Local Government Association

LGA Executive
14 June 2012

Item 4

Local Government Resource Review

Purpose of Report

For discussion and direction.

Summary

This report provides an update on the key issues arising from the Government's proposals.

Recommendations

Members are asked to provide general direction on the LGA's work on these issues, particularly over the period of the House of Lords' consideration of the Local Government Finance Bill.

Action

Director of Finance and Resources to take forward actions as steered by members.

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Background

1. The February meeting of the Executive received an update report on current local government finance issues, including localisation of business rates and council tax reliefs. The Finance Task Group has considered some of the more detailed issues on business rates and council tax relief localisation. This report provides an update on business rates localisation.

2. The Local Government Finance Bill has now completed its Commons stages. Its consideration by the House of Lords is expected to have started by the time of the Executive meeting, and LGA briefings have been offered to peers from all the parties and crossbenchers. The Bill sets out the legislative framework for the Government's localisation proposals. Most of the detail, including significant matters relating to the overall quantum of funding returning to local government, will either be set out in secondary legislation or determined by Ministers. The key principle that business rates revenue can only be used for the funding of local government remains intact.

The Business Rates localisation proposals

3. The LGA's consistent position has been to advocate a fair and simple local government funding system that gives councils greater financial autonomy, supports local services and encourages economic growth. The principle of full business rate localisation, which also ensures fair treatment of councils in areas with weak economies, would be a powerful move towards localism and a driver of economic growth. The Government's own economic analysis, published on 17 May along with a number of papers setting out more of the detail of the approach the Government intends to take, supports the view that full localisation makes better economic sense.

4. What the Government proposes in the Local Government Finance Bill dilutes and potentially compromises this principle. Rather than full localisation, Government intends to keep a 50% top-slice of business rates for the Treasury. This large 'central share' will give the Government the ability to squeeze total local government funding over the next few years. This will be achieved by means of decisions to use the Government's top-slice of business rates to fund areas of local government spending that are currently paid for by using general central Government tax revenues. In its 'Statement of Intent' on central and local shares of business rates, the Government lists a number of grants that, in the future, will be funded partly through business rates. The grants listed total more than £8 billion at current levels and include the amount of just under £4

billion that will from 2013-14 be paid to fund the local council tax support arrangements that will replace council tax benefit.

5. The new proposals can be seen as half-way house between the full localisation of business rates and the original proposals for a fixed ‘set-aside’ to maintain central control over local government spending. As we said in the briefing we issued to member authorities on 18 May, the policy is a first step towards localisation, but raises a number of concerns.

6. The immediate issue is how the policy will operate in 2013-14 and 2014-15. Here, the Government has stated that the policy will be that other grants will be funded out of the ‘central share’ of forecast business rates to the extent that, assuming that the business rates yield is as forecast, the amount of funding going to local government would be as originally allocated in the Spending Review. In this way, the Government will maintain its Spending Review expenditure controls. This raises several issues for local government:

    6.1. If the Government’s forecast is over-optimistic (and there is a history of significant over-optimism in business rates forecasts), local government may receive **less** than the amount originally allocated in the Spending Review.

    6.2. To the extent that the forecast assumes real growth in business rates, the benefits of real growth are shared between central and local government rather than being wholly retained by local government.

    6.3. At individual authority level, the overall amount of funding received could fall short of expectations because of matters outside the council’s control (for example, the impact of appeals against rating valuations) and the authority would have to manage that risk up to the level of the ‘safety net’.

7. At present, there is little transparency in how the Government’s business rates forecast for 2013-14 and 2014-15 will be constructed. Officers have raised this issue with officials, and it does seem that its importance is recognised. Officers will continue to press this important issue. It can be noted that the Budget 2012 forecast for UK business rates yield shaved down the projections for 2012-13 and 2013-14 by £100 million each year from the numbers in the 2011 Autumn Statement, with the projections for 2014-15 to 2016-17 each reducing by £300 million - £400 million each year. Members will want to ensure, on behalf of the sector as a whole, that local authorities are not penalised by excessive optimism in Government forecasts for business rates. There is a potential ‘double whammy’ here, too, because use of an excessively optimistic forecast would have the effect of weakening still further the impact of the incentive for business rates growth in the new scheme.

8. The Government has stated its intention to run the new business rates retention system from 2013 until 2020, at which point the funding baselines for authorities will be reset. However, this decision will not be implemented through legislation, because the flexibility to make adjustments at individual authority level each year will be retained through a revision to the way in which the annual local government finance settlement works. In future, this will set the central and local shares for local authorities individually, as well as providing a distribution for money to be returned to local authorities through the central share.

9. In order to make the localisation of business rates fair for all authorities, the detailed design of the new arrangements will incorporate safeguards to help authorities that raise relatively low amounts of business rates, whilst still delivering an incentive for all local authorities to grow their local economies. The broad principles of how this is achieved are that:

   9.1. every authority will have a starting point position calculated reflecting the result of a Formula Grant calculation rolled forward to 2013-14 – that will be the **funding baseline**;

   9.2. every authority will also have allocated to it a share (less than 100%) of the business rates raised in its area – that will be the **business rates baseline**, and the percentage share will remain fixed until the system is reset;

   9.3. going forward, if an authority's business rates baseline is **more** than its funding baseline, then its future funding will be the fixed percentage share of actual business rates raised less a tariff equal to the RPI indexed difference between the two baselines. For authorities paying the tariff, a levy may also be charged at a rate which will vary from authority to authority but which will be designed to ensure that a 1% real growth in business rates income will translate into a 1% real growth in the authority's income net of the tariff;

   9.4. if on the other hand an authority's business rates baseline is **less** than its funding baseline, the authority's future funding will be the fixed percentage share of its actual business rates raised, plus a top-up amount equal to the RPI indexed difference between the two baselines;

   9.5. the levy receipts will fund a safety net to protect any authorities whose business rates fall significantly. The Government intends to set the safety net at somewhere between 7.5% and 10% of each authority's indexed funding baseline.

10. The material issued by the Government does not provide any detailed assessment of calculations of whether the money that is raised from the levy is likely to be sufficient to pay for the safety net, or whether the levy is in fact excessive having regard to the safety net obligation. An over-prudent calculation of the levy would have the effect of withholding money from tariff authorities that had achieved the best rates of growth, potentially limiting much-needed protection to some authorities whose business rates fell, or both. Given the other limitations on the incentive element in the scheme, the lack of transparency around the Government's calculations is a matter that needs to be put right, and officers have raised this point with officials in the Department for Communities and Local Government (DCLG).

11. In two tier areas, the business rates share will be split on a roughly 80:20 basis between Shire Districts and Counties. This will provide districts with a high degree of incentive to grow their business rates (and higher risk if growth is not achieved), and give counties more stability in their funding, as they will be more likely to be 'top-up' than 'tariff' authorities.

12. Single service Fire and Rescue Authorities will come within the scope of the scheme, as will the Greater London Authority (GLA), the revenue elements of whose general grant will be funded from business rates.

13. Alongside the Statements of Intent covering the central and local shares and the manner in which the levy and safety net will operate, the Government has also published a prospectus inviting applications for 'pooling' from groups of local authorities. The deadline for such applications is tight – 27 July – and officers have already raised issues around this with DCLG officials. Pooling would allow groups of authorities to share the risks and benefits of the scheme and, potentially, avoid the impact of the levy on tariff authorities in a pool.

Summary

14. It is considered that the key points that need to be pursued in discussions with the Government, ahead of further formal consultation planned for July, are:

    14.1. our concerns that, although the policy is a step towards localisation, maintaining a Government-allocated central share is not a localising policy, and the continued Treasury insistence on putting control ahead of growth;

    14.2. our concerns around optimism in the forecast for business rates yield;

    14.3. the lack of transparency in the assessment of the likely levels of levy and safety net, and the impact of excessively cautious forecasts on both the growth incentive and the depth of the safety net.

Financial implications

15. This is core work for the LGA which is funded from existing budgets.