Rural Service Network (RSN)

Business Rates Retention: Analysis for Rural Authorities and Proposals for Future Lobbying

Introduction

1. In the Spending Review (25 November 2015) the Chancellor confirmed that local authorities will be allowed to retain 100% of their business rate income by the end of the current parliament. This is hugely significant to local government and to rural authorities.
2. In this report we have outlined how the current rates-retention system works and how it might have to change to accommodate 100% retention. We have then analysed the business rates collected and reliefs awarded in rural areas, and how the current retention system impacts on rural authorities.
3. From this analysis we have highlighted features of the current system that work to the advantage and disadvantage of rural authorities. We have recommended where RSN could lobby for changes to the current system, and outlined the issues that RSN needs to be aware of during the period that the Government is designing 100% retention.

Operation of the current rates-retention scheme

4. The current rate retention regime was introduced in 2013-14. Before this, a nationalised business rates system operated whereby local authorities acted as collection agents for central government; business rates were collected locally, pooled nationally and then redistributed to local authorities through Revenue Support Grant (and other grants). Under the rate-retention system introduced in 2013-14, local government retains 50% of business rates, with the remaining 50% being paid over to central Government (and returned to local government through RSG and other grants).
5. Within local government, different rate retention amounts are set for different functions. District functions retain 40%, upper-tier functions 9% and fire functions 1%. A unitary council with fire functions will retain 50% of rates. A district council will retain 40% of rates. A county council will only retain 9%, unless it still has fire functions, in which case it will retain 10%.
6. Importantly, there is still rates equalisation in the system, otherwise the authorities with the largest rate bases would have far too much income for their needs, and most of the rest of local government would have too little. To adjust for the massive differences between rates collected and needs, the Government still sets a needs target and a business rates target for each authority.
    - Where the business rates target is greater than the needs target, then the authority pays over a **tariff** into the national pool; and
    - Where the needs target is greater than the business rates target, then the authority receives a **top-up** from the national pool.

7. Across the whole country, top-ups and tariffs balance each other out; the system of transfers between authorities balances out the differences between needs and income potential. Top-ups and tariffs – and the underlying needs and rates targets – are fixed until 2020 and only uprated each year by the increase in the national business rates multiplier (usually the Retail Price Index from the previous September).
8. There is protection – a safety net – for authorities whose business rate income falls significantly in any one year. The threshold for the safety net is set at 92.5% of the authority's baseline funding level.
9. Levies are also payable by authorities on business rates that are collected above their rates target. The levy rate is calculated by comparing the needs target with the rates target. If the rates target is, say, £25m and the needs target is £20m, then the rates target is 25% greater and the levy for the authority would be 25% (i.e. the authority would pay over to central government 25% of any business rates is collects over-and-above the business rates target). The levy rate is capped at 50%. For any authority whose needs target is lower than their rates target (i.e. all top-up authorities), no levies are payable at all, even if business rate income exceeds the target.
10. District councils have very large business rates targets (because they retain 40%) relative to their needs targets. As a result they are all tariff authorities, and all pay a levy. Conversely, almost all county councils are top-up authorities and do not pay levies. Because most rural areas have two-tier structures, most of the rates collected in these areas are at risk of being reduced by levies. In contrast, most urban areas – outside the major city centres – are top-up areas, and above-target business rates in those areas are not exposed to levies.
11. There is a way that two-tier areas can reduce the levies that are payable, and that is by using business rates pools. In these pools, county councils (top-ups) and district councils (tariffs) combine together to reduce the average levy rate on above-target business rates collected. In most cases, the average levy-rate is reduced to zero, although not in all cases. This arrangement does not work for every area or for every district council, which means that many districts – and many rural areas – are exposed to the full levy rate.
12. The rates baselines that authorities were given in 2013-14 included the reliefs that were given to businesses at that time. These included both the mandatory and discretionary reliefs. However, any change in those reliefs (except those funded specifically by central Government through a section 31 grant) has a financial effect on the local authority broadly equivalent to the function shares outlined above. If the amount of relief awarded (such as charitable or rural relief) increases then the local authority has to pay for its share of the increase; if it reduces, then the authority gets its share of the reduction. There is therefore a financial incentive to reduce the value of reliefs that are awarded locally, but in the case of mandatory reliefs the authority has no choice other than to award the relief to qualifying businesses.
13. When the Retained Rates system was introduced in 2013-14 it was envisaged that the system would be "frozen" until 2020-21. This meant that the rates targets, top-ups and tariffs would be untouched (other than to increase for inflation every year). Freezing the rates target for 7 years means that there is a reasonable incentive effect for those authorities with growing rate bases (although those with falling rate bases have to suffer the effects for this period as well). There are two problems with this approach:

- Revaluation of rateable values (RV) in 2017-18 – part-way through the freeze – and it is unclear how this would be handled. The revaluation would change the RV of every property in England and change the national multiplier as well. It would cause significant disruption to the system.
- The needs target will remain frozen until 2020, which means that the formulae for assessing needs will not be changed for 7 years, and neither will the underlying data that drive the formulae. "Errors" (perceived or real) could not be corrected during this period; and the formulae cannot respond to changes in demography. For rural authorities, the damping that eroded their "gains" in 2013-14 cannot be addressed or reduced until 2020.

14. It is unclear how the reset in 2020-21 would be handled: would the new baselines be reset entirely, would authorities be allowed to retain some of their previous gains, and would there be a transitional period?
15. In practice, the Government could change the targets (and the resulting top-ups and tariffs) if they wished: the mechanics of the system allow ministers to do this; it has been a policy choice to freeze targets and the top-ups and tariffs. At least until now.

100% business rates retention

16. 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.
17. It is important to note that what is being proposed is not proper localisation of business rates or self-financed local authorities. The Government will continue to tell every authority how much of their own business rates they can keep, and how much has to be paid over to support other authorities. The amount authorities can keep – and how much they have to spend – will continue to be determined by the Government's assessment of their ability to collect taxation (council tax and business rates) and their need to spend (needs assessment).
18. A recent Ministerial Statement by the Secretary of State, 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 goes on to say, "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".
19. 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. A period of engagement with local government is starting in early 2016, and there will be a consultation paper in Summer 2016 followed (possibly) by primary legislation. With such a timetable it is possible that the transition to 100% retention could start in 2018-19, however.

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

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20. The increase in locally-retained rates to 100% 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 around £9.1bn in new burdens, funded through Business Rates retained income, by the end of the parliament if the increase in retention is going to be fiscally neutral.
21. 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). Other ideas could take a little more thought (e.g. housing benefit) or be more controversial (e.g. unemployment benefits). Attendance Allowance looks to be a very likely candidate; if this is the case, then it would account for more than half of the additional new burdens (£5.5bn out of the £9.1bn). What is important for local government for the medium term is whether growth in local business rates matches the growth in spending pressures on these new burdens; this balance will be different for each authority. And it will be important to understand where there will be greater costs of delivery of the new burdens in the rural context.
22. 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 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 (or contraction). Some of them will also be much higher per head in higher-need (typically urban) areas, which will increase the amount of rates than needs to be retained in these areas. This could push some urban authorities into the tariff category, and could reduce the levy rates in some rural areas.
23. With 100% retention, 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, but our view is that this is probably unlikely. 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.
24. It is not clear how ministers will deal with any needs assessments. A freeze in needs was expected until 2020-21. The 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.
25. 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.

Scope

26. This report will seek to address a range of questions about how the current and future rate-retention regimes work. The answers to these questions will help us to understand how rural and sparse authorities have fared in the current system, and how they would be better advantaged by changes to the system.

27. First of all, it is essential to establish what business rates bases are like in rural areas:

- Are business rates nationally growing more quickly or more slowly than the national average in rural authorities? Are there different prospects for different types of rural authority?
- Is the incidence of reliefs greater in rural areas and does this reduce the amount of collected rates more in rural areas than in urban areas?
- Is the incidence and impact of appeals greater in rural areas?

28. We then need to establish whether there are features of the way the system has been implemented that are good – or bad – for rural authorities:

- Did rural authorities gain or lose from the way that the initial baseline was set at the start of the retention scheme in 2013-14?
- Does the way that levies are calculated work against rural authorities, particularly in two-tier areas?
- What type of equalisation would work best for rural authorities?
- Is the current method of protection through the safety net appropriate for rural authorities?
- How much business rates has been retained by rural authorities above the Business Rates Target?

29. We know little about how 100% retention will work, but these are some of the questions that we need to consider:

- 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?
- 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?
- What impact is revaluation of business rates likely to have on rural areas?

Methodology

30. In this report we have analysed the key elements of the rates collected by each billing authority. This includes showing the trends and the amounts per head. Amounts are shown in both cash and real terms based to 2010-11 (the start of the current rating list). Adjustments for inflation have been done using the rates multiplier (updated for the Sept RPI).

31. The element of rates that have been analysed are:

- Rateable value. The valuation for each business hereditament; it is provided by the Valuation Office Agency (VOA).

- Gross rates payable. The amount payable by local businesses before the application of various reliefs; effectively the RV multiplied by the national multiplier.
- Mandatory relief.
- Discretionary reliefs
- Unoccupied property reliefs
- Discretionary relief
- Rural relief
- Net rates payable. The amounts payable by businesses after the application of reliefs.
- Retained Rates, including levies and safety net payments. The amounts that local authorities are able to retain; includes adjustments for local and national shares, top-ups and tariffs, and the levy and safety net.

32. We have used a combination of NNDR1 and NNDR3 (these are the budget and outturn forms that are returned by each billing authority). There can be variances between budget and outturn both for differences between plans and actual performance, and as a result of budgeting strategies used by local authorities. We have used NNDR3 outturn where this is available (the latest is for 2014-15 outturn). These forms show data at the billing authority level; they are not returned by preceptors (county councils, fire authorities).
33. To calculate Retained Rates, and levies and safety net payments, we have used the DCLG's levy and safety net calculator for 2014-15. This shows the estimates for 2014-15 based on the 2014-15 NNDR3. It shows all local authorities, including districts, single tier authorities, county councils and fire authorities.
34. We have used the following classification of authorities, which are produced by DEFRA:
    - Major Urban (MU) – districts with either 100,000 people or 50% of their population in urban areas with a population of more than 750,000
    - Large Urban (LU) – districts with either 50,000 people or 50% of their population in one of 17 urban areas with a population between 250,000 and 750,000
    - Other Urban (OU) – districts with fewer than 37,000 people or less than 26% of their population in rural settlements and larger market towns
    - Significant Rural (SR) – districts with more than 37,000 people or more than 26% of their population in rural settlements and larger market towns
    - Rural 50 (R50) – districts with at least 50% but less than 80% of their population in rural settlements and larger market towns
    - Rural 80 (R80) – districts with at least 80% of their population in rural settlements and larger market towns

Gross Rates Payable and Rateable Value

35. Gross Rates Payable (GRP) and Rateable Value (RV) are the two top-level indicators of the amount of rates that is generated in an area, and the direction of travel. There are numerous adjustments between gross rates and the amounts that authorities can recognise in their

budgets (reliefs, losses on collection, levies), but the gross position gives the clearest broad indicator of overall change in the ratebase.

36. GRP is much lower per head in rural areas than urban areas (Chart 1). It is £565 per head in Major Urban areas (including central London and the major cities). The average is £506 for England, with all other areas of England apart from MU being below average. Major Urban authorities collect almost 50% of the total gross rates in England (£12.1bn compared to £14.7bn in the rest of England as a whole). Rural areas have by far the lowest GRP per head: SR £366, R80 £317, and R50 £310. The amount per head in R50 authorities is only 55% of the amount per head in Major Urban areas (and only 72% of the average).

37. There are also some very significant outliers in the Major Urban authorities. For examples, GRP is £8,669 in Westminster, and as high as £777 per person in London as a whole. Other Urban authorities and, in particular, Large Urban authorities have much lower business rates per head (£422 and £361 per head respectively). Large Urban authorities actually have lower GRP per head than the average for SR authorities.

38. Differences in rates are adjusted for in the rates retention scheme at the start (i.e. in the rates target). Nevertheless, a larger rate-base will give an authority a greater opportunity to grow in future, and a 1% increase in GRP will result in much greater additional income. **For instance, a 1% increase in the GRP for Major Urban authorities will generate c.£123m whereas it would generate only £20m for R80 authorities and £27m for R50 authorities.**

39. This is illustrated by the growth in GRP which – in cash terms – is greater in urban areas, particularly Major Urban (Chart 3). Growth was particularly strong in Major Urban areas in 2012-13 and 2013-14. The picture is not always clear-cut, as can be seen in the dip in growth in Major Urban areas in 2014-15 and 2015-16,but over the period since 2010-11, growth in GRP has been higher in urban than rural areas.

40. In contrast, the strongest growth in GRP and in Rateable Value is in rural areas (Chart 2 shows the percentage increases in GRP since 2010-11). Average growth rates in percentage terms have been higher in rural areas than urban areas during the period of the current rating list (starting in April 2010). The average growth in GRP is 2.1% (real terms) in R80 authorities, 1.7% in R50 authorities, compared to an average for England of 0.3%, -0.5% for London and -0.3% for Major Urban authorities.

41. **As can be seen, urban areas are on average able to convert a lower percentage increase in GRP into a higher cash-terms increase**.

Chart 1 - Gross Rates Payable

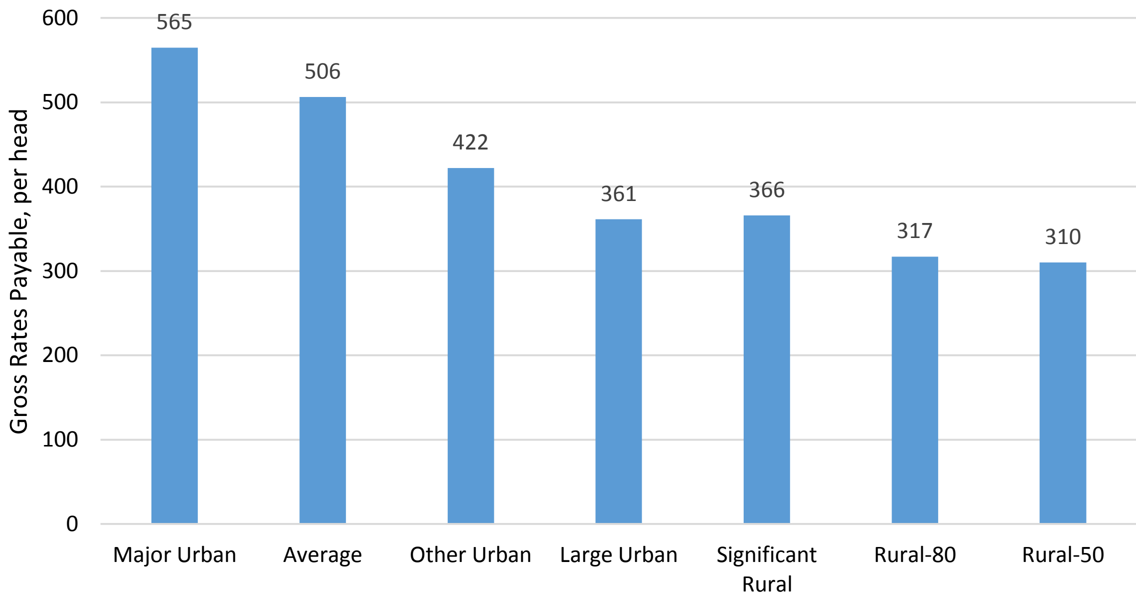
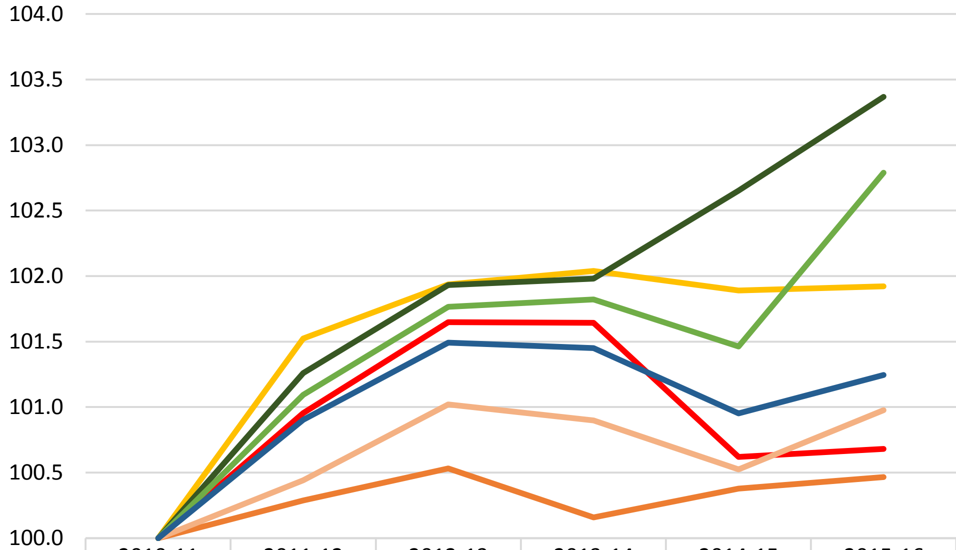


Chart 2 - Gross Rates Payable



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Major Urban	100.0	101.0	101.6	101.6	100.6	100.7
Large Urban	100.0	100.3	100.5	100.2	100.4	100.5
Other Urban	100.0	100.4	101.0	100.9	100.5	101.0
Significant Rural	100.0	101.5	101.9	102.0	101.9	101.9
Rural-80	100.0	101.3	101.9	102.0	102.7	103.4
Rural-50	100.0	101.1	101.8	101.8	101.5	102.8
England	100.0	100.9	101.5	101.5	101.0	101.2

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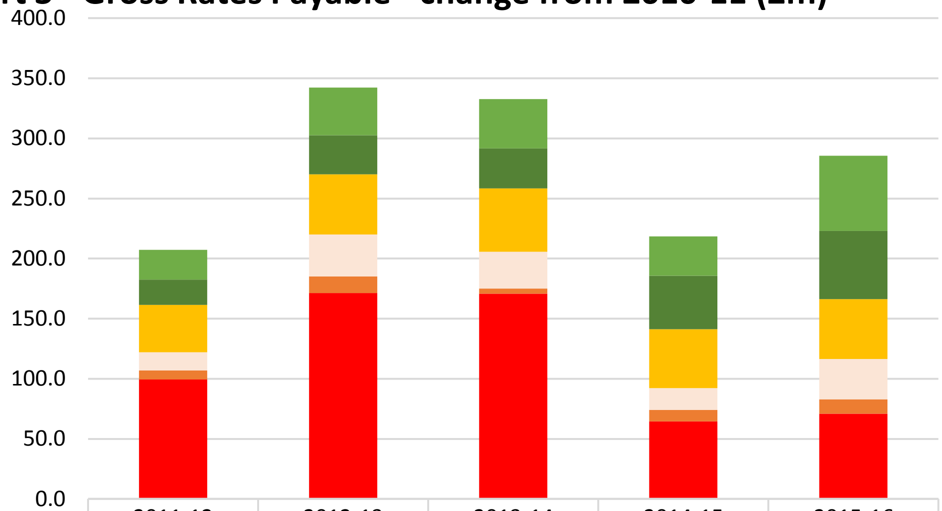
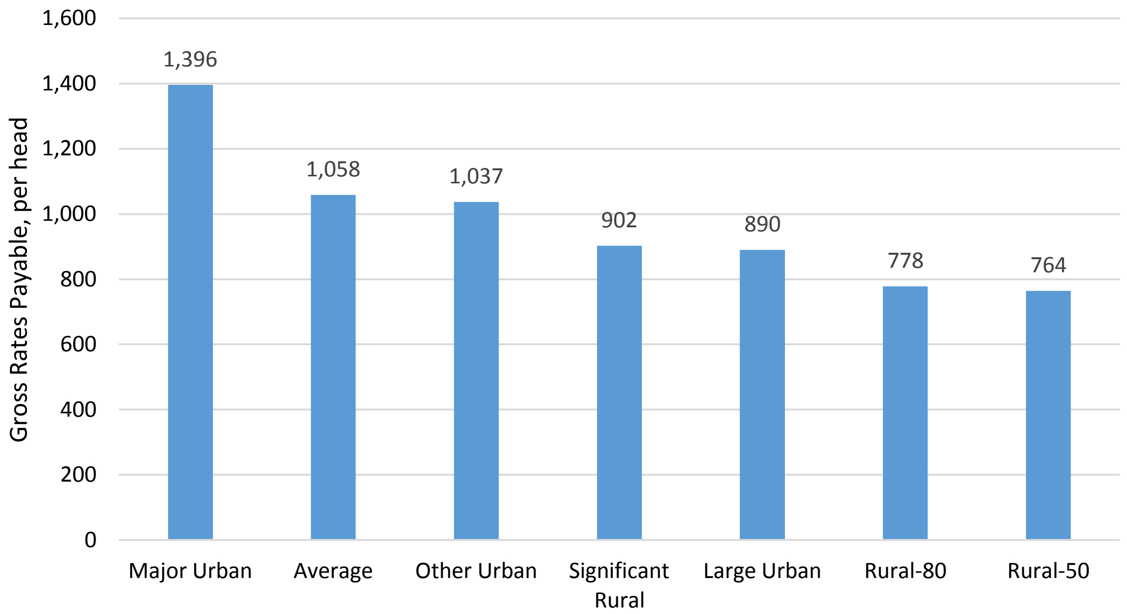
Chart 3 - Gross Rates Payable - change from 2010-11 (£m)



	2011-12	2012-13	2013-14	2014-15	2015-16
Rural-50	24.6	39.6	40.9	32.8	62.6
Rural-80	21.2	32.5	33.3	44.6	56.6
Significant Rural	39.5	50.2	52.8	49.0	49.8
Other Urban	15.1	35.0	30.7	17.9	33.4
Large Urban	7.4	13.8	4.1	9.8	12.1
Major Urban	99.4	171.3	170.8	64.4	70.9

Chart 4 - Rateable Value



42. We have undertaken further analysis of the composition of the rateable value in urban and rural authorities.[2] Specifically:

- **Number of business hereditaments (Chart 5)**. The number of business hereditaments is overwhelmingly in the Major Urban authorities, and there are roughly double the number of hereditaments in urban areas (850,000) than rural areas (487,000).
- **Square metres (sqm) per hereditament (Chart 6)**. The average size of business hereditament is smallest in the most urban and the most rural authorities.
- **Rateable value per sqm (Chart 7)**. Rateable value per sqm is highest in Major Urban areas, and gets progressively lower in more rural areas. Average RV per sqm was £44 in Rural 80 authorities and £88 in Major Urban authorities. (There are further classifications of business that can show the RV per sqm; we have shown the average for all businesses.)
- **Rateable value per hereditament (Chart 8)**. Reflecting the lower RV per sqm the average RV per hereditament is much lower in rural areas than rural areas. Average RV per hereditament is less than half that of a business in Major Urban authorities.

43. Our broad conclusion from the data is that a new business hereditament will attract more RV in an urban area than a rural area. RV is about twice as high in Major Urban areas compared to the most rural authorities. This means that the economic development activity of a rural council will be much less well rewarded than in an urban council. To generate the same amount of additional rateable value –in cash terms – a rural authority would have to attract twice the amount of additional new business space. This is something that should be taken into account in both the equalisation and the levy system in a future retention scheme.

44. Additional analysis has been undertaken using data from NOMIS on business counts in the UK. This data shows what is happening to all businesses whether they have business premises eligible for business rates or not:

- Chart 9 shows that the increase in the number of businesses is much lower in rural areas than urban areas. In the period 2010 to 2015, the growth in Predominantly Rural areas has been 8.19% compared to 17.8% in Predominantly Urban areas. This suggests business formation is almost twice as strong in urban areas.
- Chart 10 shows that businesses are likely to be larger in urban areas. This should result in businesses that have premises eligible for business rates.

45. The growth in businesses does not appear to be feeding through into the growth in GRP and RV in urban areas. We can only speculate that business formation in rural areas is more likely to require premises that are liable for business rates, or that the growth in GRP and RV in urban areas is dependent on fewer larger new businesses with very high RV.

46. **In the following sections of this report we review whether the increases in RV and GRP in rural areas actually gets converted into income that is retained by rural authorities**.

[2] Unfortunately the only data available at a national level is on the 2005 rating list; rateable values will have changed in the 2010 revaluation. However, the broad patterns of rateable value per sqm and per hereditaments will remain similar in the 2005 and 2010 rating lists.

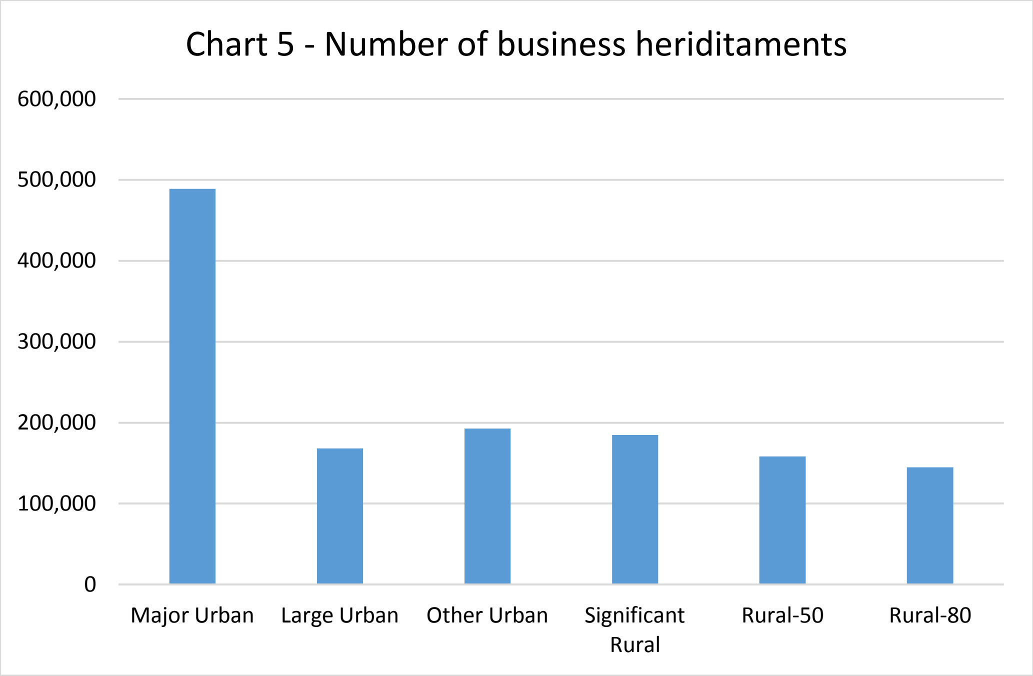


Chart 5 - Number of business heriditaments
600,000
500,000
400,000
300,000
200,000
100,000
0
Major Urban
Large Urban
Other Urban
Significant Rural
Rural-50
Rural-80

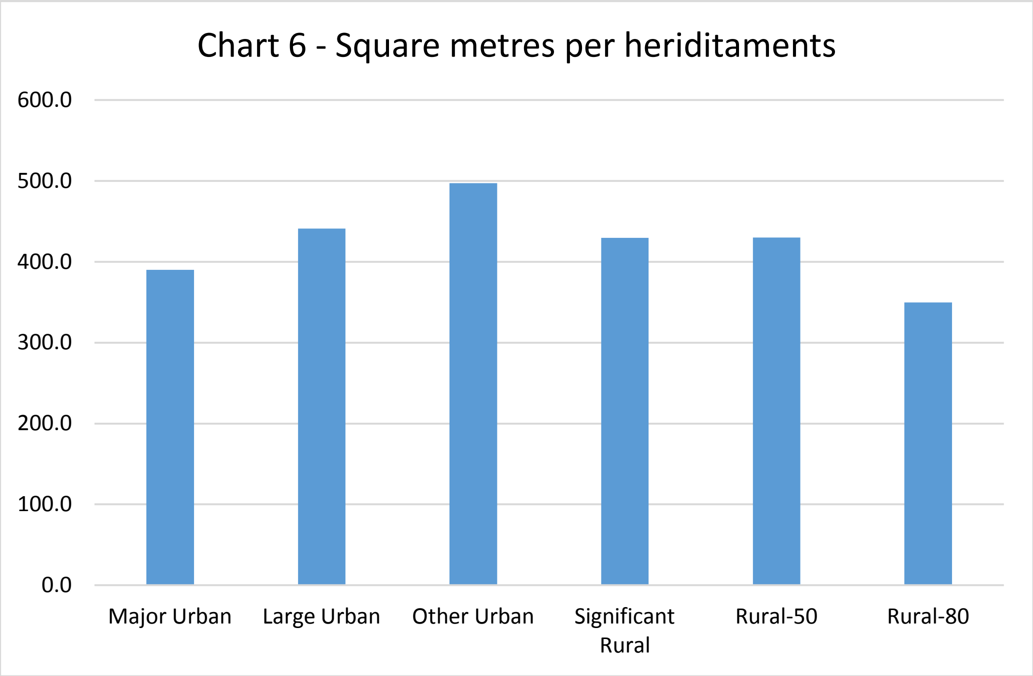


Chart 6 - Square metres per heriditaments
600.0
500.0
400.0
300.0
200.0
100.0
0.0
Major Urban
Large Urban
Other Urban
Significant Rural
Rural-50
Rural-80

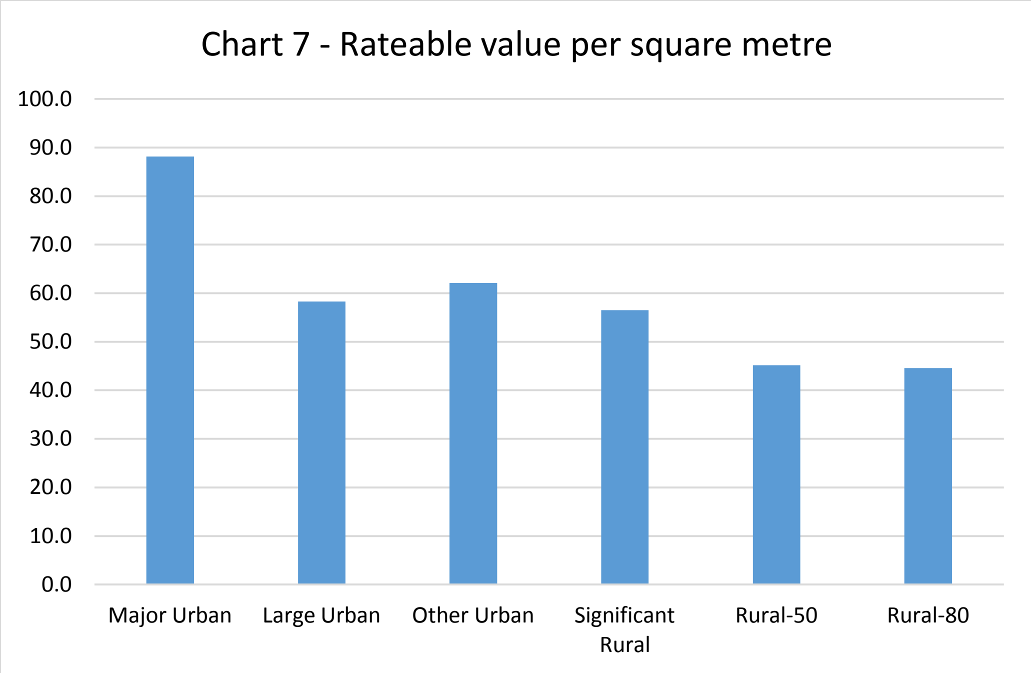


Chart 7 - Rateable value per square metre
100.0
90.0
80.0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
Major Urban
Large Urban
Other Urban
Significant Rural
Rural-50
Rural-80

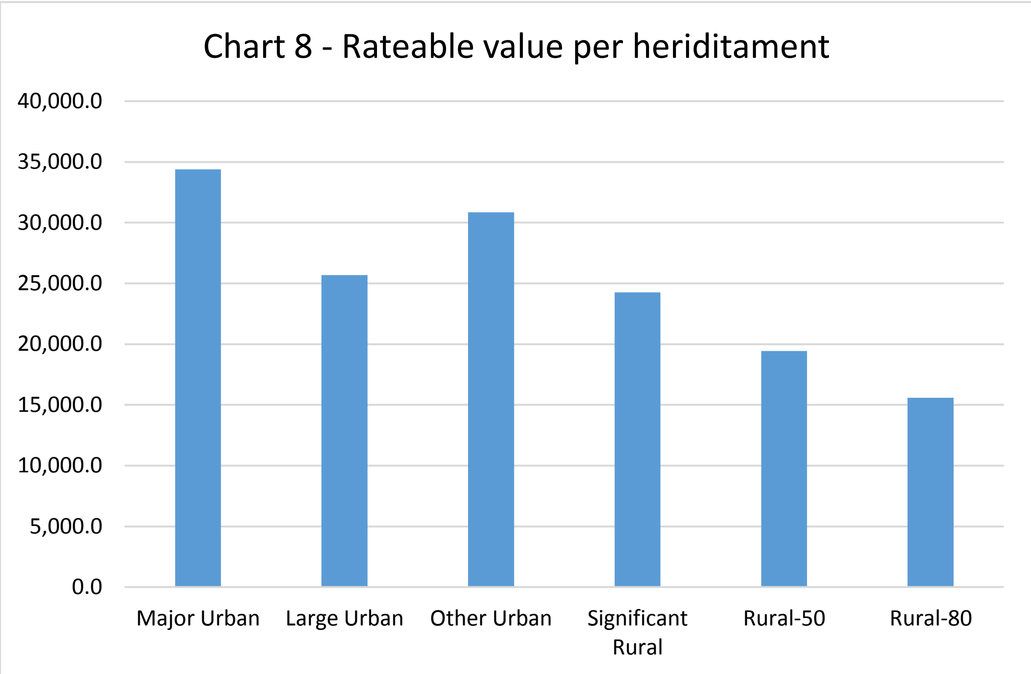


Chart 8 - Rateable value per heriditament
40,000.0
35,000.0
30,000.0
25,000.0
20,000.0
15,000.0
10,000.0
5,000.0
0.0
Major Urban
Large Urban
Other Urban
Significant Rural
Rural-50
Rural-80

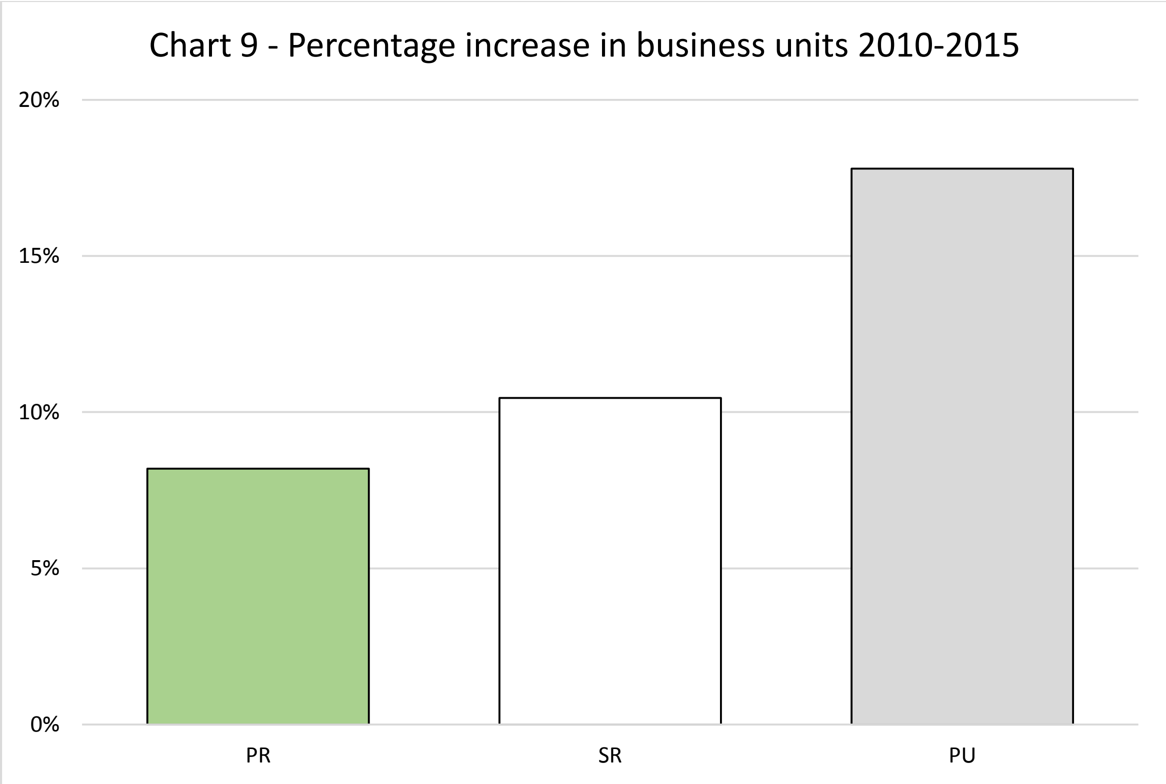


Chart 9 - Percentage increase in business units 2010-2015
20%
15%
10%
5%
0%
PR
SR
PU

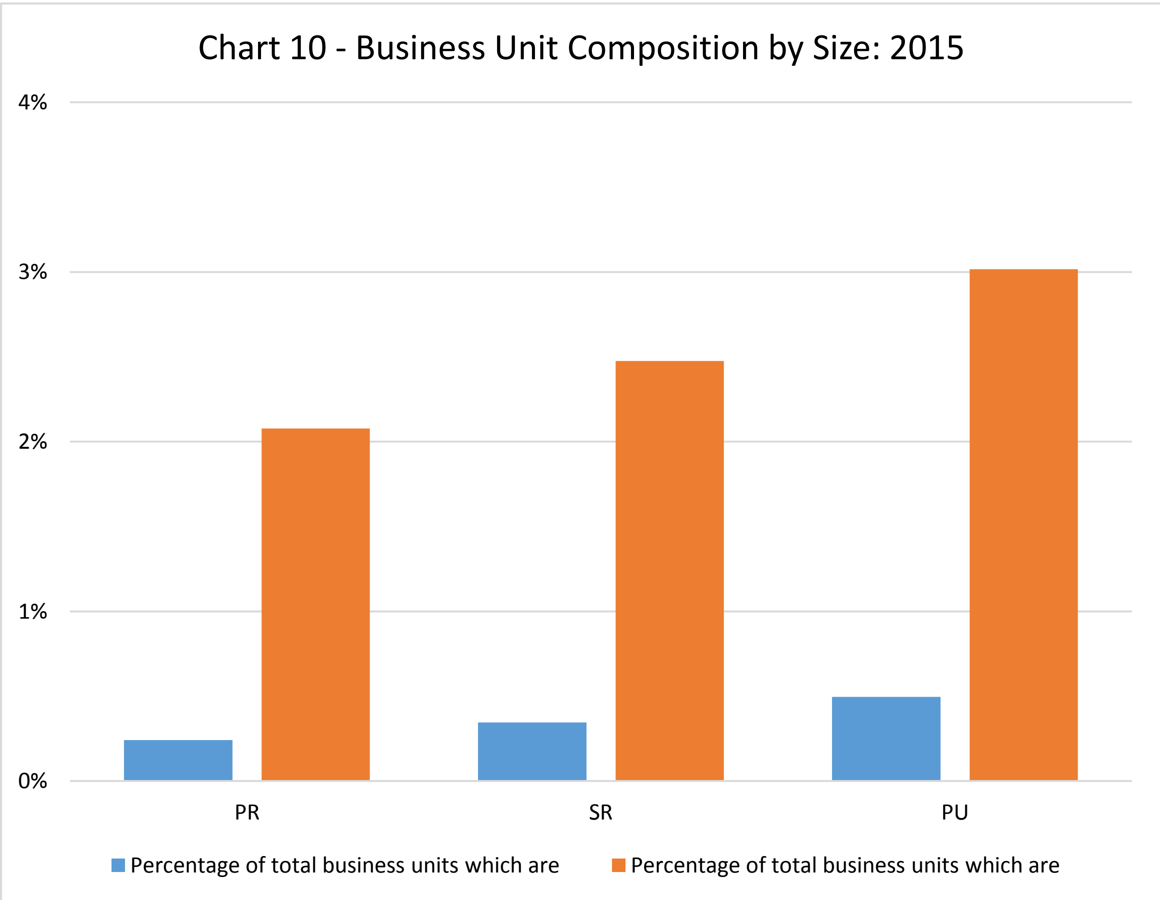


Chart 10 - Business Unit Composition by Size: 2015
4%
3%
2%
1%
0%
PR
SR
PU
Percentage of total business units which are
Percentage of total business units which are

Mandatory reliefs

47. Mandatory reliefs include:

- Small Business Rate Relief (SBRR). Small businesses occupying one property with an RV of less than £12,000 can get relief of 50%. In recent years this has been doubled to 100%, and the Chancellor has announced that it would be extended further (to March 2017) in the Spending Review on 25 November. (There is also a lower multiplier for small businesses.)
- Charitable organisations and amateur community sports clubs. These organisations can apply for relief of up to 80%. This relief is mandatory but charities can apply for discretionary relief of up to 100%.
- Rural Rate Relief. This is available to businesses with rural populations of less than 3,000. Mandatory relief at 50% is available if the business is the only village shop or post office (with an RV of less than £8,500) or the only petrol station or public house (with an RV of less than £12,500). Further relief (up to 100%) is available at the discretion of the local authority and can include businesses with rateable values of up to £16,500.

48. There is a mixed picture on Mandatory Reliefs in rural areas (Chart 11). Rural 80 authorities have a very high level of Mandatory Relief (at £45 per head). Other types of rural authority, though, have a similar level of reliefs to urban authorities – with Mandatory Reliefs at between £29-32 per head. The very high level of Mandatory Reliefs in R80 authorities is probably because the average business size is relatively small, so many qualify for SBRR and Rural Relief; many will potentially also be charitable organisations.

49. As at 1 April 2013, Mandatory Reliefs are fully funded because there were included in the baseline for each authority. But changes away from this – with the exception of SBRR, which is funded by section 31 grant – are shared between the local authority and central government. So, if total Mandatory Relief increases by £50,000 locally, 50% is funded by the local authority and 50% by central government; and the converse if Mandatory Relief reduces.

50. R80 authorities are most likely to have businesses that attract relief. So, growth in new businesses is likely to result in less bottom-line retained income because gross rates will be reduced by reliefs, and a smaller proportion of new RV is translated into income that can be retained by a rural authority.

51. There is some evidence that Mandatory Reliefs are falling more quickly in urban areas than rural areas. Since the start of the retention scheme 2013-14, Mandatory Relief has fallen by 24% (in real terms) in Major Urban authorities, by 9% in R80, 13% in R50, and by between 18% and 20% in other authorities (including SR). As rates of Mandatory Relief fall, then 50% of the benefit accrues to the local authority. The fall in Mandatory Relief in Major Urban authorities is worth £10 per head, whereas the fall in R50 and R80 authorities is worth only £4 per head.[3]

52. Expressed another way, Mandatory Relief represents a larger share of GRP in rural than other authorities, as can be seen in Table 1. Mandatory Relief reduces GRP by only 6.1% in Major Urban authorities but by nearly twice as much in Rural 80 authorities.

[3] Note that we have excluded the City of London from these figures.

Table 1 – Gross Rates Payable and Mandatory Reliefs, by Urban/ Rural Classification

	Cash figures. 2015-16		
	GRP (excl City)	**Mandatory Relief**	**%**
Major Urban	11,537,246,463	701,439,640	6.1%
Large Urban	3,076,301,401	255,960,070	8.3%
Other Urban	4,075,651,719	301,620,216	7.4%
Significant Rural	3,113,915,704	247,343,297	7.9%
Rural-50	2,721,193,561	265,046,873	9.7%
Rural-80	2,049,823,311	244,524,347	11.9%

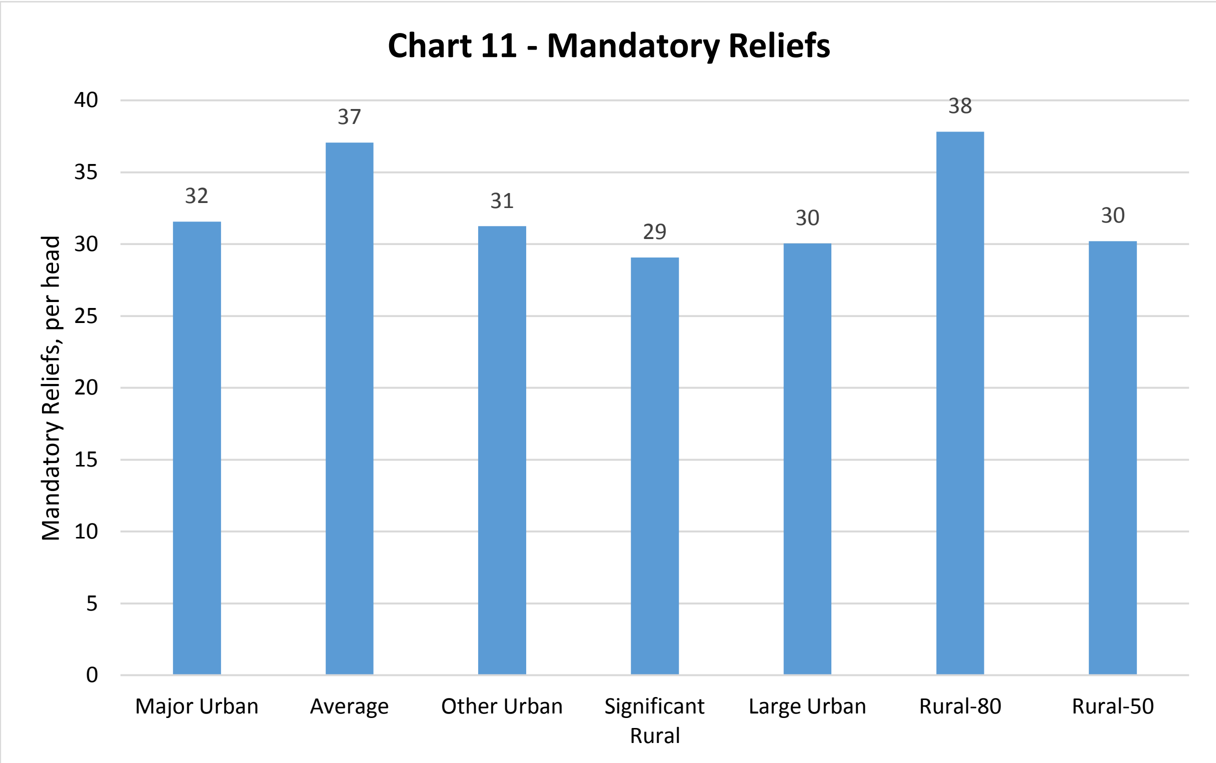


Chart 11 - Mandatory Reliefs

Unoccupied property reliefs

53. These reliefs are

- Exempted buildings. These include agricultural land and buildings, buildings used for training or welfare of disabled people, and buildings registered for public religious worship, including parish halls.

- Empty properties. Business rates are not payable for the first 3 months that a property is empty.

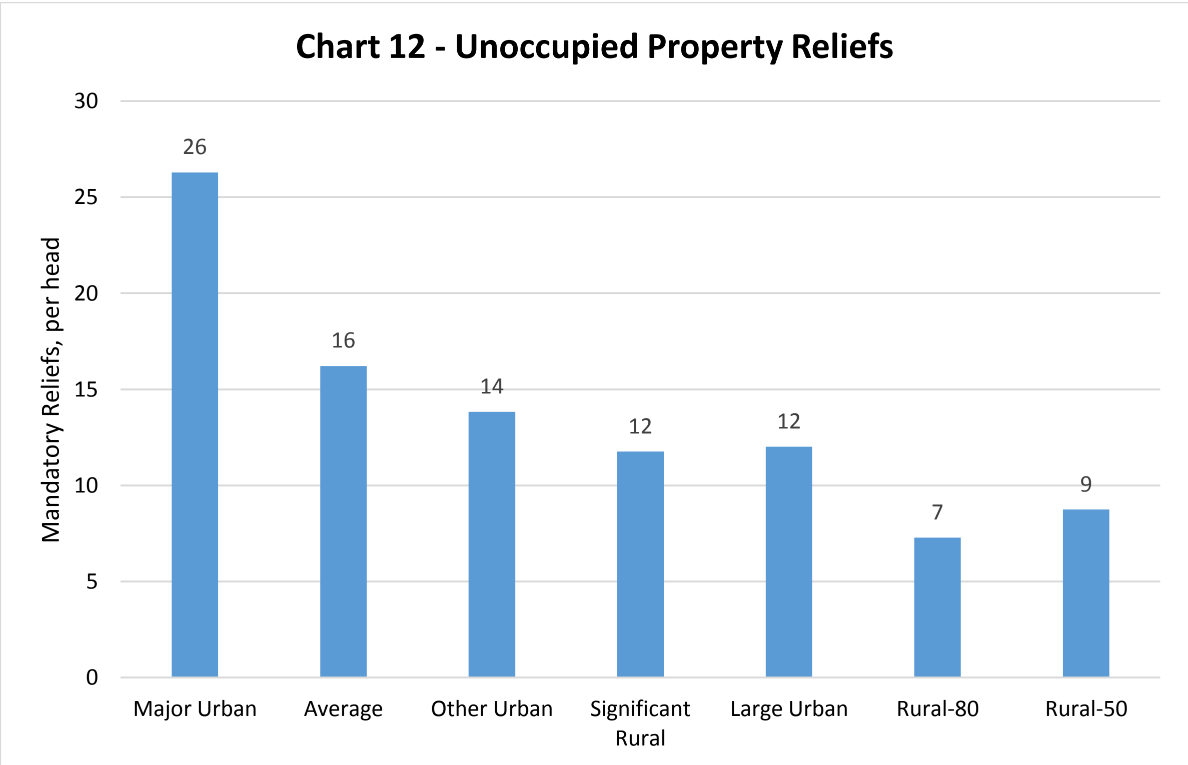
- Partial empty relief. Extended relief can be granted for some types of property (e.g. low RV (below £2600), between charitable occupation, industrial premises).

54. Unoccupied Reliefs are higher in per-head terms and as a proportion of GRP in urban areas than rural areas. Chart 12 shows that Major Urban authorities have empty rates at an average of £26 per head, compared to £12-£14 in Large Urban/ Other Urban/ SR and £7-£9 per head the Rural 50 and Rural 80 authorities. As a proportion of the GRP, these reliefs represent 2.4% and 1.9% of Rural 50 and Rural 80 GRP, 3.9% of Major Urban authorities, and 2.7% to 2.8% of the remaining authorities.

55. This data suggests that urban authorities – particularly very urban – will typically have a higher rate of "empties". We do not know the reason for this, but we would suggest that there is greater turnover both in terms of churn and the value of the reliefs in cash terms. Major Urban authorities could argue – the converse to our argument on Mandatory Relief – that their growth in GRP/ RV will be partially offset by a larger proportion of that growth being empty in future years.

56. The rate of "empties" is falling. In real terms, the value of empty reliefs has fallen by 7.2% in 2014-15 and by 11.1% in 2015-16 (budget). It is falling in cash terms as well. Generally, the most likely explanation for this trend is that the economy is improving and there is a lower rate of business failure, which results in fewer empty properties.

57. It also suggests a steadier rate base in rural areas. This possibly reflects a less dynamic rate base where more of the properties are supported by reliefs, but that there is less turnover and less loss from "empties".



Discretionary reliefs

58. Discretionary Reliefs are slightly higher per head in rural areas, particularly in Rural 50 authorities (Chart 13). It is not clear why Rural 50 authorities should have Discretionary Reliefs that are higher than Rural 80 authorities, although the latter is still above average.

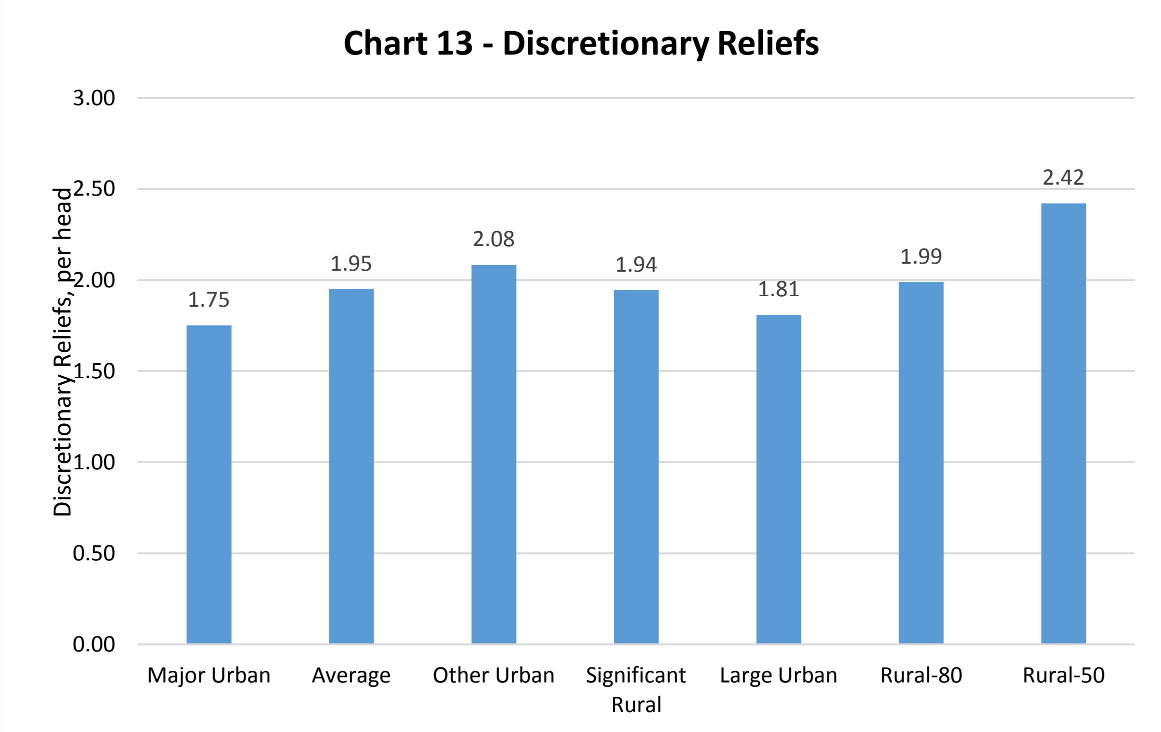
59. As a proportion of GRP, however, Discretionary Relief is a much greater factor for rural authorities (Table 2). Discretionary Relief ranges from 0.5% to 0.7% of GRP in rural groups; all urban areas are lower than this (between 0.3% and 0.4%).

60. This is caused by a much higher rate of relief for Charitable and Community and Amateur Sports Clubs (CASC), and for rural reliefs. Latter in particular demonstrates that many rural businesses might be less financially-viable, particularly in villages in sparsely-populated areas.

61. Urban authorities might argue that rural authorities have awarded more discretionary relief in the past (partly at their own cost) and it is their choice to support local organisations and businesses. If they want to reduce the cost to the rates they retain, then they have the option of reducing the discretionary relief that is awarded. The counter-argument from rural authorities should be that rural businesses need more support, and provision of services is more likely to be from charitable or community organisations in rural areas.

Table 2 – Gross Rates Payable and Discretionary Relief, by Urban/ Rural Classification

	Cash figures. 2015-16		
	GRP (incl City)	**Discretionary Relief**	**%**
Major Urban	12,341,599,542	32,441,759	0.3%
Large Urban	3,076,301,401	13,066,945	0.4%
Other Urban	4,075,651,719	17,062,848	0.4%
Significant Rural	3,113,915,704	14,024,619	0.5%
Rural-50	2,049,823,311	10,903,945	0.5%
Rural-80	2,721,193,561	18,016,177	0.7%



Rural relief

62. Rural Reliefs – which are described above – are funded through a combination of mandatory and discretionary reliefs. They are worth £10.8m in 2015-16.

63. As we would expect, the majority of Rural Relief is awarded in rural areas (Chart 14): £0.83 per head for Rural 80, £0.48 per head for Rural 50 and £0.28 for SR. (A couple of Major Urban authorities, such as Bradford, award reasonable amounts of Rural Relief.)

64. In the short term, rural authorities will want to retain Rural Relief is something like its current format. With 50% Retained Rates, Rural Relief is partly funded by central government, and 50% of any reduction in relief would be pocketed by central Government. Clearly the relief has significant benefits to the rural economy and to rural services.

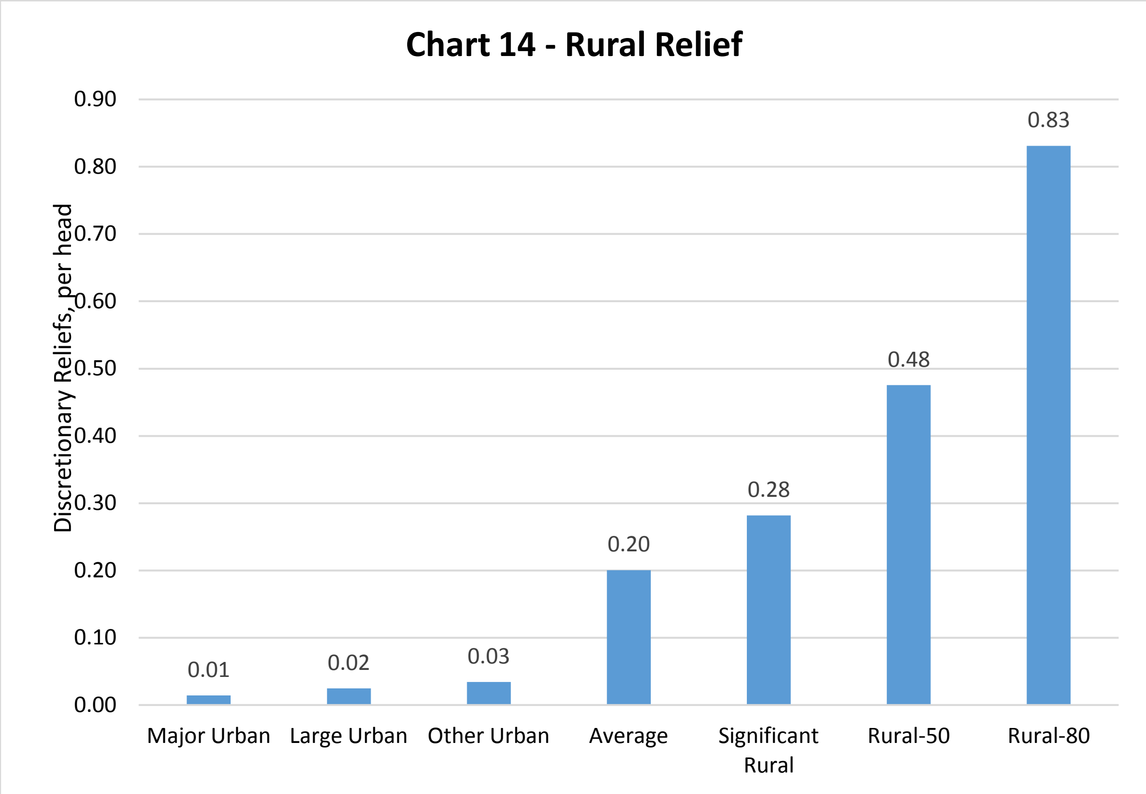
65. In the longer term and as we move towards 100% retention, rural authorities will want to make sure, as a minimum, that the new baseline fully recognises the current level of Rural Relief.

66. It should be noted that, with 100% retention, any increase in Rural Relief awarded will have to be fully funded by rural authorities themselves; there will be no 50% contribution from central Government. And although rural authorities would pocket 100% of any reduction, this implicitly means that there is less support going to rural businesses and rural services.

67. Options to consider are:

- To transfer funding for Rural Relief to central Government and have it paid to qualifying rural organisations directly. This has the advantage that growth in relief would be paid for by the Treasury, but it would leave the funding at the risk of Government cuts or change.
- To continue to get the Government to fund 50% of any increase in Rural Relief. Allows control to remain with rural local authorities, but requires central Government to make some contribution, even if authorities themselves have to contribute 50%.

- To ask Government to make more central funding available through the rates system, for instance to increase support from the current £10.2m to say £20-30m.



Net Rates Payable

68. Net Rates Payable (NRP) is calculated by deducting all the reliefs from GRP.

69. Based on the analysis above, for rural authorities, growth in the business ratebase tends to get eaten away by reliefs: greater support is required for businesses and a greater proportion of business premises likely to be occupied by charities. This makes it more difficult for rural authorities to achieve economic growth that can be converted into actual business rates income.

70. This concept can be illustrated in Table 3, below, which shows that NRP is a smaller percentage of GRP in rural areas than in urban areas. Chart 15 shows the NRP (per head of population) actually collected in each group of authorities for 2013-14 and 2014-15.

Table 3 – Net Rates Payable as Percentage of Gross Rates Payable

	Net Rates Payable	Gross Rates Payable	NRP as % of GRP
Major Urban	594	666	89.2%
Large Urban	371	426	87.2%
Other Urban	438	498	88.0%
Average	445	506	87.8%
Significant Rural	377	432	87.3%
Rural-50	313	366	85.6%
Rural-80	313	374	83.8%

71. Growth in NRP has been by far the greatest in Major Urban authorities, with all other groups of authority having below-average growth (Chart 16). It should be noted that large and other urbans do particularly badly as well. RSN might need to think about making common cause with these authorities, although the reasons for their poor performance might be different and they might, as a result, require different sort of help to rural authorities. For example, rural authorities are seeing growth in GRP, which is then offset by an increase in reliefs; Large/ Other Urban authorities are experiencing very little increase in GRP.

72. This additional growth – and higher levels of NRP per head – converts into much higher additional yield in urban areas, and in Major Urban areas in particular (Chart 17). The average additional yield in urban areas in 2014-15 (£15.4 per head) is almost double that received in rural areas (only £8.2 per head). Major Urban authorities have by far the largest increase per head (£19.5).

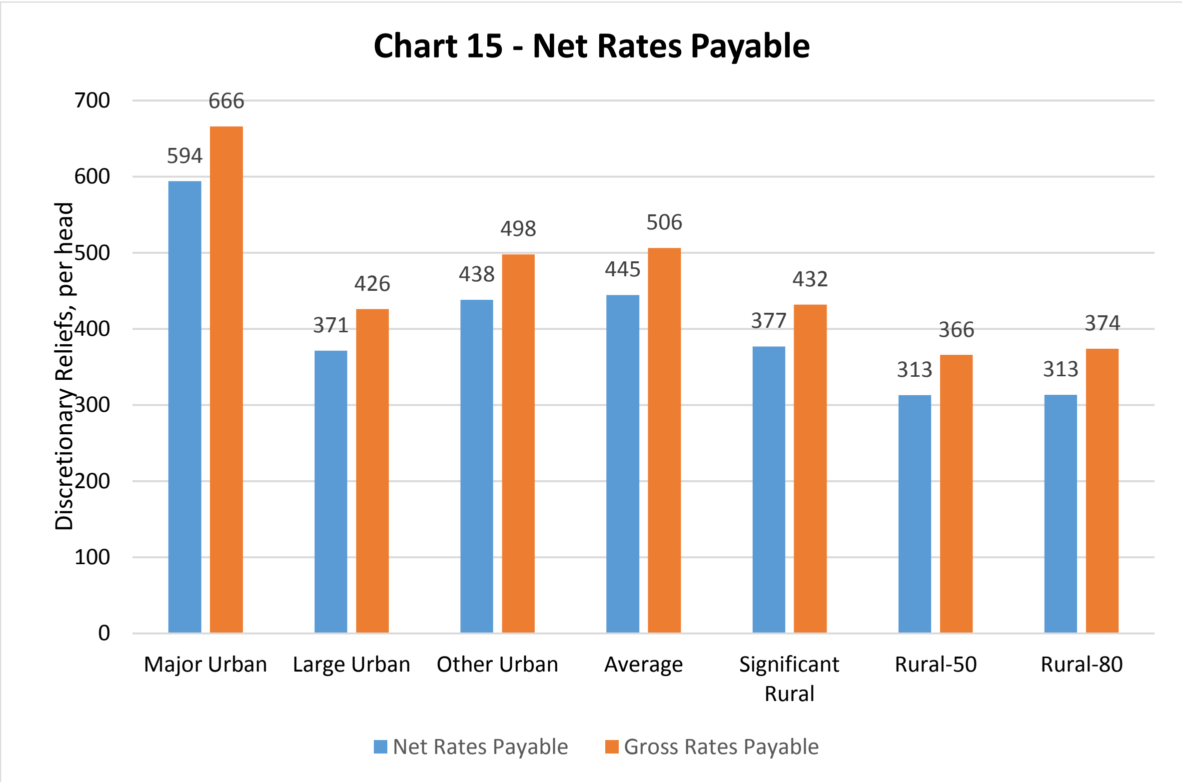
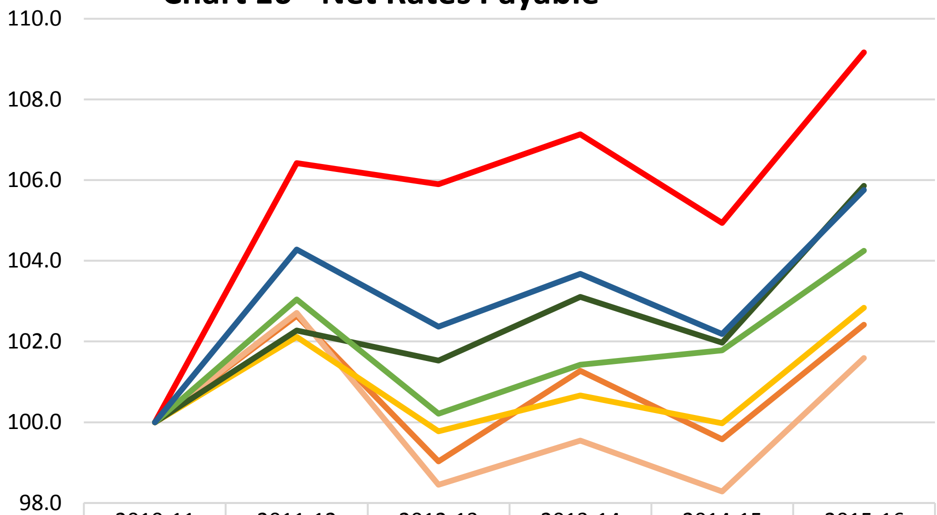
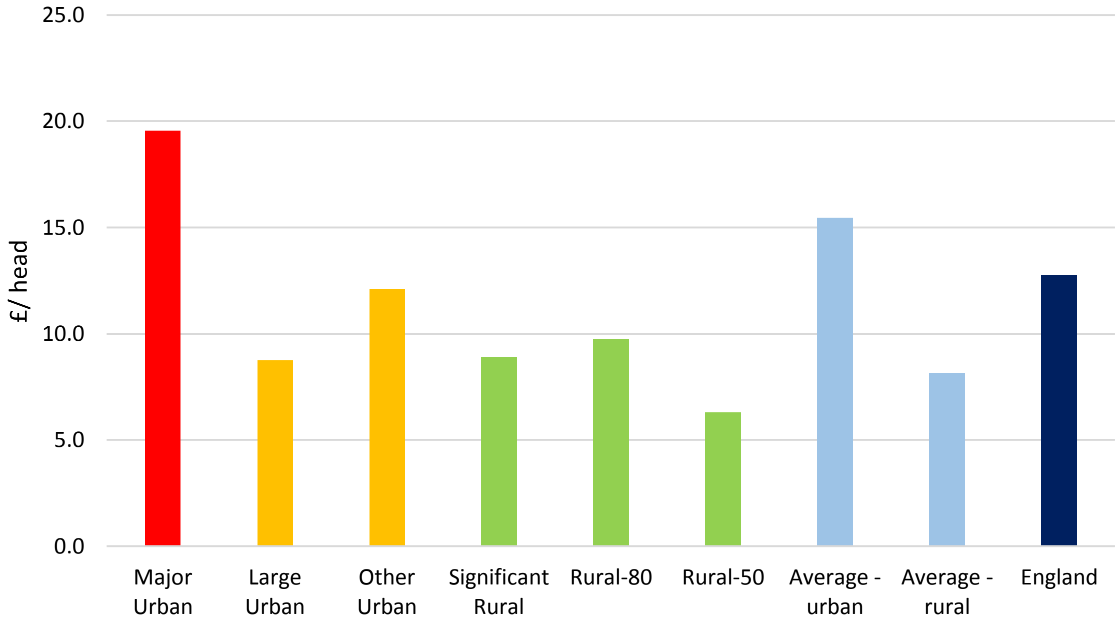


Chart 16 - Net Rates Payable



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Major Urban	100.0	106.4	105.9	107.1	104.9	109.2
Large Urban	100.0	102.6	99.0	101.3	99.6	102.4
Other Urban	100.0	102.7	98.4	99.5	98.3	101.6
Significant Rural	100.0	102.1	99.8	100.7	100.0	102.8
Rural-80	100.0	102.3	101.5	103.1	102.0	105.9
Rural-50	100.0	103.0	100.2	101.4	101.8	104.2
England	100.0	104.3	102.4	103.7	102.2	105.8

Chart 17 - Net Rates Payable - Additional yield per head (2014-15)



Appeals

73. Businesses can appeal against their Rateable Valuations (RV). It takes time for the VOA to hear the appeal and reach a decision; there are still many outstanding appeals on the 2010 list. The VOA provides lists of outstanding appeals, and authorities use their judgement to ensure that there is a suitable provision for losses from future appeals. There was a big increase in charges to provisions in 2013-14 because local authorities had to take financial responsibility for future losses for the first time rather than them being pooled nationally. Local authorities also had to provide for losses on current year's business rates income and for backdated losses, which could be backdated to April 2010.

74. Crucially the amount charged to appeals is based on the judgement of the authority, within the bounds of proper accounting practices. It is in the financial interests of councils to set their provision for appeals in such a way that maximises their returns from the Retained Rates system; many authorities have done so.

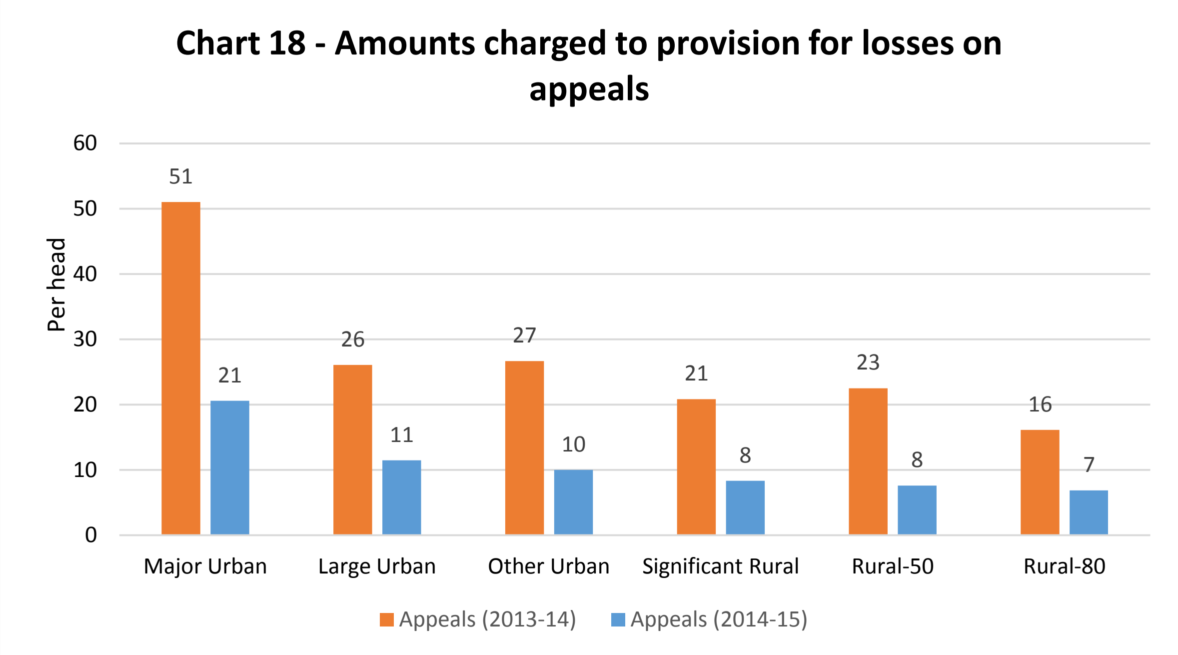
75. For instance, if an authority is expecting to be on or around the safety net threshold it makes financial sense for the authority to maximise its charge to the provision for losses on appeals because it will be recompensed pound-for-pound through the safety net. Alternatively an authority might choose to spread out its charges to the provision to reduce the levies that it pays.

76. Table 4 shows the authorities with the largest increases to the provision for losses on future appeals in both 2013-14 and 2014-15. Most of the largest provisions are in Major Urban authorities, or in Large Urbans (Chart 18). Mostly this reflects the greater potential for appeals and their greater cash value in the largest cities in the country. In some cases, it might also reflect a tactical decision to use the provision to maximise safety net payments. Two Rural 80 authorities are on this list – Suffolk Coastal and Copeland – and we assume that the reason for these very large provisions are closures or expected closures of large power stations or parts of them.

Table 4 – Appeals provision – charge in 2013-14 and 2014-15 (by local authority)

			Provision for Appeals	
Rank	**Rural/ Urban Classification**	**Local Authority**	**2013-14**	**2014-15**
1	Major Urban	Westminster	163,184,686	0
2	Major Urban	City of London	113,704,178	57,742,604
3	Major Urban	Manchester	111,515,442	15,431,698
4	Major Urban	Birmingham	43,419,890	28,743,276
5	Major Urban	Hammersmith & Fulham	39,083,406	10,784,412
6	Major Urban	Southwark	38,939,283	9,363,087
7	Major Urban	Trafford	36,822,880	9,947,864
8	Major Urban	Tower Hamlets	27,500,000	23,465,469
9	Major Urban	Camden	27,120,746	35,544,097
10	Other Urban	Milton Keynes UA	23,200,000	12,937,960
11	Major Urban	Leeds	23,095,265	22,589,093
12	**Rural-80**	**Copeland**	**22,007,680**	**278,027**
13	Major Urban	Ealing	20,569,598	6,372,242
14	**Rural-80**	**Suffolk Coastal**	**18,261,166**	**1,341,929**
15	Major Urban	Newcastle upon Tyne	16,596,525	0
16	Major Urban	Liverpool	15,165,509	16,795,745
17	Large Urban	Southampton UA	15,145,245	5,058,475

			Provision for Appeals	
Rank	Rural/ Urban Classification	Local Authority	2013-14	2014-15
18	Large Urban	Reading UA	15,000,000	3,871,499
19	Large Urban	Bristol	14,082,000	3,581,433
20	Large Urban	Portsmouth UA	13,864,261	4,008,448



77. If appeals are successful, they will then be shown as net reductions to Rateable Value and GRP. Outstanding appeals remain in the appeals provision. In future years we may see the provision unwind and some authorities releasing over-provision back into their Retained Rates (which will increase their Retained Rates). However the position for authorities is still very uncertain, with continued and numerous outstanding appeals, and the revaluation in 2017-18 will make the potential for uncertainty and future appeals even greater.

Retained Rates

78. We have analysed the Retained Rates position for each local authority in 2014-15 using the NNDR3 (outturn) (Table 5). The calculation is based on the Levy and Safety Net Calculator published by the DCLG.

79. Retained Rates is, in simple terms:

- Share of local rates (plus adding back a share of SBRR, section 31 grants, and some other discretionary reliefs)
- Deduct tariff or add top-up
- If more than 9.25% below target: add safety net
- If above target: deduct levy (for tariff authorities)

80. The model shows the Retained Rates, and safety net and levy payments, assuming there are no pools. In practice many authorities, particularly in two-tier areas, are in pools and this reduces the levies that are paid (and in a few isolated cases, reduces safety net payments).

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Table 5 – Retained Rates including safety net and levies, by Urban/ Rural Classification

	Retained Rates income		Total safety net due to the authority		Levy due from the authority		Retained income after levy and safety net		Variance between Target and Retained Rates	
		Per head		Per head		Per head		Per head		Per head
Major Urban	5,341.3	288.3	82.9	4.5	8.3	0.4	5,416.0	292.3	-59.8	-3.2
Large Urban	1,409.6	195.2	2.3	0.3	7.2	1.0	1,404.7	194.5	15.0	2.1
Other Urban	1,640.2	200.4	16.2	2.0	11.4	1.4	1,645.0	201.0	15.0	1.8
Significant Rural	1,095.4	151.9	14.0	1.9	12.2	1.7	1,097.2	152.1	10.9	1.5
Rural-50	844.1	113.5	9.4	1.3	10.0	1.3	843.6	113.4	27.4	3.7
Rural-80	734.5	134.0	10.1	1.8	15.8	2.9	728.8	133.0	15.9	2.9

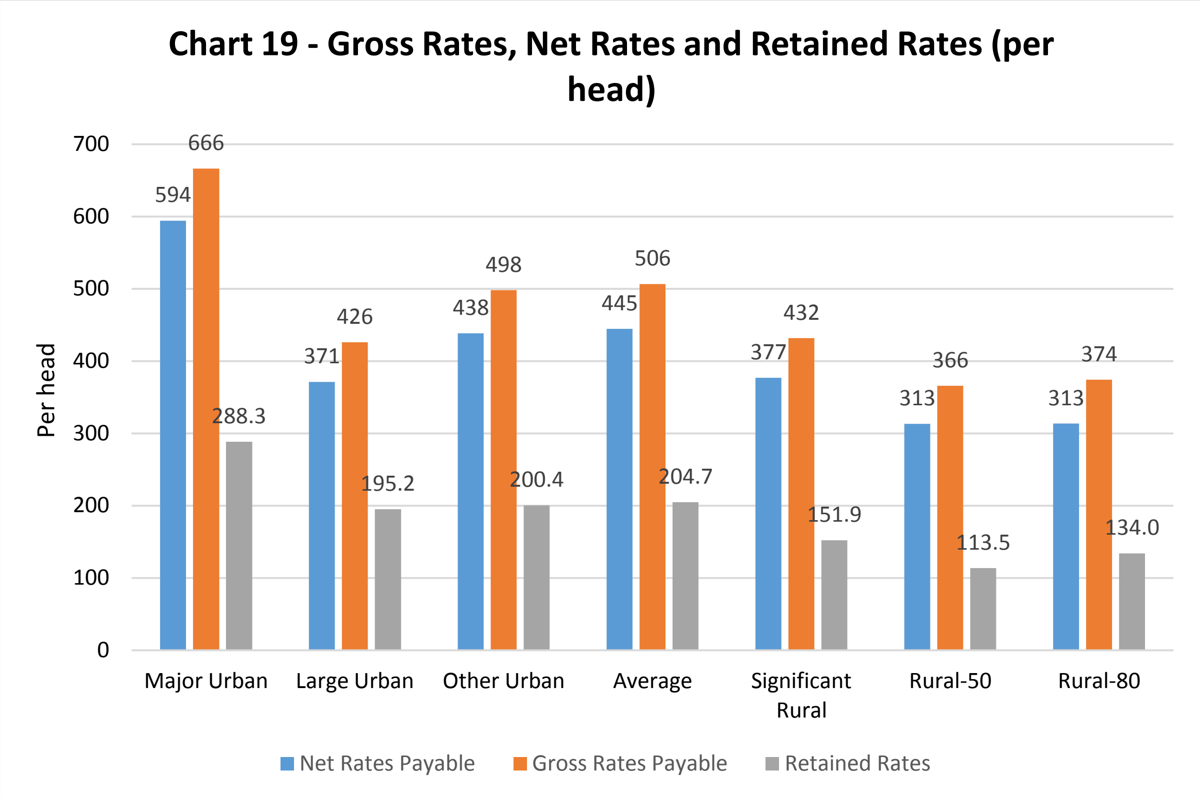
Note: all figures in this table are calculated using the DCLG Levy and Safety Net Calculator for 2014-15; they show the position before business rate pools.

81. Retained Rates before levy/ safety net are much higher in total and per head in urban areas than in rural areas. This reflects the positon we have explored earlier in the report with higher GRP and NRP being higher in urban areas.

82. It should be noted that Retained Rates are calculated differently from both GRP and NRP because they add back the reliefs that are funded by Government through section 31 grants (SBRR, retail relief, etc). They also take account of the top-ups and tariffs for each authority.

83. The result of these adjustments is actually to marginally widen the range between Major Urban and Rural-80 (Chart 19)

84. . For example, the average gross rates per head for the Major Urban authorities is 78% greater than Rural 80s; but the average Retained Rates per head for Major Urban authorities is 115% greater than Rural 80s.



85. The bulk of the safety net payments in 2014-15 have gone to Major Urban authorities, with the overwhelming bulk going to Westminster. Out of a total safety net payment in England of £134.9m, £82.9m went to Major Urban authorities, of which £65.3m went to Westminster. This partly shows the volatility in the rates system and the impact that appeals can have on Retained Rates income, particularly where there are major infrastructure projects, such as Crossrail. However, what is less clear to establish is the extent to which an authority, in this case Westminster, can overstate its potential losses from appeals, and thus benefit from the safety net. If Westminster has indeed overstated its losses from appeals, there is no mechanism for clawing this back.

PIXEL FINANCIAL MANAGEMENT

86. 23 rural 50 and Rural 80 authorities received safety net payments in 2014-15, with the highest being £4m in Tewkesbury. (Note that 9 of these authorities did not receive their safety net payments because they were in pools, including Tewkesbury.)

87. For rural authorities, a safety net will continue to be an important feature of the rates system. It is likely that the majority of payments will go to Major Urban authorities because the volatility in their rates base tends to be much greater. However, it would be in the interests of rural authorities if there was an effective clawback mechanism, which will tend to favour authorities with the greatest volatility.

88. Levies payable on Retained Rates are higher in rural areas than urban areas. This is because rural authorities are more likely to be tariff authorities (top-up authorities do not pay levies) and because district councils (which retain 40% of rates) are all levy-paying tariff authorities. Thus the average levy per head in Rural 80 authorities is £2.90 compared to only £0.40 in Major Urban authorities and £1.00 in Large Urban authorities.

89. Rural districts are able to reduce the levies they pay by creating business rates pools. (This enables levy-paying districts to pool with top-up authorities – usually counties – to reduce the levy rates on income in the pool, usually to zero.) It is difficult to calculate the actual saving on levy payments because each pool has a different levy rate, but if we assume that all pools have a levy rate of zero, then this significantly reduces the levies that rural authorities are paying.

90. List of rural 80 and Rural 50 authorities who are subject to 50% levy and are not in a pool:

    - 47 rural authorities have 50% levy and are not in a pool
    - Of those, only 13 were below the safety net threshold, and 31 paid a levy
    - These 31 authorities paid levies worth £10.4m
    - Only 8 of the Rural 50/Rural 80 authorities are top-up authorities (these are all unitaries, including Cornwall, Northumberland, East Riding of Yorkshire, Durham, North Somerset) (excludes precepting authorities).

91. Additional rates generated by top-up authorities is not subject to the levy, whereas in most rural authorities a levy would be payable (unless a pool can be set up). The system works against vast majority of rural authorities who are tariff authorities, and in most cases largely because they are district councils.

92. One interesting point is that rural authorities are more above their rates target than urban authorities. This could be for two reasons: that growth in retained rates has been higher in rural authorities or rural authorities did better out of the way the original 2013-14 baseline was set. The evidence suggests that rural authorities are above their baselines because of the way the baseline was set rather than from growth in rates. This might have happened because of the way that DCLG treated losses on appeals in the opening baseline. They assumed that average losses were around 5.3% and reduced every authority's baseline accordingly. Actual losses from appeals have actually been very random (e.g. power station) and much higher in Major Urban than rural areas. Rural authorities benefitted at the expenses of urban authorities in this respect.

93. For many authorities (particularly many rural authorities), the only growth they have got out of the system is the underestimate for their baseline in 2013-14. And rural authorities would

benefit from the Government taking a similar approach to appeals when setting any future baseline. However, we would caution against taking such an approach. Firstly there are some rural authorities who have lost out significantly from the appeals process and would have benefitted from having more targeted support (e.g. Suffolk Coastal with the appeal Sizewell B; Tewkesbury with the Virgin Media appeal). Secondly this is a poorly-designed aspect of the scheme and local government as a whole would benefit from an approach that takes into account where appeals have actually been lodged

Rates retention and future budget pressures

94. Determining whether 100% retention is good or bad for local government (and for rural authorities in particular) depends on a number of factors:

    - Is growth in business rates going to be greater or less than future Government funding would have been? This is almost impossible to answer because we do not know how much money a future chancellor would have to spend and how much of that would be spent on local government. If local government is allowed to keep all future growth then this must be better than the cash-terms cuts in funding that have been experienced since 2010.
    - Will growth in new burdens transferred in to local government be greater than the growth in business rates? There is not much logic in using a fairly static property-based tax to fund a service such as Attendance Allowance which is driven by all sorts of factors (demographics, infirmity, etc). It is likely that the growth in something like Attendance Allowance will be greater than the real-terms growth in business rates.
    - What will be the relative impact on rural authorities? Rural authorities are likely to underperform on growth in rates. In terms of services such as Attendance Allowance or with, say, social care more generally, the picture is less clear. High-need authorities (largely in urban areas) are likely to be most exposed to growth pressures in services. But many rural authorities have large populations of older people and are experiencing high levels of service growth. Fairly frequent updates of need in the system are likely to be in rural authorities' favour.

95. Generally local government funding is moving increasingly towards local authorities funding themselves through locally-raised taxation (subject to national equalisation regimes). It puts more pressure on authorities to maximise local tax revenues as far as possible. Rural authorities appear to be able to grow GRP and RV reasonably well (at least in percentage terms), but that growth is more likely to be relief-attracting than in urban areas (or at least MU). This presents a problem for rural authorities in that they will be less able to general real revenues to keep pace with service pressures and to keep pace with urban areas (or at least with Major Urban areas). We address some of the ways that Government could help to "level the playing field" later on in this report.

96. However, the focus is increasingly on getting the best out of the current and future rates retention schemes, putting in place plans that will help to grow the local economy, and investing to attract new businesses (or to encourage existing ones to expand).

Conclusions

97. Gross Rates Payable and Rateable Value give the broadest indications of trends in the ratebase in each council. Levels of both GRP and RV per head are very low in rural areas, with Major Urban authorities having average GRP of £565 per head compared to £310 in R50 and £317 in R80 authorities.

98. Growth in GRP and RV has been higher in urban areas since 2010 in cash terms but higher in rural areas in percentage terms.

99. The growth in GRP and RV in rural areas is largely offset by higher reliefs, reflecting the type of economy in rural areas. Growth in Net Rates Payable is similar in rural and most urban areas (with the exception of Major Urban authorities, where it is much higher).

100. It is clear that MU authorities are on average very different from the rest of the country. And although there are Large/ Other Urban and rural areas have similar levels of net growth, the reasons for this are different in urban and rural areas.

101. Rural areas have very high levels of reliefs and growth in these reliefs that offset a large proportion of the growth in RV and GRP. Reliefs are equivalent to only 10.9% of GRP in Major Urban areas but as much as 16.2% in Rural 80 areas.

102. Reliefs are important in rural areas because they support local rural businesses and rural organisations. These include a range of reliefs including Charitable and CASC relief, Rural Relief and SBRR. The benefit from these reliefs is to the local rural communities rather than directly to the rural local authorities themselves.

103. Support to rural authorities is actually very low in cash terms at only £10.2m (although very important to rural local businesses and rural local authorities). There is a clear case for RSN to argue that more support is required.

104. Rural authorities will want to ensure that the funding for these reliefs is not jeopardised in the transition to 100% relief or in any future reset. There are a number of options for achieving this but the most effective is almost certainly to continue to fund it through the rates baseline and potentially to ask the Government to continue to fund a 50% share once rates retention is increased to 100%.

105. Rural authorities are at risk of paying higher rates of levy on growth in business rates. Many rural authorities are in two-tier areas where levy rates for districts are typically 50%. Rural authorities can create pools to reduce the levy rate but this creates additional uncertainty and does not cover every authority. As a result, an additional pound of rates generated in many rural authorities might only be worth 50p, but the same increase in most urban areas would be worth £1. The regime ought to be reformed so that there is consistency across the country.

106. In principle, levies and safety nets are sensible features of the Retained Rates system, and rural authorities ought to support their continuation in the future 100% retention system. There are some changes that would benefit rural authorities, in addition to making the levy system consistent across the country.

107. The needs assessment for all authorities has been frozen since at least 2013-14 – and in practice for years before this as well. For rural authorities, it means that the additional funding that was allocated in 2013-14 and damped-away has still not been received.

Recommendations

108. **To ensure Major Urban authorities with the greatest opportunities to grow do not take home too high a share of "national growth". Including consideration of the following:**

- Levy on growth. This needs to be better balanced so that two-tier areas are less disadvantaged by high levy rates. Levy rates should be set so that there is a uniform levy rate across the country, but with some targets set to take account of an authority's ability to expand.
- Banded targets for authorities with greatest chance of growing. This could be based on past performance, and could be adjusted using knowledge of large sites that will be introduced in future years. A similar system was used for the Local Authority Business Growth Incentive scheme in 2004, and the Government is consulting on using deadweight to "sharpen the incentive" on New Homes Bonus. Such an approach should be based on Net Rates Payable to take into account the higher reliefs in rural areas.

109. **To provide additional or alternative incentives for authorities with the least opportunity to grow.** This could be direct support from Government (investment) or help in providing targeted reliefs to attract new businesses.

110. **More frequent review of needs and equalisation of resources.** Equalisation of income from business rates should take place at set intervals with a maximum of every 5 years. It is also important that the needs assessment is updated a regular intervals. Rural authorities were allocated additional funding in 2013-14, most of which was damped away. There is a strong case for rural authorities to receive funding for the additional need that has been assessed.

111. **To preserve the arrangements for the reliefs that are already included in the baseline, and to ask Government to continue to contribute to growth in reliefs above the baseline level once 100% retention is introduced.**

112. **For Government to continue to fund a share of any growth in reliefs in rural areas.** This could apply to specific reliefs (such as rural relief) or it could apply more generally to reliefs of all types. The latter approach would be more beneficial to rural areas, and would acknowledge that rural business growth can more marginal and as a result require greater support through reliefs.

113. **To increase the support for rural businesses through increased central support for Rural Reliefs, with options including:**

- Transfer funding for Rural Relief to central Government and have it paid to qualifying rural organisations directly. This has the advantage that growth in relief would be paid for by the Treasury, but it would leave the funding at the risk of Government cuts or change.
- Continue to get the Government to fund 50% of any increase in Rural Relief. Allows control to remain with rural local authorities, but requires central Government to make some contribution, even if authorities themselves have to contribute 50%.
- Government to make more central funding available through the rates system, for instance to increase support from the current £10.2m to say £20-30m.