SPARSE-Rural – Proposals for lobbying following 100% rates retention

Introduction

1. On 5 October 2015 the Chancellor announced that local authorities will be allowed to retain 100% of their business rates income by the end of this parliament. This is hugely significant to local government and to rural authorities. It is not clear how 100% retention will be implemented, and the way that it is implemented will be critical to rural authorities.
2. Graham Biggs has asked Pixel to make a proposal to the SPARSE-Rural meeting on 16th November to show how RSN can prepare for 100% retention and to start developing "lines of attack" to be used later.
3. In this report we have outlined the Chancellor's proposal, and how we think it might be implemented, about which there is still considerable uncertainty. We have then set out the analysis that we suggest is required in the short term – particularly about business rates growth in rural areas – and the further issues that RSN needs to be aware of. As part of this analysis we would set out a range of recommendations of what RSN should be asking from Government.

100% business rates retention

4. Under the Chancellor's proposals all business rates income (£26bn) would be retained locally, although it is unclear whether this includes the £1bn "central list". 100% retention would apply to the sector as a whole; the Government is still envisaging transfers between local authorities – possibly by using something similar to the current top-ups and tariffs. This is not strictly the same as allowing rates to be retained locally where they are collected.
5. A recent Ministerial Statement by Communities Minister Greg Clark confirmed there would be redistribution between Councils – although gave no hint of what that may be. The Statement reads 'Redistribution between Councils will remain important, to reflect the needs of different authorities'.[1] The Statement also states ' In developing the reforms we will consider the responsiveness of the system to future changes in relative needs and resources whilst maintaining a strong incentive for authorities to grow their local economies' and 'we will also consider how risk and business rates volatility can be better managed and how to protect authorities against significant falls in income'
6. Phasing of the proposals is still unknown. All that has been promised is that 100% of rates will be retained locally by the end of the parliament. The transition to 100% retention could start in 2016-17, however.
7. However, the increase in locally-retained rates does not represent "new money" or increased spending power for local government. The increase in retained rates will be in return for the elimination of "core" grants (e.g. RSG, and possibly New Homes Bonus) and new burdens. We estimate that local government will have to shoulder at least £10bn in new burdens, funded

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[1] Written statement (HCWS221), 12 October 2015

through Business Rates retained income, by the end of the parliament if the increase in retention is going to be fiscally neutral.

8. The nature of these new burdens will be as important as rates retention itself. Ministers might already have an eye on what these new functions could be (e.g. the expanded childcare offer, new public health responsibilities, health and social care investment). Other ideas could take a little more thought (e.g. housing benefit) or be more controversial (e.g. unemployment benefits). What is important for the medium term is whether growth in local rates matches the growth in spending pressures on these new burdens; this balance will be different for each authority. And for it will be important to understand where there will be greater costs of delivery of the new burdens in the rural context.

9. Another consequence of the increase in retention is that many of the new burdens are likely to be for upper-tier services (social care, childcare). This will increase the share of business rates that is retained by county councils in two-tier areas (currently districts retains 40% of business rates growth and counties c.10%), as well as its share of future growth.

10. Authorities will be able to keep all the growth in their business rate income. The Government wants authorities to promote growth and attract businesses, and in return to benefit from increases in business rates. This suggests that there will be no more levies on above-target growth. This leaves the question of what kind of safety net there will be for those with falling business rate income, and how that will be paid for.

11. It is not clear how ministers will deal with any needs assessments. We were expecting there to be a freeze on needs assessments until 2020-21. These proposals for increased local business rates retention are not incompatible with the current freeze. Treatment of specific funding streams within RSG – council tax freeze grant and rural services delivery grant – also needs to be watched.

12. The vexed question of equalisation is left open. There is the suggestion that resources will be equalised once at the start of the new scheme, and possibly not again thereafter; this would allow growing authorities to keep all their future business rate income (this is "point" equalisation). More frequent equalisation of resources (and of needs) would help those with less ability to generate business rates growth (and those with growing needs); but would come at the price of "taxing" growing authorities and reducing the incentive effect on these authorities. Ultimately the balance between equalisation and incentives is one that ministers will have to make.

13. We are likely to find out more about how the proposals will be implemented in the Spending Review (25 November 2015), although it is likely that many of the details will still be unknown at that stage. If implementation starts in 2016-17, then we will know more about the details in the provisional settlement in December 2015.

14. These are the questions that rural authorities will need to consider in relation to the 100% retention proposals:

    - Are business rates growing more quickly or more slowly than the national average in rural authorities? Are there different prospects for different types of rural authority?

- Will the spending pressures of new burdens for rural authorities be greater than the benefit from the increased retained rates? What services would rural authorities like to be funded from retained business rates? Is there a "Rural Premium" in terms of service delivery costs?
- What type of equalisation would work best for rural authorities?
- How do rural authorities ensure that their "needs" are properly taken into account, both at the outset of the new system and during its operation?
- Is the incidence and impact of appeals greater in rural areas?
- What impact is revaluation of business rates likely to have on rural areas?

Proposed areas of work

15. In our note to RSN on lobbying options (1 July 2015), we identified changes in local government funding that RSN would have to take account of when developing its lobbying strategy. We said "*The emphasis is increasingly on giving authorities greater tax retention powers, and less on needs-based funding. Rural authorities are less well placed than most urban areas, and need to come up with solutions that will reward and incentivise growth in rural areas.*" The proposal to increase retention from 50% to 100% makes responding to this agenda even more important.
16. The starting point for this analysis has to be to understand more about rural authorities' taxbases and their prospects for growth. The principal winners from 100% retention are likely to be those with the greatest opportunity to increase their business rates base. Our presumption is that "urban" authorities have had higher rates of growth in the past and have greater scope to continue these growth rates than rural authorities.
17. We would propose looking at growth rates since the start of the retained rates system to find out (a) whether urban authorities do indeed have higher rates of business rate growth and (b) what is happening to rural authorities' rates base. There are a number of issues to unpick here:
    - is the rateable value per head higher in urban than rural areas?
    - is rateable value growing more slowly in rural areas?
    - do rural authorities tend to have a higher proportion of reliefs, thereby reducing actual income?
18. If there is any evidence that rural authorities would be disadvantages in any way, then RSN can start to argue for, for instance, levies on growth, enhanced retention for low-growth areas, more frequent equalisation, or more support for reliefs.
19. A note of caution at this stage is that there could be two groups within the RSN membership: well-connected rural authorities with, say, distribution centres, who will have rapidly growing taxbases; and peripheral rural authorities with very little scope to grow their business taxbases. This might make it difficult to develop a consensus or it might be that the RSN case has to focus on more specific issues (such as support for reliefs, or proper "needs" equalisation). It should also be noted that urban authorities might be even more polarised, with the bulk of taxbase growth concentrated in a small group of authorities. RSN might find that it has common cause with low-growth, high-need urban authorities.

20. From this analysis RSN will be able to start addressing the other key questions for rural authorities.

- Equalisation. The Chancellor's announcement suggests that "point" equalisation is likely – i.e. only equalise at the start of the system. If rural authorities do indeed have less scope to generate business rates growth, then more frequent equalisation will be preferable. If so, how frequent, on what basis? Does regional equalisation offer a better solution?
- Rural authorities with funding from RSG – especially for things like freeze grant, rural service delivery grant – will want to make sure that these "benefits" are preserved in the new system. The likely effect of 100% retention is that these benefits will be eroded, at least in real terms, because the system is equalised at its outset but then not again in future. What protections can authorities get for their existing funding? Is this something that is relevant to rural authorities?
- At least £10bn of new burdens will need to be transferred to local government. We do not yet know what these will be but they will need to be substantial: childcare, social care/ health, public health. Do rural authorities get a fair share at the outset? These transfers-in will come with spending pressures – is the growth greater in rural areas than urban, and is there a mis-match between spending and taxbase growth?
- If the new system is going to be locked-down early, with little prospect of it being reviewed, it is really important that the most egregious failings of the system are addressed. For RSN, these will be (a) fully implement rural formula and (b) phase-out damping in a reasonable timescale.

Proposal

21. In our preliminary analysis we would undertake a full analysis of the retained rates system since April 2013, including:

- Analysis of 2013-14 and 2014-15 NNDR3s (and NNDR1 for 2015-16). Key business rates factors, including rateable value, growth in rateable value, reliefs, and losses on appeals. Take account of the adjustments that authorities have made (particularly providing for losses on appeals).
- Presentation of data in benchmarking format – useful to RSN as a whole, but also potential for individual RSN members to see how they compare to others.
- Rework the SFA per head in urban/ rural areas, and show for a range of business rates factors, including rateable value per head, net collectable rates per head, and growth in gross/ net collectable rates.
- For rural authorities compared to urban, what are the current differences (per authority, and average for rural v urban) between 100% Business Rates and current Business Rates Retention, and the present funding streams likely to be lost? This may give some ideas of scale and perhaps some points for MPs and/or media purposes. The RSN's Dan Worth could carry out this work with some tutelage and support from Pixel

22. The outputs would be an interactive benchmarking model, and a short report analysing the data and making recommendations about RSN's future lobbying strategy.

23. We can update the analysis as the operation of the new rates retention system becomes clear. We would have particular focus on how equalisation works, ensuring that current and future needs are properly recognised, and on how the £10bn of new burdens is being allocated and funded.
24. This work will be undertaken by Adrian Jenkins and Dan Bates. We would expect the benchmarking model and report to be ready before the provisional settlement in December . We estimate that we would require 15 days for the in-depth benchmarking analysis and report, and that this would include a meeting/ presentation of our findings.

Adrian Jenkins

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