From: Peter Oakford, Deputy Leader and Cabinet Member for Finance & Traded Services

To: Policy & Resources Cabinet Committee – 16th May 2019

Subject: Business Rates Retention

Classification: Unrestricted

Summary: This report accompanies the presentation to be made to the committee at the meeting. The report and presentation aims to inform members about the business rate tax base in Kent and how this compares with other authorities in the south east, how the current 50% business rates retention funding system operates, and potential changes to business rates retention in the future.

Recommendations:
Members are asked to NOTE this report and the accompanying presentation.

1. Introduction

1.1 The current system of business rates, or National Non-Domestic Rates (NNDR) as they are sometimes called, was introduced in 1990 under the Local Government Finance Act 1988. This replaced the previous system which had been in place under the General Rate Act 1967. The use of property taxes to fund local services is a long-established principle and was first formalised under Elizabethan poor laws (although there are examples of property taxes which predate these poor laws e.g. taxes levied to fund drainage of Romney Marsh).

1.2 Business rates are based on assessing all non-domestic properties to include on the rating list. There are two lists, the local list which comprises the vast majority of hereditaments, and a central list which comprises of network properties of major transport, utility and communications companies and cross-country pipelines. Local billing authorities (district councils) are responsible for collecting business rates from the local list, payments for properties on the central list are made directly to Ministry for Housing and Local Government (MHCLG).

1.3 The rateable value (RV) of all properties is assessed by the Valuation Office Agency (VOA) based on the market rental value of the premises. This is not the same as the actual rental cost and the VOA use a variety of techniques to assess market value and often usage often has a significant bearing on the RV e.g. retail areas are valued much higher per m^2 than storage areas.

1.4 Business rates are calculated according the RV multiplied by a national multiplier set by government. There is a larger multiplier for properties with an RV in excess of £51k[1]. The multiplier is uplifted each year in line

[1] Since 2015-16 this has been set 1.3p higher than the small business multiplier. The small business multiplier for 2019-20 is 49.1p

with inflation, since 2018-19 this has been based on Consumer Price Index (CPI), although authorities are compensated for the difference had Retail Price Index (RPI) still been used. Some hereditaments qualify for discounts/reliefs or exemptions, these are mainly mandatory with ratepayers qualifying by right although there is also some local discretion available to billing authorities. In recent years the government have introduced additional discounts/reliefs (including the lower indexation of the multiplier outlined above) to help reduce the burden of business rates on businesses. Authorities have been compensated for the impact of these additional reliefs on their retained business rates through a specific section 31 grant.

1.5 RVs are recalculated every 5 years (quinquennial review). The review scheduled for 2015 was delayed until 2017 due to the impact on property values of the recession. The revaluation was based on values in April 2015. The multiplier is reset following each revaluation to ensure the overall yield is not affected by the review. Transitional relief is applied to reduce the impact of upward revaluations and to limit reductions from downward revaluations. Smaller properties benefit from higher relief on upward revaluations and lesser mitigation on downward revaluations. The overall impact of transitional relief is neutral nationally and does not impact on local authority retention.

1.6 The current 50% retention arrangements were introduced in 2013-14. These allow authorities to keep 50% of any business rate growth achieved since the arrangements were introduced, but also carries the risk that authorities bear 50% of any reductions. Reductions can arise from appeals against the original valuation, change of use of premises, or loss of local businesses. The system is adjusted to ensure that authorities do not benefit additional retention from upward revaluations in 2017 (or bear the consequences of downward revaluations).

2. Business Rate Taxbase in Kent

2.1 There are around 48,500 individual hereditaments in Kent included on the local list. The vast majority are small businesses with over 30,000 valued under £12k (and thus eligible for extended 100% relief). Larger hereditaments (those with RV over £51k) account for only 12% of the total properties but contribute over 80% of business rates yield. The outcome of the 2017 revaluation by district and size of property is shown in table 1.

Table 1

	Total Number of Properties	Total RV £m	Average RV	Number with RV <=£12k	Number with RV <=£15k	up to £51k	Total RV <=£12k £m	Total RV <=£15k £m	Total RV<=£51k £m
ASHFORD	4,312	121.317	£28,135	2,635	2,894	3,749	13.872	17.409	40.661
CANTERBURY	5,603	143.107	£25,541	3,788	4,097	5,034	16.700	20.896	46.582
DARTFORD	**3,035**	**197.526**	**£65,083**	1,610	1,749	2,376	9.360	11.243	28.748
DOVER	3,919	109.902	£28,043	2,787	3,000	3,573	13.510	16.407	31.547
GRAVESHAM	2,273	63.810	£28,073	1,419	1,592	2,052	8.239	10.570	22.806
MAIDSTONE	4,846	144.418	£29,802	2,628	2,969	4,090	15.080	19.710	49.883
SEVENOAKS	3,820	94.066	£24,625	2,204	2,474	3,339	12.476	16.133	38.968
FOLKSTONE & HYTHE	3,731	77.901	£20,879	2,699	2,890	3,439	12.573	15.164	29.863
SWALE	4,397	119.293	£27,131	2,905	3,167	3,975	15.686	19.251	41.122
THANET	4,909	93.804	£19,109	3,676	3,912	4,528	17.675	20.876	37.240
TONBRIDGE & MALLING	3,600	143.512	£39,865	1,831	2,045	2,995	9.977	12.880	38.827
TUNBRIDGE WELLS	4,002	134.026	£33,490	2,125	2,393	3,437	11.835	15.486	15.486
TOTAL	48,447	1,442.683	£29,779	30,307	33,182	42,587	156.984	196.024	421.733

2.2 Dartford district has the largest tax base of all districts within the county. Nearly half of Dartford's tax base relates to Bluewater, even though this only comprises 421 out of over 3,000 hereditaments in the district. The average RV for hereditaments in Bluewater is £226.4k. This is significantly higher than the average for the rest of Dartford (£39.1k) and results in a significantly higher average RV in Dartford than other districts shown in table 1, or the average for the whole county (£29.8k).

2.3 Movements in the RV for the largest hereditaments have a much greater impact on retained growth than changes for the much larger number of properties with smaller RV. Analysis of the volatility in the tax base should focus on these large hereditaments.

2.4 The tax base is divided into four sectors; retail, industrial, office and other. Within each sector there a number of sub sectors categorising different types of property. These sub categories help to explain differences in RVs between similar size properties. Kent's average RV is similar to the rest of South East for retail (although without Bluewater the Kent average retail would be nearly £7k less). The average RV for office accommodation is significantly lower in Kent than South East or nationally. The average RVs in all sectors are considerably higher in London. Table 2 shows the comparisons for each sector.

Table 2

	Kent	South East	National	London
Retail				
Total Properties	12,170	67,820	485,440	91,050
Total RV (£m)	448	2,471	16,185	4,697
Average RV	£36,791	£36,438	£33,341	£51,589
Industrial				
Total Properties	12,580	70,220	474,050	49,060
Total RV (£m)	351	2,139	13,272	1,768
Average RV	£27,936	£30,460	£27,998	£36,035
Office				
Total Properties	8,990	55,680	365,840	90,200
Total RV (£m)	157	1,732	15,137	9,100
Average RV	£17,432	£31,106	£41,377	£100,892
Other				
Total Properties	14,770	77,430	531,120	71,260
Total RV (£m)	498	3,087	18,617	4,745
Average RV	£33,713	£39,866	£35,053	£66,594

2.5 District councils are responsible for estimating the tax base for budget planning purposes. These estimates start from the VOA list (including any changes since the list was originally compiled following the revaluation). It also includes the impact of reliefs, estimated in-year growth/decline and losses on collection (including bad debts and repayments). These combine to derive the net collectable tax base available for retention. The estimated tax base is collated through a government return (NNDR1).

2.6 The individual shares for local authorities include an adjustment for the cost of collection for billing authorities and other adjustments such as impact of enterprise zones, renewable energy schemes, etc. The remainder is distributed for retention (50% to central government, 40% to collection authority, 9% to upper tier authority and 1% to Fire authority).

2.7 The government have introduced a number of additional reliefs in recent years to help reduce the impact of business rates on individual businesses. These include extending the relief to small business with properties with an RV of less than £12k to 100%; uplifting the NNDR multiplier by CPI rather than RPI; additional reliefs for shops and pubs; discretionary relief schemes to help reduce the impact of the 2017 revaluation (in addition to transitional reliefs). Authorities are compensated for the loss of their retained share by a specific section 31 grant from central government to supplement retained growth.

3. The Retention Arrangements

3.1 The business rate retention scheme is based around the same redistribution principles as the previous Formula Grant regime it replaced.

Under the Formula Grant regime all the proceeds from business rates were pooled nationally and redistributed by the Formula Grant. This included a supplement to the business rate distributed as Revenue Support Grant (RSG).

3.2 The Formula Grant was recalculated and updated each year and included a central block (which allocated an amount per head of population to all authorities albeit a different amount for lower tier, upper tier and single tier authorities reflecting differing responsibilities), an additional relative needs block and a reduction through relative resource block to reflect council tax base. The latter elements were effectively a means to redistribute funding from areas with low needs/high wealth to areas with high needs/low wealth.

3.3 The objectives under business rate retention were to initially provide each authority with a similar amount to the Formula Grant (with other additional grants rolled in such as Early Intervention Grant) and over time allow authorities to retain a share of business rate growth. The equivalent to Formula Grant would not be recalculated each year and only recalculated for changes in relative needs and resources when the system was reset on a periodic basis (the first reset originally intended for 2020).

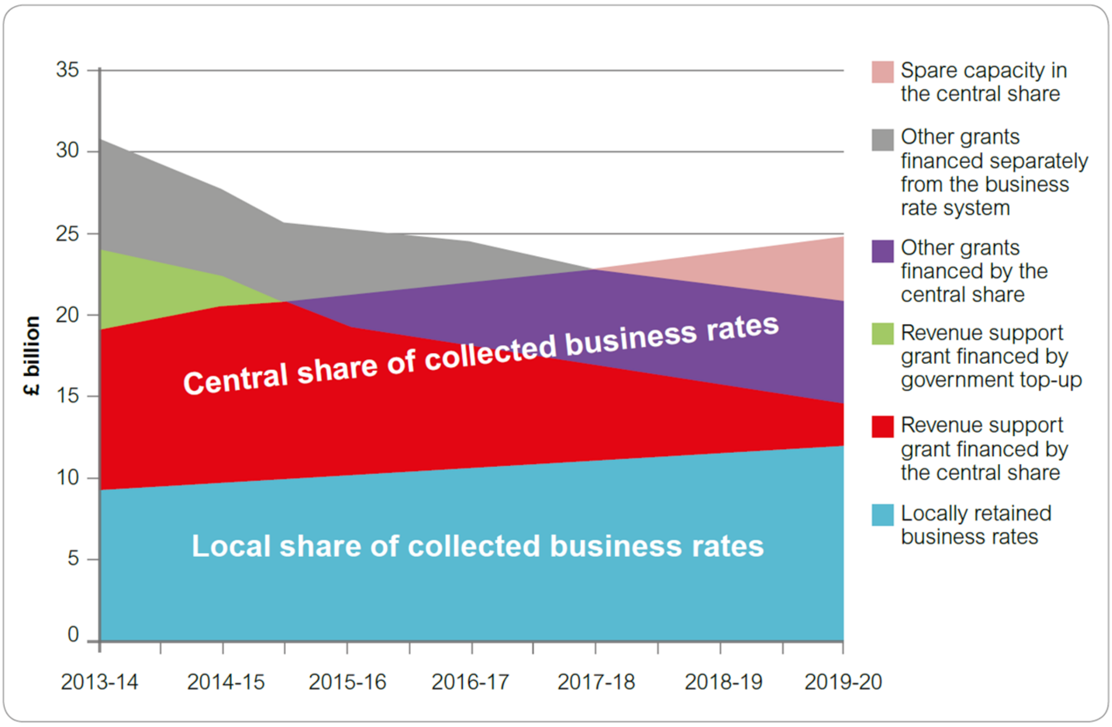
3.4 To achieve this a baseline for each authority was set according to the historic grants which were to be funded from retained business rates. This was then compared to the historic share of business rates available for retention to determine whether an authority would pay a tariff i.e. their share of business rates exceeded previous grants, or an authority would receive a top-up i.e. their share of retained business rates was less than previous grants. The government's retained 50% share of business rates (together with the previous supplement) was paid to authorities as new RSG pro rata to the remaining share of historic grants. This represented a significant change in emphasis in RSG from the previous system (where it was a supplement to redistributed business rates) to be a mechanism to distribute the government's share of business rates.

3.5 In subsequent years the historic baseline share of retained business rates and tariffs/top-ups are uplifted by the same % as the NNDR multiplier. Where the estimated share of retained business rates from NNDR1 returns (i.e. the updated tax base as referred to in paragraph 2.5) is more than the uplifted baseline (after deducting the uplifted tariff) authorities would retain a share of the growth. Where the estimated share of retained business rates from NNDR1 is less than the baseline share (after deducting the uplifted tariff) authorities would receive less than their baseline and effectively suffer a loss in funding from the decline in business rates.

3.6 The retained growth for tariff authorities is subject to a levy (up to 50% of retained growth). There is no levy for top-up authorities. The reductions for authorities suffering a decline are subject to a 92.5% safety net. It was envisaged that the levies would fund the safety net protection.

3.7 The RSG element has reduced since the system was introduced as part of the local authority settlement following the outcome of the Spending Reviews. This has meant that since 2015-16, the RSG has been less than the government's 50% share of business rates, and since 2018-19 the combination of RSG and other grants to local authorities from central government are less than the government's 50% share of business rates. This has severed the historic link between business rates and the funding of local services which has been such an established principle outlined in the introduction to this report. The effect is demonstrated in figure 1 below.

Figure 1: Centrally retained business rates surpass revenue support grant



Source: LGA Future Funding Outlook Analysis 2014

3.8 Effectively the system ensures that the growth in the tax base due to inflation is redistributed via the tariffs and top-ups i.e. according to historic grants. Retention effectively means that only a share of growth from new business is retained in the areas where it is earned (subject to levy), or a share of decline due to business closing or appeals is borne locally (subject to safety net). The tariffs and top-ups have been recalculated to reflect the revised RVs following the 2017 revaluation. This ensures that areas which saw an increase in market values through the revaluation did not benefit from additional retention, and areas which saw little or no increase in market values did not suffer a decline in retained funding.

3.9 In two tier areas the retained share is split 80% to the lower tier, 18% to the upper tier and 2% to Fire. This was to encourage planning authorities (lower tier) to promote growth and meant that every lower tier authority pays a large tariff (and is subject to full 50% levy), and upper tier authorities receive a large top-up. This results in the upper-tier receiving the inflationary uplift through additional top-up each year (affording a degree of stability and predictability) but does not receive very much from growth (or suffer from decline). The lower tier receives a much larger share of growth but carries the risk of decline and does not have the same certainty and stability from inflationary growth in business rates.

3.10 Pooling arrangements allow lower tier and upper tier authorities scope to propose local arrangements which mean more growth can be retained locally (and distributed between tiers according to local priorities). Pooling can also be used to mitigate the risks of losses.

3.11 The original 2013-14 baseline, tariff/top-up, safety net thresholds and levy rates for Kent authorities are shown in table 3. The uplifted baseline for 2019-20 and the uplifted tariffs/top-ups (including the revaluation adjustments are shown in table 4. Table 4 also shows the latest NNDR1 estimated tax base and thus additional retained growth/decline, the section 31 compensation for impact on retention from additional reliefs, and the net retained growth.

Table 3

	Historical Share of 50%			Baseline	**Top-up /**	Safety Net	Levy Rate
		Total £m	**Two-Tier Split £m**	Spending Needs £m	**(Tariff) £m**	Threshold £m	
Ashford	0.20%	21.78	**17.43**	2.51	**(14.91)**	2.33	£0.50
Canterbury	0.23%	24.94	**19.95**	4.09	**(15.85)**	3.79	£0.50
Dartford	0.36%	39.36	**31.49**	2.37	**(29.12)**	2.19	£0.50
Dover	0.15%	16.70	**13.36**	3.24	**(10.12)**	2.99	£0.50
Gravesham	0.10%	10.94	**8.75**	2.59	**(6.16)**	2.40	£0.50
Maidstone	0.25%	27.01	**21.61**	2.85	**(18.76)**	2.63	£0.50
Sevenoaks	0.16%	16.96	**13.57**	2.01	**(11.56)**	1.86	£0.50
Folkestone & Hythe	0.11%	11.72	**9.37**	3.26	**(6.11)**	3.02	£0.50
Swale	0.17%	18.54	**14.83**	3.75	**(11.09)**	3.47	£0.50
Thanet	0.15%	15.81	**12.65**	4.41	**(8.23)**	4.08	£0.50
Tonbridge & Malling	0.25%	26.76	**21.41**	2.01	**(19.39)**	1.86	£0.50
Tunbridge Wells	0.22%	24.01	**19.21**	2.07	**(17.13)**	1.92	£0.50
KCC			**45.82**	164.14	**118.33**	151.83	£0.00
Medway	0.39%	42.56	**41.71**	42.12	**0.41**	38.96	£0.00
K&MFRA			**5.94**	13.02	**7.08**	12.04	£0.00

Table 4

	2019-20 Uplifted Baseline £m	2019-20 Uplifted and Adjusted TT £m	Baseline Change since 2013-14	Top up / Tariff change since 2013-14	NNDR1 £m	Net Local Share after Tariff/ Top-up £m	Gross Growth/ Decline £m	Section 31 Grants £m	Net Growth after Grants £m	Net Growth
Ashford	2.83	(15.86)	12.64%	6.34%	20.19	4.33	1.50	2.23	3.73	131.8%
Canterbury	4.61	(16.29)	12.64%	2.74%	20.16	3.88	-0.74	2.58	1.84	39.9%
Dartford	2.67	(29.26)	12.64%	0.48%	34.22	4.96	2.29	1.17	3.45	129.2%
Dover	3.65	(12.07)	12.64%	19.27%	17.77	5.70	2.05	1.75	3.80	104.2%
Gravesham	2.92	(6.22)	12.64%	1.04%	9.76	3.53	0.62	1.21	1.83	62.7%
Maidstone	3.21	(19.03)	12.64%	1.43%	22.72	3.69	0.48	2.37	2.85	88.9%
Sevenoaks	2.27	(12.40)	12.64%	7.27%	14.05	1.65	-0.62	1.73	1.11	48.8%
Folkestone & Hythe	3.67	(6.11)	12.64%	-0.13%	11.17	5.07	1.40	1.83	3.22	87.8%
Swale	4.22	(11.56)	12.64%	4.26%	19.74	8.18	3.96	2.36	6.31	149.5%
Thanet	4.97	(8.43)	12.64%	2.40%	13.29	4.86	-0.11	2.29	2.18	43.8%
Tonbridge & Malling	2.26	(20.97)	12.64%	8.12%	22.48	1.51	-0.76	1.28	0.53	23.2%
Tunbridge Wells	2.34	(18.37)	12.64%	7.18%	20.71	2.34	0.00	2.20	2.21	94.4%
KCC	184.89	136.21	12.64%	15.11%	50.95	187.15	187.28	10.92	13.19	7.1%

3.12 Table 4 shows the significant impact on the tariff for Dover, where the revaluation resulted in a significant increase in the RV for a large hereditament (the valuation for the Channel Tunnel originally increased RV from £15.4m to £35m). It also shows the impact on retained growth in Tonbridge and Malling which had a major business closure on the Aylesford Newsprint site.

4. Potential Future Changes to Distribution of Business Rate Retention

4.1 In 2015 the government announced its intention to increase business rate retention to 100%. This would require primary legislation. However, this was deemed not feasible within the constrained parliamentary timetable following the 2017 general election. Instead the government announced its intention to move to 75% retention and reform of the risks and rewards from retention (both through exiting legislative framework).

4.2 The government also announced in 2015 that it would undertake "Fair Funding" review of the relative needs and resources formula which set the baseline for historical grants. The aim was to set a new up to date baseline for all authorities which was simpler (without compromising equity), more transparent, sustainable, robust, and sufficiently stable to support multi-year settlements. The revised baseline would reset tariffs and top-ups alongside the reset of business rate growth distribution.

4.3 The government made it clear that the intention of additional retention was not to increase resources for local government as it would be fiscally neutral (the additional retained business rates base would either fund new responsibilities or existing grants). The aim was to better encourage and promote business growth. The additional retention and reforms do not necessarily have to be introduced together.

4.4 The government carried out consultation on additional retention in July 2016 and February 2017 before the draft Local Government Finance Bill fell. These consultations did not reach any firm conclusions which additional responsibilities would accompany additional retention, although the suggestion that local authorities take responsibility for attendance allowance payments was not well supported. There was a very high level of support that the remaining RSG should be funded out of the additional retention, and a good level to use business rate retention to fund other grants e.g. Rural Services Delivery Grant (RSDG) and Public Health Grant. There were mixed views whether Improved Better Care Fund should be funded from retained business rates.

4.5 To support the additional retention the government announced five devolution deal areas for 2017-18 to pilot 100% retention. The pilots were based on devolving additional responsibilities to combined authorities in each area in return for retaining 100% business rates. A Greater London pilot was subsequently agreed later in the year. For 2018-19 a further 10 (largely county areas) were selected to pilot 75% retention (including Kent and Medway). The 2018-19 pilots funded RSG and RSDG from the additional retention but did not take on any additional responsibilities and the excess retention was returned via a tariff. Effectively these 2018-19 were partial pilots only retaining growth and testing alternative tier splits. In 2019-20 15 pilots were approved (including two of the 2018-19 pilot areas) with an emphasis on strengthening financial resilience from retention.

4.6 A further consultation was launched alongside the 2019-20 local government settlement in December 2018. This consultation looked at a number of other aspects of the business rate retention arrangements which had been raised in previous consultations. It did not look at additional responsibilities from increased retention. The consultation looked at how the risks and rewards from retention could be better managed and options to mitigate volatility in business rates. The consultation considered the following aspects of the arrangements:

- Resetting the baseline for growth – full; partial; or phased reset
- Changes to safety net protection
- Changes to levies on growth
- Tier splits in two tier areas
- Pooling incentives
- Treatment of central and local lists
- Treatment of appeals
- Reforms to administration

The government has not yet published the outcomes from this consultation which closed on 21st February.

5. Recommendations

Recommendations:
Members are asked to NOTE this report and the accompanying presentation.

6. Background Documents

None

7. Contact details

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