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| Leaders’ Committee |
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| Business rates devolution  | Item | 6 |
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| Report by: | Paul Honeyben | Job title: | Strategic Lead: Finance, Performance & Procurement |
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| **Summary** | On 5 October the Chancellor of the Exchequer announced substantial changes to the way local government will be funded by the end of the current parliament (2020). Most significantly, this included 100 per cent retention of business rates, accompanied by new (as yet undecided) responsibilities, and the abolition of Revenue Support Grant (RSG).This paper outlines for Leaders:* + how the current system works and reforms that London Councils has proposed in recent lobbying;
	+ the details of the reforms announced by the Chancellor so far;
	+ issues for London local government to consider as these reforms develop; and
	+ what this means for the wider local government finance system.
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| **Recommendations** | Leaders are asked to:1. note the content of the report and the issues described in paragraphs 12 to 21; and
2. support ongoing technical work and lobbying to secure the changes advocated in the Spending Review submission.
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**Business rates devolution**

**Introduction**

1. On 5 October, in his Conservative Party Conference speech, the Chancellor of the Exchequer announced substantial changes to the way local government will be funded by 2020[[1]](#footnote-1). Most significantly, the full £26 billion of business rates will be devolved to local government (100 per cent retention), RSG will be abolished and local authorities will be expected to deliver additional responsibilities with the extra net funding these changes imply.
2. In addition, the uniform (national) business rate will be abolished and local authorities will be able to reduce business rates locally to attract businesses. Areas with city-wide elected mayors will be able to levy an increase in business rates (up to a 2 per cent cap), subject to a majority vote of the business members of the LEP.
3. Much of the technical detail around these reforms is still to be developed and legislation will be required. Some further information is expected in the Spending Review on November 25.
4. This paper outlines for Leaders:
	* how the current system works and reforms that London Councils has proposed in recent lobbying;
	* the details of the reforms announced by the Chancellor so far;
	* issues for London local government to consider as these reforms develop; and
	* what this means for the wider local government finance system.

**Context – the current business rates retention system**

1. Introduced in 2013-14, the current business rates retention system sees 50 per cent of business rates collected by boroughs pooled centrally by government and used to fund Revenue Support Grant (RSG) and other specific grants. In London, the remaining 50 per cent is split between the GLA (20 per cent) and local billing authorities (30 per cent). A system of equalisation sees 25 boroughs receiving a top up from, and 8 paying a tariff to, central government, in order that boroughs receive an amount assessed by government as meeting their needs (the funding baseline).
2. Any business rates growth above the expected baselines is split between central government, the GLA and the local authority in proportion to these shares, with tariff authorities paying an additional levy to government, capped at 50p in the pound. For authorities that do not achieve the baseline target there is a safety net, which means that an authority cannot lose more than 7.5 per cent of its funding baseline in any one year.
3. In 2015-16 London boroughs will be expected to collect £6.6 billion, with the GLA retaining £1.3 billion and boroughs collectively retaining £2.0 billion prior to top-up and tariff adjustments. However, a number of limitations with the current system, notably the negative impact of business rates appeals, mean boroughs are unlikely to achieve these targets. London Councils has consistently argued that the current retention scheme fails to sufficiently incentivise growth: confirmed by the lack of substantial growth in retained rate income across London in the first two years of the system.
4. The recent Spending Review submission[[2]](#footnote-2) asked for a number of reforms to be made to address this, including asking for:
	* full retention of business rates growth across all local authorities (not just pilots announced at the Budget in March);
	* 100 per cent retention of business rates taxation by the end of the parliament;
	* devolution of power to local government to determine mandatory reliefs; and for
	* locally defined areas to be able to vary the national business rates multiplier according to the needs of their local areas.
5. In addition, the submission highlighted the fact that in 2015-16 there will be a surplus in business rates for the first time, which will grow to around £11 billion nationally by 2020 as total business rates yield increases by RPI inflation and total funding falls as part of deficit reduction (see Chart 1). The submission asked for the Government to clarify what it intends to do with the business rates surplus between now and 2020, including clarifying which specific grants it is funding, and what other existing grants it intends to fund through this mechanism.

**Chart 1 – Estimated local government funding and business rates to 2020 - England**



## Source: London Councils’ Spending Review submission

**The proposed reforms**

1. The details that have been announced so far are that, by the end of the current parliament (2020):
* local government will retain 100 per cent of business rates locally;
* the core grant from Whitehall (RSG) will be phased out;
* local government will be expected to fund new responsibilities with the increased business rates funding;
* the Uniform Business Rate (i.e. the nationally set multiplier) will be abolished and instead local authorities will be given the power to reduce business rates by varying the multiplier locally;
* areas which choose to have city-wide elected mayors will be given the power to increase business rates by up to 2 per cent for spending on local infrastructure projects, as long as they win the support of local businesses through a majority vote on the LEP.
1. The full details of the reforms are still to be announced and, due to the level of complexity, are likely to take considerable time to be developed by DCLG. However, it has been indicated that further detail will be announced at the Spending Review (November 25), which is also likely to include the findings of the government’s overarching review of business rates that has been running since the spring[[3]](#footnote-3).

**Issues for London local government**

1. The Chancellor’s announcement is welcome. It directly addressed a number of the points that London Councils and the sector more widely has been lobbying for. In addition, local control over the multiplier, albeit with restrictions on increases, is also a welcome step towards local authorities having greater dialogue with their business communities. It is not yet clear whether boroughs will be given local flexibility to target discounts and reliefs to help support specific business sectors, which London Councils will continue to press for.
2. There are, however, still a number of unknown parameters that the Government has yet to decide which will help determined the particular impact on London. Perhaps most importantly is the nature of what “new responsibilities” local government will have to fund through business rates. Local government receives a number of grants for specific purposes, such as the New Homes Bonus (£1.2 billion), Public Health grant (£2.6 billion), and the Better Care Fund (£3.5 billion). It is not yet clear exactly which grants will be “rolled in” to the system. It may also be the case that Government will take a view of the relationship between the reform of public services and this ‘surplus’. Officers will need to work to identify options for members to consider in terms of influencing this overall consideration by Government.
3. There is also an important question for London and its relationship with the rest of the country. Latest estimates suggest that there will be a ‘surplus’ of around £4 billion in London by 2019-20. It is not yet clear whether it will stay in London. Leaders will want to consider whether London Councils’ policy on the current 60%-40% split between boroughs and the GLA will have to be revisited in light of which grants are included. Officers will be undertaking further work on this and anticipate bringing further papers to Leaders’ Committee with a view to trying to influence this process.
4. With regard to equalisation, there may well be some continuation of a national system of top-ups and tariffs (albeit recalculated against new business rates baselines). It is assumed that funding baselines, which represent the current assessment of need, will continue to be reset as previously proposed. The next reset is planned for 2020, and future resets are anticipated to be every 10 years. However, this is yet to be confirmed by the Government.
5. The new local powers to vary business rates create several issues that will have to be resolved. It is unclear how the “power to cut business rates” will work in practice, for example, and whether there will be a limit imposed on how far the multiplier can be adjusted downwards locally, and how this could impact on how the safety net is triggered.
6. With regard to the 2p supplement to fund investment in infrastructure, it is not yet clear whether this will be in addition to, or in place of, the existing Business Rates Supplement that funds Crossrail in London. While this is broadly welcome, if this simply extends the BRS approach to be more widely available to Metro Mayors, it may not mean any significant change for London.
7. There is no clarity about how the two new powers will work in places like London, where city-wide increases to fund infrastructure could coincide with locally planned reductions. Whilst the closer visibility of the relationship between local business tax and local services creates a new opportunity to engage with local business, there will be a series of challenges around maintaining local political accountability, and questions around whether the current accountability structures are sufficiently robust. London has slightly different LEP governance arrangements to elsewhere for example, with the London Enterprise Panel acting as an advisory body to the Mayor of London.
8. More fundamentally, full devolution of business rates means local authorities bearing 100 per cent of the risk of negative growth. It will be important, therefore, that current issues with the business rates as a tax are addressed before full devolution: most importantly, that an adequate solution is found to the funding uncertainty caused by rating appeals. A fully funded safety net system will also be necessary, and there is currently no detail on how this will be funded.
9. A further issue with the system is the narrow definition of growth as physical rather than revaluation growth. This makes it difficult for local authorities in built-up areas, to benefit financially from the current system, as there is a general scarcity of land and physical growth often requires the demolition of existing buildings first. London Councils’ Spending Review submission asked for the definition of growth to be broadened and for the retention of growth for a fixed period of time to avoid the “cliff edge” effect which could act as a disincentive for developments in the years before a system reset.
10. In welcoming the reform, there is, of course, still a lot of further work and clarification required and London Councils officers will continue to engage with civil servants, DCLG working groups and by responding to government consultations. Officers will keep Leaders informed as the timetable for the reforms develops in the coming months.

**Wider reform of local government finance**

1. The announcement should be seen within the wider context of reforms to local government finance and suggests the government may develop a longer-term strategy for reforming and devolving funding to local government.
2. The commitment to using the uplift in local taxation to fund infrastructure suggests there could be further scope to develop other forms of tax retention type mechanisms as other devolution deals progress.
3. The fact that local taxation will now fund most of the services delivered by local government by the end of the decade may suggest a greater level of local accountability within the system; however, it may put even more importance on how those taxes are determined and whether they operate efficiently. It may offer the opportunity for London Councils to advocate reform of other property taxes over the course of the parliament, in line with the Spending Review submission.

**Recommendations**

1. Leaders are asked to:
2. note the content of the report and the issues described in paragraphs 12 to 21;
3. support ongoing technical work and lobbying to secure the changes advocated in the Spending Review submission.

**Financial Implications for London Councils**

None

**Legal Implications for London Councils**

None

**Equalities Implications for London Councils**

None

1. <https://www.gov.uk/government/news/chancellor-unveils-devolution-revolution> [↑](#footnote-ref-1)
2. <http://www.londoncouncils.gov.uk/download/file/fid/16387> [↑](#footnote-ref-2)
3. As updated in the Summer Budget (paragraph 1.244) [↑](#footnote-ref-3)