Executive

Business Rates Devolution and London Finance Commission

Item 4

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Summary

London Councils officers have continued to work closely with the GLA on a joint response to the government's consultation on the 100% business rates retention.

Work is progressing in the context of the reconvened London Finance Commission, which is due to report in time to influence the Autumn Statement.

It is proposed that the joint consultation submission incorporates a set of "asks" of Government that would be necessary to implement the design principles agreed by Leaders and the Mayor in June. This report presents a draft summary of those asks and seeks Executive's guidance on further work to finalise the draft response. Following discussion by the Executive, it will be discussed further with the GLA, SLT & CELC and brought back to the Leaders Business Rates Working Group, along with more detailed papers covering the asks and the responses to the Government's specific consultation questions, before final sign off by Group Leaders and the Mayor.

Recommendations

The Executive is asked to note the contents of the report and comment on the draft summary response at Appendix A.

Business Rates Devolution and the London Finance Commission

Introduction

1. Since the Chancellor’s announcement that local government would retain 100 per cent of business rates by 2020 in October 2015, London Government has been working collaboratively to develop a strategic pan-London response to the reforms.

2. Leaders’ Committee in December 2015 agreed a set of overarching ambitions for the potential devolution of business rates to London, and established a small working group to oversee the development of proposals which has so far met three times.

3. The Government committed in the March 2016 Budget to “explore with London options for moving to 100% business rates retention ahead of the full roll out of the business rates reforms.” Officers from London Councils, the GLA and the Society of London Treasurers have been attending a series of technical working groups at DCLG since April.

4. In June, Leaders’ Committee and the Mayor of London agreed a set of key principles on which to build a pan-London approach to the reforms, which was formally submitted to the Chancellor of the Exchequer and the Secretary of State for Communities and Local Government on 1st July.

The Consultation

5. DCLG launched a detailed consultation on July 5 entitled *Self-sufficient Local Government: 100% Business Rates Retention*. London Councils, working with the GLA, is developing a detailed joint response. It is proposed that this builds on the principles agreed in June to spell out a set of “asks” of Government that would be necessary to implement those principles in full. Appendix A presents a draft summary of those asks for Executive to consider.

6. The consultation is open and asks for comments on broad proposals rather than the Government’s preferred options at this stage. It focusses on areas of the business rates retention system that will specifically require new legislation (likely to be in early 2017).This includes:
    - Devolution of responsibilities
    - The business rates system: rewarding growth and sharing risk
    - Local tax flexibilities
    - Accountability and accounting.

7. Alongside the main consultation, DCLG has published a separate call for evidence on the forthcoming *Fair Funding Review* (again with a deadline of 26 September). London Councils will draft a separate response to this consultation. A more detailed technical consultation on this is expected in the autumn. The Government's timetable on this work is longer, with the final consultation on the needs formula not expected until the summer of 2018.

Timetable and next steps

8. Following discussion at Executive, London Councils officers will continue to work with GLA officials to finalise the draft response, including the detailed responses to the Government's consultation questions. Further input will be sought from borough chief executives and finance directors at the CELC and SLT meetings on 16 September.

9. A further meeting of the Leaders' Working Group is being arranged to discuss the proposals and the consultation response (w/c 19 September), before final sign off by group leaders. Final sign off with the Mayor will also be arranged in order to meet the deadline for submission of 26 September.

The London Finance Commission

10. At the same time as these significant reforms to business rates, the Mayor of London has reconvened the London Finance Commission (LFC). This originally reported in 2013 and set out bold proposals for fiscal devolution to London Government including full devolution of the 5 main property taxes (including 100% of business rates). Leaders' Committee and the Mayor of London endorsed the recommendations.

11. Professor Tony Travers of the London School of Economics is once again chairing the reconvened LFC. It met for the first time in August, with an interim report expected in early October and an aim of reporting in time to influence the Autumn Statement. London Councils will be represented on the Commission by Cllr Kober, Cllr O'Neill, with John O'Brien and Guy Ware acting as official observers, and among those supporting Professor Travers in his work.

12. It is likely that the recommendations of the Commission will be more ambitious than in 2013, recognising the changing macro-economic and political circumstances in light of June's EU referendum result. This may provide an opportunity for London Government to make some significant asks of the new Chancellor in his first Autumn Statement. London Councils and GLA

officers will support the Commission specifically on its business rates recommendations, and more broadly on further proposals around broader fiscal devolution.

Recommendations

1. The Executive is asked to note the contents of the report and comment on the draft summary response at Appendix A.

Financial Implications for London Councils

None

Legal Implications for London Councils

None

Equalities Implications for London Councils

None

Appendix A

"Self-sufficient local government: 100% Business Rates Retention"
A joint consultation response by London Councils & the Greater London Authority: Summary

1. This paper sets out a joint position on how we believe the reforms should be implemented in London in order to benefit not just the capital but the local government sector – and the UK economy - as a whole. This develops a set of key principles that were agreed by London Councils Leaders' Committee and the Mayor of London in June, and formally submitted to the Chancellor of the Exchequer and the Secretary of State for Communities and Local Government on 1st July.

Rationale for London devolution

2. The Government's proposals to localise business rate income create an opportunity to secure devolved responsibility for an important strand of local government funding – to which London has a long-standing commitment. Developing a successful London approach will help protect and promote economic growth in the capital –and therefore in the UK as a whole - will secure funding for public services and strategic infrastructure investment, and will support local public sector reform and enhance the accountability of London Government to its business taxpayers.

3. In order to achieve this, however, it will be necessary to recognise that London's circumstances may require different solutions to other parts of the country, and that those solutions require joint and collective approaches by all parts of London Government. It will also be important to overcome some of the key flaws of the existing business rates system.

4. London's economy is vital to the success of the UK as a whole. In 2013/14 London generated £127 billion in tax – exceeding the cost of public services in the capital by £34 billion. But London's economy – and its business rate taxbase – is different to the rest of the country: with only 16% of England's business premises, it currently generates around 30% of business rate income; 68% of those rates come from office and retail premises, compared to only 43% elsewhere.

5. Two key elements of the current system could undermine the Government, and London's, ambition to use business rates to provide incentives and rewards for promoting growth: appeals and revaluations.

6. The effect of appeals – particularly in London – has been to undermine the benefit of growth, to introduce an unacceptable degree of uncertainty in funding and to tie up vast amounts of resources in provisions for successful appeals.

7. Under the current system, where the total business rates yield is fixed at the national level, revaluations act as a redistribution mechanism over and above the resetting of business rates and funding baselines. This will be brought home in the impact of the revaluation due to come into effect in April 2017. In areas in which property values rise faster than the national average, rates paid by businesses will rise, while those paid in other areas will fall. This has two interrelated consequences which potentially undermine the Government's policy objective. Firstly, the burden of business rates will fall on a smaller and smaller number of businesses (we

estimate that, under current arrangements, London businesses' contribution would double from 30% to 60% of the total). Secondly, the taxbase in areas with lower rates of property market growth is artificially depressed, thus leaving local authorities in those areas increasingly reliant on top-up funding and increasingly unable to benefit from the economic growth they are seeking to promote.

8. The difficult balance between rewarding growth and reflecting needs in local government funding is also made harder by a national approach which seeks to address the issues of authorities of hugely different scale, geography, demography and economic activity. The result is complex, opaque and promotes unhelpful division. A more devolved approach could improve clarity and accountability.

9. London's proposals, as set out in the thirteen "asks" summarised below, would help address these problems in ways that would not only help London manage its future sustainable economic growth, and the financial sustainability of its local public services, but would benefit local government in the country as a whole.

Retention level

10. The level of rates retained is inextricably linked with the additional responsibilities to be funded (see Ask 2 below). Following the 2017 revaluation it is likely that London's rates will exceed current spending responsibilities (including those agreed for transfer in April 2017) by around £4 billion. Transferring additional spending responsibilities to match these resources would maintain "fiscal neutrality" ensuring that neither the government nor the rest of the local government sector is financially disadvantaged. It could also provide the opportunity to pilot devolution approaches across a range of services. The headroom anticipated would be sufficient to fund all of the grants and services London would seek to transfer (see Ask 2).

11. If however, the agreed national approach requires a lower level of transfer and a continued contribution from London, this should be calculated as a single aggregate tariff for London, based on regional business rate and funding calculations (see Ask 7). London Government would then take responsibility to manage top-ups and tariffs to balance to zero *within* London.

Ask 1 – London Government seeks to explore full retention of the business rates collected in the capital buy 2020; if London does not retain 100 per cent of its business rates, we ask that the tariff is one single payment at the aggregate London level

Additional responsibilities

12. The Government consultation identifies a list of grants and services for potential transfer. London would seek the transfer of those responsibilities which best support its ability to promote economic growth and implement local public sector reform. As stated above, the future level of business rates in London would be sufficient to fund all of these within the capital (see Annex 1 for details); but the same is not true for the country as a whole. If the level of transfers has to be scaled to match the national total of business rates (rather than, say, Government identifying additional budgets to devolve) London's priorities would be to transfer those responsibilities which best support its ability to promote growth and implement local public sector reform.

Ask 2 – London Government would prioritise the transfer (over and above what has already been decided) of:

- Skills - 16-19 funding
- Adult Education Budgets
- Work and health programme
- Capital funding for Affordable Housing; and
- Early Years funding

13. Devolution should be an on-going process, not confined to those services which can be funded by current business rates. Any future transfers should be accompanied both genuine transfer of control of the services concerned as well as clarity about future funding – whether through increased business rates yield, other devolved taxes or government grant.

Ask 3 - London Government would wish to agree prior to the start of the 100 per cent retention system a robust mechanism for negotiating and agreeing with central government any new responsibilities that are to be delivered in the capital beyond 2020

Revaluations and Resets: balancing needs and resources

14. As indicated in paragraph 5, the current revaluation system distorts both the economic effectiveness of the tax and the taxbase of local authorities around the country: in future that taxbase should rise or fall in line with economic performance. London believes that sub-national areas that can show to government they are willing and capable of delivering devolved control of business rates should be allowed to benefit from increases, and manage the risk of decreases, in their taxbase arising from changes in valuation. Breaking the link between revaluation and the fixed quantum of tax yield benefits both those areas where commercial property markets are strong and those where they are not. Where values rose, local authorities would be able to fund additional investment or services, or reduce the multiplier while maintaining current expenditure levels. This would both underpin devolved local government and improve local political accountability.

Ask 4 - London Government asks for London's business rates to be "de-coupled" from the national valuation system.

15. Government is considering changes to the frequency of valuations and the appeals process they inevitably generate. However, accountability for the accuracy and timeliness of decisions would still not be aligned with their impact on local authorities' finance. Once London's rates were "de-coupled" from the national valuation system, greater alignment could be achieved by a corresponding devolution of the valuation process to match devolved control and accountability for raising rates.

Ask 5 - London Government calls for the ability to determine its own valuation system to be administered by a regional valuation office for London.

16. Finding the appropriate balance between risk and reward - meeting need and incentivising growth - is perhaps the biggest challenge in setting up the 100 per cent retention system. We believe that, within a London retention system, the frequency of resets of business rate and funding baselines should be determined locally by London Government. We would seek to manage future resets taking into account the overall balance between spending need, council tax base, the speed of change and the desire to maintain incentives within a devolved system. We think that it should be possible to reset funding and business rates on different timetables,

for example with business rates baselines being set over a longer period (10 years for example) and funding baselines being reset more frequently (every 3 years for example), and would explore options around this.

Ask 6 – London Government calls for the ability to manage future resets of business rate and funding baselines, and their impact, within London.

17. Measuring relative need to spend will be a key factor in any reformed system that balances authorities' capacity to spend and raise tax. There is common agreement across the sector that any new needs assessment system should be less complex and more responsive to changes than the current system. A potential solution could involve a two-stage approach to assessing need. The first stage would be an assessment of needs at a suitable sub-national level, followed by a more local/sub-regional approach to allocate within these areas.

18. Such an approach would:
    - be less complex and therefore more transparent;
    - be more responsive to population changes; and
    - give London boroughs and the GLA more collective ownership over the process and therefore would build trust that the system is fair.

Ask 7 – London Government proposes a two-stage process in which a regional needs assessment for the capital would be combined with the ability to vary a needs formula within London over time to reflect local circumstances.

Determining the allocation of resources between tiers of London Government

19. The allocation of resources in London should follow the responsibilities to be funded. The starting point should therefore be the agreed transfer of responsibilities: any future revisions should be periodically agreed and managed by London Government.

Ask 8 – London Government asks for the ability to decide collectively for itself how business rates are shared between the boroughs and the GLA.

Setting Business Rates – flexibilities

20. London Government would wish to explore options for either a collectively agreed single multiplier across London, or two separate multipliers with the Mayor of London being granted the ability to set a proportion of the rate on a London wide basis, and boroughs collectively setting the rest of the multiplier.

21. Following successful implementation of a London scheme, however, we would want to explore with Londoners how this could be developed towards full control of rate setting – including the safeguards that would be required to prevent a disproportionate tax burden on business – along with a broader range of fiscal devolution as envisaged by the London Finance Commission.

Ask 9 – London Government initially seeks the flexibility to determine the business rates multiplier(s) in London, agreed collectively between the Mayor and London's borough Leaders over a defined period

22. In the short term, it will be important that the 2% infrastructure levy opportunity offered to Combined Authority areas should also be available in London, over and above the existing Business Rate Supplement that funds Crossrail.

23. Mandatory reliefs awarded in London will amount to around £650 million in 2016-17, and are currently set by central government. London Government believes these could be used more constructively to improve local economies and to encourage greater dialogue and engagement between councils and local businesses. London Government should have the collective ability to set the qualification criteria and thresholds of the existing mandatory reliefs currently set by central government (and the discretionary elements of those schemes), as well as determining new mandatory relief schemes periodically when deemed necessary. This would include the small business rates relief threshold. Where individual boroughs or the Mayor wished to offer additional discounts over and above a collective scheme agreement, this could be achieved through adjustments to their retained rates.

Ask 10 – London Government seeks the flexibility to determine all business rates discounts and reliefs, including scheme parameters and thresholds

Distributing the benefits of growth

24. Within a devolved system, any business rate growth could be retained by boroughs and the GLA in line with their overall share. However, London's economy is a complicated system in which different parts of the capital will have different, but inter-related, roles to play. For the economy to keep growing in a sustainable manner, we need to expand the overall business premises capacity, but also to find ways to house, train, transport and provide access to leisure and culture for millions of people around the capital. We may therefore want to use some of the proceeds of growth to facilitate additional investment, and to create targeted rewards that incentivise contributions to the capital's overall success beyond hosting new business properties.

25. This could be achieved by retaining a central pool for distribution according to collective priorities. Ultimately, however, this should be a matter for London Government to determine.

Ask 11 – London Government asks for the ability to determine collectively how the proceeds of growth are shared within London

Managing risk: safety nets and the Central List

26. If the move to 100% retention is to be successful then the need to share and manage risk effectively will be essential. However, the balance between central and local responsibility cannot be separated from the questions of the overall proportion of rates retained, and the degree of local control allowed.

Ask 12 – Under a devolved retention system, London Government asks that the safety net mechanism and thresholds are determined locally by London Government

27. The central list has been identified as a potential source of funding for future safety net arrangements. Where responsibility for such arrangements is devolved, it would be appropriate also to maximise local access to the rates derived from properties currently held on the central

list. This would also increase opportunities and incentives to maximise the value and use of such assets where possible.

28. London local government considers that, unless there is a clear case for an assessment to be on the central list, it should be on either a local list or regional list.

Ask 13 - London Government would seek to transfer central list properties to either a local or regional list wherever possible, including the transfer of TfL's separately identifiable assessments potentially as a single TfL operational assessment.

Governance

29. A regional approach to managing business rates in London will require appropriate mechanisms to ensure that robust, timely and accountable decisions can be taken to raise and distribute tax revenues. In return for the level of devolution and autonomy London Government is asking for, central government will require reassurance that London is capable of governing such a system collectively.

30. The proposals set out in this paper generate three classes of decisions for London to Government address:

- ***Initial set-up:*** decisions and agreement with Government on the scheme design, including the level of retention, responsibilities transferred, the basis and frequency of revaluations, and resets, the allocation of resources between GLA and boroughs, the multiplier(s), the framework for discounts and reliefs, the distribution of growth proceeds, the operation of a regional safety net and a regional list. Such decisions would need to be taken collectively – and unanimously – by the Mayor of London and Leaders.
- ***On-going tax-setting and resource allocation:*** annual decisions such as setting the multiplier(s) and allocating the collective growth pool; periodic decisions such as agreeing revised baselines and changes to the needs formula. These decisions would need to be taken collectively by the Mayor and Leaders, building on the existing Congress arrangements, with appropriate voting and other principles consistent with the London Finance Commission in 2013, built in to ensure the appropriate protection of minority interests within London.
- ***Technical underpinning and review:*** it may require two independent technical commissions to manage on-going work around valuation (including the performance of a regional VOA) and the operation of the tax, and around maintaining the needs formula and distribution model. Political oversight of these commissions could be undertaken by the Governance structures described above.

Annex 1: Additional Responsibilities

1. London Government believes, when determining the existing grants and new responsibilities that should be funded by business rates, priority should be given to responsibilities that maximise London Government's ability to improve the life of Londoners, the effectiveness and efficiency of its public services, and the future economic success of the capital.

2. We would therefore wish to prioritise the transfer of grants and responsibilities that:
    - have a direct relationship to business;
    - help tackle key infrastructure challenges, including housing and transport; and
    - have a compelling public service reform case to be delivered more efficiently and effectively by local government.

3. As such, London Government believes the following grants and responsibilities (listed in Table 4) are suitable candidates to be transferred.

Table 4 – Existing grants & new responsibilities - Suitable candidates for transfer

	Existing grant or responsibility	Reason(s)	Estimated London value in 2019-20 (£bn)
Early Years Block of DSG	Grant	PSR	0.748
Revenue Support Grant	Grant	PSR	0.538
Public Health Grant	Grant	PSR	0.628
Skills - 16-19 funding	New responsibility	Business link/PSR	0.449
Affordable Housing capital funding	Grant	Infrastructure	0.417
Improved Better Care Fund	Grant	PSR	0.247
Adult Education Budgets	New responsibility	Business link/PSR	0.227
Youth Justice	New responsibility	PSR	0.054
Valuation Office Agency	New responsibility	PSR	0.050
Housing Benefit Admin Subsidy	Grant	PSR	0.033
Independent Living Fund	Grant	PSR	0.019
Council Tax Support Admin	Grant	PSR	0.015
Work and health programme	New responsibility	PSR	0.014
Careers Service	New responsibility	Business Link/PSR	0.009
Rural services Delivery Grant	Grant	PSR	n/a
Transport capital (outside London)	Grant	Infrastructure	n/a
Total grants & responsibilities			**3.448**
Total "headroom" in 2019-20			**3.975**
Remaining capacity			**0.527**

NB: The RSG figure here is net of the GLA's RSG which will be funded from business rates from April 2017. TfL Capital grant is also not included as this will be transferred in 2017-18.