arrangements are likely to be the most contentious, and are considered in the subsequent section. The consultation also deals with local flexibility over business rates, rewarding growth and sharing risk, and accountability and accounting issues.

2.6 Some changes to business rates were announced in the March 2016 Budget:

- taking the smallest businesses (those with a rateable value of less than £12,000 such as small shops, vehicle repair workshops, etc.) out of business rates altogether through permanent relief from April 2017
- allowing more businesses (those with rateable value under £51,000) to be charged the lower business rate multiplier from April 2017
- the NNDR multiplier or all businesses to be uprated by Consumer Price Index (CPI) from April 2020

These changes will reduce the business rate yield. At the time of the announcement it was confirmed that local authorities would be compensated by a separate grant. There are no further details about this grant in the consultation.

3. Devolution Proposals

3.1 By far the most significant aspect of the new proposals is the devolution of additional responsibilities. The consultation states that this devolution should be fiscally neutral i.e. at least equivalent to the additional local share to be retained, and allows for top-up funds if the further devolution exceeds the additional business rate income.

3.2 The consultation proposes that the devolution should be founded on four core principles:

- Build on the strengths of local government i.e. represent opportunities for greater integration across local services, remove barriers, reflect appetite for local delivery and local capacity
- Support the drive for economic growth e.g. links to local employment, skills and infrastructure
- Support improved outcomes for service users and local residents
- Take account of medium-term financial impact on local government e.g. costs should be predictable, relative to changes in business rate tax base, demand is stable or can be managed

These principles appear to be sound; however, some of proposed responsibilities in the paper do not appear to fit well with them.

3.3 The consultation paper suggests 10 possible areas for further devolution. The majority of these represent existing grants already paid to local authorities e.g. remaining RSG, Rural Services Delivery, Public Health, Early Years, Youth Justice, Council Tax Support and Pensioner Housing Benefit Administration Subsidies, and GLA Transport. The possible transfer of grants also includes the Improved Better Care Fund planned to be introduced from 2017-18.

3.4 It is questionable whether transferring existing grants to be funded out of local business rate yield constitutes further devolution. It achieves the aspiration of fiscal neutrality and where it includes the un-ring-fencing of grants allows some additional local flexibility. However, it also means that income to support these activities is likely to be more volatile as a result of changes in the business rate tax base (in many cases these grants are currently allocated according to either activity or relative need). For example the Early Years element of Dedicated Schools Grant (DSG), worth around £2.7bn to local authorities in 2016-17, is currently allocated according the actual number of 2, 3 and 4 year olds taking up the Early Years offer. This could present a significant financial risk for some local authorities.

3.5 The most significant proposed further devolution would transfer responsibility for Attendance Allowance payments to local authorities from the Department for Work and Pensions. Attendance Allowance is paid to approx. 1.5m UK residents aged over 65 who have care needs (need help with daily activities). It is non-means tested and applies to claimants with disabilities or illness. It does not cover those with mobility needs. It is paid as a weekly amount (£55.10 or £82.30 depending on severity on need) directly into recipients bank accounts. It does not have to be spent on care support. It is estimated that total spending on Attendance Allowance payments will be £6bn by 2019-20.

3.6 The proposed devolution of Attendance Allowance is likely to cause most comment in consultation responses. At this stage it is unclear whether the proposed devolution would leave local authorities with the responsibility to administer the current scheme or whether authorities would be able to vary the criteria and/or amount (it is clear that support for existing claimants would be protected). There is a strong risk that responsibility for a growing demand for Attendance Allowance ends up being devolved due to an ageing population.

3.7 There are also concerns that Attendance Allowance is non-means tested (while other aspects of local authority social care remains means tested), and devolution could lead to earlier contact with potential social care clients (with the attendant risk of rising demand for local authority social care) and income from charging could reduce (if the authority had the option to reduce Attendance Allowance amounts). There are also concerns that devolution risks undermining the vital role played by Attendance Allowance in keeping people out of the formal care system, of supporting carers (and their access to Carers Allowance), as well as a number of other potentially significant issues if devolution means authorities have to consider reducing Attendance

Allowance for new clients. The proposed devolution of Attendance Allowance does not include Personal Independence Payments for those aged under 65.

3.8 The other main area that is likely to draw comment in consultation responses relates to unfunded pressures. At a time when funding from central government has been reducing for a number of years (and the power to raise council tax has been limited by referendum requirements) most local authorities have had to deal with rising demand for/cost of services. Many of these additional spending pressures are either a direct result of central government policy e.g. National Living Wage, removal of National Insurance rebate; or arise from demographic or economic trends. This has meant that most local authorities have had to make far greater savings than those required to offset the central government funding reductions. The local government sector is likely to make the case that first call on the additional funding available from 100% business rate retention should be to compensate for these unfunded pressures. The main problem with this is that using the business rate income in this way would not meet the fiscal neutrality condition.

3.8 The consultation considers separately whether the funds from 100% business rate retention could be used to support devolution deals. This carries the risk of making an already very complex system even more complex as authorities in different areas could end up having different responsibilities funded from the same source. This is unfortunate, particularly as some of the spending covered by devolution deals (especially that relating to adult education, transport infrastructure and local growth fund) is the spending that we have identified should be a priority to be devolved to "historic county" level. This spending more closely fits the 4 core principles than some of the spending proposed to be devolved to all authorities (see above). Consideration of whether Mayoral Combined Authorities should be given additional powers under business rate retention is a consistent theme throughout the consultation.

4. Other Consultation Issues

4.1 The consultation deals with how authorities should be rewarded from business rate growth and how risks can be shared. In particular it considers how often the funding system should be reset and whether the resets should take account of the business rate growth which authorities have retained in the intervening periods. The government is keen that the new arrangements give local authorities the right incentives to promote economic growth. The consultation confirms that the new arrangements will not include a levy on any growth. Balancing this improved incentive to promote growth with the need for a sufficiently nuanced system that ensures authorities have sufficient funding to meet statutory obligations is likely to be difficult and finely balanced.

4.2 The section on rewarding growth and sharing risks considers the interaction between local authority funding and the periodic revaluation of business rates. Currently business rates are revalued every 5 years (although the review for 2015 has been deferred until 2017). The government is considering whether reviews should be undertaken more frequently and reform to the appeal system to make the impact less unpredictable. The national multiplier is reset at each revaluation to maintain a consistent overall yield. The revaluation in individual areas is linked to market rental and is an indicator of overall economic conditions. The business rate income for local authorities would rise and fall in line with revaluations and the consultation considers whether this should be reflected through changes in the funding system or whether authorities should retain a share of the impact of revaluations as well tax base changes through new/changed businesses.

4.3 The consultation provides an opportunity to comment on the current 80:20 split in two tier areas and whether this split should be changed under the proposed 100% retention. The advantage of the low share for upper tier authorities is that they are largely cushioned from the impact of tax base changes (since the majority of funding comes through the top-up). This provides a degree of assurance for demand led services like social care. The downside is that upper tier authorities may not receive adequate incentive for promoting growth. The corollary is that lower tier authorities could be over incentivised/bear too much risk from business rate decline. The consultation also considers whether Fire Authority funding should be removed from business rate retention arrangements.

4.4 The consultation identifies that some authorities have already identified their exposure to financial risk under the current arrangements and this may be even greater under 100% retention. These risks can either arise from revaluations/appeals or changes to the business use of premises (including closure from business failure). In particular the consultation considers whether this exposure could be managed by transferring high risk national infrastructure to the central list (business rates paid directly to CLG) e.g. power stations, national airports, etc. The consultation also considers whether risks can be managed by establishing new wider “area based” lists which by their nature would mitigate risks. The consultation also considers how a safety net could insulate authorities from shocks (significant reductions in business rate yields).

4.5 The section on business rate flexibility considers a number of options to allow local authorities greater control over the amount of business rate levied. The government has already announced its intention to allow authorities to reduce the multiplier in their area (the consultation considers how this should work in two tier areas) and to allow Mayors to raise the multiplier (the consultation considers how this sits with existing supplementary business rate powers). The consultation also considers the impact of decisions to vary the multiplier in neighbouring authorities and impact of consequential business rate migration.

4.6 The accountability and accounting section deals with the balance between central and local accountability, collection fund accounting and how 100% retentions sits with the requirement on local authorities to set a balanced budget.

5. Needs and Redistribution

5.1 The resetting of the existing baseline is covered in a separate Call for Evidence. This aspect of the new arrangements does not require primary legislation and thus can be resolved over a longer period. It is nonetheless an important consideration as it deals with resetting the existing top-up and tariffs, as well as the distribution of some of the grants proposed to be devolved via 100% retention (principally the remaining RSG and Improved Better Care Fund).

5.2 The call for evidence focusses on the formula to be used to assess local authority needs. In particular it considers the extent to which this should be simple/transparent compared to a more complex approach (which should in theory be more nuanced towards individual needs). We remain convinced that a simple formula is possible and should be satisfactory for the vast majority of authorities if it focuses on getting a more accurate allocation for the material aspects of local authority spending. For most authorities the vast majority of the budget (excluding schools) is spent on adult social care, children's services, capital financing, waste collection/disposal, public transport, highway maintenance/management, and planning/building control.

5.3 We have consistently contended that the funding allocated by previous block grant and specific grant mechanisms does not adequately take account of spending needs in county areas. This can be evidenced by the lower per capita grant allocations, lower core spending power (which includes both grants and council tax, and despite our reservations is the government's preferred approach to assessing local authority spending) and higher levels of council tax.

5.4 We will also be contending that since the baseline will be used to determine tariffs and top-ups for a number of years until the next reset, the formula should include forward looking indicators. These should be based on forecast trends e.g. population growth, and not rely on backward looking indicators such as previous census or regression against current spend. This latter aspect is particularly relevant as we contend that spending is influenced by the previous funding arrangements (which we believe are flawed and thus regression risks crystallising this previous pattern of redistribution).

5.5 The Call for Evidence also considers how a local authority's ability to raise income through council tax and business rates should be reflected in the needs based formula. We are largely supportive that income should be included in the calculation and that it should include all major sources of income e.g. car parking charges, but should not include discretionary decisions of individual councils to levy additional income (this was one of our chief criticisms of the changes introduced to RSG in 2016-17 in that authorities were penalised for historical discretionary decisions over council tax levels).

5.6 The Call for Evidence also considers transitional arrangements, the geographical area to which needs assessments should be applied and future resets. We are supportive of transitional arrangements as long as they ensure a manageable transition from the historical pattern to the new needs led distribution (a criticism of previous transitional arrangements is that they have effectively crystallised the previous distribution and prevented change). We can also see some merit in assessing needs at combined authority level as this should result in a simpler formula (although this will need much more evaluation particularly in two tier areas).

6. Conclusions

6.1 The consultation poses 36 specific questions, with a further 14 questions considered in the Call for Evidence. By its nature this is a very complex topic and some of the issues are technical while others have a significant policy implication. We have explored the main policy implications in this paper (particularly in relation to further devolution, rewarding business rate growth and managing business rate flexibility).

6.2 The proposed 100% retention marks a significant change in local authority funding arrangements. We have previously reported the possible issues arising from business rate devolution to County Council in March and comments made during this debate will be fed into KCC's response. We intend to report the full response to Cabinet on 26th September for agreement (which happens to coincide with the consultation deadline).

7. Recommendation(s)

Recommendation(s):

Policy and Resources Committee is asked to NOTE the report and make recommendations on any aspects which should be considered to be included in the formal response to the consultation and call for evidence papers.

8. Background Documents

8.1 DCLG Consultation and Call for Evidence
https://www.gov.uk/government/consultations/self-sufficient-local-government-100-business-rates-retention

8.2 KCC Medium Term Financial Plans
http://www.kent.gov.uk/about-the-council/strategies-and-policies/corporate-policies/medium-term-financial-plan

9. Contact details

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