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24 October 2011

Dear Joel

**South East England Councils - Response to Local Government  
Resource Review: Proposals for Business Rates Retention**

**Introduction**

Thank you for the opportunity to comment on the Government's Proposals for Business Rates Retention. I write on behalf of South East England Councils (SEEC). SEEC promotes the views and interests of all tiers of local government across the South East, who together represent more than eight million residents. SEEC is a voluntary body, funded by member council subscriptions, and carries a unique mandate as the single democratic voice of the South East.

SEEC strongly supports the principle of financial incentives for local authorities. However members have voiced concerns about whether the current business rates retention proposals will deliver significant benefits and incentives for councils, communities and the economy. SEEC is asking for a pause in the proposals to allow a more fundamental review that will address major concerns, for example:

1. Incentives for local authorities are very small – independent analysis shows that only £8.6 million in real terms (0.33% of formula grant) would have been available across all 74 South East councils if the system had operated this year.
2. Local authorities should be able to retain a greater proportion of the business rate growth they generate – present proposals retain too much for central government.
3. An alternative distribution formula is needed to ensure fairer allocation of incentives – extending the current flawed, unaccountable system to business rates incentives will simply perpetuate existing unfairnesses.

The South East has long been recognised as the driver of the UK economy – in 2009/10 South East residents contributed £1 billion more to the Treasury than the area received back in Government spending<sup>1</sup> (Table 1, Annex A). Given the importance of the South East economy to the UK's success, it is critical that incentives work effectively here, and that South East local authorities see genuine benefits from prioritising growth that helps support the wider UK.

SEEC has held extensive discussions with councillors, finance officers and chief executives in coming to its conclusions. We have also commissioned independent high level analysis of the impact of the proposals on South East local authorities.

### **SEEC review of business rate proposals**

SEEC has considered business rate retention proposals against three vital criteria for a new funding system:

- Is it fairer and more accountable?
- Does it offer local authorities a genuine incentive to encourage growth?
- Is it simpler?

Our comments are kept at a strategic level, but we have encouraged individual member authorities to respond to the more detailed issues raised in the consultation. In particular, we are aware of concerns from some district councils about the level of volatility they face in business rate income from year to year. Officers have also raised concerns that the range of options included in the consultation make it difficult for individual authorities to predict the incentives they could generate, as outcomes could be very different depending on which combination of options is applied.

#### Is the new system fair and accountable?

- i. SEEC strongly supports the principle of financial incentives for local government. However members have concerns about whether the business rate retention proposals as currently drafted will offer councils a fair and accountable system that adequately rewards communities for growth and ensures adequate investment for critical local business infrastructure and services.
- ii. The South East has major concerns about the flawed and unaccountable operation of the current grant distribution formula, which does not recognise South East councils' funding needs. Members oppose the suggestion that it should be extended to inform operation of the new business rates system, as this will simply perpetuate existing unfairness, for example when setting baselines, tariff and top up rates.
- iii. Business rate changes should be part of a wider review of local government financing. Business rate income has no correlation to a local authority's need to spend on services. Changes therefore need to be part of a package of measures that give local authorities the ability to demonstrate a transparent link between local need, councils' income and the amount spent to support business growth and services for both businesses and the local community.

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<sup>1</sup> *Why the South East Matters: Investing in Britain's economic engine room*. Independent research for South East Strategic Leaders by Oxford Economics, March 2011.

- iv. SEEC members want to see a pause in these proposals to allow a more fundamental review of local government resources that addresses the wider picture of local government financing in a transparent and accountable way. Members are keen to work with CLG ministers to help design a more localist system that will stand the test of time and achieve a step change in the way council services are funded.

Does the new system offer real incentives for growth?

- v. Members welcome the fact that the business rate retention proposals have been designed to offer immediate access to incentives from the first year of operation. However, this is tempered by serious concerns about the amount of money that will be deducted from the business rate pool before council incentives are calculated – too often leaving minimal gains for local authorities to address the needs of their communities and businesses.
- vi. Independent analysis carried out for SEEC calculates the likely level of incentive resulting from business rate growth for South East councils at just 0.33%. This is based on historic growth trends seen in the South East (Table 2, Annex A). Had authorities in the South East received this incentive in 2011-12, it would have generated real terms income growth for the entire South East of only £8.6 million (after adjusting for inflation). This represents 0.33% of the South East's 2011/12 formula grant of £2.611 billion. The 74 South East local authorities would obviously only receive a small proportion of this incentive each.
- vii. The main reason for the small level of incentive is that the proposed system does not allow authorities to benefit from growth in their business rates tax base that results from the 5-yearly revaluations. Over the past 5 years, the 2010 revaluation accounted for the significant majority of all tax base growth in the South East. From a starting business rateable value £7.3 billion, only £0.123 billion growth over the five years is not attributable to revaluation. This gives total growth over 5 years of 1.67%, which is just 0.33% per year.
- viii. Top-slicing of growth by the Treasury will act as a disincentive to councils by limiting the uplift available. This centralist approach does not support the principles of localism and significantly reduces the financial incentive to councils. SEEC supports a system that allows local authorities to keep a greater proportion of the business rate growth they generate. Limits on the additional income that councils can receive will not allow councils, their residents and businesses to realise significant benefits from business rate retention. In many cases there will be expectations of major service or infrastructure improvements resulting from economic growth but the incentive funding available will not enable local authorities to meet those aspirations. At present SEEC members feel the scale of top-slicing of business rate income by the Treasury reduces the potential benefit for councils too much.
- ix. The South East contributes some £895.4 million (Table 3, Annex A) a year more to the national business rate pool than it receives back in grants, but sees little prospect of a significant increase in funding through the proposed changes to business rates. For every £1 that the South East receives in grant it pays £1.38

into the national pool. While SEEC members recognise the need to redistribute funds to those who have lower business rate potential, the limit on gains risks becoming a disincentive.

- x. Because councils in the South East raise more in business rates than they receive in grant, this should translate to a larger percentage growth in their funding. However, one option that CLG is proposing is to restrict the percentage increase in income to the percentage increase in business rates (through the levy mechanism). In an area like the South East that is a net contributor to national coffers a careful balance is needed to ensure that the process of equalisation does not act as a disincentive to councils.
- xi. Also important in the South East is the fact that the incentive system appears to favour business developments with a large footprint, which could encourage creation of lower value jobs rather than high value jobs in the knowledge economy. Under the proposals, attracting a new warehouse or retail development with low value jobs would deliver a greater increase in business rateable values than attracting a hi-tech business with a small office footprint but high value jobs.

#### Is the new system simpler?

- xii. Taken together, business rate proposals, other incentives such as New Homes Bonus (NHB), CIL and TIF and the local government core funding formula create a highly complex web of funding streams for councils. This approach does not meet the need for a simpler, more accountable system of finance.
- xiii. Differing approaches to incentive schemes also create potential for unbalanced growth and unsustainable development. For example, councils may focus on house building rather than business growth if the NHB is seen to be more profitable. NHB payments are simpler and easier to predict compared to the complex calculations around business rate retention. This could lead to a situation where resources are devoted to seeking housing development rather than economic growth, resulting in unsustainable development patterns as well as missed economic growth opportunities. In turn this could also reduce the amount of business rate incentives available due to the fact that NHB is funded from the national business rates pool.
- xiv. Members have also raised concerns about the cost and administrative burden involved in managing the business rate retention system at both local and national levels.

#### **Conclusion**

SEEC are disappointed that the business rate retention proposals fall short of the 'optimum model for incentivising local authorities' that Government set out to deliver when it announced the Local Government Resource Review in March 2011.

SEEC supports the principle of business rate retention as an important step towards devolution of responsibility to local government. However, the current proposals need to be amended and developed further to ensure they offer greater local control and greater incentives to councils.

SEEC is keen to work with Government to help ensure final proposals on business rate retention are fit for purpose and can be implemented efficiently. SEEC members and officers would be happy to speak further with ministers or officials to help develop proposals that deliver greater local control and incentives in a simpler and more transparent manner.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Paul Carter', with a horizontal line underneath.

**Cllr Paul Carter**  
Chairman  
South East England Councils

## Annex A

### South East England Councils - Response to Local Government Resource Review: Proposals for Business Rates Retention

**Table 1: Contributions to UK public finances 2009/10**

Area	Revenue (residence based) £ billions	Expenditure £ billions	Contribution £ billions
South East	81.9	80.9	1.0
Greater London	91.3	94.0	-2.7
East of England	49.1	53.5	-4.4
East Midlands	32.9	42.0	-9.2
Northern Ireland	11.5	22.6	-11.1
North East	16.7	29.0	-12.3
Scotland	48.3	61.9	-13.6
Wales	19.0	33.5	-14.5
South West	40.1	55.5	-15.3
West Midlands	38.8	54.8	-16.0
Yorkshire & Humber	35.3	52.4	-17.1
North West	49.9	74.2	-24.3

Source: Oxford Economics/PESA calculations. Data drawn from *Why the South East Matters: Investing in Britain's economic engine room*, South East Strategic Leaders & Oxford Economics, March 2011.

**Table 2: Business rateable value growth in South East England 2006/7 – 2011/12**

	£ billions
Starting rateable value in the South East	£7.349
Total growth in rateable value over 5-year period	£1.132
Growth resulting from revaluations	£1.009
Growth <b>excluding</b> revaluation	£0.123
Average annual growth rate, excluding the effects of revaluation	0.33%

Source: Analysis by Local Government Futures for South East England Councils, October 2011.

**Table 3: Projected contributions to business rate pool compared to formula grant 2012/13**

Area	Projected contribution to business rate pool £ millions	Damped formula Grant (exc Home Office Police Grant) £ millions	Net contribution £ millions	Ratio (business rate contribution to grant)
South East	3,268.73	2,373.30	895.43	1.38
London	5,697.82	4,996.90	700.92	1.14
East of England	2,091.72	1,843.60	248.12	1.13
South West	1,715.92	1,771.70	-55.78	0.97
East Midlands	1,381.23	1,741.70	-360.47	0.79
West Midlands	1,878.51	2,603.70	-725.19	0.72
Yorkshire & Humber	1,700.69	2,484.50	-783.81	0.68
North West	2,389.56	3,629.60	-1,240.04	0.66
North East	776.25	1,470.10	-693.85	0.53

Source: Analysis by Local Government Futures for South East England Councils, October 2011.