Communities and Local Government

Local Government Resource Review - Proposals for Business Rate Retention - consultation

Government response

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Any enquiries regarding this document/publication should be sent to us at:

Department for Communities and Local Government
Eland House
Bressenden Place
London
SW1E 5DU
Telephone: 030 3444 0000

December 2011

ISBN: 978-1-4098- 3272- 0

Local Government Resource Review

Proposals for Business Rates Retention Consultation: Government Response

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Ministerial Foreword

A strong local economy is the backbone of a strong community. Councils already work hand in hand with local businesses, seeking to boost growth, attract investment and support local jobs. This is manifestly good for the national economy: we in Government want to give councils every encouragement to go for sustainable growth.

But for too long, the business rates system has failed to give them that encouragement. At the moment, councils collect rates from local businesses, only to see the money pooled and redistributed by central Whitehall. The Organisation for Economic Cooperation and Development have called this one of the most centralised systems in the world. It means that councils who succeed in attracting new businesses bear burdens - a bigger bill for street cleaning, for example, or busier roads - but don't always feel a direct financial benefit.

The Government is proposing to repatriate business rates, allowing councils to keep a greater proportion of the taxes raised locally. This would mean that councils who succeed in growing their local economy get a direct boost to their coffers. It would give them every possible reason to create the conditions for local growth. And it would also allow them to borrow in a safe and sustainable manner against the anticipated future increase in business rates, helping them invest in the infrastructure needed to support new jobs.

This isn't simply about redistributing the proceeds of growth. If these reforms lead to every council working as hard as it possibly can to help businesses thrive, then they have the potential to increase growth overall. It's good news for communities - in as much as any increase in business rates means more money to invest in local services. And it's good news for local businesses, who can look forward to an even stronger partnership with councils.

Over the autumn, we have consulted widely on our proposals. This document sets out in more detail how our proposals will work in practice. For example:

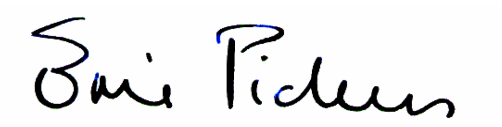
- Every council that grows its local economy will benefit. But equally we want to make sure that the system is fair from day one, with support for the most vulnerable, a top up for places that start from a lower business rates base and a safety net for when areas face unexpected challenges

- The small businesses who play such an important role in driving growth need to have certainty so they can plan ahead; they can rest assured that central government will still control the setting of the business rate

- And where councils want to join forces to pool their business rates - sharing the rewards and risks with their neighbours, and thinking together strategically about how they should invest the money - they will be able to do so

Alongside this document, the Government is putting before parliament a Local Government Finance Bill to be debated in 2012. The Bill will provide the means to put these proposals into effect, giving councils encouragement to boost growth, and a new means to support their local economy.

Restoring the country to strong, sustainable growth is a national challenge, but local leadership is a crucial part of meeting it. Business rate reform will enable and encourage councils to show the leadership and ingenuity that will do their communities, local businesses, and the national economy proud.



THE RT HON ERIC PICKLES MP

Executive Summary

The Government has consulted on proposals to radically reform the way in which local authorities are funded, providing a strong incentive for local authorities to change their behaviours and go for growth whilst ensuring all local authorities have adequate resources to provide services to local people.

This document provides the Government's response to consultation, and confirms its intention to introduce business rates retention from April 2013.

The current local government funding system is one of the most centralised in the world. Business rates are collected by local authorities, pooled centrally by Government and redistributed to local authorities (including police and fire and rescue authorities) through formula grant.

This centralised approach means that there is no real financial incentive for local authorities to promote growth, even though they have a huge influence over their local economies through planning, investment in local infrastructure and building strong relationships with businesses.

Local authorities should receive a financial benefit, by being able to retain a proportion of rates, if they achieve local growth in business rates. This will act as a financial incentive.

The business rate retention scheme as set out in this document will create this incentive while being both deliverable and sustainable. It will also ensure that all authorities have sufficient resources to deliver local services and that authorities can maximise their potential for growth through Tax Increment Financing schemes.

We will ensure **a fiscally sustainable system** by:

- localising a percentage share of business rates from April 2013, consistent with agreed spending control totals (subject to any revisions following the 2011 Autumn Statement) - thereby ensuring that local government shares in the risks and rewards of growth from the outset of the scheme whilst avoiding putting our deficit reduction programme at risk

- building into the scheme a power for the Government to alter the size of the local share in future, specifically to maintain affordability and protect the interests of the taxpayer and wider economy

- considering the scope for further simplification and decentralisation of funding, to ensure that the local share is as large as possible to maximise the incentive for growth and the number of self-sufficient authorities produced through this reform. We will set out the size of the local share in the spring of 2012

- rolling in revenue elements of the Greater London Authority

(GLA) general grant, ensuring that the GLA is funded through the business rates retention scheme and is under the same incentive to go for growth as other authorities. This is in line with the Government's objective to achieve a closer alignment between services and business rate, helping to increase the share of business rates that is localised and so maximise the rewards for growth

At the outset of the scheme, we will ensure **a stable starting point for all authorities** so that no council is worse off as a result of its business rates base at the outset of the scheme through:

- a one-off rebalancing of resources through a system of *tariffs* and *top ups*. Tariffs and top ups will be calculated by comparing:

    - an individual authority's *business rates baseline*, established on the basis of an average of its rates income over a number of years

    - its *baseline funding level,* established by applying the 2012-13 formula grant process to the 2013-14 and 2014-15 spending control totals, and using numbers after damping

- This means that where an authority has more business rates than its baseline funding level, it will pay the difference to government as a tariff; and where an authority has less business rates than its baseline funding level it will receive the difference as a top up grant. Tariffs and top ups will be self-funding and fixed in future years to provide the growth incentive

In establishing baseline funding levels, we will:

- update all existing datasets and consider limited technical adjustments to the relative need formulae for the cost of rural services and concessionary travel and the resource equalisation component

- include the 2011-12 council tax freeze grant, and consult further on the method for doing this

- exclude the 2012-13 transition grant and the grant for freezing Council Tax in 2012-13 since these are one-off, temporary funding streams

From that stable starting point, the core scheme design places **a strong growth incentive on all authorities, whilst ensuring all authorities have adequate resources to provide services to local people**. It achieves this by:

- uprating tariffs and top-ups by the RPI business rates multiplier, so that a major part of top up authorities' income within the scheme is not eroded in real terms, and tariff authorities are under a strong incentive for physical growth

- placing a levy on disproportionate benefit, so that any two authorities achieving the same levels of growth in their business rates, will see the same percent increase in their income under the retention scheme

- using levy income to fund support through a safety net for local authorities that in any year see their income drop by more than a set percentage below their baseline funding level

- uprating baseline funding levels by RPI when assessing whether a council is eligible for support, to maintain the protection provided through the safety net in real terms

- allocating, in two-tier areas, the greatest share of business rates to district councils. Such a split ensures that no authority loses out at the outset of the scheme, as funds are allocated to all authorities according to their baseline need. It also provides a high degree of income stability for authorities responsible for adult social care and children's services, which would see a major part of their income provided through an index-linked top up. But this also places the strongest incentive on the tier of government responsible for planning decisions, which would receive around 80 percent of growth on the local share, subject to any levy

- setting an aspiration to allow 10 years before resetting tariffs and top ups, except in exceptional circumstances, so that authorities have long term certainty about the rewards of growth, maximising the incentive effect

- funding all fire and rescue authorities in the same way, through a percentage share of each district or borough council's billing authority business rates baseline

- providing a fixed allocation of business rates in 2013-14 and 2014-15 to support Home Office grant funding of police bodies. The allocation will be consistent with the 2010 spending review settlement, subject to any revisions following the 2011 Autumn Statement

The long term certainty over the rewards of growth provided by the core scheme will:

- **enable authorities to undertake Tax Increment Financing** within the existing prudential borrowing rules

We will also:

- allow **a limited number** of Tax Increment Financing Projects to be **exempted from any levy and reset for 25 years.** More details will follow in the New Year

We will ensure that **local budgets are not affected by changes in the business rates system at five yearly revaluations,** which ensure bills reflect changes in relative rental values across the country, by:

- adjusting tariffs and top ups to ensure that an authority's retained rates income is not affected by revaluation. In the absence of such an adjustment, the Government's commitment to reduce the business rates multiplier so that the overall tax burden on businesses does not increase at revaluation would mean that any council with increases in rental values below the England average would see its retained rates income fall

- managing the transitional relief scheme put in place at each revaluation to phase in significant changes to individual business rates bills at revaluation outside the business rates retention system, ensuring that local authorities' budgets will not be affected by transitional relief

We will **enable local authorities to come together voluntarily to form a pool, with scope to generate additional growth through collaborative effort and to smooth the impact of volatility across a wider economic area.** We believe local authorities are best placed to determine their pooling arrangements. However, we will:

- require assurances around governance and workability**,** including a requirement that the proposals have been signed off by all of the relevant Chief Executives and s151 officers

- work with the sector to set out a clear framework for local authorities who wish to pool, using the criteria set out in the consultation document

- expect authorities to publish their pooling arrangements

- encourage authorities to consider the benefits of pooling but not offer further incentives to pool at the outset of the scheme, reflecting consultees' concerns that incentives would reduce resources for authorities that chose not to pool

- allow district councils to pool outside of county boundaries - local authorities may, for example wish to consider pooling within Local Enterprise Partnership boundaries

We maintain our commitment that moving to this new scheme will **not change the way businesses pay business rates, nor increase the level of business rates they pay**.

Chapter 1

Introduction and the case for change

Introduction

1.1 The current local government finance system, where rates are collected by local authorities, pooled centrally by government and then redistributed to local authorities as part of formula grant, is overly centralised. It makes local authorities dependent on central government funding and does not recognise the real influence that local authorities can exercise on local growth.

1.2 This is a missed opportunity. Income from business rates could be an incentive for local authorities to do all they can to support and nurture local business and to build a secure and healthy local economy. It could help to radically shift the approach that local authorities and their partners take to growth in their area.

1.3 In October 2010, we published *Local Growth: realising every place's potential*[1] which outlined a new approach to local growth, shifting power away from central government to local communities, citizens and independent providers. This highlighted the Local Government Resource Review and announced that the Government would be considering ways of enabling local authorities to retain locally-raised business rates.

1.4 Since then, we have introduced the New Homes Bonus which acts as a powerful incentive for local authorities to deliver housing growth and forms part of *Laying the Foundations: A Housing Strategy for England*[2] published on 21 November 2011.

1.5 We have put in place a new, fair and transparent system which allows local authorities to raise funds from developers through the Community Infrastructure Levy. We are reforming the levy to ensure a proportion of the revenue raised in each neighbourhood goes back to that neighbourhood. This can then be used to support infrastructure development wanted by the community, which in turn supports future growth.

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[1] www.bis.gov.uk/assets/biscore/economic-development/docs/l/cm7961-local-growth-white-paper.pdf
[2] www.communities.gov.uk/documents/housing/pdf/2033676.pdf

1.6 Measures taken through in the Localism Act 2011[3], such as the General Power of Competence, will give more power and space to local authorities to find local solutions for local problems. Enterprise Zones, announced as part of the 2011 Budget[4], will create new business and growth in a range of locations across the country. We have also established Local Enterprise Partnerships, which bring business, local authority and other interests together to help stimulate local economic growth.

1.7 In March 2011, the Terms of Reference for Phase 1 of the Local Government Resource Review[5] were published, setting out that the Review would consider the opportunities the business rates system offered to give local authorities greater financial autonomy and strengthen the incentives to support growth.

1.8 On the 18 July, we published our proposals for business rates retention, as part of the Local Government Resource Review, for consultation[6]. This was followed by a series of eight technical papers, published on 19 August, which provided further detail on the following topics:

- Technical Paper 1: Establishing the Baseline[7]
- Technical Paper 2: Measuring Business Rates[8]
- Technical Paper 3: Non-Billing Authorities[9]
- Technical Paper 4: Business Rates Administration[10]
- Technical Paper 5: Tariff, Top Up and Levy Options[11]
- Technical Paper 6: Volatility[12]
- Technical Paper 7: Revaluation and Transition[13]
- Technical Paper 8: Renewable Energy[14]

1.9 The consultation closed on 24 October. This document provides the Government's response to consultation and sets out a clear central proposition for the business rates retention scheme. It is accompanied by a summary of the consultation responses received.

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[3] www.legislation.gov.uk/ukpga/2011/20/pdfs/ukpga_20110020_en.pdf
[4] http://cdn.hm-treasury.gov.uk/2011budget_complete.pdf
[5] www.communities.gov.uk/documents/newsroom/word/1866550.doc
[6] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[7] www.communities.gov.uk/documents/localgovernment/pdf/19695701.pdf
[8] www.communities.gov.uk/documents/localgovernment/pdf/196957311.pdf
[9] www.communities.gov.uk/documents/localgovernment/pdf/196957710.pdf
[10] www.communities.gov.uk/documents/localgovernment/pdf/19695831.pdf
[11] www.communities.gov.uk/documents/localgovernment/pdf/19695901.pdf
[12] www.communities.gov.uk/documents/localgovernment/pdf/19695951.pdf
[13] www.communities.gov.uk/documents/localgovernment/pdf/19695981.pdf
[14] www.communities.gov.uk/documents/localgovernment/pdf/1969601.pdf

1.10 The proposals for the local retention of business rates from April 2013 will apply to England only. The Welsh Government will continue to be responsible for policy on the administration of business rates in Wales. The Department for Communities and Local Government has consulted with the Welsh Government in developing the proposals and will continue to engage with the Welsh Government going forward.

1.11 On 19 December 2011, the Government introduced a Local Government Finance Bill into the House of Commons to give effect to the reforms set out in this document.

Why are we doing this?

1.12 On average, councils only raise 47 percent[15] of their revenue locally. The rest is given to them by central government through both specific grants and formula grant distributed to local authorities through the Local Government Finance Settlement. Formula grant consists of Revenue Support Grant (funding from central government) and business rates, paid into the centre and then redistributed. Formula grant uses the four block model to determine the amount of resources to be allocated to each authority.

1.13 The four block model has been widely discredited as being both overly complex and lacking transparency. These sentiments were strongly echoed by a majority of respondents to our consultation. Formula grant is clearly not working and needs reform. A recent report from the National Audit Office supports this view.[16]

1.14 The problems with the current local government finance system are compounded by the fact that it lacks any direct financial incentive for local authorities to grow their economies. In fact local authorities actually face a direct financial disincentive to promote business growth because the costs to them from congestion or the additional provision of services to commercial property can be larger than the benefits. This can make it difficult for local authorities to garner community support for new developments leading to planning restrictiveness. Reflecting this, in November 2010, the UK had six of the thirty most expensive global business property markets[17], and work by McKinsey suggests that planning restrictions have created barriers to the entry of new firms.[18]

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[15] Excluding dedicated schools grant and other specific and special grants.
[16] *Landscape review: Formula funding of local public services* (http://www.nao.org.uk/publications/1012/formula_funding.aspx)
[17] CBRE, (Nov 2010), *Global Office MarketView: Rents*
[18] McKinsey Global Institute, (1998), *Driving Productivity and Growth in the UK Economy*

1.15 Research undertaken by Cheshire and Hilber at the LSE[19] found that the level of planning restrictiveness increased significantly following the centralisation of business rates in 1990 because local authorities no longer had a direct financial incentive to pursue development. This led to less business development and subsequently higher costs for business through restricted supply. Reintroducing a fiscal incentive could help to reverse these effects.

1.16 We know that local authorities are keen to grow their local economies. We know that they can have a big influence on local economic growth through planning, investment in local infrastructure and through building strong relationships with their local businesses. We have a real desire to make sure that local authorities see a clear financial benefit from doing so.

The solution

1.17 Our consultation on business rates retention set out proposals which will deliver this strong incentive for local authorities to nurture and grow their economies. The proposals were firmly based on four key principles:

- to build into the local government finance system an incentive for local authorities to promote local growth over the long term
- to reduce local authorities' dependency upon central government, by producing as many self sufficient authorities as possible
- to maintain a degree of redistribution of resources to ensure that authorities with high need and low tax bases are still able to meet the needs of their areas
- to ensure protection for businesses and specifically, no increases in locally imposed taxation without the agreement of local businesses

1.18 The new rates retention scheme will enable local authorities to retain growth in their business rates, providing a clear link between the effort they put in to grow their local economies and the amount of resources available to them to fund local services. This will provide a clear incentive for local authorities to find new ways to support businesses, to invest in local infrastructure and to build their economies year on year.

1.19 It will mean local authorities have the capacity to increase their own spending power without needing to come to central government for additional resources. They will have more control over their finances and will be able to raise additional resources for themselves by growing their local tax base.

[19] Cheshire and Hilber, (2008), *Office Space Supply Restrictions in Britain: The Political Economy of Market Revenge*

1.20 The scheme will also strengthen links between business and local authorities and will highlight for communities how the work of their local authorities relates to the resources the local authority has to use, giving local authorities increased credibility when making difficult choices about spending.

1.21 We maintain our commitment that moving to this new scheme will not change the way businesses pay business rates, nor increase the level of business rates they pay.

Chapter 2

A stable starting point for all authorities

A fiscally sustainable system

2.1 The Government made clear in the consultation paper[20] that the business rates scheme would be managed within the spending control totals set out in the 2010 Spending Review.

2.2 The consultation proposed to achieve this through a set aside. The amount set aside would be the difference between the forecast national business rates and the spending control totals in 2013-14 and 2014-15. The sums set aside in this way would be returned to local authorities through other grants.

2.3 This approach was not welcomed by all. Local authorities, in particular, were concerned that in the first two years of the scheme they would only benefit from business rates growth above forecast levels and that they would bear the risk of business rates growth being below forecast.

2.4 The Government confirms that it will manage the scheme within the spending control totals set out in the 2010 Spending Review. It is paramount that the move to business rates retention does not put the deficit reduction programme at risk. The necessity of tackling the deficit was reiterated in the Autumn Statement[21] on 29 November. The Government will achieve this objective not through a set aside fixed in cash terms as initially proposed, but by localising a percentage share of business rates from the outset of the scheme in 2013. The local share of business rates will be set in a way that is consistent with the agreed spending control totals.

2.5 In practice, this means that each billing authority will retain a fixed percentage of the business rates it actually collects (subject to any levy) and will pay the remaining share to central government. This will ensure that local authorities benefit from growth in the local share of business rates from the outset of the scheme. And it will ensure that not only the rewards of positive growth but also the risks of negative growth are shared with central government. The share of business rates that is paid to central government will be returned in full to the local government sector through other grants.

[20] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[21] http://cdn.hm-treasury.gov.uk/autumn_statement.pdf

Setting the local and central shares of business rates

2.6 In determining the percentage of business rates that is localised, the Government will have regard to the spending control totals for local government set in the 2010 spending review; the functions and services to be funded through retained business rates; and the wider interests of the taxpayer and the economy.

2.7 The Government's ambition is to ensure that the local share of business rates is sufficiently large to maintain a strong incentive through the scheme. To that end, we will consider the scope for further simplification and decentralisation of funding, to achieve greater alignment between the business rates collected by local authorities and the functions and services which they fund.

2.8 In line with its objective of aligning business rates and services to maximise the incentive effect, the Government will fund the revenue elements of Greater London Authority general grant and fire funding through retained business rates from April 2013. We want to build from this, as far as possible and dependent on the economic climate, to more fully close the gap between the business rates collected and retained by local authorities by more fully aligning services with business rates yield. This will also increase local authorities' self-sufficiency, making them less dependent on central Government grant and increasing their autonomy and their accountability to local tax-payers.

2.9 The Government is committed to resolving the double funding of local authorities for services which devolve to Academies permanently from 2013-14. As part of this review, we will explore removing the funding for these services from formula grant into the budgets of the Department for Education. Under this option, the Department for Education would then administer a grant to authorities and to Academies proportionate to the number of pupils for which they are responsible according to a national rate. The Government plans to consult in 2012 about how to put this commitment into effect.

2.10 We will set out the percentage share of business rates that it is to be localised, together with the mix of functions and services to be funded through retained business rates, in the spring of 2012.

2.11 The Government will retain the ability to alter the local share of business rates where it is necessary specifically to maintain affordability and protect the interests of the taxpayer and the wider economy.

Establishing the Baseline

2.12 The business rates retention scheme set out in this document balances a strong growth incentive for local authorities with adequate protections to ensure that all authorities can maintain services for local people. One of the ways in which it does this is by ensuring a stable starting point for all authorities, which ensures that no local authority is worse off as a result of its business rates base at the outset of the scheme.

2.13 Some local authorities collect more business rates than they currently receive in formula grant (which is based on relative need and resources), while the business rates collected by others are lower than their current funding level.

2.14 The consultation document[22] proposed to rebalance resources at the outset of the scheme through a system of tariffs and top ups. An authority which collected more business rates than its baseline funding level would pay the difference to central government as a tariff. An authority which collected less business rates than its baseline funding level would receive the difference from central government as a top-up. Tariffs and top-ups would be self-funding and would be fixed in future years to ensure that changes in budgets reflect business rates growth.

Establishing individual authority business rates baselines

2.15 Establishing a business rates baseline for each authority that is part of the scheme would involve two steps:

- determining the amount of business rates that each billing authority collects
- establishing how this is to be shared between billing and non-billing authorities

2.16 In the consultation document[23] we set out two options for determining the amount of business rates that each billing authority collects:

- a spot assessment based on authorities' business rates income on one particular day
- authorities' average business rates income over two or three years

2.17 A large majority of respondents preferred using an average of an authority's rates income over several years. We agree with this approach.

[22] http://www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[23] as above

2.18 A spot assessment would not provide an accurate or fair forecast of the business rates income actually collected by that authority, due to the inherent volatility in business rates. It could distort authorities' business rates by possibly measuring rates at a particularly high or low point for the authority. This would go against the central tenet of creating a stable starting point for each authority.

2.19 The Government will adopt the approach of using an average assessment. This will help to smooth some of the natural volatility in business rates, leading to a more stable assessment of an authority's business rates base. We will work further with the sector to determine the number of years over which the average should be calculated and the data that should be used.

Allowable deductions

2.20 In *Technical Paper 2: Measuring Business Rates*[24] we proposed that in calculating each billing authority's business rates income, we would make a series of allowable deductions to reflect differences in the local costs of items such as reliefs. The deductions would reduce the estimate of a billing authority's individual authority business rates and hence the business rates baselines of authorities. We also proposed that these allowable deductions should be fixed until a re-set.

2.21 The consultation document proposed no changes to the current system of reliefs, or to the criteria that determine eligibility.

2.22 A large majority of respondents to the consultation document were content with the proposal of making an allowable deduction for reliefs and that deductions should be fixed between resets. The Government will adopt the proposed approach.

Establishing individual authorities' baseline funding levels

2.23 The consultation document[25] and Chapter 5 of *Technical Paper 1: Establishing the Baseline*[26] proposed the use of 2012-13 formula grant as the basis for constructing the baseline in the first year of the new business rate retention system. It sought views on two options:

- scaling back actual 2012-13 formula grant allocations to reflect the lower local government spending control totals for 2013-14 and 2014-15
- applying the 2012-13 formula grant process to the lower amount, with the opportunity to make limited technical updates to existing datasets and formulae

[24] www.communities.gov.uk/documents/localgovernment/pdf/196957311.pdf
[25] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[26] www.communities.gov.uk/documents/localgovernment/pdf/19695701.pdf

2.24 Once individual authorities' baseline funding levels had been established they would not be reviewed to take account of changes in relative need or resources until there is a reset, ensuring changes in local budgets reflect local business rates growth.

2.25 Some respondents to the consultation document[27] put forward concerns about basing baseline funding levels on 2012-133 formula grant. We recognise and understand these concerns; however, we think it is important that the new scheme starts, as far as possible, from a position of funding stability for those concerned. Although criticised, the formula grant process is a known process and local authorities' current spending levels will be based on formula grant allocation. So we believe this is the only way to ensure budget stability for local authorities. Introducing a new process for deriving baseline funding allocations would create massive upheaval in the system which would undoubtedly make it more challenging for authorities to adapt to the new scheme. We consider it is more important to drive the growth incentive and to help local authorities benefit from that growth from the very start of the scheme.

2.26 The 2012-13 transition grant will not be included in the baseline as it is a temporary measure to take account of spending power reductions in the first two years of the spending period.

2.27 The 2011-12 council tax freeze grant, but not the grant for freezing council tax in 2012-13 which is only being provided for one year, will be included in the baseline. We will consult more fully on the mechanism for this next year.

Floor Damping

2.28 Whichever of the two options is adopted, it will be necessary to decide whether to use numbers before or after damping. *Technical Paper 1: Establishing the Baseline*[28] sought views on this question. If numbers were used after floor damping, it asked which year should be taken as the base position for the floor damping calculations.

2.29 Floor damping is used to ensure stability in the financing of local services. The Government sets a lower limit, the floor, to each authority's change in their formula grant allocation year on year. This floor works on a like-for-like basis (i.e. after adjusting for changes in funding and responsibility).The floor is paid for by scaling back the change above the floor for other authorities.

2.30 Responses to the consultation document were divided on this issue. The main reason given by respondents for basing the baseline on formula grant after floor damping was stability, with some authorities linking this stability with the ability to have a longer re-set period. Those

[27] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[28] www.communities.gov.uk/documents/localgovernment/pdf/19695701.pdf

authorities who favoured using formula grant <u>before</u> floor damping generally said that the distortions caused by floor damping meant that current formula grant allocation was not a fair basis for distribution.

2.31 In line with our objective of ensuring a stable starting point for all authorities, we have decided to use numbers after floor damping. Removing damping would have a significant detrimental effect on those authorities below the floor, with some local authorities experiencing very significant turbulence in their budgets. This could destabilise the system from the outset, putting some authorities into a very difficult funding position and jeopardising the sustainability of the scheme.

2.32 A small number of respondents to the consultation suggested that damping could be phased out either completely, or partly, during the current spending review. We have considered this suggestion and understand that some authorities, who believe that floor damping distorts the basis for distribution, believe this approach could have benefits. However, we are concerned that phasing damping out over time will introduce further complexity into the system which could blunt the incentive effect and as such we have decided not to pursue this approach.

Options for using 2012-13 formula grant

2.33 As set out above, the Government sought views on two options for basing baseline funding levels on 2012-13 formula grant.

2.34 Over two thirds of those who expressed a preference in the consultation document preferred option 1 (scaling back 2012-13 allocations) because they believed it would provide greater stability and earlier certainty about their baseline positions. Some respondents thought it would never be possible to secure a fair base position based on formulae and so it would be simpler just to use the 2012-13 position.

2.35 However, option 1 would not provide earlier certainty for the 137 upper tier authorities which provide more than one service tier since the Government would need to break down their 2012-13 formula grant into the amount allowed for each tier of service they provide. Due to the technical complexity and judgements involved, the proposed service tier splits could not be provided to authorities until summer 2012, which is the same timetable for consulting on any adjustments to the formulae. For a wide group of authorities, therefore, this approach would not provide earlier certainty. In addition, in view of the Government's decision to use numbers after damping, both options 1 and 2 would offer stability as the effect of technical updates would be smoothed.

2.36 Those respondents who preferred option 2 (applying the 2012-13 formula grant process) saw benefits to updating all or some of the data so that the baseline reflected the most recent situation possible. Some respondents had specific concerns around some aspects of the current formulae and were keen to see remedies to ensure fairness at the outset of the new scheme. In particular, respondents suggested:

- updating population data to take into account 2011 census data
- changes around concessionary travel
- changes to the shares of needs and resources
- changes to the allowance for the costs of providing services in rural areas

2.37 On balance, the Government believes that there is a strong argument for updating datasets and making limited technical changes to some formulae within the formula grant process. We propose, therefore, to establish each local authority's baseline position by applying the process used to determine their 2012-13 formula grant allocation to the local government spending control totals for 2013-14, while updating all datasets and making some limited, technical updates to the formula.

Updating Data

2.38 Under the current system we use the most up-to-date data available in setting formula grant. Around 100 datasets are used, including population data and data on the costs of service delivery.

2.39 Some respondents to the consultation said they would be keen to see all the data updated and stressed the importance of using the most up-to-date data available to ensure that baseline funding levels at the outset of the system are assessed as fairly as possible. Population data were specifically mentioned, with respondents arguing it should be updated to take into account the 2011 Census data.

2.40 We agree that population data should be updated to ensure a more fair allocation of funding. This is the biggest driver influencing the cost of providing services. This is in line with the view of the Office for National Statistics and the National Audit Office Landscape Review of Formula Funding[29] which was critical of the age of some of the data used in formula grant. Given the proposed Office for National Statistics' timetable for releasing population estimates and projections that take account of 2011 Census data, we will consult further as to whether to use estimates or projections in the baseline assessment.

[29] Landscape review: Formula funding of local public services (http://www.nao.org.uk/publications/1012/formula_funding.aspx)

2.41 We also believe that all other datasets should be updated so that the baseline assessment is as accurate as possible at this time from the outset of the scheme. We would like to reassure some authorities who were concerned that we were proposing to revisit data sources that we will not do this unless the existing data source has ceased to exist; generally we will just update existing data.

Reviewing the formula for grants

2.42 As part of the 2010 Spending Review, a number of special grants were rolled into formula grant with distributions based on their 2010-11 allocations. In the consultation we asked whether we should update all, some or none of these.

2.43 Only a small number of respondents believed we should update all grants with tailored distributions, with limited support specifically for changing the Supporting People formula.

2.44 Given the limited positive support from local authorities, we will make no technical changes to grants rolled in using tailored distributions. This will also help to limit distributional turbulence in the new system.

Reviewing relative needs formulae

2.45 *Technical Paper 1: Establishing the Baseline*[30] asked whether we should review any relative needs formulae. Respondents were mixed in their views. Responses suggested specific appetite for reviewing two aspects of the formulae:

- The cost of providing rural services – where some respondents said the current formula makes insufficient allowance for the cost of providing rural services
- Concessionary travel – where some respondents were concerned about the inadequacy of the current formula

2.46 We will take this opportunity to review the formulae for the cost of rural services and concessionary travel prior to further consultation, when Ministers will take a decision on whether to consult on any proposals.

Taking service demands and resources into account

2.47 In the current settlement we increased the proportion of formula grant distribution going to relative needs at the expense of the central allocation to support the most dependent authorities but made no change to relative resources.

[30] www.communities.gov.uk/documents/localgovernment/pdf/19695701.pdf

2.48 The consultation asked whether, or not, we should take this opportunity to look at the relative shares apportioned to the relative needs amount, the relative resources amount and the central allocation.

2.49 Responses were mixed on this point and we have decided to look again at this issue prior to further consultation, when we will take a decision on whether, or not, to consult on any proposals.

Funding new burdens, dealing with boundary changes and handling changes in local authority funding

2.50 *Technical Paper 1: Establishing the Baseline*[31] set out options for funding new burdens, dealing with any boundary changes, and handling any changes in local authority functions that may arise once baseline funding levels have been fixed.

New burdens and function changes

2.51 As part of the Government's commitment to keeping the pressure on council tax down as far as is possible, it has agreed a long-standing principle that the net additional cost to local government as a whole of any new burdens placed on local authorities by central government must be assessed and fully funded.

2.52 *Technical Paper 1: Establishing the Baseline*[32] proposed that burdens that arose between resets would be funded through section 31 grant or Revenue Support Grant, and that, at reset, this funding would become part of the baseline resources available for rebalancing the system.

2.53 The technical paper also set out proposals for dealing with changes to local authorities' functions and responsibilities that occur after baselines have been established. Funding for any new functions would be provided in the same way as that for any new burdens (through section 31 or Revenue Support Grant prior to being incorporated into the baseline at the next reset).

2.54 A majority of respondents supported these proposals and we have decided to proceed as proposed in the consultation document.

Boundary changes and mergers

2.55 Under the current system, boundary changes and mergers within a multi-year settlement are handled in such a way as to ensure formula grant for all other authorities is not changed.

2.56 We proposed that boundary changes and mergers occurring between resets in the new rates retention scheme should, similarly, not affect

[31] www.communities.gov.uk/documents/localgovernment/pdf/19695701.pdf
[32] www.communities.gov.uk/documents/localgovernment/pdf/19695701.pdf

the position of other authorities. In this vein, we proposed not to alter tariffs and top ups if only a small number of properties with a new rateable value were affected by the change. We proposed that only the tariffs and top ups of the authorities concerned directly in the boundary change should be altered if the net rateable value was larger.

2.57 In relation to mergers we proposed that, where mergers of two or more authorities occurred, we would add together the tariffs and top ups of the authorities concerned to construct the tariff or top up of the new authority. In the case of a new combined fire and rescue authority, created by the merger of one or more county fire and rescue authorities, we would consult the authorities involved in how to split off the fire and rescue function, whilst the combined tariff and top up position would remain the same.

2.58 Almost all respondents to the consultation agreed with our proposals for boundary changes and mergers and, as such, we will implement the proposals as set out in the consultation document.

The future of Revenue Support Grant

2.59 In the current local government finance system, the amount of business rates collected has previously not been sufficient to fully fund the services that local government provides, allowing for funding raised through council tax and specific grant. To make up the difference, the government has used Revenue Support Grant which it is legally obliged to pay each year.

2.60 In *Technical Paper 1: Establishing the Baseline*[33], we proposed making Revenue Support Grant discretionary rather than mandatory which would mean it would become similar to section 31 grants.

2.61 Two thirds of respondents agreed with this proposal. Some authorities were concerned that by making Revenue Support Grant discretionary, it could mean that government would not honour its commitment on new burdens until the next reset. We have already set out our commitment to the new burdens principle and the importance of reducing pressure on council tax. As such, we have decided to make Revenue Support Grant discretionary.

[33] www.communities.gov.uk/documents/localgovernment/pdf/19695701.pdf

Chapter 3

The central proposition: key elements of the rates retention scheme

Introduction

3.1 As we set out in the consultation document[34], we want a rates retention scheme which is able to:

- deliver a strong growth incentive where all authorities can benefit from increases in their business rates growth and from hosting renewable energy projects
- include a check on disproportionate benefits
- ensure sufficient stability in the system
- include an ability to reset in the future to ensure levels of need are met.

3.2 This chapter sets out the central proposition, a set of core elements of the rates retention scheme, which together will deliver a strong growth incentive for all authorities.

Setting tariffs and top ups

3.3 The business rates retention scheme will provide a stable starting point for all authorities, which ensures that no local authority is worse off as a result of its business rates base at the outset of the scheme. It will achieve this through a system of tariffs and top ups as set out in chapter two.

3.4 Tariffs and top ups will be fixed and will not be reviewed until any reset. This will give a strong financial incentive, if authorities want to see an increase in their resources, for local authorities to grow their business rates base and support their local businesses.

[34] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

3.5 The consultation document[35] sought views on two options for fixing the tariff and top up amounts:

- option one would see tariff and top up amounts uprated by the Retail Prices Index (RPI) each year to reflect the annual RPI increase in the nationally set business rates multiplier
- option two would see the tariff and top ups fixed in cash amounts and not uprated by RPI

3.6 The options for fixing the tariff and top ups amounts have distinct effects on the overall balance achieved between maximising the growth incentive and ensuring adequate protection. Respondents to the consultation paper had strong views on the correct course. There was a large majority in favour of option one, uprating tariffs and top ups by RPI. But it should be noted that responses appeared to be affected by the position authorities perceived themselves to be in under the new system.

3.7 Since the nationally set business rates multiplier is uprated by RPI, there is a risk that if tariffs and top ups were not similarly index-linked, tariff authorities could see their incomes rise over time without achieving any growth in their business rates base. Conversely, authorities with low tax bases relative to their spending need that are highly dependent on top up grant could see their incomes erode in real terms over time despite achieving growth in their business rates base.

3.8 Therefore, we intend to uprate tariff and top up amounts by RPI. This will ensure that top up authorities are relatively protected from risk within the scheme. Conversely this will mean that tariff authorities will face a strengthened incentive to increase their business rates by more than the increase in the nationally set business rates multiplier to ensure that they do not face a real terms reduction in income.

The incentive effect

3.9 From the outset of the business rates retention scheme, all local authorities will be able to benefit from increases in their business rates. The principle of fixing tariffs and top ups ensures that in future years, a significant proportion of additional business rates will be retained by the local authorities in which they were generated. There is also a corresponding disincentive for authorities to see their rates base fall.

3.10 To maximise this incentive effect, we will not cap the amount of business rate growth an authority can benefit from under the rates retention scheme so that the more an authority grows its business rates base, the better off it will become.

[35] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

3.11 This hands power to local authorities, enabling them to take responsibility for increasing the financial resources available to them. It provides a strong driver for local authorities to engage more effectively with their businesses, to ensure the provision of services more properly reflects the needs of both communities and the businesses that service them and to look for ways to maximise their business rates base and grow their local economies.

3.12 It will also directly link the resources used by local authorities to their actions and their local economies rather than local authorities being assigned a level of funding by central government. This change signifies a paradigm shift for both local authorities and central government. It furthers our commitment to realigning accountability for funding and the use of resources, from local government reporting to central government, to local government reporting to themselves and their communities.

A levy recouping a share of disproportionate benefit

3.13 Due to the gearing effect i.e. the differences in the relationship between an individual authority's business rates base and its baseline funding level, some authorities with existing large tax bases in relation to their funding levels will experience increases in their income that is out of proportion to the growth in their business rates base. The imaginary example below illustrates this issue.

Disproportionate Benefit

In 2014 Prospero Borough Council has a business rates base of £100m. Its total budget requirement is £50m. During 2014-15, Prospero Borough Council increases its business rate base by £5m, taking it to £105m. This represents a 5 percent increase in the Council's business rate base. Prospero Borough Council finds that this in effect means they have a 10 percent increase in their revenue for 2015-16.

Across the river, Needsmust Borough Council has a business rates base of only £10m. They have the same budget requirement though, of £50m. Needsmust Borough Council has also worked hard to increase their business rates base, and have managed to increase their business rate base, by £500,000. Like Prospero, this represents a 5 percent increase in the Council's business rate base. Needsmust Borough Council finds that, although they have built their base by the same percentage as Prospero, they have increased their revenue by only 1 percent while Prospero have increased theirs by 10 percent.

3.14 The consultation document[36] proposed that the Government would collect a levy recouping a share of disproportionate benefit. This would

[36] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

not act as a cap on growth but instead would moderate the ‘gearing effect’ caused by the uneven distribution of business rates bases and the different spending needs of local authorities. The proceeds of the levy would fund a safety net to support local authorities that experience significant negative volatility in their business rates.

3.15 The consultation document[37] put forward three options for the way in which the levy could be calculated:

- fixed rate: a levy based on pence in the pound with the same rate for all authorities
- banded: a levy based on pence in the pound but with a banding approach that would see authorities assigned into different bands with different levy rates
- proportionate: creating an individual levy rate for each local authority which allowed the retention of growth in an equivalent proportion to its baseline revenue

3.16 Respondents to the consultation were, in principle, supportive of the levy. A very strong majority of respondents wanted to see a proportionate levy which allowed retention of growth in an equivalent proportion to its baseline revenue.

3.17 Following consideration of responses to our consultation, we have decided that a fixed rate levy does not deal with the gearing effect described and therefore does not deal fully with the issue of disproportionate benefit. The banded levy, where authorities would be assigned into different bands with different levy rates, would lead to cliff edges which would see authorities who fall below the band boundary better off than very similar authorities who fall above the band boundary. This seems inequitable and could possibly introduce perverse incentives into the system whereby authorities try to keep their growth below the cliff edge to avoid paying the higher levy.

3.18 We believe that the proportionate levy will best serve the incentive effect these proposals aim to create whilst ensuring the fairest approach to receiving benefits in terms of revenue from the effort put in by authorities to increase their business rates base. The proportionate levy will create an individual levy rate for each local authority which allows the retention of growth in a fixed proportion to its baseline level.

3.19 We will discuss with local authorities next year what levy ratio to set – i.e. what percentage increase in retained income an authority should see for a 1 percent increase in its business rates. In setting the levy percentage, we will need to ensure that the ratio is sufficient to deliver the incentive effect that we want to achieve, but raises sufficient income from which to fund the safety net, which is important for

[37] as above

protecting those authorities that might experience sudden, and significant, shocks to their business rates income.

The safety net

3.20 The consultation proposed to use levy income to fund a safety net to protect authorities that see sudden shocks in their business rates or that are not able to respond as strongly to the incentive. It is crucial that local authorities become more self-sufficient and are incentivised to grow their economies. But where an authority experiences significant negative volatility to the point where its income falls below that which is required to fund core services relied on by the community, the emphasis must be to protect service provision.

3.21 The consultation document[38] set out two approaches to the safety net:

- option one would see the safety net come into play if an authority experienced a drop of more than a certain percentage in its business rates compared to the previous year
- option two would trigger the safety net if an authority's rates dropped by more than a certain percentage below its baseline rates

3.22 The principle of a safety net received a high level of support from respondents to the consultation paper. Respondents did not see the two approaches to the safety net as mutually exclusive and in fact some thought that both types of approach should be pursued.

3.23 There needs to be a careful balance between ensuring the incentive effect is not eroded and ensuring that the support is there to protect service provision. We believe that this balance is best met by providing a safety net which gives support when a local authority sees its income drop by more than a set percentage level below its baseline funding level, rather than providing short term protection against drops in business rates income year-on-year. We will consult next year about the specific level at which this percentage should be set.

3.24 We will uprate baseline funding levels by RPI when assessing whether a local authority is eligible for safety net support, to ensure that the degree of protection from risk remains the same in real terms.

3.25 We expect that the levy and safety net should be self-financing. This might include using benefits accrued in growth years to insure against payments that could be required in lower growth years. This will make the business rates retention scheme, and therefore local authorities, more resilient to wider economic conditions.

[38] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

3.26 In the early years of the scheme we will ensure that there are sufficient funds available to provide support for all authorities who meet the safety net criteria, regardless of the level of levy income. Levy payments and the safety net will be set at a level which seeks to ensure that the risk of a shortfall is low. In later years, in the unlikely event that insufficient funds are available for any reason, the Government will reserve the right to scale safety net payments to affordable levels, although we are clear this would only be used as a last resort.

3.27 In the July consultation document[39], we set out a number of possible additional uses for monies from the levy pot that are not paid out through the safety net. These included the option to:

- provide ongoing support to authorities that have experienced significant losses that take more than one year to recover from
- top up the growth achieved in every authority which had not contributed to the levy
- support revenue expenditure in areas of lower growth or target expenditure on projects to unlock growth and prosperity
- redistribute the remaining levy pot to all local authorities in proportion to each authority's baseline
- hold some levy money back in higher growth years to ensure sufficient funding for the safety net in lower growth years

3.28 Respondents to the consultation were keen to ensure that monies in the levy pot were kept within the sector. While some saw the benefit in using any excess levy monies to support projects to unlock growth and prosperity, they were concerned that these projects and therefore the money would be controlled by central government.

3.29 A number of respondents saw benefit in either providing ongoing support to authorities which experienced significant loss or holding money back in higher growth years to ensure sufficient funding for the safety net in lower growth years.

3.30 We consider that the design priority for the levy should be to ensure a sufficient safety net in lower growth years. Effectively this acts as a sector-level insurance policy, in the absence of which we could expect councils to store up more in reserves instead of investing business rates income in services and initiatives to promote local economic growth. In the event that sufficient money builds up in the levy to guarantee the safety net in future years, any additional levy income would be redistributed back to local government. The Government would consult on the basis of distribution.

[39] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

3.31 We plan to discuss further the detail of our approach to the levy and safety net with the sector through the Working Group.

Resetting the system

3.32 Tariff and top ups will remain fixed to achieve a strong incentive effect. However, there may come a time when a new assessment of relative spending needs and resources is required. For example, large population movements may mean that the level of resources diverges significantly from core service pressures within an individual authority area.

3.33 The consultation document[40] considered whether resets should be set for fixed periods, or whether the Government should take a judgment on when one was necessary and whether resets should only be full resets of the whole system, or partial resets against the baseline position only. These all have different advantages and disadvantages and can have different impacts on the incentive effect, the likelihood of encouraging new large scale development projects and the ability of local authorities to be able to budget successfully.

3.34 We are keen to maximise the incentive effect that these proposals could have, and recognise that the longer the period between resets, the greater the incentive effect is likely to be as the benefit of growth is retained longer. It is also likely that longer periods between resets will give authorities more confidence to undertake larger scale new development projects, which require long term investment and which ensures the certainty of the return from business rates. If there are shorter reset periods, authorities may not see the benefit of such projects before the reset occurs.

3.35 However, long periods between resets will be of concern to authorities with changing needs who may worry that a long period between resets will leave them with a baseline funding position which does not accurately reflect their funding needs.

3.36 A large majority of respondents to the consultation document were keen on a fixed reset which they believed would provide the most certainty and would ensure that a reset would not be subject to policy change within central government. However, respondents also recognised that a reset may be required outside of a fixed period in specific circumstances so some degree of flexibility may be helpful.

3.37 We recognise that certainty in the new scheme is an important consideration for authorities. The central proposition of the rate retention scheme will ensure a sustainable system where the strong incentive effect bites on those who have the most levers for growth with a levy and safety net which support those authorities who need

[40] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

protection. For this central proposition to work effectively and for there to be a genuine incentive effect, the reset period has to be long one. As such, to provide certainty for local authorities about the rewards of growth they can expect to see, our aspiration is that the reset period should be 10 years. However, in exceptional circumstances, a reset could be required within this period.

Major precepting authorities

3.38 Within the current local government finance system, formula grant distributes resources not only to the billing authorities that collect business rates but also to major precepting authorities, such as fire and rescue authorities and police authorities and county councils in two-tier areas.

Tier-Split

3.39 In the new rates retention scheme, the pattern of risk and reward experienced by individual authorities depends critically on their "gearing", i.e. the extent to which their local business rates is higher, or lower, than their baseline funding level.

3.40 All other things being equal, highly geared tariff authorities will gain more from any increase in their business rates than lower geared top up authorities, with the most highly geared tariff authorities gaining most of all. Equally, highly geared tariff authorities will lose more from any reduction in business rates than lowly geared top up authorities.

3.41 So whilst we want to ensure all authorities have a strong incentive to grow their business rates under the rates retention scheme, arguably the incentive effect will be felt most keenly by highly geared tariff authorities. They will gain the most from growth but they will also lose the most from any decline in their tax base.

3.42 The gearing of single tier authorities cannot be manipulated. It is simply the relationship of an authority's local business rates and its baseline funding level. However, in two-tier areas, the gearing of authorities is dependent upon the choice that we make about how to share business rates between the tiers. This will determine which authorities are tariff authorities with the strongest incentive for growth, and which authorities have greater income stability with a major part of their income provided through an index-linked top up grant.

3.43 The consultation document[41] proposed that county councils would receive a share of business rates collected by district councils in their area. *Technical Paper 3:Non-Billing Authorities*[42] sought views on two ways in which the county and district share could be determined:

- fixed share: All two-tier county and district councils across the country would be allocated a standard proportion of business rates based on average national spending
- individually tailored share: county and district shares would vary from one area to another. We would work out each district councils' rates yield as a proportion of the county total. The district council would keep this proportion of its billing authority business rates baseline (pre-tier split) with the remainder allocated to the county

3.44 Responses to this question were split between option one and two. Some respondents to the consultation raised concerns about any tier-split which would see county councils receive a majority of business rates, such as a split based on current revenue share. They believed that this could dull the incentive effect on district councils who they argued hold the most levers to promote growth, since they are planning authorities.

3.45 A small majority of respondents preferred option two which they believed would offer an approach tailored to the individual needs and circumstances of each area. However, many respondents preferred option one, which they viewed as the more straightforward approach, reducing complexity in the new scheme.

3.46 Some respondents also suggested a third option where business rates were allocated along the same lines as the distribution of formula grant.

3.47 We are keen to ensure that the scheme is as simple as possible.

3.48 We therefore intend to set a fixed share that will apply to all two-tier areas across the county. In setting this share, we are mindful that, in two-tier areas, district councils are generally responsible for planning decisions and so arguably have the greatest levers to promote growth. However, county councils also have a role in the economic development of their area and so we need to provide for a reasonable percentage of growth to go to them.

3.49 We must also ensure that we avoid perverse incentives whereby district councils prioritise housing growth over business growth because they could gain more from the incentive offered for housing growth in the New Homes Bonus (an 80:20 split in favour of district councils). Although there is not complete parity in the level of reward offered by the New Homes Bonus and business rates retention, we

[41] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[42] www.communities.gov.uk/documents/localgovernment/pdf/196957710.pdf

must put in place a share of rates which does not encourage perverse incentives.

3.50 With these considerations in mind, we believe that district councils in two-tier areas should receive the highest percentage of local business rates and therefore of any increase in business rates growth. We believe that a split where around 80 percent of growth is retained by the district council, after any adjustments, offers a good balance.

3.51 Our intention is that the level of tier split pursued would result in all district councils becoming tariff authorities, with the majority of these being highly geared with a strong incentive to grow their economies. County councils, which have fewer direct levers to promote growth, would be lower geared top up authorities. As a result they will experience greater income stability with a major part of their income being an index-linked top-up grant, protecting their ability to provide upper-tier services such as adult and childrens social care and transport, but will see less gain from business rates growth in their district councils.

Local policing bodies[43]

3.52 Police responsibilities are, in the main, delivered by single purpose authorities which cover each metropolitan area and shire county, with some combined authorities covering a combination of these areas. The exceptions are the Metropolitan Police Authority which is a functional body of the Greater London Authority and the City of London police.

3.53 All police authorities in England and Wales currently receive unringfenced Police Core Settlement funding (as set out in the annual Police Grant Report) from the Home Office. All police authorities in England also receive formula grant through the local government finance system. The Home Office Police Core Settlement funding is funded by the Home Office and not from Revenue Support Grant and National Non-Domestic Rates. As a result, it is beyond the scope of the rates retention model. However, consideration needs to be given as to whether the portion of funding for police authorities that currently comes from Revenue Support Grant and National Non-Domestic Rates should be funded from within the business rates retention scheme or from outside of it.

3.54 We proposed in the consultation document and *Technical Paper 3: Non Billing Authorities*[44] that police authorities should be funded from

[43] Section 1 of the Police Reform and Social Responsibility Act 2011 (c. 13) replaces police authorities in England and Wales, other than in London, with police and crime commissioners. Section 3 of the same Act replaces the Metropolitan Police Authority with the Mayor's Office for Policing and Crime. It is intended that section 1 will come into force in November 2012 and section 3 in January 2012, during the period covered by this Report. Police and crime commissioners, the Mayor's Office for Policing and Crime and the Common Council of the City of London (which retains its role as police authority for the City of London) are referred to collectively in the Act as "local policing bodies".

[44] www.communities.gov.uk/documents/localgovernment/pdf/196957710.pdf

outside of the business rates retention scheme. This would be achieved by allocating a portion of the forecast national business rates to the police sector in 2013-14 and 2014-15. This recognised that police authorities have limited levers to influence growth.

3.55 In the main, respondents to the consultation were content for police authorities to be funded from outside of the business rates retention scheme; this was particularly supported by police authorities themselves.

3.56 The full implications of the Autumn Statement[45] on the overall level of police funding over the remainder of the Spending Review period are still being worked out. In doing so, the Government will consider pay policy across its workforces. The Home Secretary will take into account general pay policy in considering proposals from the Police Negotiating Board when taking final decisions on police officer pay.

3.57 The Government confirms that it will provide a fixed allocation of business rates for the remaining years of the 2010 Spending Review to support Home Office grant funding of police bodies. The allocation will be consistent with the 2010 Spending Review settlement, subject to any revisions following the Autumn Statement 2011.

3.58 The way in which the police are funded will be fully reviewed in time for changes to be made following the end of the current Spending Review period (2015).

Fire and rescue authorities

3.59 Fire and rescue authorities can be either the responsibility of the county council, or can be delivered by single purpose fire and rescue authorities. Both receive formula grant through the current local government finance system. This diversity of delivery makes the question of how fire and rescue authorities should be funded in the new rates retention scheme less straight forward.

3.60 As we have already set out above, given the clear levers two-tier county councils have to promote growth, they will be funded within the rates retention scheme. The consultation document[46] and *Technical Paper 3: Non-Billing Authorities*[47] proposed that county fire and rescue authorities should be funded from within the business rates retention scheme and as such able to benefit from growth. This was supported by a majority of county authorities that deliver fire and rescue services.

[45] http://cdn.hm-treasury.gov.uk/autumn_statement.pdf
[46] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[47] www.communities.gov.uk/documents/localgovernment/pdf/196957710.pdf

3.61 We set out two options for single purpose fire and rescue authorities:

- the first option would see them removed from the rates retention scheme and funded through fixed funding allocations for 2013-14 and 2014-15 similar to police authorities
- the second option was to treat all fire and rescue authorities in the same way and to fund single purpose fire and rescue authorities though a percentage share of each district council's billing authority business rates baseline

3.62 Single purpose fire and rescue authorities generally were in favour of being funded through fixed funding allocations for 2013-14 and 2014-15. They were concerned about being subject to the potential risk of a reduction in business rates income. A number of other respondents, particularly county councils with fire and rescue responsibilities, were concerned about the implications of treating single purpose fire and rescue authorities and county fire and rescue authorities differently. They were also keen to emphasise the role that fire and rescue authorities can play in providing the right environment for businesses and were worried that some fire and rescue authorities would have less incentive to create efficiencies if they were not part of the business rates retention scheme.

3.63 While we understand the concerns of single purpose fire and rescue authorities we believe that all fire and rescue authorities should be funded through the same route. As such, in the new rates retention scheme all fire and rescue authorities will be funded though a percentage share of each district or borough council's billing authority business rates baselines (pre-tier split), subject to the tariffs and top ups required to bring them to their baseline funding level. The potential risk of a reduction in business rates income in the area covered by a fire and rescue authority will be mitigated by the fact that such authorities are receiving a percentage of the business rates income of all unitary and district councils in their area which should mitigate the risks of financial loss.

3.64 We recognise that single purpose fire and rescue authorities do have fewer direct levers for growth. As such, we will ensure that the percentage share of billing authority business rates that single purpose fire and rescue authorities receive reflects this and provides them with a degree of protection within the scheme.

London

3.65 As set out in chapter two, the Government intends to roll in the revenue elements of the Greater London Authority general grant and fire funding from the outset of the business rates retention scheme in 2013. Therefore, the Greater London Authority will receive a percentage share of business rates in the future scheme. We will discuss this further with the Greater London Authority and London borough councils before determining what this share should be.

Tax Increment Financing

3.70 Tax Increment Financing can be used to capture the value of uplifts in local taxes that occur as a result of infrastructure investment; in effect it borrows against the value of the future uplift to deliver the necessary infrastructure.

3.71 Local authorities have not been able to undertake Tax Increment Financing schemes in the past, because they have not been able to retain any of their business rates and therefore could not leverage monies against any predicted increases in these rates.

3.72 The consultation document[48] set out two broad options for Tax Increment Financing under the rates retention scheme:

- option one would see local authorities, within the existing prudential borrowing rules, able to borrow against their income within the business rate retention scheme
- option two would allow a limited number of Tax Increment Financing schemes to be permitted in which the business rates growth would not be subject to the levy or reset for a defined period of time

3.73 Some respondents to the consultation preferred option one, as they saw that the unfettered access of option one would be more in line with the localism agenda. There were also concerns that exempting option two Tax Increment Financing schemes from the levy and reset would reduce the resources available to the wider sector.

3.74 However, some respondents argued that option one Tax Increment Financing would not deliver a business rates funded Tax Increment Financing for large scale developments, only for small scale projects that can be completed, and borrowing repaid, within a reset period. This is because the levy and the reset would cause a level of uncertainty that could not be tolerated for longer term projects with repayments of 20 years of more.

3.75 We believe it is important that authorities have a number of avenues open to them to build their local economies and unlock growth potential. Therefore the Local Government Finance Bill will enable the delivery of both Tax Increment Financing options as well as the policy guarantee that Enterprise Zones can retain the rates uplift from within the zone for 25 years.

[48] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

3.76 However, because option two Tax Increment Finance schemes could reduce the resources available to the wider sector, the Government will limit the number of Option two Tax Increment Finance schemes that can proceed. We will publish further details of how we manage this process in the new year, alongside a technical document which sets out more details.

Enterprise Zones

3.77 The Government's Enterprise Zone policy already guarantees that any uplift in rates revenues from 2013-14 will be kept by the Local Enterprise Partnership for 25 years, and will be disregarded from the calculation of the levy and in any resetting of the rates retention system. This provides the certainty of revenue required for long term borrowing, akin to option two Tax Increment Finance schemes, without the need for any further approvals or consent from Government.

Chapter 4

Other elements of the rate retention scheme

Introduction

4.1 The previous chapter set out the central proposition of the new rates retention scheme. Outside of this central proposition there are a number of areas which will affect how the core scheme will function, including:

- revaluation
- transitional Grant
- pooling
- New Homes Bonus
- renewable energy

4.2 This chapter sets out how these will interact with the core business rates scheme.

Adjusting for revaluation

4.3 Revaluation, which occurs every five years to reflect changes in the property market across the country, requires the Valuation Office Agency to reassess all business properties and give them new rateable values (based on rental values) which are used when calculating what business rates are payable.

4.4 *Technical Paper 7: Revaluation and Transition*[49] set out the Government's proposals in relation to revaluation.

4.5 When a revaluation occurs, the overall increase in aggregate yield is capped by Retail Price Index as in all other years, and the multiplier is reset to achieve that effect. As different properties' rateable values will change by different proportions at a revaluation, the tax charge is redistributed across England. This means the business rates yield in each authority could go up or down significantly, depending on whether rateable value growth in their area has been greater or less than the national average.

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[49] www.communities.gov.uk/documents/localgovernment/pdf/19695981.pdf

4.6 This could lead to local authorities experiencing turbulence in their budgets as a result of revaluation changes which are, for the most part, out of their control. Allowing the impact of revaluations to feed through into the business rates retention scheme could result in significant changes to the income that authorities retain from business rates through no fault of their own. This could dull the incentive effect at every revaluation.

4.7 We are clear that we do not plan to make changes to the way revaluation works but we must ensure the incentive effect is not distorted by revaluations. We proposed adjusting each authority's tariff, or top up, following a revaluation, to ensure, as far as possible, that their income from business rates retention, will be unaffected by the revaluation.

4.8 Respondents to the consultation document had a number of concerns about the revaluation process itself, particularly the impact of appeals made by businesses. However, most respondents were in support of our proposal to adjust tariffs and top ups at revaluation.

4.9 In line with the consultation responses, in the new rates retention scheme, we will adjust tariffs and top ups at the five yearly revaluation to ensure, as far as is possible, that no local authority is worse off as a result of our commitment to ensure that the amount of business rates paid by businesses nationally does not increase as a result of revaluation. This will have the effect of ensuring that the sum of each authority's retained rates and tariff or top up adjustment (the income from business rates retention) will be unaffected by the revaluation.

4.10 We do not intend to make any further changes to reflect subsequent appeals against the rating list including appeals against the rateable values set at revaluation. Appeals made to the rating list, which subsequently change the local revaluation impact, will be treated as part of the normal volatility on the rating list and authorities will be expected to manage their budgets to deal with such volatility. Where there is significant volatility and an authority sees its income drop by more than a certain percentage level below its baseline funding level, then the safety net will apply. Nevertheless, we recognise that in some instances alterations to the rating list and backdated appeals may have a significant impact on rates income and we will continue discussions with the local government sector on this matter.

Transitional relief

4.11 We have been very clear that we do not wish to make any changes to the way in which business rates are set or to the system of reliefs available for small businesses, charities and so on. We are also clear that businesses should not be adversely affected by these changes and with this in mind we do not wish to change the practice of putting a transitional relief scheme in place to phase in significant changes to bills at revaluation, or make changes to the current scheme.

4.12 Transitional relief can be extremely important for ratepayers who, as history has shown, can face immediate and significant increases in their business rates as a result of the revaluation. This can be very damaging, particularly for smaller business, and can have a knock-on effect on the local economy. Since 1990, successive Governments have provided assistance at revaluation to ratepayers through transitional relief and it is now a statutory requirement.

4.13 We believe strongly in the benefits of transitional relief. However, at the local authority level, transitional relief could have significant implications for a business rates retention scheme, as rates income collected by authorities will vary depending upon whether the ratepayers in their area are overall net contributors or net beneficiaries of the transitional relief scheme. Some authorities will collect more because of the transitional relief scheme whereas some will collect less.

4.14 The impact is most greatly felt in the first few years of the transitional relief scheme so by the first year of the rates retention scheme in 2013-14, we would expect there to be little variation in local authorities rates income as a result of transitional relief. However, we cannot predict what will happen in future revaluations, although we can extrapolate that these would have similar consequences for some authorities as previous revaluations have.

4.15 We could ignore this issue, allowing individual authorities' rates income to be affected by the cost or surplus of transition relief locally; this would mean that a local authority's pre-levy income could be significantly affected by the transitional relief scheme. This could undermine the whole rates retention scheme and would obscure the incentive effect as authorities could find that their individual authority business rates would rise and fall purely as a result of changes to transitional relief.

4.16 The consultation document[50] proposed that transitional relief should be taken outside of the main rates retention scheme which would necessitate a system of separate transitional adjustments for its impact on the rates revenue collected by billing authorities. We proposed to do this by comparing the rates income of a billing authority excluding transitional relief, with the rates income of a billing authority inclusive of transitional relief.

4.17 Where a billing authorities' income inclusive of transitional relief was less than their rates income exclusive of transitional relief, the authority would receive an additional payment from central government. Where

[50] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

the income inclusive of transitional relief was more than their income exclusive of transitional relief they would need to pay the balance to central government. All payments would need to be apportioned between billing and major precepting authorities on the basis of the tier-split share.

4.18 Most respondents to the consultation agreed with the proposals to take the transitional relief scheme outside of the business rates retention scheme although some had concerns that this adds complexity to the rates retention proposals. They were also content with the proposed system for adjustments and the proposals.

4.19 Although this adds an element of complexity to the system, by requiring a separate system of transitional adjustments to ensure tariffs and top-ups are not affected by transitional relief, it ensures a more balanced approach for local authorities, smoothing out the repercussions of transitional relief across the whole period.

4.20 The transitional relief scheme is intended to be self financing but it can run at a deficit and this is especially likely in the years immediately following a revaluation. This is due in part to the complexity of modelling a transitional relief scheme but also due to an inherent cash flow deficit in the early part of the scheme which unwinds in later years once rating appeals are settled.

4.21 *Technical Paper 7: Revaluation and Transition*[51] proposed that the cost of any deficit might be met from the levy pot. A number of respondents had concerns with this approach especially that local authority revenue should not suffer because of deficits on transitional relief and many argued that central government should carry the cost. Having considered these responses we have decided that central government will carry the risk of a deficit in the transitional relief scheme.

Pooling

4.22 Over the last few years, local authorities have been increasingly working together in a number of ways, including to deliver efficiency savings by sharing back office functions, to collaborate on issues which affect a wider area and as part of Local Enterprise Partnerships. We want to encourage more joint-working by local authorities, which we believe can provide a variety of benefits such as delivering efficiency savings and ensuring more streamlined services. As such, we are keen to ensure that the business rates retention scheme offers opportunities for local authorities to come together to collaborate on how to build growth within a wider area, taking advantage of economic efficiencies and taking a coherent approach to growth within natural economic geographies.

[51] www.communities.gov.uk/documents/localgovernment/pdf/19695981.pdf

4.23 In the consultation document[52], we set out that there would be a single tariff and top up for any pool which would be the sum of all tariffs and top ups of the individual authorities. There would also be a single levy for any pool calculated on the aggregate income and growth across authorities in the pool. Pools would decide for themselves how to distribute aggregate revenues. The Government made clear in *Technical Paper 5*[53] that it did not want pooled authorities to be worse off collectively than had they been treated as individual authorities.

4.24 The consultation paper[54] then set out a number of considerations for allowing local authorities to come together to form a pool. It proposed that pools would need to follow three criteria, that:

- they were voluntary – pooling would not be imposed on areas
- they were subject to assurances around governance and their workability before being recognised by central government as a pool
- that if the pool dissolved, the members of the pool would return to their individual tariff, top up and levy amounts

4.25 The consultation document asked:

- whether these were the right criteria for pooling and what assurances should be required around workability and governance
- whether there should be further incentives for groups of authorities to form pools
- how pooling in two-tier areas should work

4.26 Most respondents to the consultation were keen on having the option of forming a pool with like minded authorities but were clear that pooling should be voluntary. A majority of respondents were also content with the criteria that we put forward in relation to agreeing pools, although some stressed the importance of the Government not prescribing how local authorities should work together. A large majority of respondents were keen that no further incentives were offered to pooling authorities particularly incentives that could take money out of the levy pot and therefore affect non-pooling authorities. Finally, a number of responses recognised the benefits of being able to pool outside a county area, reflecting economic geography, but there was concern about the potential impact on upper-tier authorities, which provide a range of important services.

[52] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[53] www.communities.gov.uk/documents/localgovernment/pdf/19695901.pdf
[54] as above

The criteria for pooling and workability and governance

4.27 Pooling offers opportunities for local authorities to share both the risks and rewards of the rates retention scheme across a wider area and to co-operate to maximise the potential for growth. As such, we have decided that pooling should be allowed and should be undertaken on a voluntary basis.

4.28 We believe that local authorities are in the best position to know when and how it would benefit them to form a pool. They should be able to determine how best to manage their local pooling arrangements. As such, although we plan to set out some basic requirements, we will look mainly to the sector to produce guidance for local authorities about what local pooling arrangements should cover.

4.29 We will consider and approve pooling applications from local authorities to ensure that applications meet the following basic requirements:

- all local authorities to be included in the prospective pool agree with the proposal
- there is a formal pooling agreement setting out how the pool will operate
- pooling proposals have been signed off by the Chief Executive and the s151 officer of each local authority
- pooling proposals meet any legislative requirements that may be in place

4.30 Transparency will be important in pooling and, as such, the Government expects local authorities that pool to publish details of their pooling arrangements and how they will work.

Incentives to pool

4.31 As many respondents to the consultation recognised, pooling offers inherent benefits and should be based on a desire to co-operate and work closely together with other authorities. On the issue of offering further incentives, respondents were concerned that offering an incentive to pool, by offering pooling authorities a more financially advantageous levy rate, would take money out of the system for all other non-pooling authorities. They were concerned that this could force authorities into pools that they were not genuinely attracted to and could potentially act as a disincentive for those authorities which choose not to pool. With this in mind, the Government does not propose to introduce further incentives at the outset of the scheme. However, we reserve the right to return to this issue at a later date if it would be beneficial

Pooling in two-tier areas

4.32 In the consultation document[55] we asked how pooling in two tier areas should be managed, i.e. whether districts should be permitted to form pools outside of their county area. This has both advantages and disadvantages. Pooling across boundaries would allow pools to be aligned with Local Enterprise Partnerships and city regions, but some respondents had concerns it could also make pooling complex and difficult to operate. While restricting pooling to county boundaries would ensure that accountability was clear, it does not reflect that county boundaries are not necessarily the same as functional economic areas, nor would it take account of existing cross boundary partnerships and relationships.

4.33 A number of district councils were keen to have the option to pool outside of their county area and some did not see the need to obtain the county council's permission if they want to pursue this. Pooling outside the county area was also supported by some responses from businesses or business representatives, who saw logic in allowing pools that are more in line with functional economic areas. Some county councils were concerned that pooling outside of county areas could significantly reduce their resources and put services at risk.

4.34 We believe that pooling arrangements can be made to work outside of county boundaries. The central proposition outlined in Chapter 3 will provide good protection for county council spending. The proposed tier-split and uprating tariff and top ups by RPI will reduce the risk on counties. With this in mind, we believe it is right to allow pools to cross county boundaries where this is what district councils want. District councils will still need to pass a proportion of business rates to their county, but contributions to pools would be for districts to agree locally with other pool members.

4.35 Government will invite applications next year, ahead of publication of the draft Local Government Finance Report, from those local authorities that wish to pool. The Government encourages those authorities interested in pooling to start discussions with other authorities that might wish to pool with them about the opportunities that pooling presents, so they are in a position to submit an application in due course.

New Homes Bonus

4.36 The New Homes Bonus is designed to incentivise local authorities to deliver housing growth in their area. Responses to our consultation noted that we must strike a delicate balance between the incentive

[55] www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

offered by the New Homes Bones and the incentive offered to local authorities through business rates retention. We do not want to put in place the perverse situation where either the New Homes Bonus or business rates retention offers an incentive which overrides the incentive offered by the other.

4.37 We intend the Bonus to be cost neutral whilst ensuring a powerful and transparent incentive for housing growth within the current local government finance system. Housing and business growth go alongside each other. Sustainable business growth needs a mobile workforce and sustainable housing growth needs jobs. Local authorities can play an essential role in creating the places people want to live and work.

4.38 We have set aside almost £1bn over the Spending Review period including nearly £200m which fully funds the Bonus in 2011-12 (year 1). In the following three years there is £250m, with the rest of funding due to come from formula grant.

4.39 In setting the local and central percentage shares of business rates for 2013/14, therefore, we will ensure that provision is made to fully fund the New Homes Bonus.

Running a good business rates system

4.40 As set out in the consultation document, we have been considering what improvements to the collection and enforcement of business rates may be desirable in moving to the new business rates retention scheme.

4.41 The Local Government Finance Bill will allow billing authorities to publish online certain statutory information which accompanies business rates bills, instead of sending hard copies (though local authorities will be required to send out hard copies when they are requested). We hope that this move will make it easier and cheaper for billing authorities to meet their statutory requirements.

4.42 The Government will bring forward provisions to operate multi-year billing for business rates and will clarify legislation on business rates refunds, so that billing authorities are permitted to offset outstanding liabilities from previous years, before offering refunds.

Renewable energy

4.43 Increasing the deployment of renewable energy across the UK forms a key component of our strategy to decarbonise the energy sector by 2030 and our proposals to ensure a more energy secure UK. We have a legally-binding target of generating 15 per cent of energy (electricity, heat and transport) from renewable source by 2020.

4.44 As part of this drive to exploit our renewable resources to their fullest extent, it is a clear coalition commitment that communities that host renewable energy projects should be able to keep the additional business rates that these projects generate.

4.45 The main consultation document and *Technical Paper 8: Renewable Energy*[56] set out our proposals to ensure that all business rates revenue from new renewable energy projects would be kept by the local authorities within the area of the project and how those revenues would be discounted in the calculation of any levy that would be applied to business rates revenues. There was widespread support for our proposals.

Eligible renewable energy technologies

4.46 *Technical Paper 8: Renewable Energy*[57] proposed that we would define the types of properties that would be treated as new renewable energy projects for the purposes of business rates retention. We proposed using, as a starting point, criteria already set out in a previous business rates statutory instrument[58]. We then set out a number of technologies that we believed should be included in the definition of "renewable energy projects". These were:

- onshore wind power
- offshore wind power
- hydroelectric power
- biomass
- biomass conversion
- energy from Waste combustion
- anaerobic digestions, landfill and sewage gas
- advanced thermal conversion technologies – gasification and pyrolysis
- geothermal heat and power
- photovoltaics

4.47 Most respondents were generally supportive of this list of technologies. Some respondents called for nuclear and all low-carbon technologies to be included, which are not renewable technologies, while some highlighted the absence of solar thermal technologies and the importance of proposals being able to adapt to new technologies as they emerge.

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[56] www.communities.gov.uk/documents/localgovernment/pdf/1969601.pdf
[57] www.communities.gov.uk/documents/localgovernment/pdf/1969601.pdf
[58] The Electricity Supply Industry (Rateable Values) (England) Order 2000 SI 2000/947

4.48 We have decided to proceed with the list as stated in the consultation but will keep it under review for other technologies, including solar thermal and heat pump technologies. Further work is needed to establish to what extent solar thermal and heat pump technologies give rise to a separate identifiable impact on rateable value.

Establishing a baseline for existing renewable energy projects

4.49 *Technical paper 8: Renewable Energy*[59] proposed that at the introduction of the scheme, a baseline of business rates income from existing renewable energy projects in each billing authority area should be established against which we could measure change to identify the rates collected from new projects.

4.50 Whilst there was general support for this proposal, a number of respondents questioned whether it was really necessary to them to bring forward a baseline rather than merely identifying new development. Having considered this further, we can understand this view and will now not require a baseline to be set.

Establishing rates from new Energy from Waste plants

4.51 The Government said in *Technical paper 8: Renewable Energy*[60] that it did not believe it would be appropriate for all of the business rates generated by new Energy from Waste plants to fall within the scheme, when a significant element of rateable value will relate to the waste disposal function. The Government proposed that the Valuation Office Agency should apportion the rateable value from new Energy from Waste plants (including those with Combined Heat and Power) that is attributable to the renewable energy element. An equivalent proportion of the business rates from such plants would be retained in full. There was general support for this and Government proposes to proceed as set out in the technical paper.

Renewable energy technologies on existing properties

4.52 It is possible that an existing renewable power station, in place before the introduction of the rates retention scheme, could expand after introduction. *Technical Paper 8: Renewable Energy*[61] proposed that, in this case, above RPI increases in business rate income from existing renewable power stations (other than increases directly resulted from five yearly revaluations) should be treated as arising from new renewable energy projects and, as such, would be retained in full by the local authority.

[59] www.communities.gov.uk/documents/localgovernment/pdf/1969601.pdf
[60] www.communities.gov.uk/documents/localgovernment/pdf/1969601.pdf
[61] as above

4.53 In some cases, a large installation of renewable technology on a property used for other purposes will increase the rateable value and, therefore, the rates bill on that property. *Technical Paper 8: Renewable Energy*[62] proposed that where a new renewable technology has had a separately identifiable impact on the rateable value of a property, the Valuation Office Agency should certify the proportion of the total rateable value which is attributable to the renewable technology and any associated land and buildings. An equivalent proportion of the total business rates income from the property would then be treated as arising from a qualifying renewable energy project and would be retained in full by the local authority.

4.54 These proposals received broad support from respondents and we plan to implement the proposals as set out in the technical paper

Determining which properties qualify

4.55 *Technical Paper 8: Renewable Energy*[63] set out two options for who should determine whether a property is a "new renewable energy project" either because the property has been newly built, converted or expanded and meets the relevant definition of a renewable power station or because new renewable technologies have been installed which have had a separate identifiable impact on the rateable value.

4.56 The two options set out in the technical paper were that:

- under option one, the relevant billing authority would be responsible for deciding whether these criteria apply
- under option two, responsibility for identifying relevant projects could be given to the Valuation Office Agency

4.57 There was general support from respondents for billing authorities to be responsible for determining which properties should qualify. We believe that, if an incentive is to work, billing authorities have to have a role in determining which properties qualify. They of course will be much closer to new development than the Valuation Office Agency or others and are therefore better placed to identify whether they should qualify.

Allocation of revenues in two-tier areas

4.58 *Technical Paper 8: Renewable Energy*[64] set out two options for the allocation of business rates revenues from renewable energy projects in two-tier areas that could be pursued independently of the proposals

[62] as above
[63] as above
[64] www.communities.gov.uk/documents/localgovernment/pdf/1969601.pdf

in *Technical Paper 3: Non-Billing authorities*[65], on sharing business rates income between district and county councils in two-tier areas. The two options were that:

- a transparent and straightforward process should be maintained whereby the local planning authority retained all the business rates of the business rates revenues generated by new renewable energy projects
- similar arrangements to those which apply to the New Homes Bonus could be introduced namely that, in two-tier areas, the lower tier receive 80 per cent of the bonus, whilst 20 per cent goes to the upper tier

4.59 A majority of respondents were in favour of the local planning authority retaining the full income from new renewable energy projects. However, it was not clear cut with a number of respondents favouring some financial recognition for the role of counties.

4.60 Our proposals are designed to incentivise authorities to help meet our commitment to bring about the delivery of new renewable energy projects. This has the most chance of success if the incentive is placed on the decision maker. We have therefore decided that all of the business rates income from new renewable energy projects will be retained by the local planning authority, by which we mean the decision maker, for the relevant renewable energy project at county or district level.

4.61 In areas where a national park authority is the local planning authority, it would be for the park authority to determine any applications for new renewable technology projects. However, national park authorities are not part of the business rates system and will not feature in the rates retention scheme. As such, any income generated from new renewable energy projects in national parks will be retained by the billing authority in which any renewable energy project sits.

4.62 In London, the Mayor has discretionary development control powers in relation to strategic planning, including for large waste applications. The Mayor can direct a borough to refuse a planning application or take over the application to make the decision himself. The Government believes that planning decisions should be made at the most appropriate level and would not wish to create a perverse incentive for the Mayor to take over strategic energy from waste applications. Business rates income from renewable energy projects in London will therefore be retained by the relevant borough, including where the Mayor has decided the application.

[65] www.communities.gov.uk/documents/localgovernment/pdf/196957710.pdf

Chapter 5

Next Steps

5.1 We hope that the Local Government Finance Bill will achieve Royal Assent by summer 2012. Following this, we intend to introduce business rates retention by April 2013, so that authorities can begin to feel the benefit of rates retention at the earliest opportunity.

5.2 This document sets out a clear central proposition for the business rates retention scheme and commits the Government to a certain direction of travel which is reflected in the legislation. Alongside this document we have also published a summary of the consultation responses received.

5.3 However, there is lot of detail that still needs to be decided upon and we will be working with the local government sector and welcoming the contribution they have to make to ongoing policy development and into the drafting of any necessary second legislation. We recognise that a good business rates retention scheme can only be delivered through effective collaborative working between central government and local government.

5.4 As such, we will set up a working group, which will be comprised of a range of individuals from the local government sector, who will contribute to the policy and technical debate and act as a critical friend to central government in designing the detail underpinning the scheme.

Annex A

GLOSSARY OF KEY TERMS

Allowable deductions
A deduction made to a billing authority's business rates income, when calculating its proportionate share. Examples of where allowable deductions will be made are for rate reliefs and cost of collections.

Billing authority business rates baseline (pre-tier split)
Derived by dividing the national business rates baseline between billing authorities on the basis of their proportionate shares.

Central share
The percentage of business rates that will be paid to central government and re-distributed to local government through other grants.

Gearing effect
The relationship between individual authority business rates baseline and the individual authority baseline funding level.

Individual authority business rates
The amount of business rates income which each authority receives before payment of tariffs and top ups.

Local authority baseline
Based on the formula grant distribution. An authority's baseline funding level provides a stable starting point for the rate retention scheme.

Localised share
The percentage of business rates retained by local government.

Levy
The levy will recoup a share of disproportionate benefit, so that for each percentage of growth in business rates, an authority sees no more than a set percentage increase in its retained income.

Multiplier
The business rates multiplier when multiplied by the rateable value of a property determines a ratepayer's business rate bill. There are two multipliers – one for small businesses and one for larger businesses. These are set nationally and up-rated annually by RPI. There will be no change to the way in which multipliers are set as a result of the introduction of the rate retention scheme.

Post-levy income

Individual authority business rates minus/plus the tariff or top up, minus any levy.

Pre-levy income
Individual authority business rates minus/plus the tariff or top up.

Retained income
Individual authority business rates minus/plus tariff or top up, minus any levy, plus any safety net payments

Revaluation
Business properties are re-valued every 5 years to reflect relative changes in rental valuations. There will be no change to revaluation as a result of the introduction of the rates retention scheme.

Revaluation adjustment
An adjustment to tariffs and top ups to ensure that authorities do not see their retained income change as a consequence of a revaluation.

Reliefs
The rating system currently provides mandatory relief to charities and other categories of ratepayer (e.g. certain rural ratepayers). There will be no changes to mandatory relief as a result of the introduction of the rate retention scheme.

Safety net
The safety net offers support to authorities that see their retained income drop, in any year, by more than a set percentage below their baseline funding level (with baseline funding levels being uprated by RPI for the purposes of assessing eligibility for support).

Tariffs and top ups
Achieve a one-off rebalancing of resources to ensure that no council is worse off as a result of its business rates base at the outset of the scheme. An authority will pay a tariff if their individual authority business rate baseline is more than their baseline funding level. An authority will receive a top up if their individual authority business rate baseline is less than their individual authority baseline funding level. Tariffs and top ups will be self-funding and fixed in real terms (i.e. uprated by RPI) in future years, ensuring that changes in retained income are driven by business rates growth.

Tax Increment Financing (TIF)
Allows authorities to borrow against future growth in business rates, in order to finance infrastructure development.

Transitional adjustment
An adjustment to ensure that authorities do not experience gains or losses as a consequence of granting transitional relief.

Volatility
The degree to which individual authority business rates in a particular area may change.