CCN
COUNTY COUNCILS NETWORK

A FAIRER FUTURE FOR COUNTIES
COUNTY COUNCILS NETWORK

Consultation Response

Business rates retention reform

Summary

- We welcome the opportunity to respond to the Ministry of Housing, Communities and Local Government's latest consultation on Business Rate Retention. The outcome of this consultation will have a significant impact on council authorities at a time of real financial strain. It will also help ensure our member councils to realise their ambitions in supporting local growth, allowing local government to shape their local economies.

- County authorities have had a mixed experience of business rate growth since 2013-14. Some authorities have generated significant amounts of growth, particularly those in areas that are close to major transport routes or large conurbations. Growth has been less strong in other county areas, particularly those that are in more rural or remote parts of the country.

- For shire counties, the current system means that they have only been able to retain a 9% share of business rate growth. As a result, counties have not benefitted from the move towards 50% retention of business rates as much as other classes of authority, in particular district councils.

Baseline Reset

- CCN strongly support the government's proposal to proceed with a full baseline reset for 2020. Looking beyond 2020, it is clear that the Government do not intend to undertake further full baseline reset. In light of this, we join the SCT in supporting a phased reset.

Safety Net

- CCN supports the concept of the safety net. It is the fairest way of ensuring that no authority is exposed to catastrophic business rate reductions. However, it should be noted that since 2013-14, no county authority has had any support from the safety net. Unless gearing disparities are addressed, CCN and the SCT will not support a top-slice to fund the safety net. Should gearing disparities continue, it cannot be fair to expect lowly geared LAs to pay for a safety net that they are so extraordinarily unlikely to use.

Levy

- CCN members strongly support continuing some method of applying a levy to gains from the business rate system. A reformed levy should be fair and should be applied regardless of whether gains arise from "normal" or extraordinary growth. Many authorities have gained excessively from the current system, even with a levy. Creating a levy in the way that the consultation paper proposes would allow these authorities to retain even greater amounts.

- CCN members would prefer to see the levy linked to a threshold. However, they could not support the suggestion in the consultation paper that the threshold could be as high as 150%. This would render the threshold almost meaningless and would allow some authorities (with large growth and high gearing) to retain excessive growth. CCN would prefer the threshold to be set at about 20% of Baseline Funding Levels (BFL). Such a threshold would capture only growth that is well above average.

Tier Split

- CCN believe that a *default* national tier split is a fundamental necessity. Whilst areas should have the option of attempting to agree a locally determined tier split it would be wholly unacceptable to not have a default tier split as a lack of agreement would have no means of resolution nor distribution mechanism – a situation which would completely undermine the Government's two-fold ambition for BRR.

- It is sensible for MHCLG to ask the sector to agree tier splits. CCN is keen to engage with colleagues in the District Councils Network (DCN) and to seek an agreement. Initial discussions have already taken place and further talks are planned over the coming weeks.

- The commentary in the consultation outlines that there is "appetite for change within the sector" on the tier split, reflecting "pooling and pilots of greater rates retention have shown that all authorities have a role to play in generating growth and so this should be reflected in their growth incentives". We welcome this commentary and believe it be reflective of the position of our member councils. Now that there is more awareness of how the BRRS operates, our members have told CCN consistently that they are willing to accept more risk in return for a greater share of local business rates growth.

- We believe that in taking forward discussions with both DCN and Government, this response sets out a number of important factors that must be fully considered in order to arrive at a decision that is based on evidence.

- CCN would support greater flexibility at the local level provided a national default as outlined above and there are other certain safeguards, such as consensus amongst *all* affected authorities before agreeing a local change in tier split and clarity that all billing authorities within an area must remain within the county area.

Simplified Administration

- CCN members understand the reasons for MHCLG exploring a different approach to the BRRS and supports the proposal for an alternative business rates retention system. We recognise that there are some genuine practical problems to reforming the current system and we are interested in exploring an alternative approach, especially if the result is a system that is less volatile and more predictable. Clearly there is a considerable amount of work to be undertake before a viable system can be unveiled.

- There are some important benefits from the alternative system that CCN members would be keen to see delivered. This includes providing protection to authorities from valuation errors. This would be a considerable advantage if such protection is not available in the reforms to the current system.

- CCN members would welcome clarification for how shire counties would fit into the new arrangements. There is an opportunity for counties to have more control over the system and the financial rewards that they receive. It is possible that they would be less exposed to decisions by billing authorities about provisions for appeals and bad debts. This would certainly be a major benefit for shire counties and would be particularly important if counties receive a higher tier split from 2020-21 onwards.

Introduction

1. The CCN represents 36 English local authorities that serve counties. CCN's membership includes both upper tier and unitary authorities who together have over 2,500 councillors and serve over 26m people (47% of the population) across 86% of England. CCN develops policy, shares best practice and makes representations to government. CCN is a member-led organisation which works on an inclusive and all-party basis.

2. Counties, as all parts of the sector, have been heavily involved in the evolution of the business rates retention proposals through the Steering and Technical Working Groups. This submission seeks to build on this engagement to date and has been developed in close consultation with member councils and the Society of County Treasurers (SCT). We would also specifically draw the department's attention to the responses of our individual member councils.

3. We welcome the opportunity to respond to the Ministry of Housing, Communities and Local Government's latest consultation on Business Rate Retention. When completed this process will be the biggest change to the business rates system for a generation, completing the process begun by 50% retention in 2013. How the government takes this forward will impact on councils for years to come, and as a result we believe that in moving towards greater business rate retention, the government ensures that the new system is sustainable and achieves the desired outcome.

4. The outcome of this consultation will have a significant impact on council authorities at a time of real financial strain. It will help ensure our member councils realise their ambitions in supporting local growth, allowing local government to shape their local economies, especially at a time of great challenge for the high street.

5. For county authorities operating in two tier areas, it is particularly important to secure a tier split that properly recognises their strategic role in generating local economic growth as well as the higher demand-led pressures that they face.

6. CCN would like to stress that this response has been developed in conjunction with our response to the consultation on the Fair Funding Review (FFR) a review of relative needs and resources. Within the FFR response, we provide extensive commentary not only on the proposals but also the wider local government finance system; including the need for Spending Review to deliver a significant increase in the quantum of local government funding. We do not seek to repeat these points within this response, but ask the department to note their importance in relation to implementation of 75% business rates retention.

County Context

7. Since 2016, Pixel Financial Management (PFM) have undertaken two in-depth studies for CCN on business rates retention in county areas. The first of these focused on the profile of business rates in counties,[1] and the second modelled the potential implications of moving to 100% business rates retention.[2] While the latter of these reports focused on 100% retention, the findings of the report are still extremely relevant to proposals to move towards 75% retention and we urge the department to continue to consider these findings as part of this consultation.

[1] Pixel: Independent Analysis of Full Business Retention in County Areas (2016) https://www.countycouncilsnetwork.org.uk/download/157/
[2] Pixel Financial Management: 100% Business Rate Retention: Further Technical Work (2017) https://www.countycouncilsnetwork.org.uk/download/1132/

8. These reports have shown that county authorities have had a mixed experience of business rate growth since 2013-14. Some authorities have generated significant amounts of growth, particularly those areas that are close to major transport routes or large conurbations. Growth has been less strong in other county areas, particularly those that are in more rural or more remote parts of the country.

9. For shire counties, the current system means that they have only been able to retain a 9% share of business rate growth. As a result, counties have not benefitted from the move towards 50% retention of business rates as much as other classes of authority, in particular district councils.

10. CCN members have welcomed their increased participation in the BRR pilots that have taken place since 2017, which have helped generate more awareness of how a future system could operate. We would hope that the government will give particular regard to the consultation responses of county authorities that have participated in those pilots. The common learning of our members from the pilot programme has been that counties require retention of a higher share of local growth, acknowledging that this means accepting a higher level of risk.

National Context

11. A further concern for county authorities is the interaction between the BRRS and the wider funding system, including the long-term sustainability of business rates and continuing calls by the business sector for reform.

12. We join the SCT in highlighting overall sustainability of the business rates system, especially its effect on high streets. Suitable taxation of large online retailers should be considered further addressing the lost business rates from on-line shopping, alongside other fiscal devolution measures as part of the long-term funding of local government in the Spending Review.

13. The amount retained collectively by local government from business rates is considerable: it has is estimated that £2.4bn of growth has been retained in 2018-19, £921m of which is from the business rate pilots. Given the funding shortfall for both adult’s and children’s social care across local government, income from business rates provides a useful source of revenue that could be invested in these important services. However, it should be noted that pressures in adults and children’s services also have little or no correlation with business rates growth so this cannot be seen as a panacea for the funding pressures faced by upper tier councils.

14. Finally, this consultation reflects the former Chancellor’s pledge to abolish the levy and focuses on removing the effect of the levy as much as possible within secondary legislation. We agree with the SCT that abolishing the levy should not be the primary focus of reforms.

15. Abolishing the levy entirely would significantly and unequally overfund some types of local authorities, without a significant increased incentive for local authorities to grow their business rates. The BRR system must be reformed in a fair way; being simplified where possible whilst protecting LAs from unreasonable losses. Further, the system must address the disparities in local authorities gearing; which, with suitable safety net arrangements would incentivise local authorities fairly. Once some of the more fundamental issues with the current system are dealt with, then there is scope to discuss options for the levy; but this cannot be allowed to supersede issues of fairness, transparency and protection of vital statutory services.

Question 1: Do you prefer a partial reset, a phased reset or a combination of the two?

Question 2: Please comment on why you think a partial/ phased reset is more desirable.

16. CCN strongly support the government's proposal to proceed with a full baseline reset for 2020. It must also be noted that MHCLG are currently consulting on changing the formula by which central government funds are distributed to local government through the FFR. CCN members would therefore like to see a full baseline reset to ensure that both streams of funding come on-line properly at the start of the 2020/21 financial year.

17. Many authorities are currently benefitting excessively from the business rate system and a full baseline reset is an effective way of creating a fair redistribution of these gains ahead of a new settlement for the sector at the Spending Review. In many cases, authorities have benefitted because of large new developments (over which they had very little influence or control) or because their baselines were set in an advantageous way in 2013-14. As we have set out above, we believe that an objective of business rate retention should be to maximise the funding that is available for services such as adult's and children's social care which are experiencing significant demand-led pressures. A full baseline reset in 2020 would ensure that this can be achieved by securing additional funding for county authorities, ensuring that a reasonable balance can be found between rewarding growth and funding services that are under extreme financial pressure.

18. Looking beyond 2020, it is clear that the Government do not intend to undertake a further full baseline reset. In light of this, we join the SCT in supporting a phased reset. This would seem preferable due to the lack of 'cliff-edges' – local authorities shouldn't have to delay plans for growth to receive the greatest retained rates reward. Rather, growth achieved should be rewarded similarly regardless of when it occurs.

Question 3: What is the optimal time period for your preferred reset type?

19. CCN would accept a 5 year reset period but would prefer a shorter reset if possible, especially if this is going to be combined with a partial reset. The same time period could be used for either a full or phased reset.

Question 4: Do you have any comment on the proposed approach to the safety net?

20. CCN supports the concept of the safety net. It is the fairest way of ensuring that no authority is exposed to catastrophic business rate reductions. However, it should be noted that since 2013-14, no county authority has had any support from the safety net. This is explained by the size of our member authorities (and consequent ability to mitigate risk across a larger and more diversified ratebase) and because county councils have only had a 9% share of rate growth.

21. Unless gearing disparities are dealt with, CCN and the SCT will not support a top-slice to fund the safety net. Should gearing disparities continue, it cannot be fair to expect lowly geared LAs to pay for a safety net that they are so extraordinarily unlikely to use.

22. CCN authorities have collectively funded a large part of the cost of the current safety net. Levies have been insufficient to fund the total cost and the resulting top-slice required to

pay for the safety net was applied based on share of the baseline funding level. CCN's preference in the future would be that the cost of the safety net is funded by the levy and thereafter by a top-slice that is based on the likelihood of an authority needing to use the safety net. This could be measured by the size of an authority's business rate income or potentially a measure of an authority's level of business rate growth.

23. CCN members would also support a safety net that is closer to the baseline (for example 97% of Base line funding rather than 95% as is used in the current 75% pilots). This provides greater certainty to authorities and shares risk across the sector. Given that the cost of the safety net is paid for as a top-slice, a higher safety net threshold provides greater mutual insurance across the sector.

Question 5: Do you agree with this approach to the reform of the levy?

24. CCN members strongly support continuing some method of applying a levy to gains from the business rate system. A reformed levy should be fair and should be applied regardless of whether gains arise from "normal" or "extraordinary growth". Many authorities have gained excessively from the current system, even with a levy. Creating a levy in the way that the consultation paper proposes would allow these authorities to retain even greater amounts.

25. A functioning levy can be used to fund the safety net, for instance, rather than funding it from upper tier authorities experiencing high demand-led pressures in adult's and children's services.

26. CCN members would prefer to see the levy linked to a threshold. However, they could not support the suggestion in the consultation paper that the threshold could be as high as 150%. This would render the threshold almost meaningless and would allow some authorities (with large growth and high gearing) to retain excessive growth. CCN would prefer the threshold to be set at about 20% of BFL. Such a threshold would capture only growth that is well above average.

27. We do not support the proposal to distinguish between different types of growth. Using an arbitrary threshold creates a distinction that doesn't reflect the real difference between growth and "appeals".

28. We would also note that the changes in the tier splits in two tier areas could also impact on the way that the levy works. Awarding upper tier authorities a higher share will reduce the amount that is paid into the levy, and therefore increase the amount of business rates that is retained within the county.

Question 6: If so, what do you consider to be an appropriate level at which to classify growth as 'extraordinary'?

29. CCN members do not believe this approach is valid because it is not possible to distinguish between "normal" and "extraordinary" growth by applying a threshold. Should MHCLG wish to apply a levy only to extraordinary growth, then it should seek to specifically identify such growth rather than by applying a threshold. However, we believe that a levy should be applied to all growth, regardless of how it is achieved. There might be an argument to apply a higher levy rate to extraordinary growth.

Question 7: What should the fall-back position be for the national tier split between counties and districts, should these authorities be unable to reach an agreement?

30. CCN believe that a *default* national tier split is a fundamental necessity. Whilst areas should have the option of attempting to agree a locally determined tier split it would be wholly unacceptable to not have a default tier split as a lack of agreement would have no means of resolution nor distribution mechanism – a situation which would completely undermine the Government's two-fold ambition for BRR.

31. Together with the SCT, we believe that the Government here should change its terminology to **default**, rather than 'fall-back'. Default is preferred to fall-back as it does not imply preference to local authorities which agree a split locally over those which (for whatever reason) do not. There should not be a presumption in favour locally agreed tier splits.

32. It is sensible for MHCLG to ask the sector to agree tier splits. CCN is keen to engage with colleagues in the District Councils Network (DCN) and to seek an agreement. Initial discussions have already taken place and further talks are planned over the coming weeks.

33. The consultation document sets out commentary in relation to tier splits, indicating that now wider design principles have been established, they are welcoming proposals on tier splits. While we agree that there is now a clearer direction of travel on 75% BRR that allows these discussions to take place, there are still outstanding issues on the administration of the system that will still require consideration before arriving at a final decision.

34. The commentary in the consultation also outlines that there is "appetite for change within the sector" on the tier split, reflecting "pooling and pilots of greater rates retention have shown that all authorities have a role to play in generating growth and so this should be reflected in their growth incentives".

35. We welcome this commentary and believe it be reflective of the position of our member councils. Now that there is more awareness of how the BRRS operates – including the risks involved, the operation of the safety net, and gearing of authority types – our members have told CCN consistently that they are willing to accept more risk in return for a greater share of local business rates growth. Moreover, we fully support the conclusion by government that *all* tiers have a role to play in generating growth, and by implication, the current arrangements do not fully recognise and reward upper-tier services such as highways, transport and education.

36. While we are not seeking to pre-determine the outcome of discussions with the DCN, we think it is important to nonetheless set out some key principles;

    - **Existing shares**: we agree with the SCT that the current tier split should not in any way be used as the baseline in establishing the default national tier split. The current tier split is neither reflective of the county council role in promoting growth, nor proportionate to revenue expenditure. For instance, using the 2017-18 Revenue Outturn data , one finds that shire districts' TSE aggregates to just over £2.6bn whilst shire counties' TSE aggregates to over £24.6bn – 90% of the total service expenditure in two-tier areas. We therefore believe that both the existing tier split, and distribution of the additional 25%, should be open to change and negotiation.

    - **Pilot shares**: while learning from two-tier pilots on how the tier split has been *used and invested* by each tier should be considered, we do not believe the <u>process or circumstances</u> of *agreeing* a pilot tier split is directly comparable to establishing a national default tier split that will have a more fundamental impact on the funding levels of local authorities going forward

- **New responsibilities**: discussions on the tier split going forward must recognise that grants rolled into 75% BRR will be upper tier responsibilities and it must also ensure that the system better reflects the distribution of demand-led pressures across the tiers.

- **Top up and tariff**: our evidence to date has also shown that a higher tier share for counties will result in a better-balanced system, requiring less top up and tariff between councils and therefore more retained rates remaining in a county area. To illustrate the point, in Appendix 1, we provide two graphs developed by Pixel Financial Management showing the difference in top up and tariff as a percentage of BFL for all local authority types under a 35% tier split for county councils and a 55% tier split.

37. We believe that in taking forward discussions with both DCN and Government, these important factors must be fully considered, and a decision is arrived at that is based on evidence.

Question 8: Should a two-tier area be able to set their tier splits locally?

38. CCN would support greater flexibility at the local level provided a national default as outlined above and there are other certain safeguards.

39. Of primary importance to county councils is an assurance that there must be consensus amongst *all* affected authorities before agreeing a local change in tier split. This must include all billing authorities and all precepting authorities.

40. We also believe that all billing authorities within an area must remain within the county area. The Government is clearly aware of the disruptive impact developments in North Yorkshire and Leeds City Region had during the pilot for the latter area during 2018/19. Clear guidance from Government on this matter will be essential to any local negotiations.

Question 9: What fiscally neutral measures could be used to incentivise pooling within the reformed system?

41. CCN supports the SCT in agreeing that measures used to incentivise pooling should be fiscally neutral. That said, CCN questions whether pooling should be incentivised at all, rather than pools being established on merit.

42. CCN would also like to point out that any measures must be available to all local authorities on an equal basis and should not be used to force elected mayors on local areas. Any devolution opportunities should made be available to counties in the same manner as they are made available to cities (including London).

Question 10: On applying the criteria outlined in Annex A, are there any hereditaments which you believe should be listed in the central list? Please identify these hereditaments by name and location.

Question 11: On applying the criteria outlined in Annex A, are there any listed in the central list which you believe should be listed in a local list? Please identify these hereditaments by name and location.

43. CCN members support the approach proposed in Annex A, and believe it is sensible to place some hereditaments on the central list because of the way that they are valued. These include networked assets and utilities.

44. There are many large hereditaments on the local rating lists in county areas, including power stations, airports and ports. CCN members want large hereditaments to stay on the local rating list wherever possible and practical. These are often a major source of business rate growth and are often at the heart of local development and growth strategies.

45. Furthermore, giving a greater share of business rates (and of risk) to counties will help to deal with the risk of large hereditaments on the local rating list.

46. CCN members have raised the possibility that assets associated with Network Rail and the rail network more generally could be transferred to the local rating list. Stations and station car parks are often important and integral elements of local developments.

47. It is important to make a clear split now between the local and central rating lists because this should limit shifts from local to central rating list between baseline resets. As a result the Government should commit to adjusting future baselines if there are moves to central list in between resets.

Question 12: Do you agree that the use of a proxy provides an appropriate mechanism to calculate the compensation due to local authorities to losses resulting from valuation change?

48. The proxy mechanism is a reasonable approach for identifying whether an adjustment to an authority's rating list is the result of a valuation error. Most – but not all – valuation errors will be backdated to the start of the rating list. Equally, some material changes to the valuation list will also be backdated to the start of the list. There should be a way of authorities requesting an adjustment if the effect exceeds a certain threshold.

Question 13: Do you believe that the Government should implement the proposed reform to the administration of the business rates retention system?

49. CCN members understand the reasons for MHCLG exploring a different approach to the BRRS and supports the proposal for an alternative business rates retention system. We recognise that there are some genuine practical problems to reforming the current system and we are interested in exploring an alternative approach, especially if the result is a system that is less volatile and more predictable. Clearly there is a considerable amount of work to be undertake before a viable system can be unveiled.

50. It is essential that an alternative system has the characteristics of rate retention system and not a grant system. To achieve this, the system should:

    a. be able to demonstrate that the full quantum of business rate is retained locally (i.e. that 75% of collected business rate is retained locally)

    b. not be cash limited

    c. allow authorities individually to retain their share of business rates with no upper limit

    d. allow authorities to calculate how much they can retain based on their own collection: the amount retained should be reliant on a total amount available or the collection achieved by other authorities.

51. There are some important benefits from the alternative system that CCN members would be keen to see delivered. This includes providing protection to authorities from valuation errors. This would be a considerable advantage if such protection is not available in the reforms to the current system.

52. CCN members would like to see similar features in the alternative system to those proposed in the current system. They would expect full and frequent baseline resets and levies on excessive growth, and for the alternative system to deliver an increase in the share of growth retained by shire counties.

53. Some CCN members will want to understand how the alternative system would compensate authorities for growth in small business rate relief (SBRR). Some county authorities, particularly in more rural areas, receive a large proportion of their growth in business rate income through the SBRR. They are concerned that the Government will cease to compensate authorities for the "lost" income that is caused by the SBRR.

54. CCN members would welcome clarification for how shire counties would fit into the new arrangements. There is an opportunity for counties to have more control over the system and the financial rewards that they receive. It is possible that they would be less exposed to decisions by billing authorities about provisions for appeals and bad debts. This would certainly be a major benefit for shire counties, and would be particularly important if counties receive a higher tier split from 2020-21 onwards.

Question 14: What are your views on the approach to resetting Business Rates Baselines?

55. CCN members support the simpler one-stage approach that is proposed in the consultation paper. This approach is preferable to the two-stage approach because it avoids the uncertainty about the estimation of the national baseline (the EBRA) and means that an authority's baseline is based entirely on the authority's own business rate income in 2018-19. This is a simpler, more transparent methodology that will allow authorities to understand how their baseline is calculated and to forecast the effect of the baseline reset with greater certainty.

56. CCN members are concerned that the consultation paper proposes using the 2018-19 NNDR3 (uprated for the change in the multiplier in 2019-20). This will mean that growth in 2019-20 will not be subject to the reset. As we outlined in our response to Question 1, CCN's preference is to maximise the value of the returned surplus that is generated by the baseline reset so that this can be directed towards social care. The growth in authorities in 2019-20 could be material. Our preference would be for the new baselines to be set initially using the 2018-19 NNDR3 and then updated in following year for 2019-20 NNDR3.

57. The approach suggested for adjusting for appeals appears to be reasonable. Making a consistent adjustment to each authority's baseline seems a reasonable approach. The effect of appeals volatility is of less concern for shire counties because they do not have any direct control over the decisions about appeals provisions and impact is spread over a number of billing authorities.

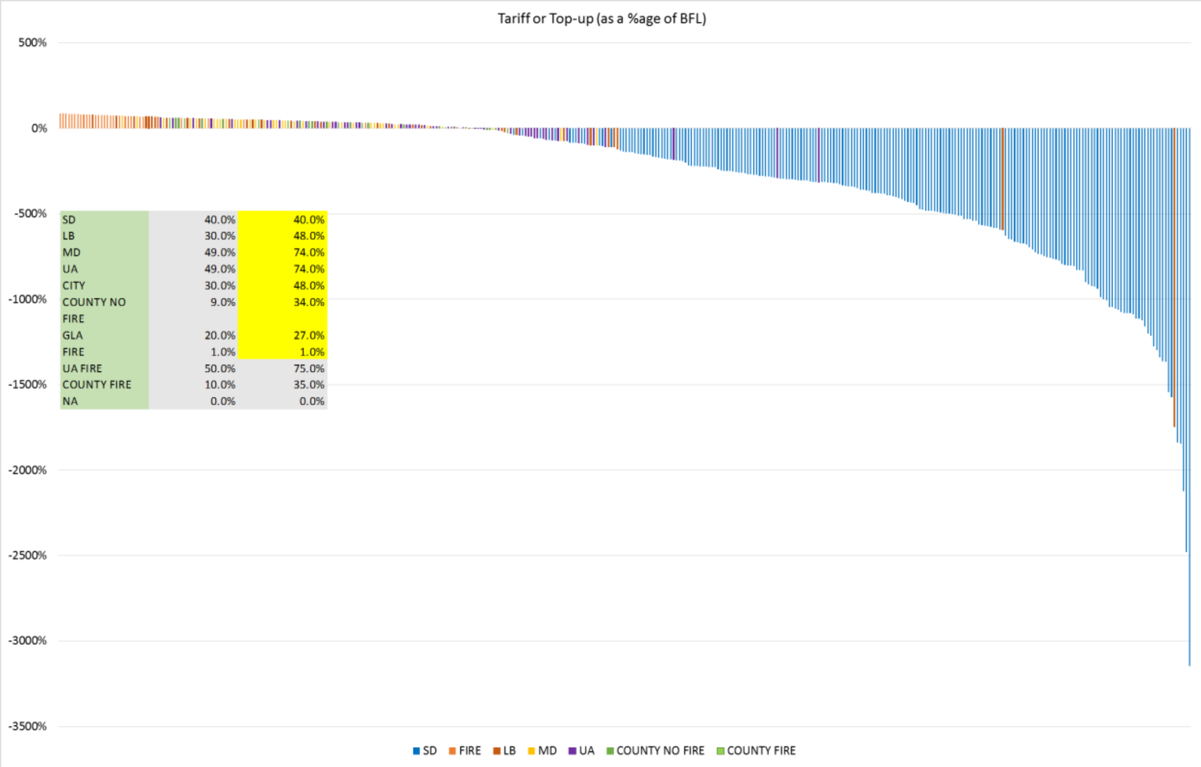
58. Proposal (a) might be workable because it excludes the provision in respect of the 2017 rating list, but there will still be much uncertainty about the 2010 rating list in the 2018-19 NNDR3. Volatility and change will be less than in previous years but still potentially significant. Proposal (b) would not be acceptable because it does not take account of the

actual incidence of appeals at authority level, and we know that the incidence varies considerably. Proposal (c) might have some potential but we would need to know more about the centrally determined guidelines that authorities would have to apply.

Question 15: Do you have any comments at this stage on the potential impact of the proposals outlined in this consultation document on persons who share a protected characteristic? Please provide evidence to support your comments.

59. N/A

Appendix One



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CITY	30.0%	48.0%
COUNTY NO FIRE	9.0%	34.0%
GLA	20.0%	27.0%
FIRE	1.0%	1.0%
UA FIRE	50.0%	75.0%
COUNTY FIRE	10.0%	35.0%
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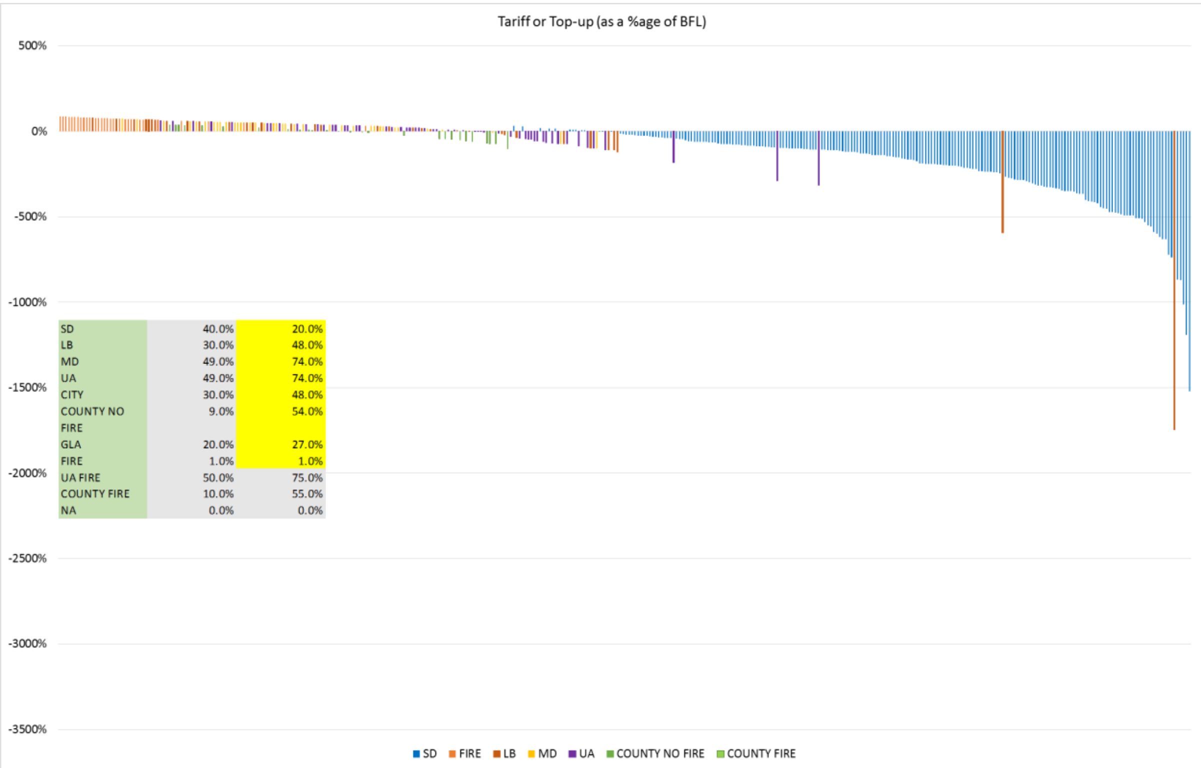

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CITY	30.0%	48.0%
COUNTY NO FIRE	9.0%	54.0%
GLA	20.0%	27.0%
FIRE	1.0%	1.0%
UA FIRE	50.0%	75.0%
COUNTY FIRE	10.0%	55.0%
NA	0.0%	0.0%