

County Councils Network (CCN)

100% Business Rate Retention: Further Technical Work

Introduction

1. Pixel Financial Management has been commissioned to build a spreadsheet-based model to help County Councils Network (CCN) understand and investigate the impact of 100% business rate retention on its member authorities. The Government has proposed that, by the end of the Parliament, 100% of business rates will be retained locally within the local government sector. Implementation could be in either 2019-20 or 2020-21.
2. In our discussions with CCN, it has become apparent that a relatively sophisticated model will be required to achieve these objectives. The model should be capable of handling a range of variables, including the interaction between those variables, and should show the financial impact on every local authority as well as the national position and the impact on local authority classes.
3. Our model has been developed and supports the analysis and conclusions in this report. It can be made available on request for any authority or group wishing to scrutinise or understand how our analysis has been determined.

Overview of the 100% Business Rate Retention Model

4. Figure 1 provides an overview of the structure of the model. These are the broad sections within the model:

Figure 1 – Structure of model

| | |
|-------------------------------|---|
| Assumptions | All the variables used within the model are summarised onto one tab. Any changes to the variables have to be made here so that they are applied correctly throughout the model. |
| Baseline Funding Level (BFL) | The BFL is based on the Government’s estimate of the “needs” within each authority, and represents the amount of funding that each authority requires from retained business rates. When 100% rate retention is implemented, additional functions or funding streams will have to be transferred to local government so that it is “fiscally neutral”. We have included within the model the main options that are being considered by the Government, and the change in BFL for each local authority. A review of “needs” is being undertaken in parallel with the implementation of 100% retention. It will change the BFL for each authority. We can reflect the results of this review in our model as they emerge. |
| Business Rates Baseline (BRB) | The BRB is the Government’s estimate of the amount of business rates that each local authority can collect. 100% retention will lead to changes in the tier splits (retention rates) for different classes of authority. Furthermore, baselines will be reset when 100% retention is implemented. The model allows for various options to be applied for both tier splits and baselines resets. |

| | |
|-----------------------|---|
| Actual Business Rates | Actual rates (based on the 2017-18 NNDR1) are used within the model. These latest budgeted amounts are used to drive much of the analysis within the model, including the estimated quantum, the baseline resets and to show the amounts that individual authorities are collected relative to their baselines. |
|-----------------------|---|

Baseline Funding Level (BFL)

- Functions or funding streams will have to be transferred to local government so that 100% rate retention is fiscally neutral. The transfers will have to be equal to the actual increase in business rates that are retained locally. Estimating this quantum will depend on a range of variables, including net growth in the business rates base, increase in the multiplier (based on the Retail Price Index until 2020-21) and future losses from successful appeals. We have estimated the additional quantum in 2019-20 by inflating using the projected RPI and used the latest budgeted business rates income (NNDR1 2017-187) as the baseline. Using this methodology, we estimate that the total business rate income in 2019-20 will be £26.5bn, and we estimate the additional quantum will be £13.1bn.
- The Government has proposed a range of possible transfers, which we have programmed into our model. Those which we consider to be the most likely to transfer are indicated and the value is shown in Table 1.

Table 1 – Potential transfers to Baseline Funding Level

| | | |
|--|---|------------------|
| Revenue Support Grant | Y | 2,282.177 |
| Rural Services Delivery Grant | Y | 65.000 |
| Public Health Grant | Y | 3,303.824 |
| Transport for London Capital Grant | Y | 1,000.000 |
| Highway Maintenance grant (formula funding) | Y | 725.000 |
| Integrated Transport Block | Y | 257.997 |
| Highway Maintenance efficiency element | N | 0.000 |
| Bus Service Operators Grant | N | 0.000 |
| Education Funding Agency - adult education | N | 0.000 |
| Skills Funding Agency - Adult Apprenticeships | N | 0.000 |
| Skills Funding Agency - Adult Education Budget | N | 0.000 |
| Skills Funding Agency - 16-18 Apprenticeships | N | 0.000 |
| Skills Funding Agency - Advance Learner Loans | N | 0.000 |
| Improved Better Care Fund | Y | 1,499.951 |
| Existing Better Care Fund | N | 0.000 |
| Independent Living Fund | N | 160.184 |
| Council Tax Benefit/ Housing Benefit Admin Support Grant | N | 0.000 |
| | | 9,294.133 |

7. Comments on the potential transfers:

- There is still a significant shortfall between the proposed transfers (£9.3bn) and the increase in the quantum (£13.1bn). Some of the shortfall can be met from the other available options (particularly CTB/ HB Admin Support Grant and the Skills Funding Agency), but it

does leave open the possibility that the Government has to transfer services to the sector that are high financial risk (i.e. demand-led, driven by Government policy change).

- To address the shortfall in the model, we have applied a balancing figure and allocated it pro rata to the BFL. This ensures that the model balances and that the increase in quantum is matched by an increase in local government’s funding responsibilities. We will build in more funding options when we are able to obtain local authority level data.
 - The bulk of the potential transfers would be to upper tier authorities. Out of the £9.3bn above, 75% of the proposed transfers would be to upper tier authorities, and of the other options, only CTB/ HB Admin Support Grant would be a transfer to lower tier authorities. This means that the increase in BFL is likely to be largely to upper tier authorities. The direct implication of the increase in BFL for upper tier authorities is that any increase in risk will mostly affect these authorities. It is therefore extremely important that the “right” services and funding streams are transferred. The indirect implication is that it strengthens the case for the tier split (retention shares) for upper tier authorities – and specifically counties – to increase as well. As we explore below, an increase in BFL does not necessarily mean an increase in the tier split for a class of authority, but it does make it more likely.
 - Given the options on the table, it is difficult to see anything other than the increases in BFL being concentrated on upper tier authorities. Therefore the scope for arguing for anything different is very limited. Any changes to the system that CCN does want to make or propose are, therefore, almost certainly going to be in other parts of the system.
8. Table 2 shows the projected increases in BFL for different types of local authority. County councils would have the largest percentage increases in BFL in both percentage and cash terms. The average increase is 117% (i.e. more than double), compared to an average of 105%. Other upper tier authorities have slightly lower average increases (their current BFLs are larger than CCN authorities because they are single-tier and therefore cover a wider range of services). District councils would have an increase in BFL that is less than half the projected average (36%), and their share of BFL is likely to fall further once we include actual transfers rather than a reallocation of the “balancing figure”.
9. There are no significant outliers within the CCN authorities. A number would see an increase in their BFL of more than 130%, with the highest increase in Lincolnshire (at 133%).

Table 2 – Change in Baseline Funding Levels

| Class | Baseline Funding Level | Modelled Baseline Funding Level | Change in BFL | Change in BFL |
|-----------------|------------------------|---------------------------------|---------------|---------------|
| | 2019-20 | 2019-20 | | |
| Shire districts | 572 | 778 | 205 | 36% |
| Unitaries | 2,271 | 4,667 | 2,396 | 105% |
| Mets | 3,083 | 6,377 | 3,294 | 107% |
| London boroughs | 2,190 | 4,318 | 2,128 | 97% |
| City of London | 17 | 30 | 13 | 79% |
| GLA | 1,078 | 2,534 | 1,456 | 135% |
| COUNTY NO FIRE | 1,583 | 3,442 | 1,858 | 117% |
| COUNTY FIRE | 1,078 | 2,292 | 1,214 | 113% |

| | | | | |
|-------------------|---------------|---------------|---------------|-------------|
| Fire | 365 | 659 | 294 | 80% |
| TOTAL | 12,238 | 25,095 | 12,857 | 105% |
| CCN | 3,294 | 6,806 | 3,511 | 107% |
| CCN COUNTY | 2,662 | 5,530 | 2,868 | 108% |
| CCN UA | 630 | 1,273 | 643 | 102% |

Tier Splits

10. The proportion of business rates that is retained by each class of authority is determined by the Tier Splits (or Retention Rates). With the increase in the overall retention rate (from 50% to 100%), the Tier Splits will have to change. In the current 50% system, the Government weighted retention rates decisively towards shire districts. Many would argue – including us – that the district share was far too great, although the counter-argument is that this reflected the Government’s view that shire districts were best placed to encourage economic growth.
11. Determining the split in single tier areas is relatively simple: it will broadly increase from 50% to 100%, with the only decision being the share that is given to fire authorities and (in London) to the GLA. The permutations for changes in the Tier Splits in two-tier areas are numerous, but, in practice, will take account of the following criteria:
 - Allocation of risk and reward between the tiers
 - Balance of the economic development role between the tiers
12. We have proposed two different options for tier splits in the model. We are not necessarily supporting either option, but using them as a way of understanding how the 100% regime might be designed and to show the impact on CCN authorities. The first assumes that the share for county councils will be 80%, with shire districts’ share reducing to 20%: there is a strong argument for reducing shire districts’ share from 40% because this is already too large relative to their BFLs and it unbalances the system, leading to a skewing of risk and reward, and requiring large transfers through top-ups and tariffs. The second assumes that the tier splits will increase proportionately to the increase in national retention shares, i.e. county councils’ share will increase from 10% to 20%, and shire districts’ share from 40% to 80%. Our view is that this is unlikely but there is support from some within shire districts for this change, and it would be consistent with the decisions taken by ministers when the system was set up in 2013-14. If this did occur, then it would create an even more unbalanced system.

Table 3 – Options for changes in Tier Split

| | Existing 50% retention scheme | Scenario 1: County share = 80% (District share reduces to 20%) | Scenario 2: County share = 20% (District share increases to 80%) | Scenario 3: County share = 60% (No change in district share) |
|--------------------------------------|-------------------------------|--|--|--|
| Unitary authority (no fire) | 49% | 98% | 98% | 98% |
| Unitary authority (with fire) | 50% | 100% | 100% | 100% |
| County council (no fire) | 9% | 78% | 18% | 58% |
| County council (with fire) | 10% | 80% | 20% | 60% |
| Shire district | 40% | 20% | 80% | 40% |
| London borough | 30% | 60% | 60% | 60% |
| Metropolitan district | 49% | 98% | 98% | 98% |
| City of London | 30% | 60% | 60% | 60% |
| GLA | 20% | 40% | 40% | 40% |
| Combined fire authority | 1% | 2% | 2% | 2% |

13. Table 3 shows the potential tier splits in each of the three options. For CCN, it is interesting to see the retention shares that would result if shire districts were held reduced from their current 40% share (Option 1). The county council share would increase from 9% to 78% (or from 10% to 80% if the county council still has fire responsibilities). This is a significant increase in the amount of rates that county councils would retain. It would make the county council the largest beneficiary of any growth in business rates in an area, as well as a larger share of the risk. Implicitly, the county councils would have been acknowledged to have the leading role in economic development. Furthermore, it would have to lead to changes in the way that decisions are made by the billing authorities in two-tier areas (i.e. the district councils). *Is this something that county councils would want?*

14. Changes in the tier splits also have implications for whether county councils would remain top-up authorities (or become tariff authorities) and for the financial risk of business rates to county councils. These are both issues that we explore in the next section.

Top-ups and Tariffs

15. An authority’s top-up or tariff is calculated by deducting the Business Rate Baseline (BRB) from the Baseline Funding Level (BFL).
- If BRB is greater than its BFL, then the authority pays the difference as a tariff (to the “national pool”)
 - If BFL is greater than its BRB, then the authority receives a top-up (from the “national pool”)
16. A tariff authority is more exposed to changes in business rate income because it retains a large share of rates compared to its budget (represented by the BFL in the rate-retention system). A tariff authority also pays a levy on any business rate income that it receives above its baseline (and a top-up authority does not), although it is expected that the levy will be abolished when the 100% scheme is introduced. Therefore, changing from being a top-up authority (most CCN

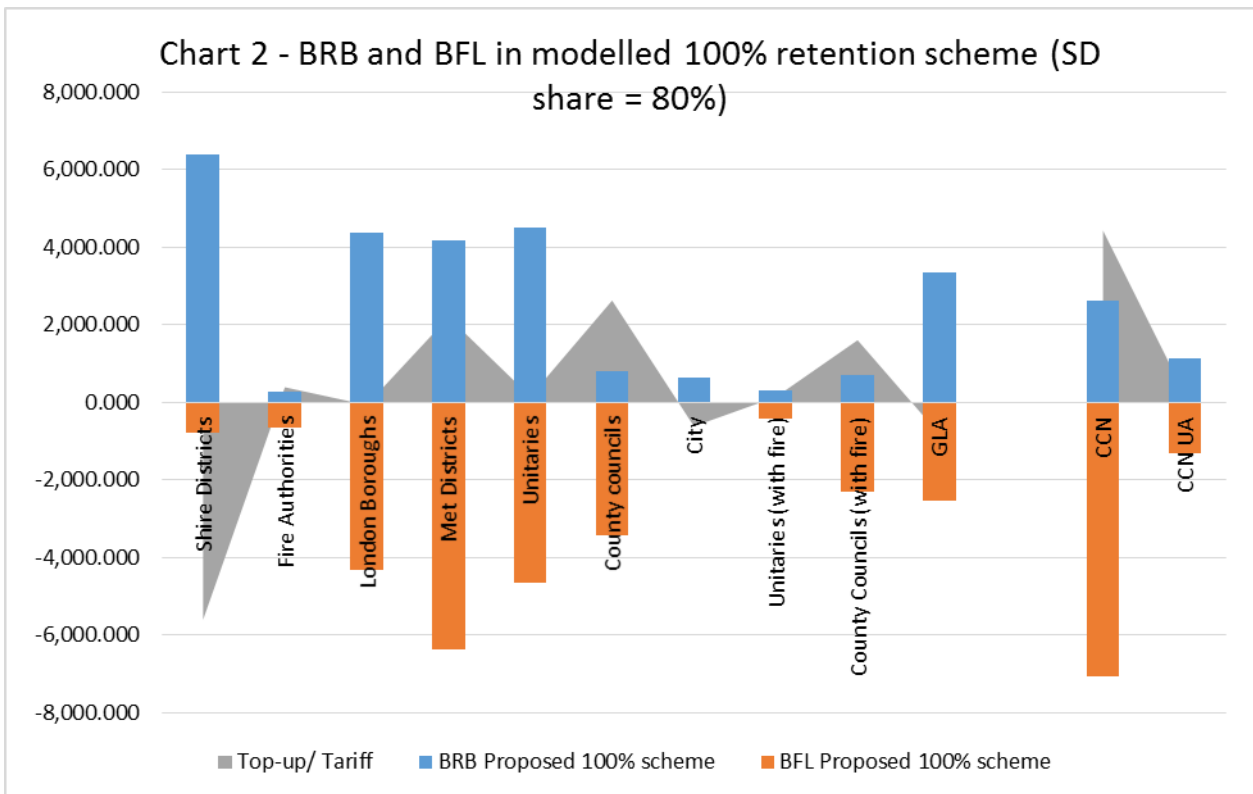
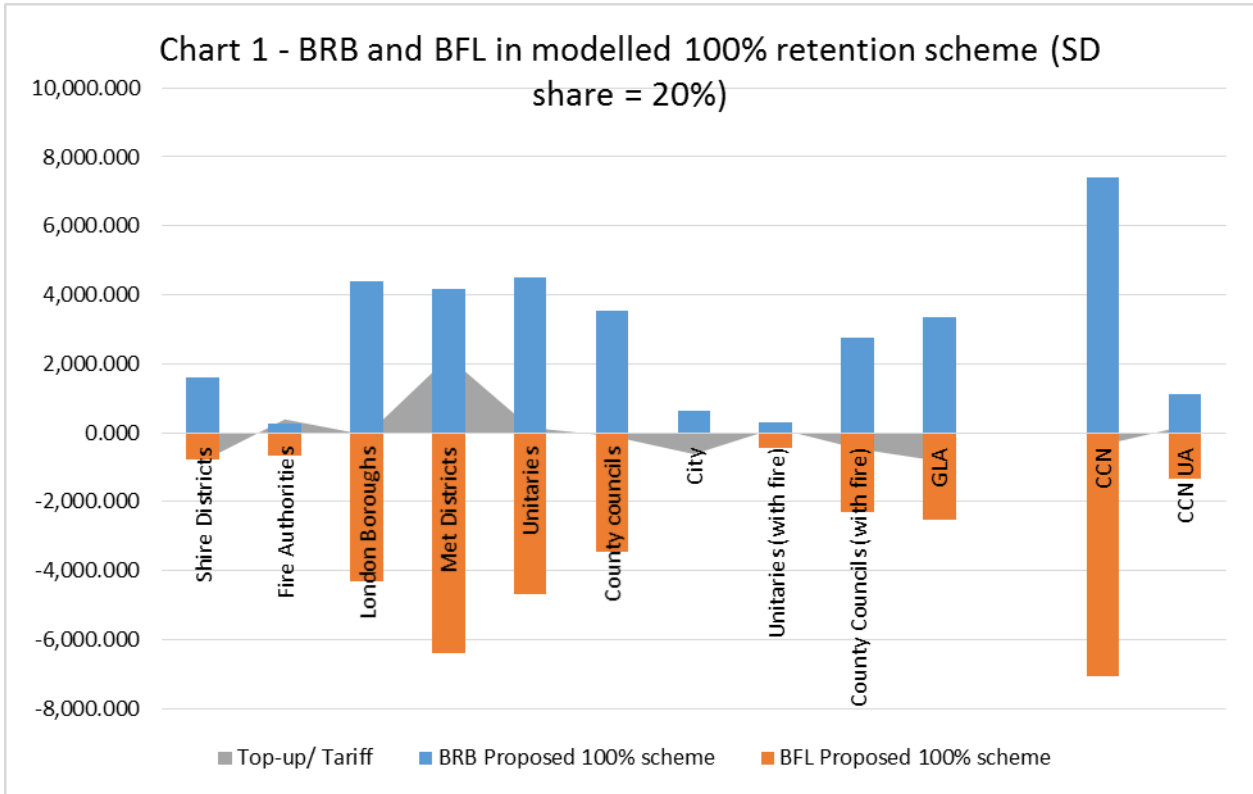
authorities are top-ups) to a tariff authority does have real-world implications because the authority would be more exposed to changes in business rate income.

17. Charts 1 and 2 show (at class/ CCN level) the effect that different retention rates have on the BRB, and how this compares to BFL. Chart 1 – where the shire district retention rate reduces to 20% - would create much better balance between BRB and BFL for all classes of authority, and would therefore also reduce the transfer payments represented by tariff and top-ups. For CCN specifically, the group as a whole would marginally become a “tariff.
18. At the individual authority level (Table 4), increasing the tier split away from shire districts towards counties would increase the number of tariff authorities within the CCN group from four currently (all four are unitaries, not counties) to 13 (including 9 counties). Those counties becoming tariffs are typically those with lower needs based on the current funding formulae (lower BFL) and higher resource (higher BRB) – Surrey CC would have the largest tariff, at £120m.
19. It should be noted that a doubling of overall retention from 50% to 100% will not necessarily lead to the doubling of the tariff for those county unitaries that are already in a tariff position (Table 4). Doubling the retention rate for these authorities will indeed double the amount of rates they retain, but the tariff will also be driven by the change in the BFL (which will increase in different proportions for different authorities) and the relationship between the BRB and BFL for each authority. If retention rates remain broadly the same (and double alongside the increase in the overall retention rate), there would be no change from top-up to tariff for any CCN authority. There would continue to be the same four tariff authorities, albeit with tariffs roughly double the size.

Table 4 – Projected Tariffs authorities (CCN Authorities)

| | | EXISTING 50% SYSTEM | MODELLED 100% SYSTEM |
|---------------------------|----------------|------------------------|-------------------------|
| | | Top-up/ (Tariff) | Top-up/ (Tariff) |
| Local authority | | 2019-20 | 2019-20 |
| Buckinghamshire | County Council | 28.541 | -16.235 |
| Cambridgeshire | County Council | 40.128 | -30.915 |
| Central Bedfordshire | Unitary | -7.114 | -22.977 |
| Cheshire East | Unitary | -25.027 | -53.188 |
| Cheshire West and Chester | Unitary | -18.555 | -43.420 |
| Hampshire | County Council | 74.348 | -48.323 |
| Hertfordshire | County Council | 74.320 | -54.183 |
| Leicestershire | County Council | 40.153 | -13.252 |
| Oxfordshire | County Council | 40.427 | -44.891 |
| Surrey | County Council | 62.585 | -120.446 |
| Warwickshire | County Council | 40.377 | -17.976 |
| West Sussex | County Council | 45.574 | -43.411 |
| Wiltshire | Unitary | -14.582 | -35.425 |

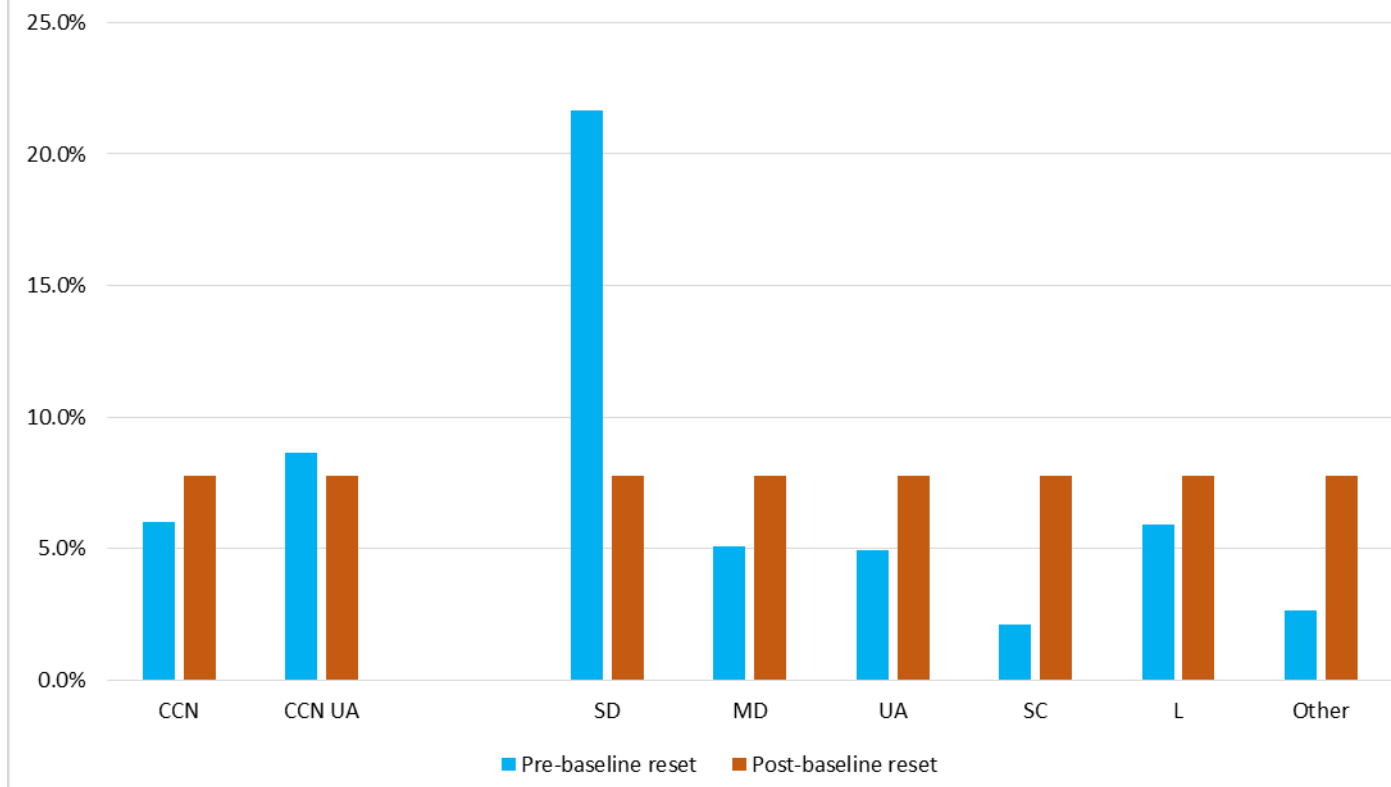
NB: assumes county retention rate is 60% and district retention rate is 40%.



Baseline Resets

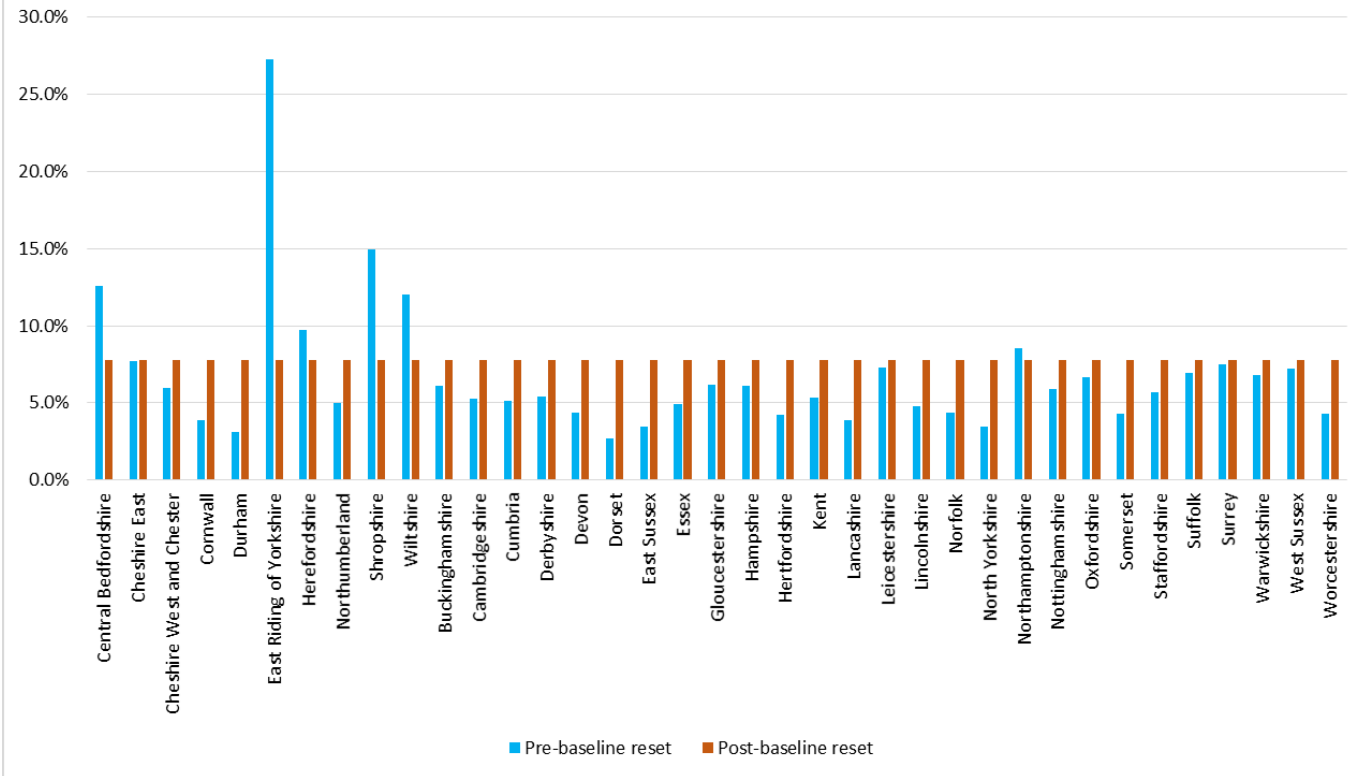
20. The Government is exploring options for resetting the business rates baselines for each local authority. Resetting the baseline ensures that there is not too much divergence in resources between local authorities (and with “needs”) over time. The basic elements of resetting are:
- Frequency of reset. This could be every 5, 10 or 20 years (or indeed never or every year, at the extremes).
 - Scale of reset. Each reset could be anywhere between 0% and 100%.
- 21. Following our meeting with the Local Government Association in May 2017, we have assumed that there will be a full baseline reset in 2019-20 when 100% retention is introduced, with partial resets in subsequent five-yearly resets.**
22. After the first full baseline reset in 2019-20, we have assumed that resets will take place every 5 years and that options of 0%, 25%, 50%, 75% and 100% are possible. Five yearly intervals would broadly correspond to the revaluations. A 50% reset appears to be the favoured option at the moment: 0% and 100% are included to show the potential range of the reset, and 0% can be selected to show the effect of never resetting.
23. This is the methodology we have used to reset the baseline (BRB) in 2019-20:
- a) Current baseline uprated for projected quantum. Baselines were created in 2013-14 by giving each billing authority a share (Proportionate Shares) of the EBRA. We have applied the same proportionate shares to a revised EBRA that is based on the projected business rates income in 2019-20 (£26.5bn, @100%).
 - b) If Non-Domestic Rating Income is > than the revised baseline, then the authority’s baseline is increased by the required factor. In the model we have allowed for this variable to be 0%, 50%, or 100%. As an example, if actual Non-Domestic Rating Income is £1m above the revised baseline, and the variable is set to 50%, then £500,000 will be added to the baseline.
 - c) If Non-Domestic Rating Income is < than the revised baseline, then the difference is deducted from the authority’s baseline.
 - d) New proportionate shares are calculated using the formula: (a) minus (b) plus (c), and scaled to the required quantum.
 - e) Any surplus is then distributed pro rata to the Baseline Funding Level (BFL). Distributing via the BFL would increase the funding to each authority and reduce the amount of above-baseline rates retained by each authority. We have used the BFL as the default option for distributing any surplus.
24. A full baseline reset in 2019-20 plus redistributing any surplus in line with BFL would result in every authority – and class – being the same amount above baseline. However, its effect would be to redistribute resources from where there has been growth in rates to authorities with higher need; or from authorities with a high share of growth to authorities with a high share of “need”.

Chart 3 - Percentage above BFL (including returned surplus)



25. Chart 3 shows that most classes of authority would benefit from the full baseline reset, with the surplus redistributed via BFL. Only shire districts would lose: districts currently have a very high share of rates relative to BFL, and a very small share of BFL. It should be noted that every authority would be the same amount above baseline after the reset (i.e. 7.8%).
26. Shire counties would be the largest gainers from such a full reset: partly this is because shire districts have a very small share of rates (10%), and a large share of BFL because they provide services such as adult social care and children’s services. CCN unitary authorities appear to lose-out from this type of reset, possibly because they currently have a larger share of business rates gains (either 49% or 50%).
27. One note of caution is that the methodology of calculating the baseline reset is far from clear, and different assumptions and methodology could have a significant bearing on the impact of the reset. A further note of caution is that lower resets (less than 50%) will result in greater divergence in business rate income across local authorities, and in future other classes of authority might have higher growth (and be more above baseline) than county areas.
28. Chart 3a shows the variance for CCN authorities if there is a full baseline reset, and the surplus is redistributed pro rata to the BFL. It can be seen that each authority would be the same amount above baseline. Any growth generated since 2013-14 would effectively be wiped-out. Any CCN authority with above average growth since 2013-14 will not support the proposal for a full baseline reset in 2019-20 (these authorities are those on the right-hand side of Chart 3 above). There are some individual unitary authorities who would lose-out as a result (especially the East

Chart 4 - Percentage above BFL pre-/ post-baseline reset (including redistributed surplus)



Riding of Yorkshire). Most shire counties – with the exception of Northamptonshire – would gain.

Levies

- 29. The only CCN authorities paying a levy are the four tariff authorities: Cheshire East (£1.652m), Cheshire West (£1.166m), Central Beds (£1.339m) and Wiltshire (£2.293m). Clearly, for these authorities the abolition of the levy will be welcome, but generally CCN authorities have benefitted from the levy since 2013-14.
- 30. As we have seen above, a number of CCN authorities would become tariff authorities if the retention rate for counties was to increase significantly. Table 5 shows the levy rates for CCN authorities the retention rates for counties is increased to 60%. Some counties would become tariff authorities and would have paid a levy has the Government not decided to abolish it. Levy rates would typically be between 0% and 50%, with only Surrey CC having the maximum levy rate of 50%.
- 31. An alternative to abolishing the levy might be to develop a more sophisticated levy. One example might be a levy that allows an authority to retain all growth above baseline up to a threshold (potentially based on the BFL), and then charges a levy on amounts above that. This would mirror the approach used for the safety net. It is likely to work well for counties, for most of whom BFL and BRB are relatively similar, but still capture authorities with very high business rates income (including shire districts).

Table 5 – Implied levy rates in 100% system

| Local authority | EXISTING 50% SYSTEM Levy Rate 2019-20 | IMPLIED 100% SYSTEM Levy Rate 2019-20 |
|---------------------------|--|--|
| Buckinghamshire | 0.0% | 17.7% |
| Cambridgeshire | 0.0% | 22.5% |
| Central Bedfordshire | 32.0% | 38.3% |
| Cheshire East | 50.0% | 50.0% |
| Cheshire West and Chester | 50.0% | 41.1% |
| Hampshire | 0.0% | 18.7% |
| Hertfordshire | 0.0% | 22.0% |
| Leicestershire | 0.0% | 10.0% |
| Oxfordshire | 0.0% | 29.8% |
| Surrey | 0.0% | 50.0% |
| Warwickshire | 0.0% | 13.7% |
| West Sussex | 0.0% | 25.7% |
| Wiltshire | 34.6% | 30.0% |

NB: the Government has already announced that there will be no levy in the new 100% system. This table shows what the levy rates might have been had the Government decided to continue with them.

Implied levy in 100% scheme is based on 60% retention for county councils.

Different geographies: area based options

32. We have been asked to look at area-based options to help mitigate risk. Options for operating at an area level could include either combined authorities (potentially at county level or wider), county areas themselves, or an alternative geography. We have used county groups to demonstrate the range of business rate risk and growth.
33. The benefit of an area-based approach is that growth in business rates can be “pooled” at a wider level and spent more strategically. Investment in infrastructure that supports economic growth is often decided at a county level. There would, therefore, be better matching between the costs of infrastructure investment and the returns via increased business rate income.
34. Broadly shire areas have done well out of the current retained rates system: on average actual rates collected in shire areas have been higher than the baselines allocated. However, this does not necessarily indicate that shire areas have higher rates of growth (often growth in rateable values is reduced by above-average increases in reliefs). Performance against baseline is affected more by the prevalence of appeals (which tend to be higher in urban areas) and by the way the original baseline was set (which again has tended to favour shire areas). It should be noted that performance against baseline also only shows growth in business rates income since 2013-14, not since the start of the current rating list in 2010-11.

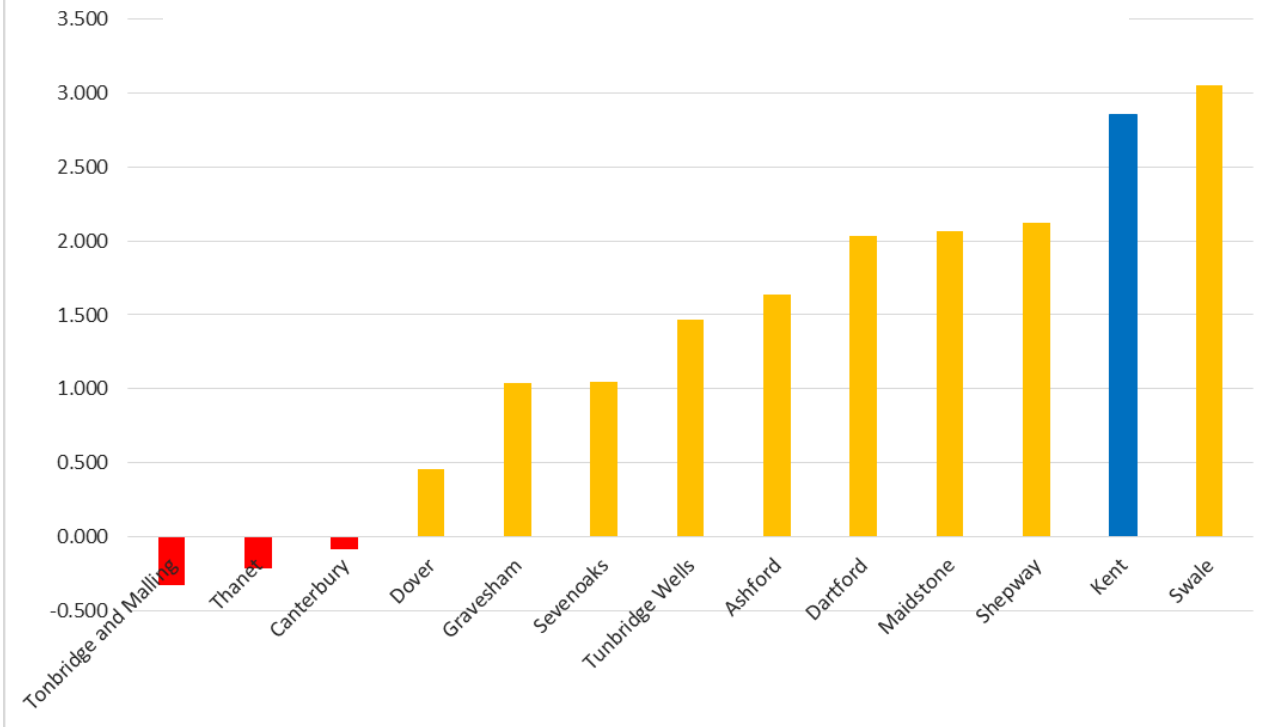
35. Only one CCN authority¹ is currently (2017-18) below its baseline (and therefore, considerably higher than the safety net threshold). This should be noted when considering the risk that county councils would be exposed to if the retention rate was to increase. On recent performance, it would be very unlikely for a CCN authority to be below baseline (and certainly not below safety net threshold). It is likely that the reason for this is that county councils are large areas, and they therefore have sufficient scale for large one-off closures to be offset by organic growth elsewhere in the county. It is notable that, whilst shire districts as a group performance in a relatively similar way on average, 11 are below their rates baseline.
36. For county councils who are concerned about the risk of higher business rate retention, an area-based approach also helps to alleviate some the risks inherent in business rates. In charts 5 and 6, we show the variation in business rates performance at district and county level. The data is based on the NNDR1 for 2016-17. In each chart it is possible to see that the county council is above its business rate baseline, even where there are district councils below their baseline:
- Kent. 3 out of the 12 district councils are below their baseline, but most of the districts are well above their baselines. Swale and Shepway are around 20% above their baseline. As a result, the county council is significantly above baseline.
 - North Yorkshire. There are fewer districts in this county, and only one below baseline. Selby is around 20% below its baseline (we assume because of appeal refunds). The county council is only marginally above its baseline.
37. The same results are apparent across county areas, with no county councils below their baseline (at least not based on the 2016-17 NNDR1). We can draw the following conclusions from the analysis:
- Average growth across a county area will in most circumstances be sufficient to ensure that the county council is above its own baseline.
 - Larger counties will be more protected from localised closures and large appeals because of the scale of business rate collection across its area.
 - The scale of losses that can be absorbed in one part of the county will depend on growth elsewhere. In Kent and North Yorkshire we can see that the former is better protected from losses in three of its districts by much stronger growth elsewhere in the county.
38. There remains a question about whether the county area is large enough and whether a larger area, such as a combined authority covering more than one county would be better. Chart 7 shows the size of county councils' business rate baselines. There is clearly a range, from the very largest (Kent £533m) to the smallest (Dorset £119m).² However, compared to single tier councils, county councils' baselines are relatively large. Other than Westminster and the City of London, even the largest single tier councils have baselines that are towards the lower end of the county range: Liverpool £204m, Manchester £341m, Birmingham £443m, Leeds £376m. This

¹ Dorset County Council

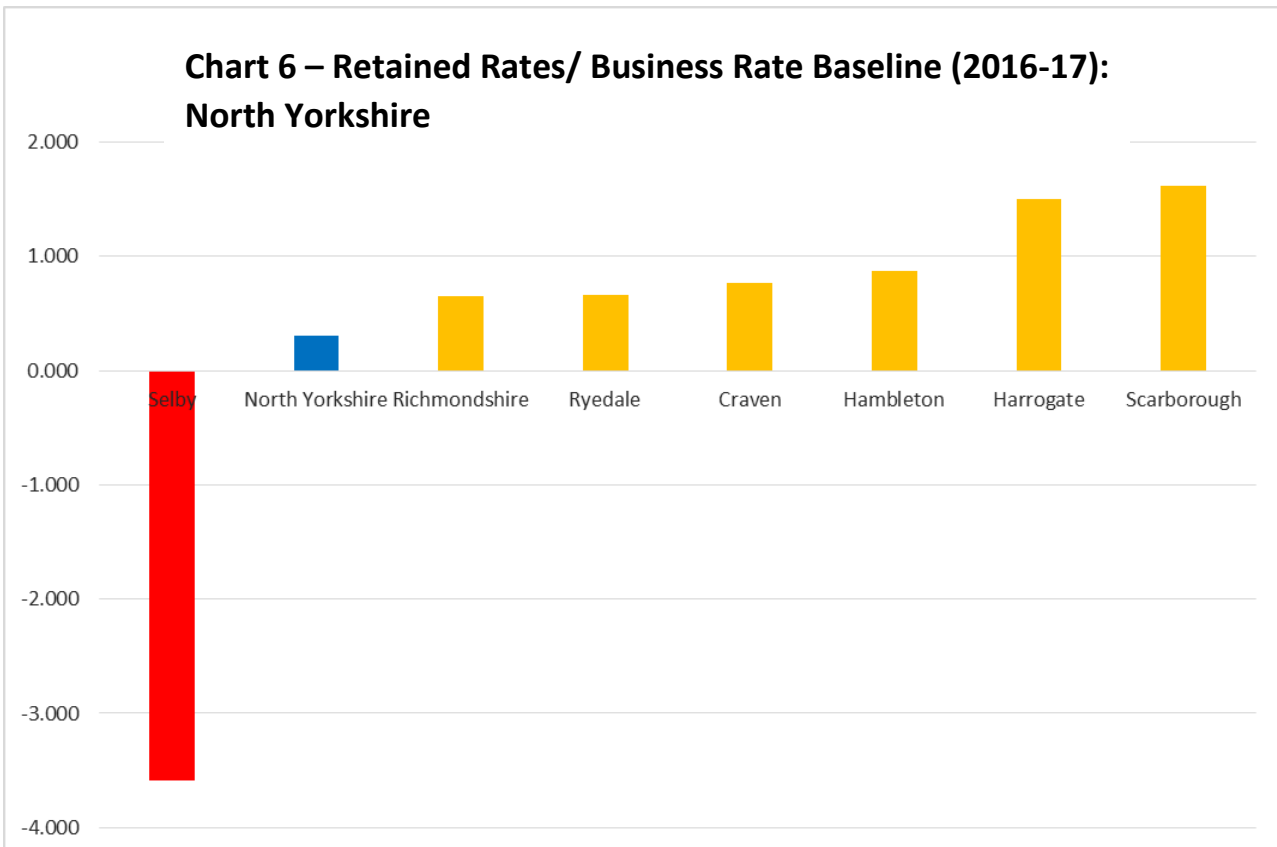
² Note that these baselines are expressed at 100% of the total for the county.

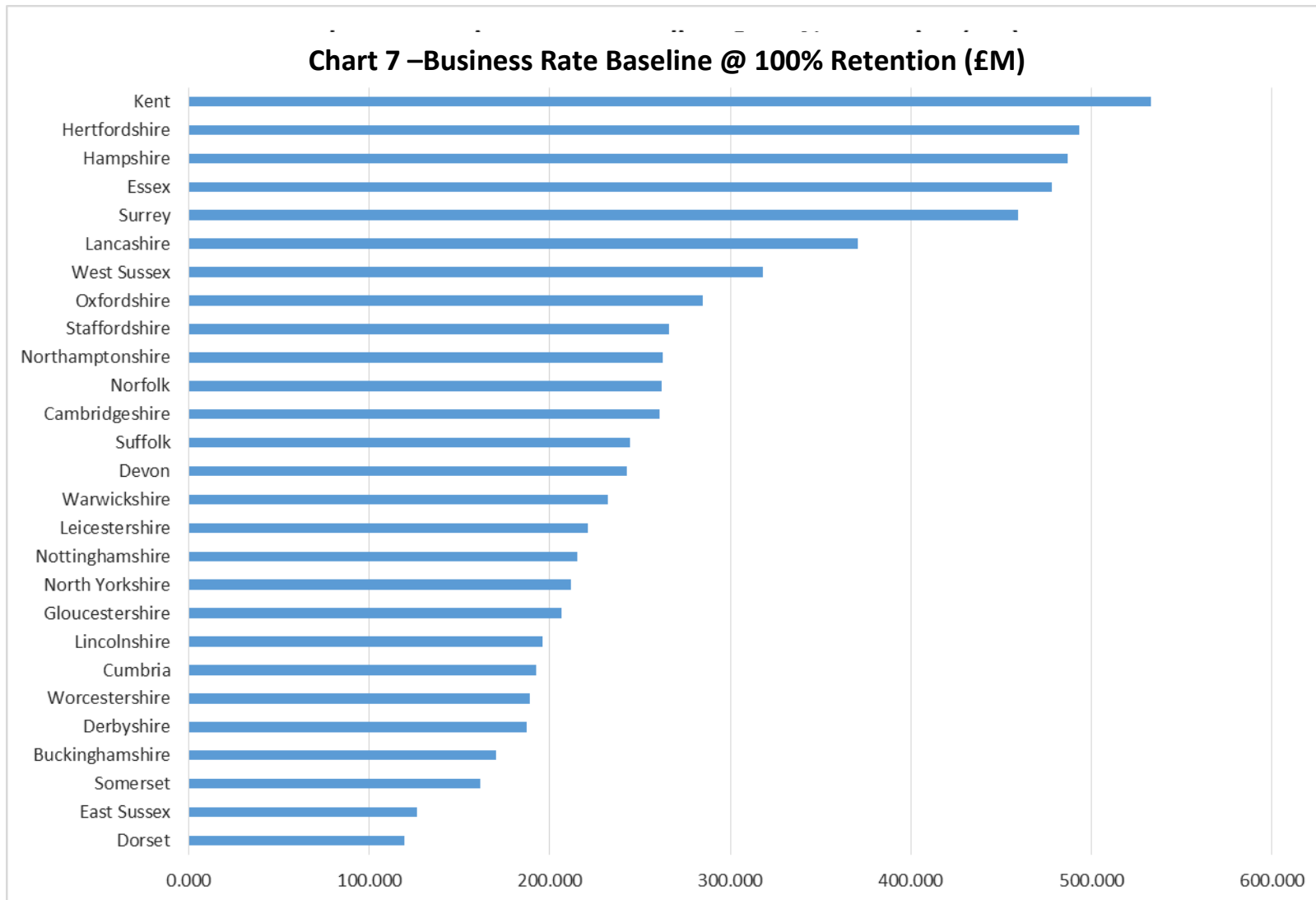
suggests that county councils will have larger business rate baselines in which to absorb risks than other tiers.

**Chart 5 – Retained Rates/ Business Rate Baseline (2016-17):
Kent**



**Chart 6 – Retained Rates/ Business Rate Baseline (2016-17):
North Yorkshire**





Forecasts and resets

39. The impact of the new 100% rate retention system on county councils will depend not just on how it is set up at its inception but also how it is operated over the medium term. There are key decisions to be made about how baselines are reset, the protection that is available to authorities with falling business rate income, and the incentives that are given to authorities with growing rates.
40. We have projected actual rates forward to 2049-50. The purpose of long-term projections is twofold:
- To show how growth in actual rates would match up with growth in “needs”/ budget over the long-term. We can show this for different classes, and show whether the divergence between “needs” and resources is greater in CCN authorities than in other classes.
 - To show how business rates income might diverge between authorities and between classes over time. The intention is to show baseline resets and levies will help to minimise this divergence, whilst allowing a reasonable level of incentive for authorities to invest in growth.
41. As with any projections, they are only as worthwhile as the assumptions used to make them. More work is required here: we will use a range of assumptions, including recent past performance, and illustrative scenarios (e.g. to show the impact if some authorities or classes were to have consistently above-average growth).
42. We have modelled the way that the system could be operated in the future, and incorporated a number of variables into the model so that we can see the impact at authority and class levels. A number of scenarios have been run through the model, focussing on the key variables for county councils. These are the variables that we have considered:
- **Growth in business rates.** Growth at local authority level needs to be programmed into the model in order to estimate the impact of the other variables on authorities. The model includes a range of options but we have used the change in rateable value between 2010-11 and 2015-16 as the assumption. This shows the change at authority level over a period of time. It is not perfect because the impact of appeals will offset underlying growth but it shows a reasonable measure of the scale of growth and its distribution between authorities. Our model effectively assumes that growth over the last 5 years will continue into the future, which might not be realistic.
 - **Tier share.** We have assumed that the tier split for county councils will be either 20% or 80% (see discussion above). Other assumptions can be programmed into the model. At each of these settings we can see the impact on county councils if they are either the major or minor recipient of business rate income. Clearly, the higher county councils’ retention share, the more important the reset decisions will be, and higher share council councils will retain of growth (or reductions) in income.
 - **Levy.** No levy is applied in any of the scenarios on the grounds that the Government has made clear its policy in this respect. However, we have shown the impact that the levy can have on retained income, particularly for district councils, and that this might still be beneficial for the sector as a whole.
 - **Safety net.** Assumed that this is going to be set at 97% of Baseline Funding Level.

- **Estimate of Business Rate Aggregate (EBRA).** This is the amount of business rates income the Government assumes local government can collect. It is the basis of the way that individual baselines for local authorities are calculated. A key decision for the Government is whether the EBRA is based on the rolled-forward baselines or on actual business rate collection. Based on advice from the Local Government Association, we have assumed that all growth will be retained within the sector, and any surplus after baselines have been reset will be redistributed (in line with “need”).
- **Baseline reset.** We have assumed a full baseline reset in 2019-20, followed by a 50% reset every 5 years.
- **Indexation.** Consumer Price Index (CPI) has been used to index the baselines and the multiplier. The Government has indicated that it will move towards the use of CPI rather than the Retail Price Index (RPI) which it currently uses to index the multiplier. CPI tends to increase less quickly than RPI, with the result that there will be slower growth in business rate income over time, and less “resource” for local government to spend as a result.

43. Modelling projects rates and the retention scheme to 2049-50, and includes 5 separate 5-yearly baseline resets.

44. Based on these variables outlined above, we have modelled two scenarios (Table 6) and the results are shown in Appendix 1:

Table 6 – Assumptions for scenarios

| | Scenario (1) 80% tier share | Scenario (2) 20% tier share |
|---|---|---|
| Growth | Rateable value (2010-11 to 2015-16) | Rateable value (2010-11 to 2015-16) |
| Tier share | 80% | 20% |
| Levy rate | 0% | 0% |
| Safety net (as % BFL) | 97% | 97% |
| EBRA (% surplus actual rates incl. in baseline) | 0% (i.e. all growth retained within local government) | 0% (i.e. all growth retained within local government) |
| Baseline reset | 100% in 2019-20, 50% every 5 years | 100% in 2019-20, 50% every 5 years |
| Indexation | CPI | CPI |

45. One of the key outputs from the model (and the scenarios) is to show the growth in retained rates income compared to spending pressures from services. To estimate these spending pressures we have split the budget of every local authority into three categories (children’s, adult social care, and other services). Growth assumptions have been applied to each category (Table 7). Our assumption is that spending pressures (in real terms) will be greater in adult social care and children’s services. 2% growth in social care has been recommended from other reports commissioned by CCN, and 3% in children’s social care is based on the average growth in spending between 2010 and 2015. Growth in spending on other services will largely be dependent on overall funding levels: for the purposes of our modelling, we have assumed that they remain constant in cash terms.

46. Typically, children’s and adult’s social care represent a larger part of county councils’ budgets, and so their spending pressures will tend to be greater than other types of local authority. Unless other funding becomes available, any spending pressures not funded from growth in retained rates will fall to be funded from council tax and will require county councils to increase the council tax paid by its residents. It should be noted that this analysis does not represent implicit support or otherwise for the current needs and funding assessments.

Table 7 – Assumed expenditure growth rates for services

| | CHILDREN SOCIAL CARE | ADULT SOCIAL CARE | Other expenditure |
|------------------------|----------------------|-------------------|-------------------|
| SHIRE COUNTIES | 3.0% | 2.0% | 0.0% |
| SHIRE DISTRICTS | 3.0% | 2.0% | 0.0% |
| LONDON BOROUGHS | 3.0% | 2.0% | 0.0% |
| UNITARY AUTHORITIES | 3.0% | 2.0% | 0.0% |
| OTHER AUTHORITIES | 3.0% | 2.0% | 0.0% |
| METROPOLITAN DISTRICTS | 3.0% | 2.0% | 0.0% |

47.

48. Summary analysis of the two scenarios:

- Scenario 1 (80% retention for county councils).** Chart A shows that the share of rates above baseline is relatively similar for most classes of authority, with the major exception of shire districts. Despite county councils retaining four-times as much of the local rates (80% compared to 20%), district councils would continue to have the largest share of any growth relative to BFL. County councils (and CCN authorities more widely) would be about 5% above baseline, although this would fluctuate with the baseline reset.

The range within a county (Chart B), between districts and compared to the county council, would still be very significant. As an example, we have shown West Sussex, where some districts might be considerably above baseline (50+%), whilst other districts could remain consistently below baseline. The County Council would remain at about 5% above baseline (+/-c.3%).

County councils would have a very significant funding gap by 2028-29. Based on our modelling, the funding gap for county councils would increase by a further £0.55bn. No other class would see a worsening funding gap if only retained rates was taken into account.

- Scenario 2 (20% retention for county councils).** Shire districts would have a much greater share of any growth, with retained rates estimated at well over 20% above baseline, even with baseline resets. County councils would only be about 2-3% above baseline, less than all the other classes of authority, and much less than shire districts. CCN unitaries would have a larger share of growth because they would have a retention share (98% to 100%).

The range within a county such as West Sussex is also much larger (Chart B). Some districts with consistently strong growth could retained growth which is more than double their BFL, whilst the county council is barely above baseline. Clearly the actual results will be driven by actual growth, which is likely to be less consistent, but some district councils will have very strong growth over a number of years.

County councils would have a funding gap of nearly £0.7bn by 2028-29(Chart C). This is only marginally larger with the lower level of retention, although the higher retention for county councils would still be worth nearly £150m per year by the end of this period, which we are sure would be welcomed by county councils.

49. Based on the analysis above, we have drawn the following conclusions on how the future rate retention system should be designed:

- The outputs provide a rough guide to future rates and retention. However, they should be interpreted at class level. We are not giving a view about whether an individual county will be above or below baseline: this will depend on actual performance and growth locally over a very long period of time.
- A higher retention rate will increase the amount that county councils are above their baseline. In other words, that they retain a larger share of growth as a proportion of the Baseline Funding Level (i.e. needs). Where retention rates for counties are 80%, county councils as a class are an estimated about 5% above baseline; where the county share is only 20%, then counties as a class are 2-3% of baseline.
- Baseline resets are essential to ensure that all classes remain in a relatively similar position in relation to baseline. Resets do not fully achieve this however, with district councils in particular retaining growth that is significantly above baseline (largely because they retain such a large proportion of rates compared to their Baseline Funding Levels). For the other classes, the variations appear to be caused by differences in growth, and not by imbalances in the way the system is designed. There is an argument that features need to be built into the system to ensure that shire districts are not retaining disproportionate amounts of growth relative to their budgets: this could be done either through a levy or reducing the share retained by districts (and higher share for counties).
- The negative financial impact on any county council below baseline is mitigated by the safety net (between resets) and then by the 5-yearly reset. In all options, every authority below baseline is brought-up to baseline at each reset, thus minimising the period over which an authority is exposed to risk and a reduction in income. This suggests a system with a combined 5-yearly reset and safety net (set at 97% of BFL) is sufficient to manage risk at the local authority level.
- Retention rates have little impact on the funding gap. The best option for closing the funding gap is: 80% retention and 50% partial reset. For county councils, there is an implied pressure on council tax to close the funding gap, and an expectation that the Fair Funding review can deliver additional funds. Additional retention is not going to solve county councils' funding shortfall at the class level, although it might contribute significantly for some counties where there is higher growth. Our model does not take into account any review of needs or any growth in needs caused by demographic changes.

Full baseline reset

50. Although the technical consultation paper indicated that there would be partial baseline resets, it has become clear that there would be a full baseline reset in the first year of 100% retention, followed by partial resets every 5 years. We have adopted this approach as the default

assumptions in our modelling, however, we need to establish the impact of a partial compared to a full baseline reset.

51. In Chart 8 we have shown the impact of a full baseline reset with the surplus being redistributed via BFL, and in Chart 9 we have shown a partial baseline reset again with the surplus redistributed via BFL (each assumes a 80% share for counties). It can be seen in each scenario, the full baseline reset does reduce the relative advantage for districts, and results in the major upper tier authorities retaining similar amounts above baseline (at a class level). This assumption is based on average growth being in line with our assumptions.
52. In both charts, district councils are the major losers. In a partial reset, districts retain the significant advantage that they have built up since 2013-14. This relative advantage has arisen from a range of sources, including above-average growth and a favourable initial baseline in 2013-14. It does appear that a full baseline reset could benefit CCN authorities generally, at the expense of districts.
53. A key qualification to this, however, is the way that the Government distributes any surplus. CCN authorities would benefit from the redistribution being linked to either RNF or BFL rather than to BRB, unless the tier split for county councils will exceed 70%. Table 8 shows that shire counties would get:
 - **24.6%** if BRB is used to redistribute any surplus if counties had a tier split of 80%, reducing to only **5.6%** if counties had a tier split of 20%
 - **22.5%** if BFL is used to redistribute any surplus
 - **28.4%** if RNF is used to redistribute any surplus
54. It should be noted that some CCN authorities would get a higher share of a redistributed surplus if BRB is used. Four CCN unitaries (Central Bedfordshire, Cheshire East, Cheshire West and Wiltshire) would get a larger share of any redistributed surplus if BRB is used under any tier split: this is because these are unitary authorities with a tier split of 98% in the new system. Then, as we increase the tier split for counties, some of the lower need/ higher resource authorities would start to benefit from using BRB to redistribute any surplus: Surrey would benefit if counties had a 30% tier split, Oxfordshire and West Sussex at 50%, and then a larger group of counties at 60%.
55. A further qualification is that other bases for redistribution could be considered. If a more favourable basis could be identified then this could benefit CCN authorities more generally. An example might be a revised funding allocation (following the Fair Funding Review) or something like adult social care relative needs formulae, which is focussed on upper tier authorities. Further work would have to be done to identify a suitable basis for CCN authorities.
56. Broadly then, CCN can cautiously agree to explore a full baseline reset in 2019-20, but it would need to be sure that the methodology for distributing any surplus is beneficial. We would also caution that a full baseline reset will disadvantage many of those CCN authorities who are above baseline. These authorities will be expecting to retain some of the business rates growth that they have generated since 2013-14 and are unlikely to support a proposal for a full baseline reset.

Chart 8 - Forecast Retained Rates (compared to BFL) plus any returned surplus

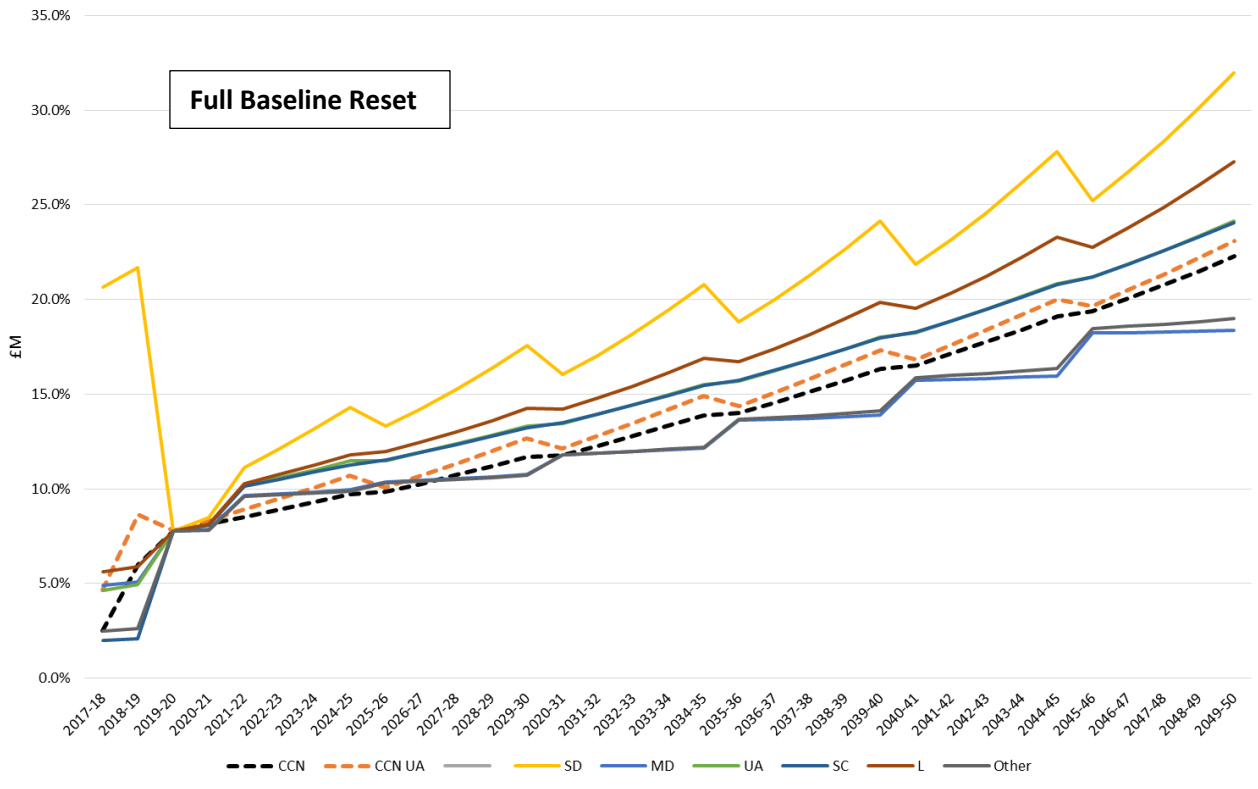


Chart 9 - Forecast Retained Rates (compared to BFL) plus any returned surplus

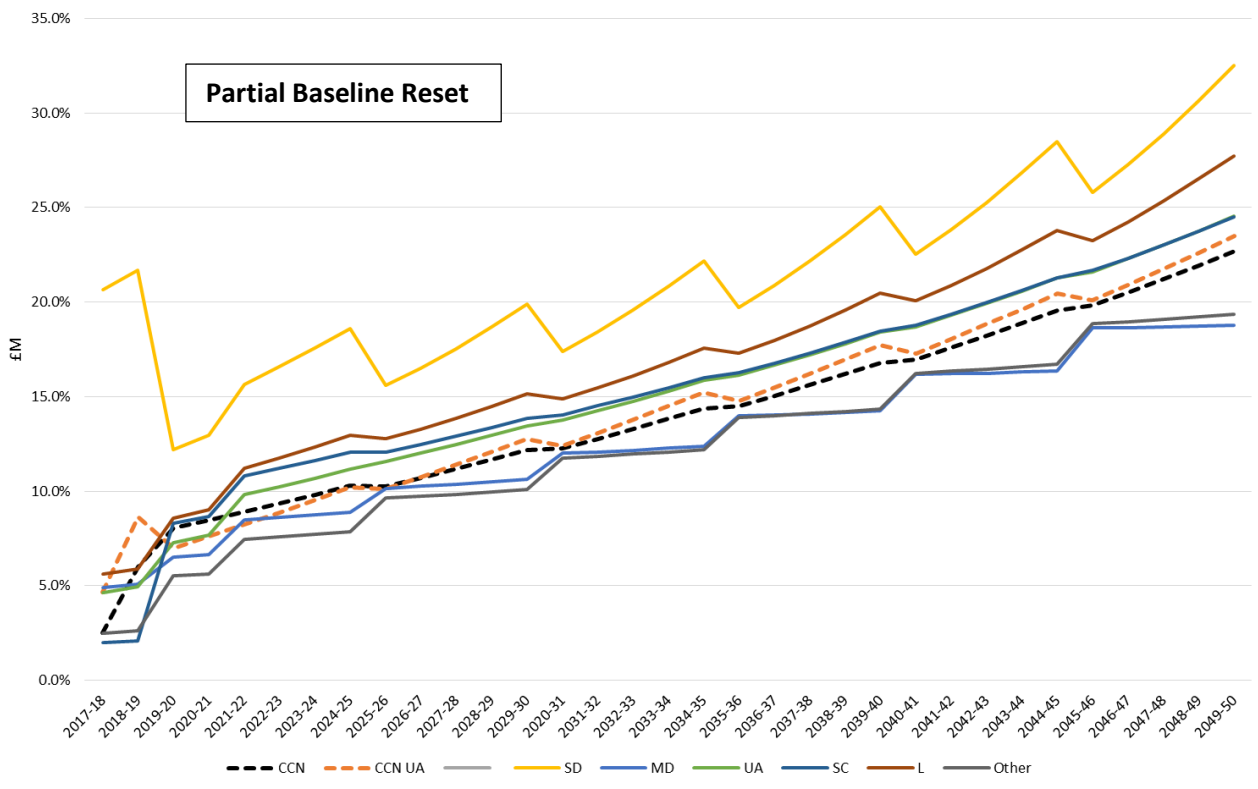
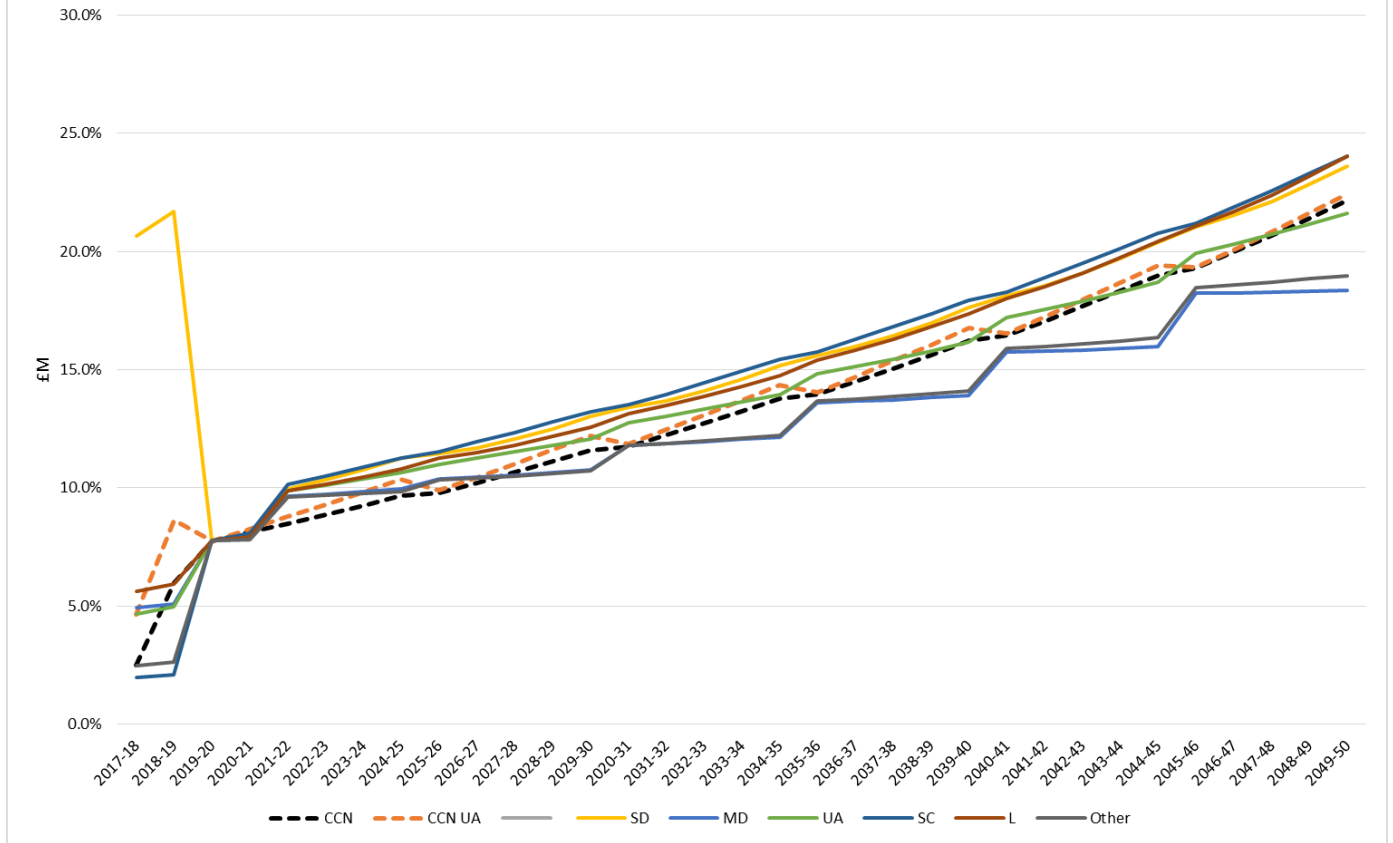


Table 8 – Surplus distributed via BFL or BRB

| County council tier split | RNF | BFL | BRB | CCN authority receiving higher share from BRB |
|---------------------------|-------|-------|-------|--|
| 80% share for counties | 28.4% | 22.5% | 24.6% | |
| 70% share for counties | 28.4% | 22.5% | 21.5% | Kent, Northants |
| 60% share for counties | 28.4% | 22.5% | 18.4% | Buckinghamshire, Cambridgeshire, Hampshire, Hertfordshire, Leicestershire, Oxfordshire, Warwickshire |
| 50% share for counties | 28.4% | 22.5% | 15.3% | Oxfordshire, West Sussex |
| 40% share for counties | 28.4% | 22.5% | 12.1% | |
| 30% share for counties | 28.4% | 22.5% | 9.0% | Surrey |
| 20% share for counties | 28.4% | 22.5% | 5.6% | Wiltshire, Cheshire East, Cheshire West, Central Bedfordshire |

57. A further variation is to combine the baseline resets with a levy. The DCLG has made clear that it will abolish the levy, but has not shown the effect that this will have on the system and on the relative retention for classes (or individual authorities). We have re-run the model to show the effect of a levy (based on revised BFL/ BRB) and assuming 100% baseline reset in 2019-20, followed by a 50% baseline reset. Chart 10 shows that the relative advantage to district councils is eliminated and that the amount retained by all classes is relatively similar and perform only marginally better than the other classes. This suggests that the higher retention shares for districts can be overcome by a combination of baseline resets and a levy. Another more sophisticated approach might, however, be more effective, e.g. by setting a cap on growth as a percentage of BFL.
58. It should be noted that, if the Government was to decide to re-introduce a levy in future, some CCN authorities could be caught by such a levy, and might lose-out as a result. However, CCN authorities collectively could benefit from the introduction of levy especially if it was designed to capture excessive growth. One way to achieve this would be to apply a levy only on growth above a certain threshold (e.g. threshold based on percentage of BFL).

Chart 10 - Forecast Retained Rates (compared to BFL) plus any returned surplus



Conclusions and recommendations

59. Based on our analysis, we have been able to propose some conclusions about how the County Councils Network could approach the forthcoming technical consultation paper on 100% business rate retention. These are the basis for discussion. We can model additional scenarios to test these conclusions further.
60. **Baseline Funding Level (BFL) transfers.** The bulk of the funding transfers in the 100% scheme are likely to be for upper tier authorities, and so the BFL for every county council will increase substantially (over 120% on average). None of the proposed transfers examined in this report have negative impacts on county councils, and can therefore be supported. There remains a gap in the transfers that will need to be made, and there is clearly a risk that some of these additional proposals do potentially pose a financial risk to county councils. We would recommend that further work is done to identify transfers that county councils can support, and to ensure that there is data available to show how the transfers could be effected. Skills and adult education would appear to be transfers that CCN could support.
61. **Levies.** CCN can support the Government's decision to abolish the current levy in the new 100% scheme but with some important qualifications. Although few CCN authorities currently pay a levy, the likely increase in retention rates for counties will push many CCN authorities into a tariff position and make them liable for a levy on above-baseline growth. However, it is also apparent from our modelling that the removal of the levy and reliance on only the baseline reset will allow some tariff authorities (particularly some shire districts and London boroughs) to retain much more of their growth, and to gain a relative advantage against county councils. Therefore, we would recommend that CCN asks the Government to ensure that there are arrangements in place to "cap" any extreme financial benefits from the rate-retention scheme at authority level. A more sophisticated levy might be possible (that is, a levy that allows authorities to retain all growth up to, say, 10% of their Baseline Funding Level).
62. **Baseline reset.** The consensus view from the DCLG and many local government representatives appears to be that there should be a partial baseline reset (50%) every 5 years, although the latest intelligence from the LGA suggests that there will be a full baseline reset in the first year of the 100% scheme. We would recommend that CCN broadly supports this approach: it appears to strike the correct balance between providing an incentive to authorities to invest in economic growth, and ensuring that there is not too much difference in financial gains and losses of individual local authorities. Most county councils are above baseline and therefore a modest baseline reset is in their interests. However, CCN should be making the point to DCLG that, without a sensible levy, the baseline reset is the only mechanism for addressing those authorities getting disproportionate gains from the system, and that there is a case for making the reset more severe (say, 75% every 5 years) to ensure that the rewards within the system are more fairly distributed. CCN should be supporting the proposal that, as part of the baseline reset, every authority below baseline is brought up to its baseline, and that this is funded from those above baseline.
63. **A full baseline reset is an emerging option and one that CCN can cautiously explore.** It appears to broadly benefit CCN authorities, and to remove the current advantage for district councils. Much, however, will depend on the methodology for redistributing any surplus back to authorities: using BFL to redistribute any surplus would broadly benefit CCN authorities, unless

the tier split for county councils is 70% or more. Alternative methodologies based on need could be explored and these could potentially benefit CCN authorities. Those CCN authorities who are currently significantly above their baseline will not support a full baseline reset, regardless of how the surplus is redistributed.

64. **Tier splits.** There is a very strong case for county councils to receive a much higher share of business rates than is currently the case. In our view, CCN should be asking for a share for counties of between 50% and 60%. At this point, county councils become at least as important as district councils in terms of rate retention locally – it gives county councils leverage over how rates are managed, and allows much greater reward from local economic investment. It also gives county councils a greater share of growth, which will help to meet the funding gap.
65. We recognise that a higher share does increase the financial risk for county councils. However, most – if not all county councils – are above baseline, which suggests counties operate over a sufficiently wide area that closures or risks are largely offset by a consistent or growing ratebase in the rest of the county. The safety net does not provide significant support to county councils, even set at 97%, because the BFL for counties is relatively large (at least compared to shire districts'). In practice, the baseline reset would provide reasonable protection if any county council was to find itself below its baseline.
66. **Top-ups and tariffs.** One of the consequences of a higher share is that many county councils will become tariff authorities. Many county councils are concerned about becoming tariff authorities because it indicates that they are more exposed to risk. Our view, however, is that being a tariff authority in itself should not be a concern: what is more important is the balance of risk and reward.
67. **Estimate of Business Rate Aggregate (EBRA).** There is a decision for Government to make about how it sets the EBRA at each baseline reset (5 years). Government could decide to allow local government to retain all its above-baseline growth, or it could decide to reduce the EBRA and thereby capture some of the growth in business rates for the Treasury. Our modelling shows that allowing local government to retain most or all of any growth makes a significant difference to the funding available for the sector, and would help to close the funding gap over the long term. We recommend that CCN pushes for the Government to guarantee that any surplus from within local government will be retained within the rate-retention system and will not be used to fund new burdens or services.
68. **Indexation (CPI or RPI).** Allied to our concern about EBRA is the indexation factor that the Government is proposing to use. From 2020-21 onwards, the Government is proposing to switch from using RPI to using CPI. Because CPI tends to increase more slowly, the amount of business rates collected by local government will also increase more slowly. Assuming all growth in rates is retained by the sector to support services, CCN should be pressing the Government to continue with RPI. Such a move would be very valuable in helping to fund social care and the budget gaps that are developing in many CCN authorities.



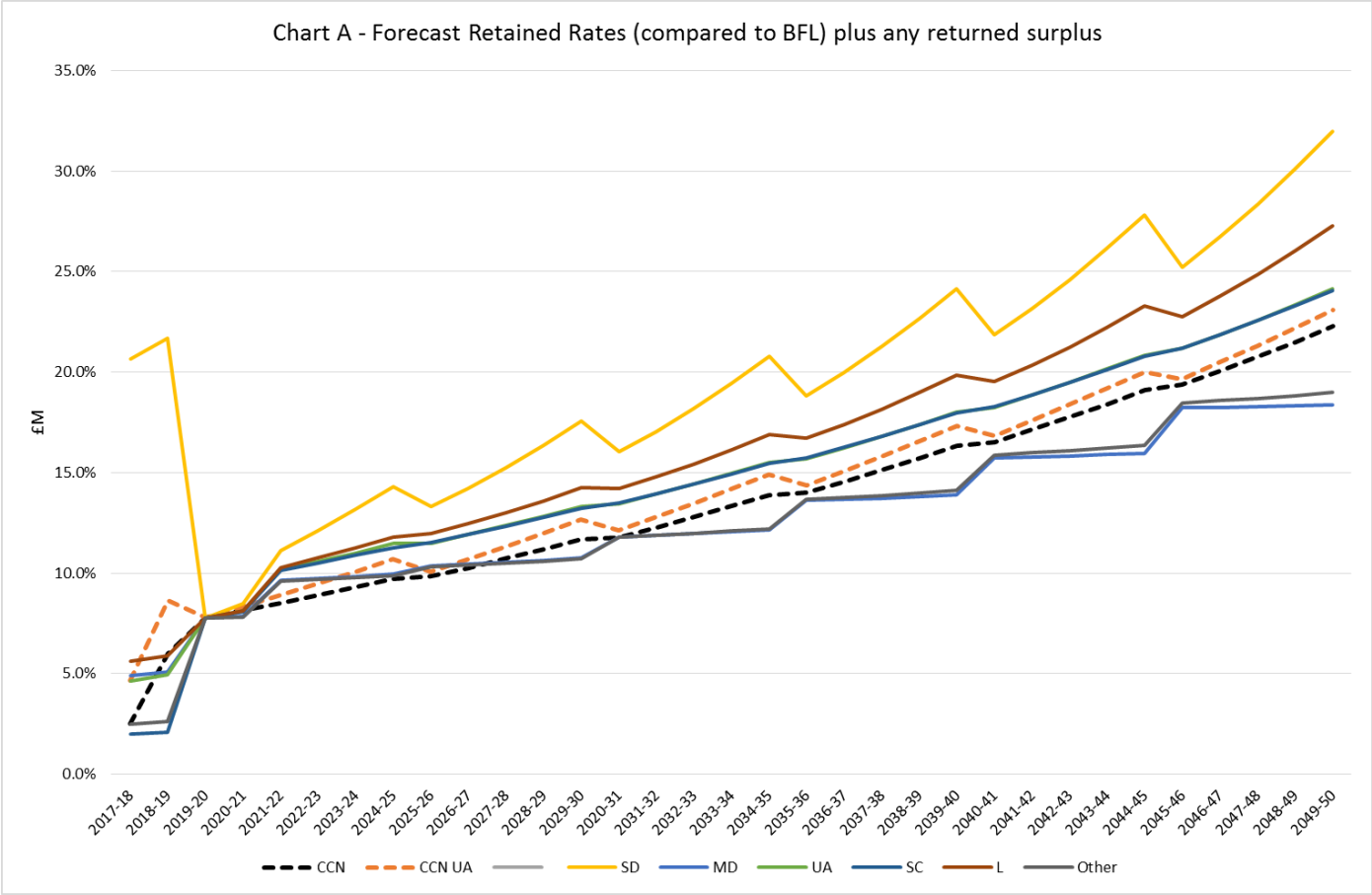
Adrian Jenkins

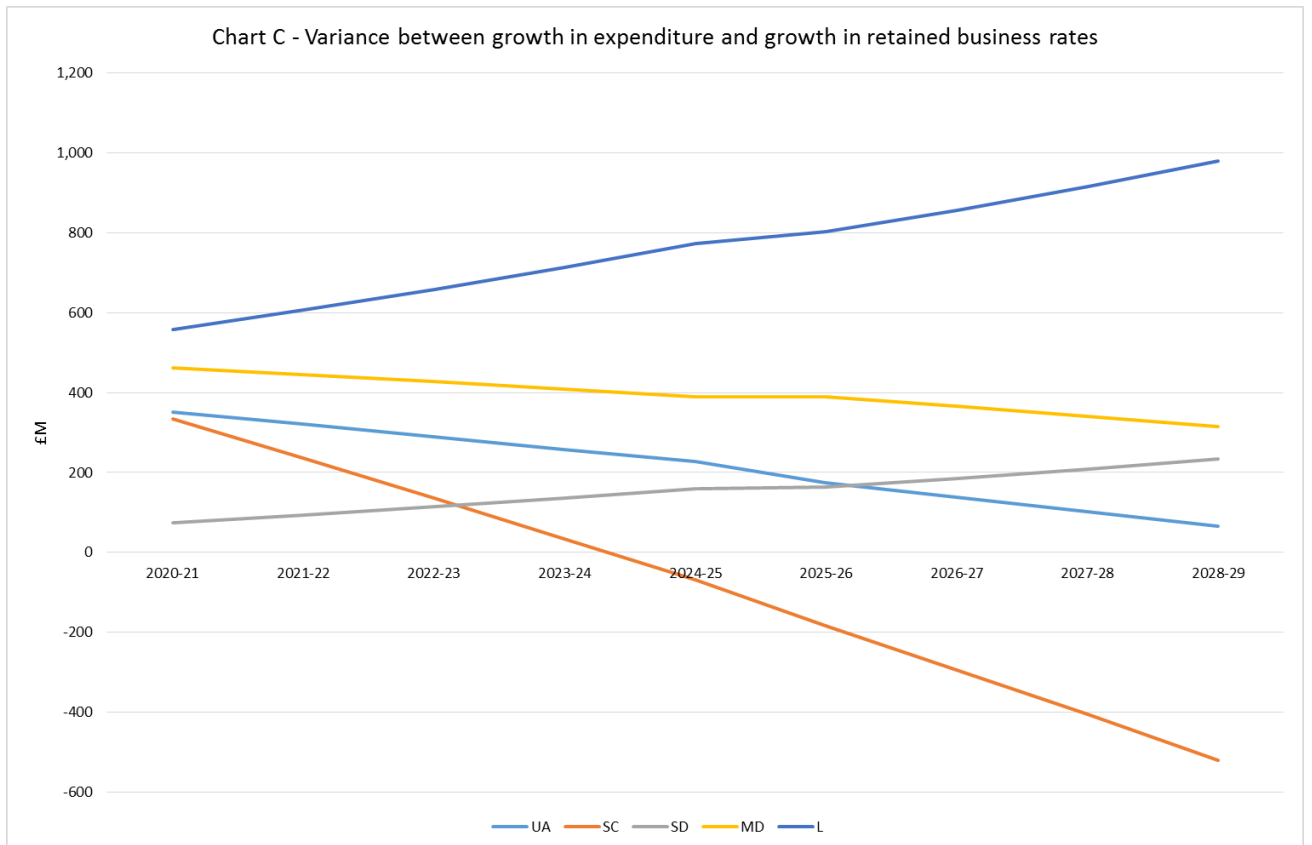
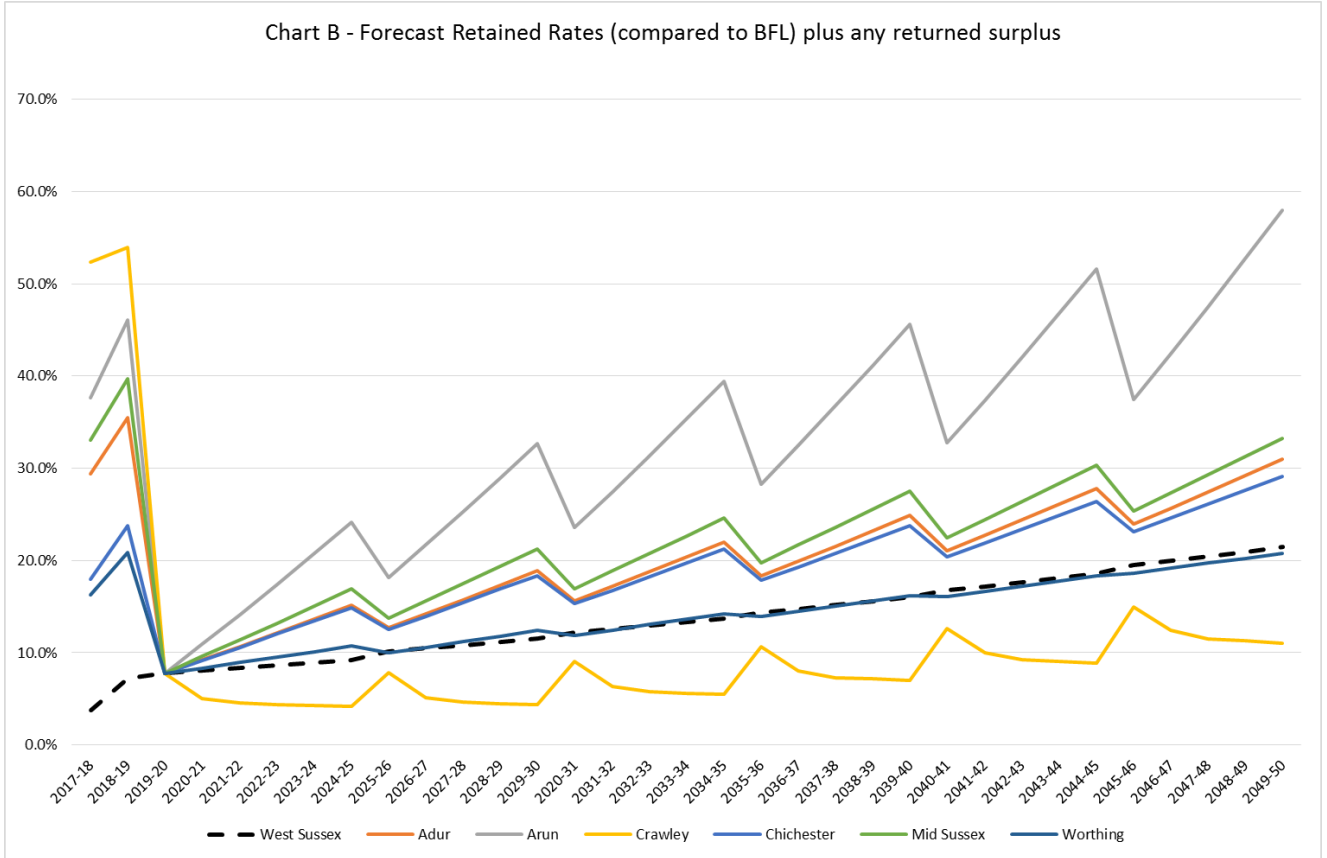
Director

Pixel Financial Management

30 June 2017

Scenario 1 80% tier share (full reset)





Scenario 2 20% tier share (partial reset)

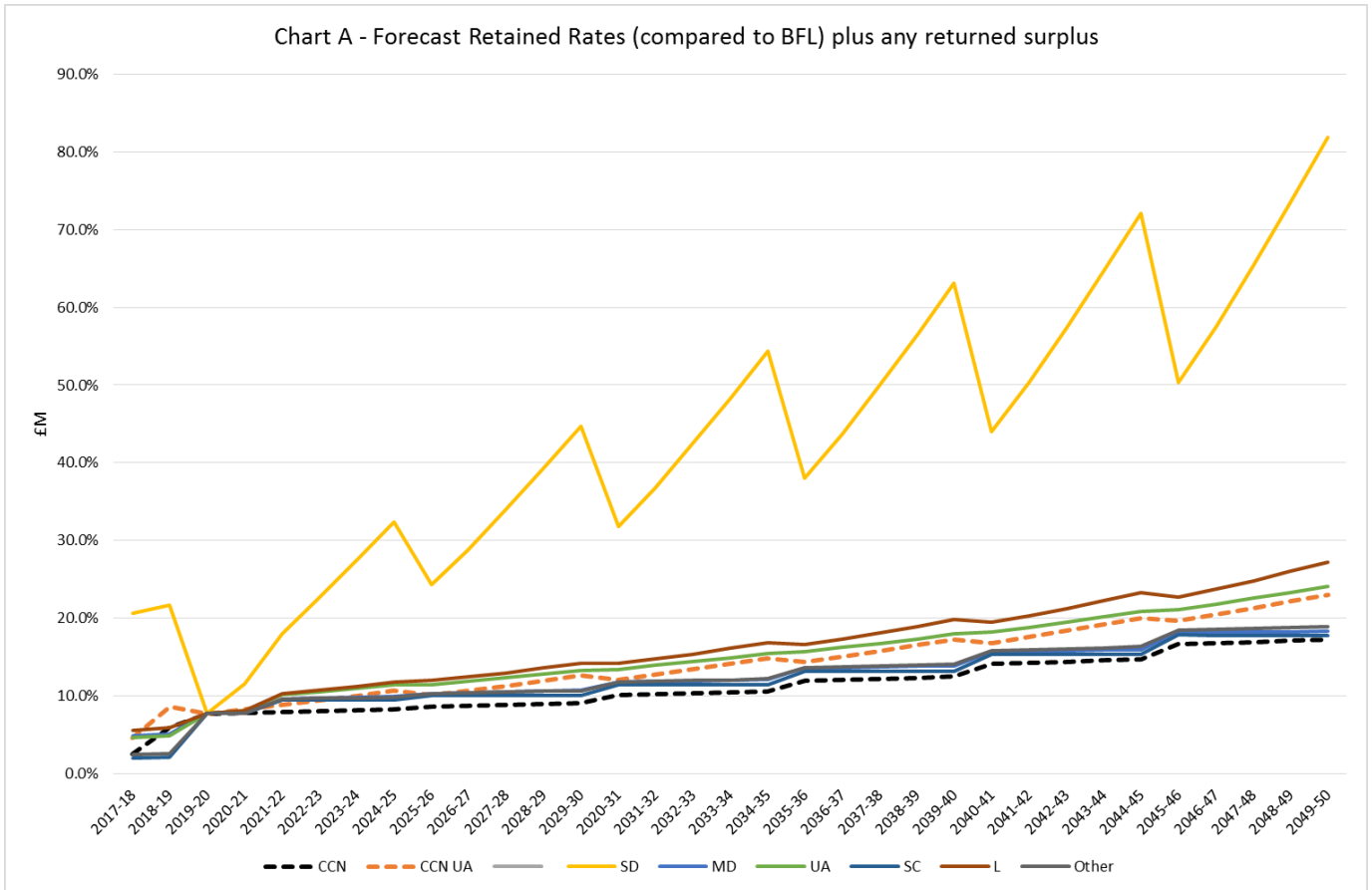


Chart B - Forecast Retained Rates (compared to BFL) plus any returned surplus

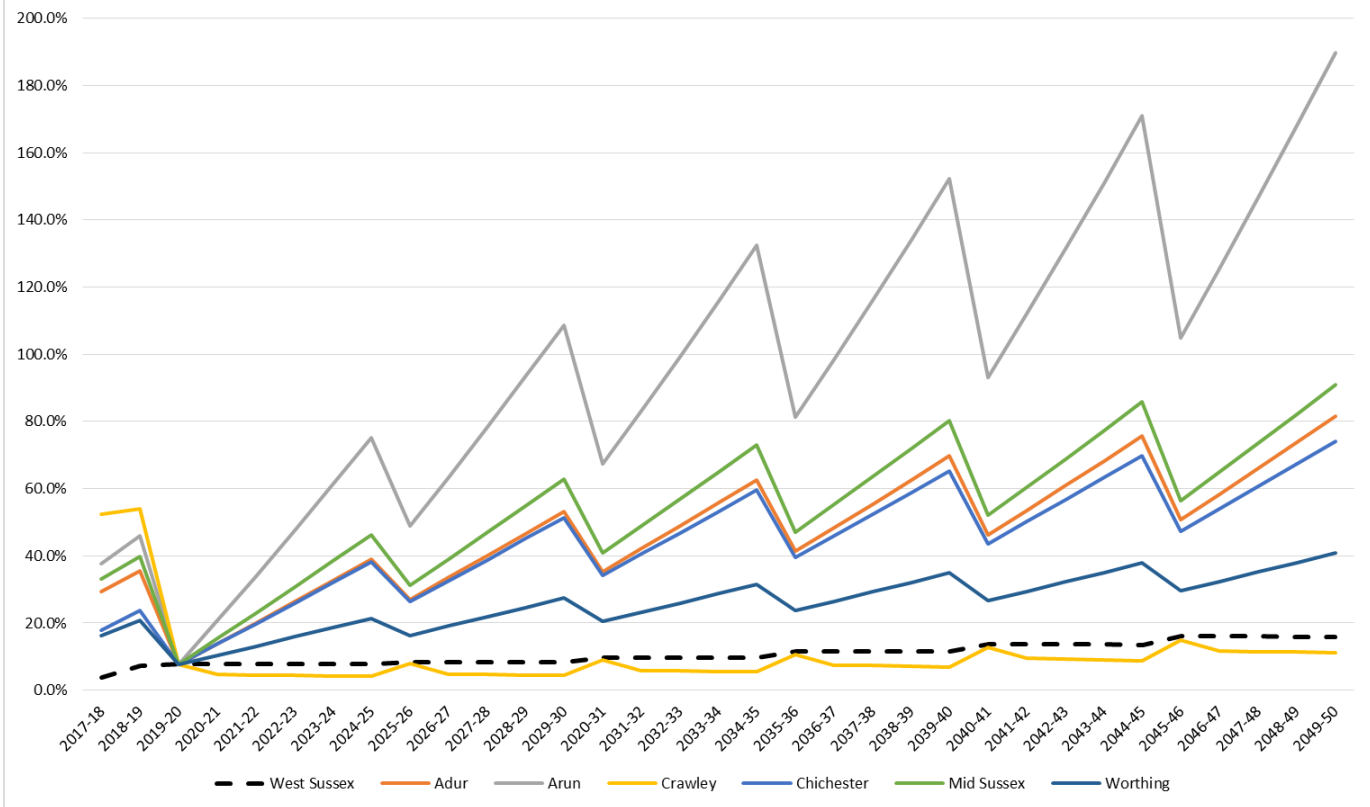


Chart C - Variance between growth in expenditure and growth in retained business rates



Scenario 3 60% tier share (full reset,)

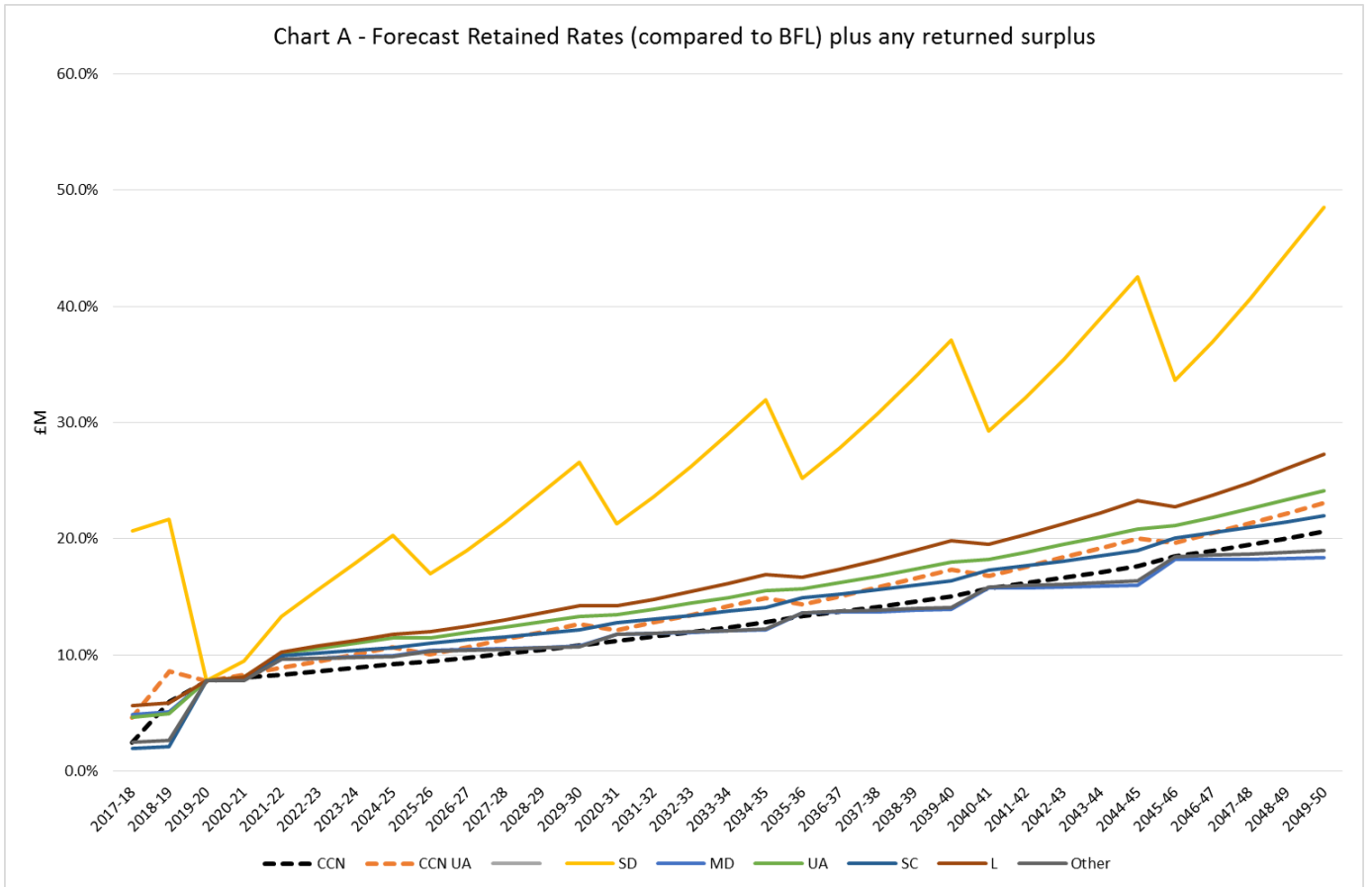


Chart B - Forecast Retained Rates (compared to BFL) plus any returned surplus

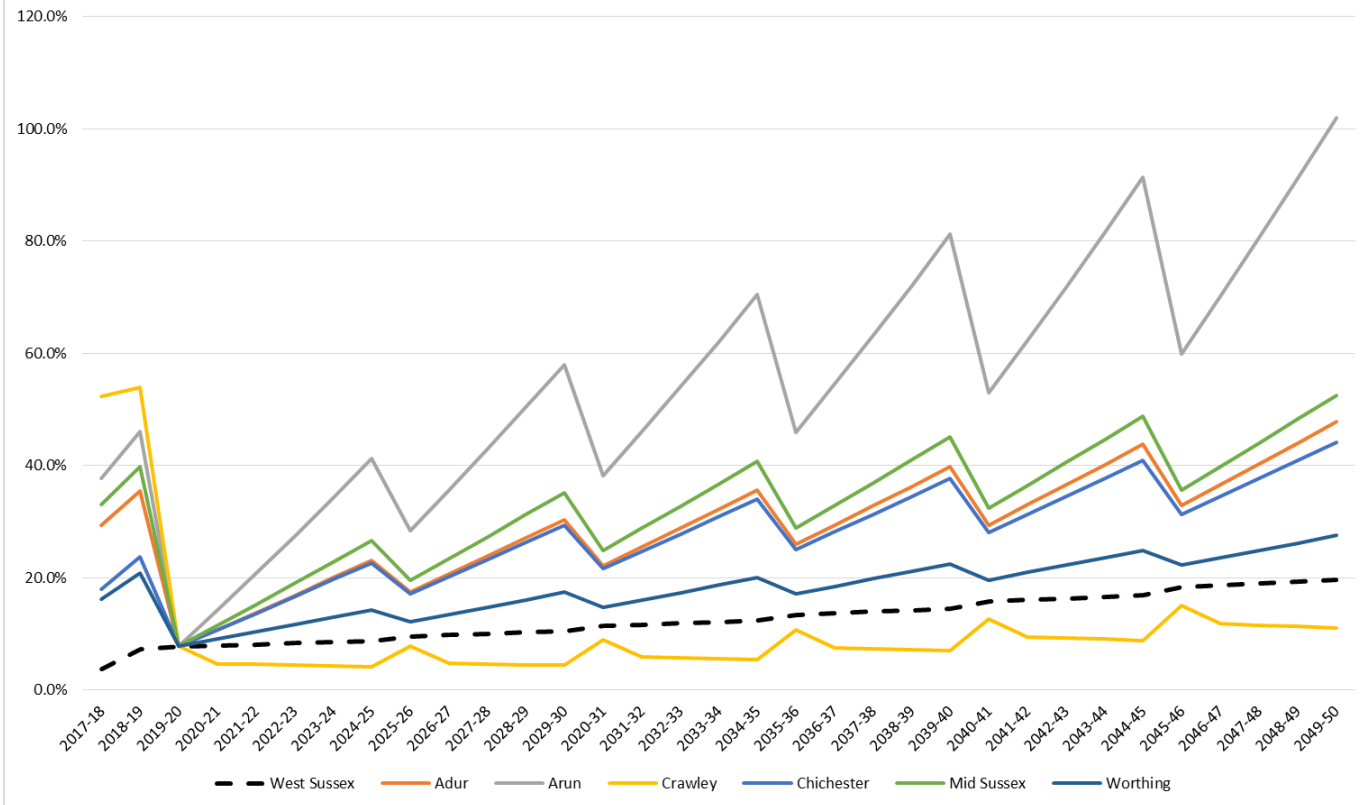


Chart C - Variance between growth in expenditure and growth in retained business rates

