apse membership resources

Briefing 13/08 March 2013

The Local Retention of Business Rates Scheme

To: APSE Members in England

Key Issues

- The Local Retention of Business Rates Scheme comes in from April 2013 and replaces the existing formula grant mechanism.
- It will see local authorities retain 50% of business rate income including growth. With a top up and tariff mechanism to equalise varying levels of resources across Local Government.
- It will include a levy mechanism ensure rewards of growth are more proportionate and a safety net mechanism to safeguard against extreme drops in business rate income from large scale local economic decline.
- The pro's of the Local Retention of Business Rates Scheme includes greater financial autonomy, with Local Councils will seeing direct financial benefit from business growth in their area.
- The con's of the Local Retention of Business Rates Scheme includes the financial risk from volatility of business rate income being held entirely by Local Councils.
- The change to non-domestic rates relief may make the business case for new leisure trusts less attractive.
- APSE believes that the re-localisation of business rates can help redress the balance of funding providing that such a system is capable of ensuring fairness in access to funding for the poorest areas, whilst encouraging innovation and business start-ups in local areas.

1. Introduction

England currently has one of the most centralised local government funding systems in the world. Business rates are collected by local government, pooled centrally by the Government and redistributed to local authorities through a formula grant. The Local Government Finance Act 2012 creates a new model for funding local authorities from April 2013. This includes the implementation of new arrangements for the local retention of business rates. The new Growth and Infrastructure Bill 2012 includes a provision to delay the next business rates revaluation from 2015 to 2017. Thus the impact on Local Authority budgets from the implementation of the business rates retention scheme from April 2013 has the potential to be with us for the next 5 years. This briefing paper is the first in a series looking at the impacts on Local Government from Central Government financial reforms to council tax and welfare. This briefing paper will provide APSE members with a technical outline of the business rate retention scheme, a discussion of the pro's and the con's, and ends with an apse policy statement.

2. Outline of the Business Rate Retention Scheme

The Local Government Finance Bill legislative process began in December 2011 and covers business rates retention as well as tax increment financing (TIF), localisation of council tax support and technical changes to council tax. The resulting financial system replaces the current formula grant mechanism, where all business rate monies collected went straight to the Treasury and was then distributed back to Local Authorities via the formula rate allocation.

The business rate retention model works on Councils retaining a share of business rates collected in their locality. All authorities will receive Revenue Support Grant from central government in addition to its baseline funding level. An authority's Revenue Support Grant amount plus its baseline funding level will together comprise its start up funding assessment.

Once underway the scheme allows Local Authorities to keep 50% of business rate income including growth, with the other 50% going to the Treasury. This introduces an incentive to go for growth and encourage local enterprise and job creation as councils retain a share of the business rate growth. You will only benefit financially from physical additions to the local business tax base not through increased rental values. If economic activity increases, the total amount of money raised from business rates will grow too. This means there will be more money 'in the pot' both for prosperous councils and to support less well-off areas.

The component parts of the business rate retention scheme are as follows:

- Tariff or Top-Up Status
- The Levy Payment
- The Safety Net Payment
- The Impact of Revaluation
- Pooling

2.1 Tariff and Top-Ups

Under the new scheme Local Authorities may earn more in business rates than they used to receive from the current formula grant and there will be other Local Authorities who earn much less. The scheme recognises the different levels of resources and the need to equalise via tariffs and top-ups.

The diagram below aims to explain how the tariff and top-up status will work.

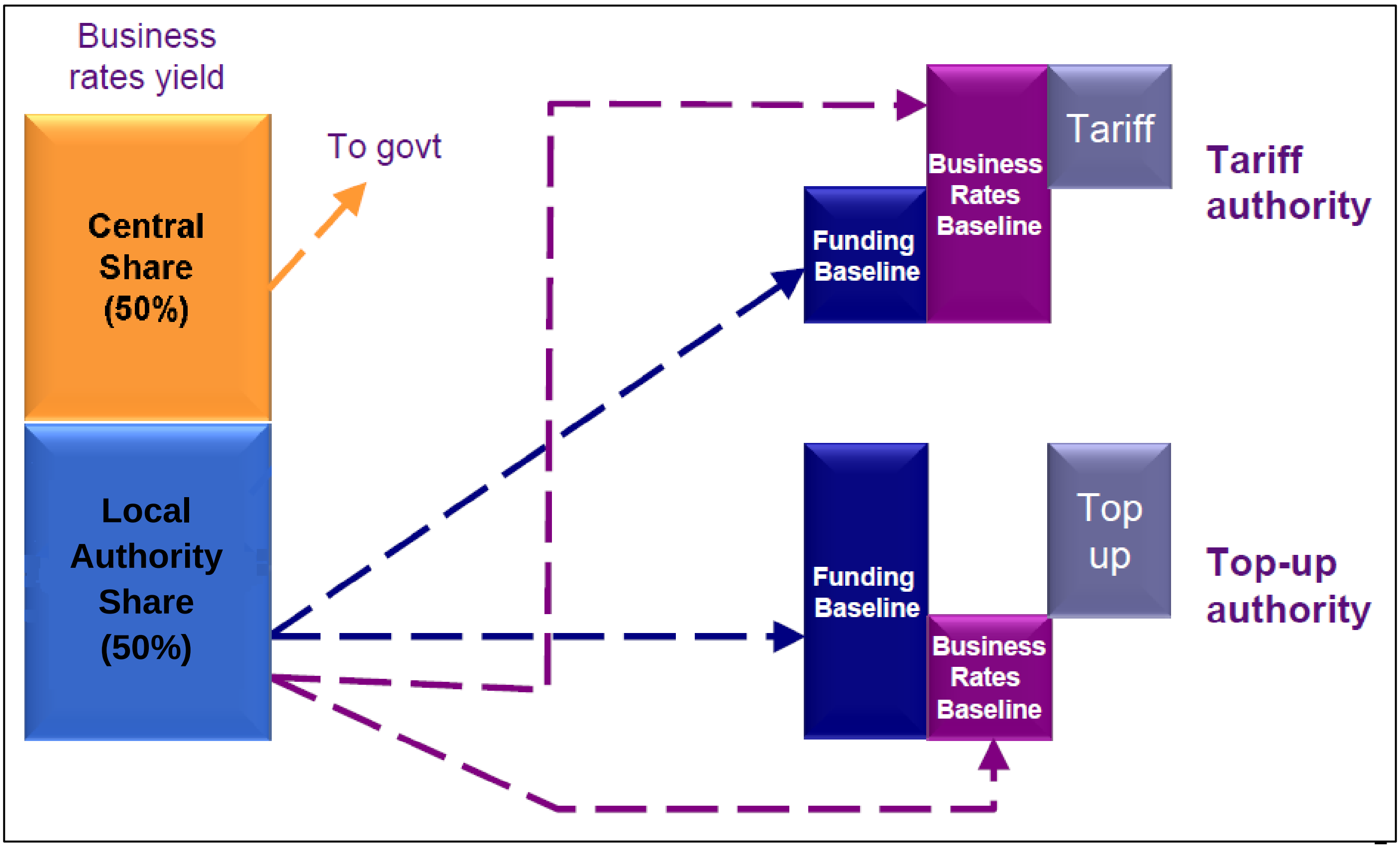

Diagram adapted from presentation delivered by Hugh Grover and Jon Rowney for London Councils, 24.10.12

Should a Local Authority receive more in business rates than its funding level then Government will pocket the difference (the 'tariff'). A top-up authority is a local authority that collects less business rates than their funding level. The Government will use the tariffs they collect to top-up authorities in this situation. Whether you are a 'Tariff Local Authority' or a 'Top-Up Local Authority' is intended to be fixed for 7 years. Both the tariff and the top-up will increase each year with RPI.

The baseline funding level is the amount of a local authority's start up funding assessment which is provided through the local share of the estimated business rates aggregate at the outset of the scheme. It will form the baseline against which tariffs and top-ups will be calculated. The baseline funding level is calculated by the subtracting of the revenue support grant for an authority from the start-up funding assessment for an authority. Local Authority data for start-up funding assessment, baseline funding level and revenue support grant calculations can be found following this link: http://tiny.cc/r4xwsw

The Government will calculate a business rate baseline for each Local Authority based on 'proportionate shares'. They are based on the percentage of the national business rates yield that an authority has historically collected. An average of 2010-11 and 2011-12 figures will be used. The business rate baselines for each individual Local Authority has been calculated by the Government and can be found in Table C following this link: http://tiny.cc/l5xwsw .

2.2 The Levy

Once underway the business rate retention scheme allows local authorities to keep 50% of business rates income including growth. But without adjustment the scheme would be weighted towards richer local authorities. This is because, for a comparatively small investment in growth, local authorities with a large amount of business property can gain large increases in their revenue. In comparison, local authorities with a small amount of business property who put a lot in may get comparatively little out. The Levy is a mechanism to limit disproportionate benefit and in times of economic growth, you may have to pay over some to the increased business rates to government.

To make the rewards of growth more proportionate for different local authorities, where local authorities have greater business rates income than their funding level, the government will take some of their business rates growth as a levy. The levy will be calculated for each individual local authority and will be based on their original business rates income and their funding level. It is designed so that a 1% increase in business rates income will provide no more than a 1% increase in funding, except where this would impose a levy rate of more than 50p in the pound. In these cases the levy will be set so the authority keeps at least 50p in each pound of growth in its business rate income. This means that, even after the government's 50% central share, at least 25p in each extra pound of business rates generated locally will be retained locally.

The worked example below aims to help demonstrate what would happen to a unitary Tariff LA and a Top-Up LA in times of growth.

(This worked example has been adapted from presentation delivered by Hugh Grover and Jon Rowney for London Councils, 24.10.12)

Scenario: 5% Growth = £14m **Starting Point= £280m**	**Tariff Authority** **£000's**	**Top Up Authority** **£000's**
Business Rate Baseline (a)	84,000	84,000
Baseline Funding	46,600	46,600
(Tariff) / Top Up	**(37,400)**	**37,400**
Business Rates Collect in 2013/14	176,400	176,400

Scenario: 5% Growth = £14m Starting Point= £280m	**Tariff Authority £000's**	**Top Up Authority £000's**
Central Share Payment (50%)	(88,200)	(88,200)
Local Authority Share (50%) (b)*	**88,200**	**88,200**
(Tariff)/ Top Up Grant	(37,400)	37,400
Levy on Growth (b-a) x 55 pence (individual retention rate)	1,890	-
Retained Business Rates	**48,910**	**125,600**

*Please note: for London Boroughs the Local Authority Share will be 60% of the balance after 50% central share payment taken by Treasury. 40% goes to Greater London Authority. For two tier authorities the lower tier council will receive 80% of the balance after the 50% central share payment taken by Treasury, with the remaining 20% going to the upper tier council.

2.3 The Safety Net

The local business rate retention scheme provides the opportunity for Councils to benefit from times of economic growth; however this independence also means Councils take on the risk of negative growth. In times of economic decline, you may receive some financial protection from the full impact of the decline. The money government takes as a levy will still be ploughed back into local authorities. In this case it will be used as a shock absorber to protect other authorities that see their business rates income drop by more than 7.5% below their baseline funding level, for example, as a result of a big local business in their local area closing. The amount of the safety net payment will be the difference between the retained rates income and the safety net threshold for that year.

The worked example below aims to help demonstrate what would happen to a unitary Tariff LA and a Top-Up LA in times of decline:

(This worked example has been adapted from presentation delivered by Hugh Grover and Jon Rowney for London Councils, 24.10.12)

Scenario: 10% Decline = £28m Assumes 10% Safety Net Starting Point= £280m	**Tariff Authority £000's**	**Top Up Authority £000's**
Business Rate Baseline (a)	84,000	84,000
Baseline Funding	46,600	46,600
(Tariff) / Top Up	**(37,400)**	**37,400**
Business Rates Collect in 2013/14	151,200	151,200
Central Share Payment (50%)	(75,600)	(75,600)
Local Authority Share (50%) (b)*	**75,600**	**75,600**
(Tariff)/ Top Up Grant	(37,400)	37,400
Safety Net	3,700	-
Retained Business Rates	**41,900**	**113,000**
Reduction in Funding (% loss of baseline funding)	**4,700 (10%)**	**8,400 (7%)**

*Please note that for London Boroughs the Local Authority Share will be 60% of the balance after 50% central share payment taken by Treasury. 40% goes to Greater London Authority. For two tier authorities the lower tier council will receive 80% of the balance after the 50% central share payment taken by Treasury, with the remaining 20% going to the upper tier council.

2.4 Revaluation and System Re-sets

Business properties are re-valued every five years to reflect relative changes in rental valuations. Government has announced its intention to postpone the 2015 revaluation to 2017 with revaluations thereafter taking place every five years. There will be no change to the current revaluation process or timing as a result of the business rate retention scheme. An adjustment to tariffs and top-ups will occur to ensure that authorities do not see their retained business rates income change as a consequence of a revaluation.

In a system reset, new baseline funding levels, new individual authority business rates baselines and therefore new tariffs or top-ups, will be set for each authority to take account of changes in relative need and resource. The first reset is intended for 2020. System resets are possible within 2013 and 2010 in 'exceptional circumstances'.

2.5 Pooling

The scheme allows the opportunity for local authorities to pool their business rates to encourage growth across their areas. A group of local authorities could come together voluntarily to form a 'pool'. There would be a single tariff or top up for the pool which would be the sum of all tariffs or top ups of the individual authorities. This would be complimented by a single levy for the pool and a single safety net payment. Pools would be able to decide for themselves how they distribute aggregate revenues. The deadline for Local Government proposals to set up pools closed in December for the scheme starting in April. Pools will continue from year to year until a designation is revoked. On an annual basis, the Department for Communities and Local Government will invite new bids for pools as well as confirm membership of existing pools.

3. The Pro's and the Con's

Pro's	Con's
Greater financial autonomy for Local Authorities directly receiving 50% of the business rates collected in their locality. Local Councils will see direct financial benefit from business growth in their area.	Potential for a drop in the overall funding received by a Local Council after the setting of the business rate and funding level baselines. This is particularly a risk for more affluent Councils.
Scheme enables councils to borrow money against future business rate growth to fund infrastructure projects in their area.	Managing stakeholder expectations for the Council to utilise new funding streams which will not be realised
Greater certainty for Local Authority budgets over a longer period of time with baselines set for 7 year period, enabling Council's to plan ahead, manage risk, budget for the long term and plan for worst case scenarios.	Volatility of rates of income held entirely with the Council. A risk in current economic climate that local businesses reduce. Council takes on the risk of economic decline in their local area and the receipt of lower business rate income. A business rate income drop of 7.5% below baseline funding level must be achieved before a Local Authority can be compensated by a safety net payment
Increased financial reward to Local Authorities of appropriately-sited and well-planned non-residential development. This is especially true of new renewable energy projects that start paying business rates from year one.	Councils may find themselves reliant on hard to estimate safety net payment if locality in prolonged period of economic decline.

Pro's	Con's
The opportunity for pooling encourages collaborative working across local authorities and allows the benefit from investment in economic growth to be shared across the wider area and helps local authorities to manage volatility in income by sharing fluctuations across budgets.	The interaction of the localisation of business rates with the wider welfare reforms make the local government finance system more volatile with the possibility for some local authority areas of a decline in business rate income at the same time as an increase in welfare claimants due to the recession.

3.1 Mandatory and Discretionary Relief- Impact on the business case for Leisure Trusts

Under the rates retention scheme, the existing costs of mandatory and discretionary reliefs, such as those afforded to Leisure Trusts, will be accounted for within local authorities' business rates baselines. However, any changes in these costs once the scheme is underway will be shared 50:50 between central and local government. This means local government will share half of any increase in the cost of mandatory reliefs once the scheme is underway.

Mandatory relief was formally provided under Section 43(6) of the Local Government Finance Act (1988) and provided that:

- Charities must receive 80% relief on the rates for premises which are wholly or mainly used for charitable purposes; and
- Community and Amateur Sports Clubs (CASC) must receive 80% relief on the rates for premises which are wholly or mainly used for the purposes of the club itself, ort for the purposes of the club and other Community and Amateur Sports Clubs.

Discretionary relief is different to mandatory relief and this allowed a local authority to grant a further 'top up' relief at its discretion to a charity or CASC, which could have seen a total relief of 100% of the business rates payable if a local authority chose to provide discretionary relief of 20%. This meant the setting up of a Leisure Trust became a very attractive way of saving money or/and way of offsetting the savings on business rates to support capital investment in facilities.

Prior to the introduction of the Business Rate Retention Scheme, the cost of mandatory and discretionary relief was generally met by central government as part of the redistribution exercise of business rates collected. However, new Trust arrangements entered into after April 2013 will still attract 80% mandatory relief but only 50% of this will be funded by central government. Additionally central government will now only meet 25% of the costs of awarding discretionary relief.

Therefore the financial advantages to the local authority of operating under a trust basis have been lessened because arguably it is self defeating to grant business rate relief which ultimately the authority must fund substantially from its own resources.

4. APSE Comment

APSE supports the re-localisation of business rates to help redress the balance of funding providing that such a system is capable of ensuring fairness in access to funding for the poorest areas whilst encouraging innovation and business start-ups in local areas Figures collated by the DCLG suggest that nearly two thirds of Councils expect to gain extra revenue in the first year of the move to localised business rates. Additionally, all 90 councils which are involved in the 13 pooled business rates arrangements are set to gain from a collective £40m in additional cash revenue than they would have had if they hadn't pooled.

APSE encourages its members to take the time to build understanding of the business rate changes and use the online calculator tools and figure tables to build more accurate income estimations. Although it is too late for

2013-14 for local councils to come together into a pool, APSE encourages Local Authorities to learn from the experience of others who have entered into pools over this coming 6 months to consider whether creating a pool with neighbouring authorities could deliver additional value by working together to support and harness growth.

Although APSE welcomes the ethos of localism that comes with the greater financial autonomy offered by the retention scheme, we don't believe this should be at the expense of Councils being worse off as a result of the changes. Although APSE welcomes government response by introducing the top up and tariff system to relieve the initial worries expressed by APSE and others of creating, or at least exacerbating, inequalities of Local Authority income. APSE is still concerned that there will be a cohort of Council's with weaker business rate potential that will continually lose out. APSE will be monitoring this scheme as it progresses from April 2013 to check a permanent two-tier system of top-up and tariff councils doesn't become a reality. Additionally, whilst local authorities are now afforded greater discretion to grant discretionary rate relief, the power to use this for the benefit of local communities and economies in reality is limited as central government will now only meet 25% of the costs of awarding discretionary relief. This leaves Local Authorities to finance such new arrangements substantially from their own dwindling resources.

APSE encourages its members to look at their asset base and revaluate commercial opportunities. For example, the opportunity posed by surplus farm land for renewable energy projects, utilising the opportunity posed as the planning authorities from change of use to business premises, the opportunity to attract buyers for warehouse space from manufacturing and logistic industries. APSE also encourages its members to be clear on what stance they will take with regard to new applications for discretionary rate relief and also to be aware that new arrangements attracting mandatory relief will only receive 50% funding from central government, with the other 50% to be resourced by the local authority purse.

Helen Burkhalter, Principal Advisor, APSE