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Report of the Deputy Chief Executive

Report to Scrutiny Board (Strategy and Resources)

Date: 14 September 2017

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. The report is intended to enable members to more fully understand the risk environment around business rates and to receive assurances that arrangements are in place to manage those risks where applicable. This is intended to inform the Board's further consideration of business rates, as agreed at its meeting of 21st July 2017.

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. The importance of business rates income to the council is emphasised by looking at the constituent parts of the £492.7m net revenue available to the council's 2017-18 budget. Council tax contributes the most, at £284.7m, but business rates income is the next largest contributor at £142.9m. The main Government grant, Revenue Support Grant, now provides only £65.0m in comparison.

4. Business rates are inherently volatile and the council's financial position can be adversely affected by a range of factors. The council's 2017/18 budget included an increase in the Net Revenue Charge relating to business rates. This increase is due to two factors, a slight improvement in the position on business rates income in 2016/17 which has resulted in an improvement in the business rates deficit of £1.24 million and an improved forecast of business rates growth in 2017/18 of £2.52 million which recognises the continuing improvement of the economic climate of the city.

5. At 31st July 2017 there were 4,255 outstanding appeals in Leeds, requiring the Council to set aside a provision of £14.46 million, funding that could otherwise be spent on services.

6. 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.

7. A revaluation of business properties has taken place with effect from 1st April 2017, with the rateable value of every non-domestic property in England having been reviewed. The impact of this revaluation was very mixed, both nationally and locally, with some businesses experiencing large increases in their rateable values and others large decreases. There was a fall in the total rateable value in Leeds, which resulted in the authority's Business Rates Baseline and tariff being reset reducing the amount of business rates income we are required to pay across to Government.

8. The 2017 revaluation is expected to bring a fresh wave of business rate appeals which will increase the financial volatility faced by local authorities. These appeals will be subject to the new 'Check, Challenge, Appeal' process, the impact of which is not yet known.

9. Government had proposed that by 2020 local authorities would be allowed to retain 100% of business rates. However, following the 2017 general election, the Queens Speech made no reference to the necessary key legislation, and we now know that it will not form part of the Parliamentary timetable for this session. Local authorities have been assured that Government remain committed to local government taking greater control of their income and is continuing to explore options for future reform without an immediate Bill. At this stage we have no indications as to the nature of this future reform.

10. We are also told that Ministers remain determined to address concerns about the fairness of current funding distributions and will continue to work with the LGA and local government on this.

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

Recommendations

12. Scrutiny Board (Strategy and Resources) are recommended to:

- note the issues and risks 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 meeting in July 2017, the Board received a report of the Head of Governance and Scrutiny Support regarding Financial Health Monitoring.

1.2 Following consideration of the Medium Term Financial Strategy (2018/19 to 2020/21) and Financial Health Monitoring 2017/18 – Quarter 1, the Board has resolved that further consideration of the matters associated with Business Rates be included in their work schedule. In relation to this matter, the Principal Scrutiny Adviser advised the attendance of a suitable representative from the Valuation Office at a future Board meeting would be progressed. It was also resolved that consideration would be given to Board members attending and observing proceedings at a Business Rates Appeal meeting.

1.3 This report is intended to provide Members with the necessary background knowledge of the business rates system to support their work in this area. Additionally the attached briefing note outlines recent developments in this area and discusses the possible implications of the delay in implementing 100 per cent retention of business rates.

1.4 Where appropriate, assurances have been identified and these are summarized at **Annex 1** of the attached 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 the then Parliament and, to match the resulting additional tax revenues, for it to take on 'new responsibilities'. This move to 100% business rates retention, accompanied by a fundamental reassessment of needs and resources, was felt to represent the biggest change to local government finance in a generation.

2.5 However, following the 2017 general election, the Queens Speech made no reference to the Local Government Finance Bill, the necessary key legislation, and it will now not form part of the Parliamentary timetable for this session. Subsequently, local authorities have been assured that Ministers remain committed to local government taking greater control of their income and that Government continue to explore options for future reform without an immediate Bill. We are also told that Ministers remain determined to address concerns about the fairness of current funding distributions and will continue to work with the LGA and local government on this.

2.6 Work to address fairness of funding distributions, the Fair Funding Review, resumed in July 2017 with the recall of the DCLG/LGA Needs Working Group. We now expect a detailed consultation in autumn 2017.

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.

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 determined by Government;
- 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 2017/18 the council's budget included an increase in the Net Revenue Charge relating to business rates. This increase is due to two factors, a slight improvement in the position on business rates income in 2016/17 which has resulted in a reduction in the business rates deficit of £1.24 million and an improved forecast of business rates growth in 2017/18 of £2.52 million which recognises the continuing improvement of the economic climate of the city.

3.4 At 31st July 2017 there were 4,255 outstanding appeals in Leeds, with just under 28% 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 £14.46 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 was implemented with effect from 1st April 2017. Under the revaluation, the rateable value of every non-domestic property in England was reviewed. The impact of the revaluation was very mixed, both nationally and locally, with some businesses experiencing large increases in their rateable values and others large decreases. Total rateable values in Leeds fell from £926.5m at March 2017 on the 2010 Valuation List to £915.5m at 1st April 2017 on the 2017 Valuation List, a reduction of £11m (1.2%). As a result of the revaluation and the fall in total rateable value in Leeds, the authority's Business Rates Baseline and tariff have been reset, reducing the amount of business rates income Leeds collects and is then required to pay across to Government as part of the redistribution mechanism.

3.7 As with previous revaluations, the Government has introduced a national transitional scheme to phase in the impact of both increases and reductions in business rates liability.

3.8 Additionally, at the March 2017 Budget, the Chancellor announced three new measures to support businesses affected by the 2017 Revaluation: support for small businesses, a business rate discount for public houses and funding for local authorities to establish local discretionary relief schemes 'to deliver targeted support to the most hard-pressed ratepayers'. The discount for public houses is for one year only whereas the other two new reliefs will be provided for four years, with a tapering effect. As at 31st July 2017 Leeds has awarded over £1.5m of discounts to 3,475 local businesses under these new schemes.

3.9 The 2017 revaluation is expected to bring a fresh wave of business rate appeals which will increase the financial volatility faced by local authorities. These appeals will be subject to the new 'Check, Challenge, Appeal' process, the impact of which is not yet known.

Future business rates reform and the Fair Funding Review

3.10 In a report to Corporate Governance and Audit Committee in September 2016 we stated that the proposed move to 100 per cent business rates retention, accompanied by a fundamental reassessment of needs and resources, probably represented the biggest change to local government finance in a generation. Local authorities across the country were participating in discussions with Government about the design of the new system and incorporating its introduction into their medium term financial planning.

3.11 However, following the 2017 general election, the Queens Speech made no reference to the Local Government Finance Bill, the necessary key legislation, and it will not now form part of the Parliamentary timetable for this session. Subsequently, local authorities have been assured that Ministers remain committed to local government taking greater control of their income and that Government continue to explore options for future reform without an immediate Bill. We are also told that Ministers remain determined to address concerns about the fairness of current funding distributions and will continue to work with the LGA and local government on this.

3.12 Work to address fairness of funding distributions, the Fair Funding Review, resumed in July 2017 with the recall of the DCLG/LGA Needs Working Group. Prior to the general election the Working Group were focussing primarily on the design of a new needs formula. More recent discussions have turned to the measurement of relative resources: how and to what extent should an individual authority's capacity to generate income be taken into account when assessing comparative need. These discussions have included proposals regarding the inclusion of income from sales, fees and charges in the calculation of resources, which are a cause for concern for Leeds and other enterprising councils. We expect a detailed consultation in autumn 2017.

3.13 The above issues are discussed in more 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 2017/18 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 proposed move to 100% business rates retention raised concern that authorities would be exposed to even greater financial risk and volatility. However, with the postponed implementation of business rates reform, it is to be hoped that we will have the opportunity to refine and simplify the design of a future retention system and to deal with the many significant problems such as balancing needs and resources and dealing with the inherent volatility of business rates income. The current delay also offers an opportunity to develop any future business rates system alongside a wider review of local government funding, which may mitigate some of the risks and concerns related to greater retention, as well as delivering the range of tools local authorities need to deal with demographic and economic change.

6 Recommendations

6.1 Scrutiny Board (Strategy and Resources) are asked to note the issues and risks identified in this report.

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

7 Background documents[1]

7.1 None.

[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.