

## Fair Funding Review and Business Rates Retention Update

### Purpose

For information and agreement.

### Summary

This report updates members on progress on the Fair Funding Review and Business Rates Retention reform since the October meeting of the LGA Executive. LGA Executive are invited to consider a number of Fair Funding Review policy positions developed by the Business Rates Retention and Fair Funding Review Task and Finish Group which could form part of the LGA's response to the forthcoming consultation on the Fair Funding Review.

### Recommendation

That members of LGA Executive note this update and provide clearance of the policy positions set out in table 1 and **Appendix 1**.

### Action

Officers will use the views expressed by LGA's Leadership Board and Executive to draft a response to the upcoming Government consultation on the Fair Funding Review.

More widely, officers will proceed with delivery of the LGA work programme on Business Rates Retention and the Fair Funding Review as directed by the LGA Leadership Board, Executive and the Business Rates Retention and Fair Funding Review Task and Finish Group.

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## **Fair Funding Review and Business Rates Retention Update**

### **Introduction**

1. This report updates members on progress on the Fair Funding Review and Business Rates Retention reform since the October meeting of the LGA Executive.
2. LGA Executive are invited to consider a number of Fair Funding Review policy positions developed by the Business Rates Retention and Fair Funding Review Task and Finish Group which could form part of the LGA's response to the forthcoming consultation on the Fair Funding Review.
3. The work on further Business Rates Retention and the Fair Funding Review is being considered by the LGA's Task and Finish Group prior to, or alongside, consideration by Leadership Board and Executive.

### **Fair Funding Review**

#### Fair Funding Review technical working group update

4. There have been no meetings of the joint MHCLG / LGA Fair Funding Review Technical Working Group since the last meeting of Leadership Board. MHCLG officials are focussing on publishing the Fair Funding Review consultation and delivering the 2019/20 provisional local government finance settlement. When the technical working group reconvenes in 2019, items for consideration are likely to include:
  - 4.1. A review of the responses to the consultation, including considerations behind the choice of how the council tax level which will be used in the resources adjustment will be determined; and
  - 4.2. A more detailed consideration of various options on transition mechanisms.

#### The Government's next steps for the Fair Funding Review

5. As set out in previous meetings to Leadership Board and Executive, the Government's work is building towards a wider consultation on the Fair Funding Review. Subject to Ministerial decision the scope of the consultation, including the extent to which the Government might identify preferred options at this stage, the consultation might cover:
  - 5.1. Options for tier-specific foundation formulas and formulas to assess specific services;
  - 5.2. The leading cost drivers for inclusion in the above, and a description of proposed analytical techniques to weight them against one another;
  - 5.3. Commentary on the area cost adjustment;
  - 5.4. Measuring the council tax base, in particular treatment of mandatory and discretionary council tax discounts. This includes local council tax support schemes;

- 5.5. The choice of notional or actual council tax levels to be used when calculating the resources adjustment;
  - 5.6. Treatment of other income, such as sales, fees and charges;
  - 5.7. High level principles that could underpin the choices of transition mechanism, such as stability, speed, transparency and time limits;
  - 5.8. The definition and measurement of the 'baseline' and 'target' which the transition mechanism would be applied to.
6. This is in line with the LGA's work programme on the Fair Funding Review, with the core LGA work programme and meetings of the Business Rates Retention and Fair Funding Review Task and Finish Group all helping explore policy options ahead of the publication of the consultation document.
  7. Once the consultation is published, officers are planning to coordinate another set of MHCLG/LGA regional consultation events. Due to the timing of the consultation and the local government finance settlement, there may be fewer but larger events organised compared to the previous model of six smaller events.

#### The LGA's policy positions on the Fair Funding Review – treatment of resources

8. The Government's Fair Funding Review will set new funding baselines through a combination of assessing each local authority's relative needs and relative abilities to benefit from local resources other than business rates. In practice this means that the relative resource adjustment will be deducted from the relative needs assessment to produce a funding baseline for each authority.
9. In terms of council tax, authorities with greater assessed income from council tax will receive relatively larger downward adjustments to their needs share than those with smaller assessed income from council tax.
10. In the pre-April 2013 formula grant system the relative resource adjustment was based on:
  - 10.1. Sizes of tax bases (which are affected by the discounts and exemptions) multiplied by
  - 10.2. An assumed level of council tax for different tiers of authority.
11. The Fair Funding Review is also exploring the potential of assessing relative ability to benefit from other sources of income, notably sales, fees and charges, which if implemented would result in councils with a higher ability to benefit from these income streams receiving a larger downward adjustment on their assessed relative needs.
12. The December 2017 consultation focussed on the relative needs assessment almost exclusively. Officers expect that the upcoming Fair Funding Review consultation will provide some emergent Government thinking on how relative resources should be assessed.

13. Members of the Task and Finish Group have had extensive discussions on these issues during their July and September meetings.
14. The following table briefly describes the various aspects of the relative resources adjustment that are likely to be consulted upon alongside some commentary about the points of consensus of the Task and Finish Group. Additional commentary on these positions is available in **Appendix 1**.
15. Please note that all of these decisions will have a distributional impact – each of these decisions will benefit some councils at a cost to others if the Fair Funding Review is a ‘zero sum’ exercise. The Task and Finish Group developed their positions on the basis of principles including a desire to avoid perverse incentives but were mindful of the distributional impact.
16. **Members of Leadership Board are asked to provide clearance on the positions set out in table 1 and Appendix 1.**

**Table 1. Relative Resources Adjustment likely consultation issues- Task And Finish Group recommendations**

Topic	Potential content (LGA officer view based on discussions in joint MHCLG / LGA groups)	Suggested policy position (developed by the Task and Finish Group, subject to approval by LGA Leadership Board and Executive)
Measuring the council tax base, in particular treatment of mandatory and discretionary council tax discounts.	The Government is expected to be leaning towards only adjusting for mandatory discounts and reliefs.	Only mandatory discounts and reliefs should be adjusted for.
Adjustments to the taxbase due to local council tax support	The Government is not expected to express a hard preference but might be leaning towards either adjusting only for the cost of the mandatory pensioner element, or on the basis of formula which aims to predict local demand for council tax support.	For pensioners, adjust the data for council tax support.  The Government should adjust for the non-pensioner element of council tax support on the basis of a formula which would estimate demand for local council tax support schemes.
Using either a 'notional' or actual council tax levels in the calculations	The Government is expected to lean towards using a notional council tax, but without much detail on what that level would be for each local authority type	Notional council tax levels should be used in the calculations.

Topic	Potential content (LGA officer view based on discussions in joint MHCLG / LGA groups)	Suggested policy position (developed by the Task and Finish Group, subject to approval by LGA Leadership Board and Executive)
<p>Treatment of factors that affect council tax levels, such as parish precepts, the adult social care precept, past acceptance of council tax freeze grant and special levies.</p>	<p>The Government's preference is unclear, but the use of notional council tax levels would make this of little importance.</p>	<p>While the use of notional council tax levels (the option preferred by members) would minimise the influence of these factors,</p> <ul style="list-style-type: none"> <li>- Parish precepts should be excluded as local authorities do not keep this income and so there funding should not be reduced.</li> <li>- The adjustment for the adult social care precept depends on whether the improved Better Care Fund is going to be funded through business rates or continue to be separate.</li> <li>- Councils should not be penalised for mandatory levies.</li> <li>- Council tax freeze grant acceptance should not be considered as a factor.</li> </ul>
<p>Treatment of sales, fees and charges (SFCs)</p>	<p>The Government is expected to prefer to not adjust for SFCs in the same way as council tax.</p>	<p>SFCs should not be adjusted for.</p>

## **Business Rates Retention**

### Commissioning a Business Rates Retention model

17. In April Leadership Board agreed to the LGA commissioning a business rates retention model to enable the effect of possible systems design changes to be estimated. Following a tendering exercise LGFutures were commissioned to produce the model which, following discussion at the Task and Finish group and delegation by the leadership board, was approved for distribution by the chairman and group leaders. The model is now on the [LGA website](#) and has been sent to Leaders, Chief Executives and Chief Finance Officers in all member authorities. An update on progress on our additional work programme on Further Business rates Retention and the Fair Funding Review can be found at **Appendix 2**.

### 2019/20 further Business Rates Retention pilots

18. As previously reported to Leadership Board and Executive, the prospectus inviting areas to bid to become a 75 per cent further business rates retention pilot closed on 25 September 2018. The five 2017/18 devolution pilots will continue at 100 per cent in 2019/20 and there will be separate discussions covering London. Non-London 2018/19 pilots had to reapply if they wished to be a pilot in 2019/20. Unlike in 2017/18 and 2018/19 there will not be a no-detriment clause. An announcement on successful pilots is expected at the time of the Local Government Finance Settlement on 6 December. Any updates will be given to your meeting.

### Other Business Rates Retention updates

19. A consultation paper on business rates retention is expected to be published at around the time of the local government finance settlement on 6 December. Officers expect the following to be covered:

- 19.1. Different options for resets;
- 19.2. The safety net;
- 19.3. Options for reforming the levy so that it covers what MHCLG consider to be 'excessive growth' within the system only;
- 19.4. Discussion of tier splits, although it is likely to be a decision made later in the process
- 19.5. How to incentivise pooling, with a more targeted levy.
- 19.6. Criteria for property to go on the central or local lists and an invitation to identify hereditaments which authorities think should change lists under the proposed criteria.

20. It is also expected that an alternative further business rates retention system will be included in the consultation document. Briefly:

- 20.1. There would be separate calculations of (i) the amount of business rates that authorities would need in order to reach their funding baseline (ii) the amount of business rates they would retain as a result of growth or any decline in the system. These would feed into an annual single tariff/top-up.
- 20.2. The Government believe this would enable the impact of appeals and provisions to be stripped out ensuring that the benefits of growth are not reduced by larger than anticipated appeals or misjudgements about the level of provisions. This would be an alternative to the previous proposal for 'nationalising' appeal risk which MHCLG do not believe it is possible to achieve without great complexity.
21. The proposal has been discussed by two joint meetings of the Systems Design Working Group and Implementation Working Group and also by the Business Rates Steering Group. It has also been discussed by the LGA's Task and Finish Group on Business Rates Retention and the Fair Funding Review. Their reaction was that alternative approach is worthy of further investigation. This includes:
- 21.1. How it can be explained more simply;
- 21.2. Ensuring that the system is operated is transparent including how it compensates for appeals, and the level of business rates and growth kept locally and nationally; and
- 21.3. Modelling to demonstrate it can achieve the above without unintended consequences.
22. We have asked MHCLG to provide the above as part of the forthcoming consultation on Further Business Rates Retention and we will discuss the alternative model with the Task and Finish Group again as part of LGA discussions of the forthcoming consultation. Following those discussions we intend to cover this issue, including any recommendations from the Task and Finish Group, at the next meetings of Leadership Board and Executive.

### **Next steps**

23. Officers will use the views expressed by LGA Leadership Board on the content of table 1 and **Appendix 1** to draft a response to the upcoming Government consultation on the Fair Funding Review.
24. More widely, officers will proceed with delivery of the LGA work programme on Business Rates Retention and the Fair Funding Review as directed by the LGA Leadership Board, Executive and the Business Rates Retention and Fair Funding Review Task and Finish Group.

### **Implications for Wales**

25. There are no direct implications for Wales arising from this report as Business Rates Retention and the Fair Funding Review apply to England. The distribution of funding to Welsh local authorities is a devolved matter in Wales.

**Financial implications**

26. Members of Leadership Board have previously approved spending of LGA reserves on the LGA work programme on the Fair Funding Review and a Business Rates Retention model (as set out in **Appendix 2**).
27. Other work outlined in the paper above is part of the LGA's core programme of work and as such has been budgeted for in the 2018/19 budget.

## **Appendix 1. Further commentary on Task and Finish Group proposed policy positions on the relative resources adjustment within the Fair Funding Review**

1. This note provides more information on the preferences expressed by members of the Task and Finish Group in their July and September meetings regarding the calculation of council tax adjustments within the Fair Funding Review, and the treatment of sales, fees and charges.
2. These preferences are summarised in table 1 above. LGA Executive are invited to consider the policy positions developed by the Business Rates Retention and Fair Funding Review Task and Finish Group which could form part of the LGA's response to the forthcoming consultation on the Fair Funding Review.

### Adjustment for discounts

3. The vast majority of council tax discounts and exemptions (such as single persons' discount or the student exemption) administered by councils are mandated by primary legislation. Local council tax support is a notable exception and is described below.
4. Members of the Task and Finish Group felt that local authorities should not be penalised for the impact of nationally mandated schemes. As a result, members have expressed support for the council taxbase used in the calculations to be expressed 'net' of such discounts and exemptions. It is a long-standing principle employed by Government in previous formula grant systems.
5. Local council tax support schemes are a specific matter as they have both mandatory (older claimants) and discretionary (working-age claimants) elements.
6. Members of the Task and Finish Group felt that, due to its compulsory nature, the impact of the older people element of the schemes should be reflected in the taxbase figures used – this is in line with the principle above.
7. Members also recognised that while the working-age element is more discretionary and there is a wide variety of schemes, it would be preferable to look at a formula which might predict the likely demand for such schemes. This way, the demand pressure could be recognised, but councils would not be rewarded or penalised for discretionary choices around local entitlements.

### Notional or actual council tax levels

8. The choice of council tax level used in the calculation of the council tax adjustment is just as important as the choices around the calculation of the relevant taxbase.
  - 8.1. Using actual council tax levels would tend to reward councils with low Band D council tax levels and penalise councils with high Band D council tax levels, regardless of the reason for the difference.
  - 8.2. Using a notional council tax level would ignore local council tax decisions and make the taxbase differences the deciding factor of distribution between councils. However, the 'tier split' of the notional council tax level – which would have a high

degree of Ministerial judgement – would have a significant impact on how the council tax deduction is split between different authority types as a whole.

- 8.3. For example, if a notional council tax of £1,000 is split with 10% applied to lower-tier services and 90% applied to upper tier services, district councils as a whole would be better off in comparison to a 20%/80% split. But how that burden is then shared out within those tiers would be the same in both scenarios.
- 8.4. One way of working out a ‘tier split’ could be to look at the actual split of council tax income at a national level.
9. While Members of the Task and Finish Group were mindful of how the use of notional council tax increases the impact of Ministerial judgement on the system, it was felt that it was still a better way forward than distributing funding on the basis of local policy choices reflected in actual council tax levels.
10. As a result Members expressed preference for the use of notional council tax levels, but without prescription of how this should be split between tiers due to the significant distributional impact. The LGA would seek the Government to be transparent on the reasons for choosing the notional council tax level and ‘tier split’ and the evidence used in making its decision.

#### Factors affecting council tax levels

11. The use of notional council tax levels would mean that all of the factors below have no impact on the distribution of funding between local authorities, as notional council tax isolates the impact of actual council tax levels from the analysis.
12. However, should actual council tax be used in any form of the analysis, or to work out the ‘tier split’ mentioned above, the Members of the Task and Finish Group expressed a preference to:
  - 12.1. Ignore parish council precepts, meaning councils with higher parish precepts would not be penalised
  - 12.2. Ignore mandatory special levies, meaning councils with higher such levies would not be penalised
  - 12.3. Consider treatment of the adult social care precept once it is clear whether the improved Better Care Fund would be rolled into the business rates retention system due to linkages in how this funding is distributed.

#### Sales, fees and charges

13. Members of the Task and Finish Group expressed a preference for income from sales, fees and charges to not be explicitly reflected in the resources adjustment. This is because
  - 13.1. The quality of data available is not particularly robust;
  - 13.2. There are sometimes only nuanced differences between mandatory and discretionary charges; and

- 13.3. This might have a penalising impact on councils which have adopted a more entrepreneurial approach.
14. However, it is worth noting that, as long as some degree of regression against past net expenditure is used in the analysis of council relative spending needs, the impact of sales, fees and charges is picked up indirectly where such income is linked to cost drivers used in the analysis.

**Appendix 2. High-level progress update on the LGA Fair Funding Review and Business Rates Retention work programme**

<b>Project</b>	<b>Purpose and description</b>	<b>Quick update</b>
<b>Criteria for assessing proposed distribution models and methodologies</b>	To give the LGA a structured and consistent way to assess new distribution models.	<a href="#">Complete</a>
<b>Formula grant: update the data</b>	<p>Update the data in the current distribution model (where updated data is available) to see the impact of this on individual allocations separate to any methodology changes. In effect this would provide an updated baseline to inform a discussion on how long the formulae remain 'future proof' without any review of weightings.</p> <p>To help the LGA and member authorities form policy on the data used in the formulae and the frequency of distribution resets, or other ways to 'future proof' the mechanism.</p>	<a href="#">Complete</a>
<b>Distribution model: develop a distribution model</b>	A model to allow local authorities to see the impact of different key cost drivers and differential weightings. To help the LGA and member councils evaluate the impact of various Government and stakeholder proposals on their council and to allow them to put forward their own proposals	<a href="#">Complete</a>
<b>Council tax equalisation: develop a model</b>	<p>A model to identify the impact of adjustments for council tax and council tax support on individual authorities.</p> <p>To inform LGA policy and to help individual member councils evaluate Government proposals.</p>	<a href="#">Complete</a>
<b>Damping /transition mechanisms</b>	A summary of historic damping / transition mechanisms and a model to inform discussions on the guiding principles of transition. To inform LGA and member authorities' policy.	Suppliers appointed; work expected to be published in late 2018 or early 2019.
<b>Business Rates Retention model</b>	<p>A model to enable LGA and local authorities to assess the impact of system design choices in areas including:</p> <ul style="list-style-type: none"> <li>• The setting of business rates baselines;</li> <li>• The extent and frequency of business rates resets;</li> <li>• Dealing with losses due to appeals;</li> <li>• The level of the safety net and how it is funded;</li> <li>• The split of business rates income in two-tier areas.</li> </ul>	<a href="#">Complete</a>