SOUTH EAST ENGLAND COUNCILS
EXECUTIVE MEETING

Date: 30 September 2011

Subject: **SEEC response on business rate retention**

Report of: Heather Bolton, SEEC Director

Recommendations:

i) Agree that SEEC submits an overview policy response to CLG consultation on business rate retention, supporting the principle of incentivisation but raising concerns about the complexity, accountability and level of incentive within the proposals.

ii) Discuss and agree key points to be included in the SEEC response based on the content of section 3.

iii) Agree that the final response will be approved between meetings by SEEC's Chairman in order to meet CLG's deadline of 24 October.

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1. Introduction

1.1 CLG has launched consultation on changes to business rates. *Local Government Resource Review: Proposals for Business Rates Retention* was published on 18 July and followed in August by a series of eight detailed technical papers setting out proposals and options for how the new system would work.

1.2 Consultation closes on 24 October. The Government's intention is to bring forward legislation that would introduce changes to business rates from April 2013.

1.3 The proposals aim to allow local authorities to keep a percentage of business rate increases in their areas as an incentive to encourage economic growth. Authorities would benefit when growth in business rate income exceeds Government forecasts. The baseline for the new system will be set using 2012-13 formula grant. Those councils with business rate income higher than their baseline would pay a tariff to fund top up payments to councils with business rate income below their baseline. In addition, a levy would be introduced to recoup 'disproportionate benefit' – funds raised via the levy would act as a safety net for councils facing volatility or low growth in business rates. Local authorities agreeing to work with other councils to 'pool' business rates may be eligible for additional incentives.

1.4 Much of the consultation is highly technical and detailed responses will be prepared by individual local authorities in consultation with their finance teams. There is, however, a role for a SEEC overview response that addresses the principles underpinning the local government resource review and draws on SEEC's work in arguing for a fairer funding system for local authorities.

2. SEEC consultation response

2.1 SEEC strongly supports the principle of financial incentives for local authorities, however members have voiced concerns about whether the current proposals will deliver significant benefits. Rather than addressing the myriad of technical details SEEC has considered the proposals against three vital criteria for any new funding system:

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

2.2 Discussions with SEEC members, finance leads and chief executives have suggested a number of key points (set out in section 3) to include in a SEEC response on business rates retention. Additional suggestions and comments are welcome in developing the final consultation response.

2.3 In addition, as part of the Fair Funding report stage 2 work SEEC has commissioned Local Government Futures to analyse the impact that retention of business rates would have had on South East local authorities if the proposed system had been introduced five years ago. Once completed, we will aim to include the results of this work in a SEEC consultation response.

3. Draft consultation comments

3.1 Suggested points for a SEEC consultation response include:

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 current business rate retention proposals will offer councils a simple, fair and accountable system that adequately rewards communities for growth.

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, so changes need to be part of a package of measures that give local authorities the ability to demonstrate in a transparent way the funding that is used to support business needs and encourage growth and the funding that is used to provide wider community services.

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 and their communities.

vi) 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 or their residents to realise significant benefits from business rate retention. In many cases residents – and indeed businesses – will expect to see major service or infrastructure improvements resulting from economic growth but the sums expected in the South East 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.

vii) The South East contributes some £827m 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. While SEEC members recognise the need to redistribute funds to those who have lower business rate potential, the proposal that no-one will lose out also implies a limit on gains for others – once more acting as a disincentive if South East councils will see little financial gain in return for delivering growth. 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.

viii) Also important in the South East is the fact that the incentive system appears to be based solely on floorspace, which could encourage creation of low value jobs rather than high value jobs in the knowledge economy. Under the proposals a large warehouse or retail development offering low value jobs could attract greater incentive payments than hi-tech businesses with a small office footprint but offering high value jobs.

<u>Is the new system simpler?</u>

ix) Taken together, business rate proposals, other incentives such a 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.

x) 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 and this could lead to a situation where resources are devoted to developing homes rather than economic growth. 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.

xi) 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.