Leeds CITY COUNCIL

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Report of the Deputy Chief Executive

Report to Corporate Governance and Audit Committee

Date: 16th September 2016

Subject: Review of Current Business Rates Issues

Are specific electoral wards affected? If relevant, name(s) of ward(s):	☐ Yes	☒ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	☒ No
Is the decision eligible for call-In?	☐ Yes	☒ No
Does the report contain confidential or exempt information? If relevant, access to information procedure rule number: Appendix number:	☐ Yes	☒ No

Summary of main issues

1. The purpose of this report is to provide a briefing on current business rates issues as requested by the Committee at its meeting of 24th June 2016. The report is intended to enable members to more fully understand the risk environment around business rates and to receive assurances that arrangements in place to manage those risks where applicable.

2. Under the current business retention scheme, local authorities retain 50% of locally collected rates, benefitting from growth but exposed to financial risks should business rates fall or fail to grow as expected.

3. Business rates are inherently volatile and the council's financial position can be adversely affected by a range of factors. As a result, the council's 2016/17 budget proposals include a net general fund cost of £12.6 million relating to business rates, which recognises a £23 million deficit position in 2015/16 due to the worsening position on business rates income, offset by forecast growth of £14.2 million in 2016/17 to recognise the continuing improvement of the economic climate of the city.

4. At 31st July 2016 there were 6,194 outstanding appeals in Leeds, requiring the Council to set aside a provision of £23.38 million, funding that could otherwise be spent on services.

5. It is important to note that the Council does not set rateable values or determine mandatory reliefs, nor does it have any role in the appeals process.

6. A revaluation of business properties will take place with effect from 1st April 2017. The rateable value of every non-domestic property is being reviewed and may go up or down. A draft 2017 ratings list will be available in early October, giving us an initial understanding of the impact for Leeds but we will not be able to do any detailed analysis until new baselines, tariffs and top-ups are confirmed later this year. The revaluation is likely to bring a fresh wave of business rate appeals, increasing the financial volatility faced by councils further.

7. By the end of this Parliament, the Government's proposals are that local authorities will be allowed to retain 100% of business rates, with an associated increase in exposure to business rate risk. Much of the design of the new system is yet to be agreed. A joint DCLG/LGA steering group has been established and two initial consultation papers have been issued by DCLG. From April 2017 the Government plans to pilot 100% retention in Greater Manchester and Liverpool City Region and Greater London.

8. The briefing note at **Appendix 1** discusses the identified issues in detail and identifies relevant assurances, which are summarized at **Annex 1**

Recommendations

9. Corporate Governance and Audit Committee are recommended to:

- note the issues and concerns identified in this report;

- note the assurances provided that appropriate action is being taken to mitigate the risks arising where possible.

1 Purpose of this report

1.1 At its June 2016 meeting, the Committee received a report of the Deputy Chief Executive presenting the 2015/16 Statement of Accounts prior to them being made available for public inspection.

1.2 Following discussion of the impact of business rates on the Council's financial position, the Committee requested a further report on business rates be prepared for consideration, to include:

- Background to the Council's current and future liabilities in respect of business rates retention;
- The roles, responsibilities and decision making processes of the Council and the Valuation Office;
- The risks to the Council's budget setting process associated with business rates retention;
- Current and future trends in respect of business rate income and liabilities arising from business rate valuation appeals;
- Any impact arising from the publication by the Valuation Office of the new ratings list.

1.3 Additionally, this report takes the opportunity to update the Committee on progress towards 100 per cent retention of business rates and discusses a number of related issues.

1.4 Where applicable, assurances have been identified and these are summarized in **Annex 1** of the accompanying briefing note.

2 Background information

2.1 Business rates were taken out of local authority control in 1990. Business rates revenue collected by local authorities was pooled in a single, national pot and redistributed based on an annual needs assessment through Revenue Support Grant.

2.2 In 2013/14, Government introduced the current Business Rates Retention (BRR) scheme. Local authorities now retain 50 per cent of locally collected business rates, including 50 per cent of any local growth but also bear 50 per cent of the risk if business rates fall.

2.3 Local authorities now act as both principal and agent, collecting business rates both to keep and to pass to central government. As a result they have needed to set aside funds to make provision to meet the cost of future repayments to ratepayers following successful appeals.

2.4 In October 2015 the Chancellor announced a commitment to allow local government collectively to retain 100 per cent of business rates revenue by the end of this Parliament and, to match the resulting additional tax revenues, for it to take on ‘new responsibilities’. The move was confirmed in the March Budget and the Queen’s Speech announced that the relevant legislative changes would be included in the Local Growth and Jobs Bill to be published in spring 2017.

2.5 The move to 100% business rates retention, accompanied by a fundamental reassessment of needs and resources, probably represents the biggest change to local government finance in a generation. It is therefore imperative that the new system is both workable and fair, and that incentives for growth are properly balanced against the needs of our most deprived communities.

3 Main issues

3.1 The issues to be considered are set out in detail in the briefing note at **Appendix 1** and its associated annexes and are briefly summarised here. For the Committee’s information, this briefing note will also be submitted to the September 2016 meeting of Strategy and Resources Scrutiny Board.

The Current System

3.2 Under the current business retention scheme, local authorities retain 50% of locally collected rates, benefitting from growth but exposed to financial risks should business rates fall or fail to grow as expected. The council’s financial position can be adversely affected by a range of factors, including:

- Slower than forecast growth;
- The impact of mandatory reliefs;
- Reductions in rateable value determined by the Valuation Office Agency;
- Most significantly, reductions in rateable value as a result of business rate appeals.

3.3 In 2016/17 the council’s budget proposals include a net general fund cost of £12.6 million relating to business rates. This cost recognises the worsening position on business rates income in 2015/16, which resulted in a £23 million deficit, offset by forecast business rates growth of £14.2 million in 2016/17 which recognises the continuing improvement of the economic climate of the city.

3.4 At 31st July 2016 there were 6,194 outstanding appeals in Leeds, with just under 45% of the total rateable value of the city subject to at least one appeal. As a result the Council has set aside a provision of £23.38 million, funding that could otherwise be spent on services.

3.5 It is important to note that the Council does not set rateable values or determine mandatory reliefs, nor does it have any role in the appeals process.

Revaluation 2017

3.6 The revaluation of business properties planned for April 2015 was delayed by the Coalition Government but will take place with effect from 1st April 2017. Under the revaluation, the rateable value of every non-domestic property is being reviewed and rateable values may go up or down. A draft 2017 ratings list will be available in early October. Whilst this will give us an initial understanding of the impact of the new list for Leeds we will not be able to do any detailed analysis until new baselines, tariffs and top-ups are confirmed later this year.

3.7 The 2017 revaluation is likely to bring a fresh wave of business rate appeals which will increase the financial volatility faced by councils further.

100% retention of business rates

3.8 By the end of this Parliament, local authorities will be allowed to retain 100% of business rates, with an associated increase in exposure to business rate risk.

3.9 The main proposals for the new business rates system are as follows:

- Revenue Support Grant (RSG) will be phased out and local authorities will be given new responsibilities so that, overall, the switch to 100% retention will be revenue neutral;
- Individual local authorities will be given powers to reduce (but not increase) the national multiplier in their areas;
- In combined authority areas directly elected mayors will be able to add a small premium (up to 2p) to raise funds to support infrastructure projects provided they secure a majority vote of the business members of their Local Enterprise Partnership. The power will not apply to combined authorities without an elected mayor;
- The changes will be accompanied by a “fair funding review” of needs and resources so that each authority has a fair starting point;
- The current equalization arrangements through tariffs and top-ups will continue, as will some sort of safety-net arrangement to protect authorities from severe losses of income from year to year. However, safety nets will no longer be partially funded from levies on growth in tariff authorities, as levies are to be abolished.

3.10 Much of the design of the new system is yet to be agreed. A joint DCLG/LGA steering group has been established and two initial consultation papers have been issued by DCLG. A summary of the questions asked in these consultations is provided at **Annexes 6 and 7** of Appendix 1, should the Committee wish to feed in to the Council’s responses. From April 2017 the Government plans to pilot 100% retention in Greater Manchester and Liverpool City Region, and will increase the share of business rates retained in London.

3.11 Key issues to be considered are:

- The identification of appropriate additional responsibilities;

- The outcome of the Fair Funding Review and the approach to establishing needs and resources;
- How and how often the system should be reset to address divergence from the needs and resources starting position;
- How the new system will engage with the devolution agenda;
- Design issues such as how safety net arrangements should work and whether all local authorities should have powers to increase the multiplier;
- Ways of addressing local authority exposure to appeals risk.

The above issues are discussed in detail in Paragraph 5 of the briefing note at **Appendix 1**.

4 Corporate considerations

4.1 Consultation and engagement

4.1.1 This report has no direct issues requiring consultation or engagement.

4.2 Equality and diversity / cohesion and integration

4.2.1 This report has no direct equality and diversity / cohesion issues.

4.3 Council policies and best council plan

4.3.1 Achievement of the priorities identified in the Best Council Plan requires that the Council's financial resources are maximised and associated risk managed appropriately. The management of business rate risk is therefore essential to ensuring that the City can deliver on its ambitions.

4.3.2 Business rates growth is identified as a key indicator in the 2016/17 Best Council Plan Update. This report discusses how the current business rates system both incentivises growth and undermines it through the appeals process. It also identifies the limited tools at the Council's disposal to mitigate appeals risk.

4.4 Resources and value for money

4.4.1 The financial implications of the current and proposed business rates systems are discussed in this report.

4.5 Legal Implications, access to information and call In

4.5.1 There are no legal implications arising from the issues discussed in this report. The report does not require a key or major decision and is therefore not subject to call-in.

4.6 Risk management

4.6.1 The adequacy of resources to meet the Best Council Plan objectives in a sustainable way is identified as one of the Council's corporate risks. The management of business rates risk is a key element of this and is subject to regular review. Detailed monitoring arrangements are in place and key issues are highlighted to Financial Performance Group and to Executive Board monthly.

5 Conclusions

5.1 This report provides assurances that current business rates issues and the associated risks are fully understood, and that appropriate action is being taken to mitigate these risks where possible. It does however acknowledge that local authorities have limited influence in many of the areas of risk and few tools at their disposal to manage these risks.

5.2 The move to 100% business rates retention raises concern that authorities will be exposed to even greater financial risk and volatility. It is to be hoped that the joint working arrangements and consultations contributing to the design of the new system will address these concerns as fully as possible. Certainly there has been positive discussion about dealing with business rates appeals risk under 100% retention.

6 Recommendations

6.1 Corporate Governance and Audit Committee are asked to note the issues and risks identified in this report.

6.2 Further, the Committee are asked to note the assurances provided and that appropriate action is being taken to mitigate the risks arising where possible.

7 Background documents[1]

7.1 None.

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[1] The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.