Please ask for: Sir Peter Soulsby
Direct Line: 0116 454 0001
Our Ref: 2016/Sept/BRRC/MH/MN/PS
Date: 19 September 2016

Leicester
City Council

Business Rates Retention Consultation,
Local Government Finance,
Department for Communities & Local Government,
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Fry Building,
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Dear Sir or Madam,

Self Sufficient Local Government: 100% of Business Rates Retention – Consultation; Fair Funding Review: Call for Evidence on Needs and Redistribution

Thank you for the opportunity to comment on the Government's proposals; I am replying on behalf of the City Council. Attached to this letter are the answers to the detailed questions you have asked in respect of these consultations. However, I think it is important that you understand our overall perspective on these proposals, which is the purpose of this letter.

General Principles

A move towards greater self-reliance for local government is welcome. I am of course aware that English local government is amongst the most centralised in the world, and steps taken to redress this are much needed.

There is, furthermore, a link between local government's self-reliance and its ability to manage risk, which is particularly relevant in these times of severe financial constraint.

In the context of the rates review, a number of proposals would involve greater risk to the authority's financial position than is currently the case. For instance, 100% rates retention with limited resets puts us at risk of losing income due to an economic shock, or funding not keeping pace with needs. The greater the buoyancy of our own local sources of revenue, the more I believe we can accept and manage such risk. Conversely, the more constrained we are, the more inevitable it is we will seek government support for unexpected surprises (such as a hike in the number of rating appeals).

Whilst I applaud the aim to provide communities with "financial independence, stability and incentives to push for local growth", I do not believe the proposals go far enough in practice. We currently have very few tools to influence our local tax income in any significant way, and this will continue to be the case if the review delivers only what is currently proposed.

The table below shows our budgeted council tax income for 2016/17, and the exemptions/discounts granted to tax payers:-

	£m	£m
Income if all dwellings paid full charge		137
Less		
Exemptions (mainly students)	8	
Single person discounts	11	
Council tax reduction scheme	24	(43)
Net tax income		**94**

In practice, apart from policies to incentivise house building (which we are committed to anyway), there are few levers available to us to influence our taxbase:-

(a) The gross charge is restricted by the referendum rules – I do not believe any tier of government would succeed in asking its electorate to support a higher tax in a single issue referendum;

(b) Exemptions and single person discounts are mandatory features of the council tax system;

(c) We are able to change the terms of our council tax reduction scheme, but only at the expense of requiring greater contributions from low income households if we need additional income.

The table below shows budgeted rates income for 2016/17 in a similar way:-

	£m	£m
Gross rates		127.3
Small business relief	8.7	
Less large businesses paying higher multiplier	(2.8)	
Mandatory charitable relief	9.1	
Mandatory empty property relief	3.8	
Discretionary relief	1.0	(19.8)
Net rates income		**107.4**

Apart from the fact that local economic regeneration will increase our rates base, we have no levers to materially increase our income. The multiplier is, of course, determined nationally. All reliefs are set nationally with the exception of discretionary relief which (as can be seen) is minimal.

I would thus urge upon the Government a more imaginative approach, which would give us greater control in return for local government accepting greater risk. This would, in addition, enable us to develop policies which are better suited to the regeneration of our area. We may, for instance, want to change council tax discounts in order to provide funds to assist recipients of council tax reductions to get back into work.

We may want to ask whether mandatory reliefs are the best approach to meeting the needs of the area, given the nature of the organisations which receive them. We may want to increase rates for some forms of property (e.g. betting and adult shops) where these are detrimental to

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the character of the area. We are aware of the extent of "gaming" empty property rates by rating agents who, for instance, use the expedient of moving single items of furniture (such as vending machines) between properties: we could set a policy which addresses avoidance, with an empty rates exemption period that best suits local needs and avoids "cliff edge" disadvantages for growing businesses.

We would also welcome genuine freedom to set council tax levels and the rates multiplier; and to complement this income with other local sources of taxation. Such measures would, I believe, help create a much more genuine partnership between central and local government and help meet our shared aims of driving local growth.

Resets

My view on resets reflects the general principles above.

I should start by saying that, from a purely parochial stand point, the authority would want full resets as often as possible (indeed, I believe we would benefit from reintroduction of the old system of annual formula grant). This is because our population growth tends to be higher than average, and our needs are more sensitive to economic change than those of more affluent areas of the country. However much we seek to promote economic growth, we will never achieve the extent of additional rates income which can be created in London and the south east.

However, I recognise the Government's aim of fiscal devolution, and understand the wish to create incentives in the rates retention system. I believe the authority can (in principle) accept a partial reset option provided the Government is also prepared to support us by giving us the fiscal tools described above.

Area Based Risk Sharing

A number of proposals concern sharing of risk at area level. For instance, there are proposals for area level rating lists of more significant properties, and area level safety nets.

The problem I envisage with this approach is that it does not provide additional tools to manage the risk at area level. It merely aggregates the limited tools we have locally.

In Leicester and Leicestershire, we operate a business rates pool, and do in effect pool risk voluntarily. However, there is currently an additional tool which enables us to do this – we are able to pool levies which would otherwise have been paid to the government. Thus, given that levies will be abolished, present indications are that we will have fewer tools in the future than we have now.

I would be willing to consider area level risk sharing as part of a combined authority devolution deal, if these deals also gave us additional tax flexibilities.

The city, unlike some areas of the country, is not heavily dependent on any large industrial hereditaments which contribute a significant proportion of rates income. There is, under the current system, no realistic prospect that the Council would ever be eligible for safety net payments. Without additional tools at area level, we would not be sympathetic to sharing other local authorities' risk.

Initial Reset in 2020

I would stress, please, the need for this to take full account of changes in needs since 2013/14, and in particular:-

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(a) To reflect the latest population estimates;

(b) To ensure full resource equalisation;

(c) To ensure that needs are fully reflected in the new system. When the current system was created in 2013/14, needs assessed at that time were never fully reflected in the post 2013/14 funding arrangements. The City Council's Start-Up Funding Assessment for 2013/14 was damped by £9m, and this loss of funding was permanently embedded in the subsequent arrangements. If damping is required on the introduction of the new system, it must be allowed to unwind in subsequent years;

(d) Fair treatment for the needs of urban areas vis-à-vis rural areas, based on objective evidence, with proper recognition of the costs associated with deprivation;

(e) Unwinding of the disproportionate grant reductions which took place in the years 2013/14 to 2015/16. (We can conclusively demonstrate, based on published spending power figures, that the most deprived authorities were the most severely affected in those years).

<u>New Burdens Doctrine</u>

Finally, I believe it is essential that the new burdens doctrine is scrupulously applied post 2020. As you know, this policy is intended to apply to all policies or initiatives which increase the cost of providing local authority services. Experience to date is that adherence to the doctrine is mixed. The CLG has been scrupulous in awarding Section 31 grants to reflect reduced income when business rates policy has been charged at national level. In other areas of service, there have been problems. Thus, for instance, support for council tax reduction schemes has implicitly been cut substantially by virtue of its inclusion within settlement funding assessments. Two other (particularly egregious) examples are as follows:-

(a) The devolution of responsibility for providing crisis support to low income families was devolved from DWP to local authorities in 2013/14. Funding followed the transfer, and this authority received nearly £2m per year. After two years, funding ceased;

(b) When the Carbon Reduction Commitment was introduced, no additional funding was provided to authorities. This may be because it was perceived as an additional tax rather than a new policy (and applied equally to the private and public sector). However, when certain (small) authorities later fell outside the scope of the scheme, adjustments were made to their Revenue Support Grant to remove the CRC that they would no longer have to pay.

I hope these comments are helpful, and will be happy to provide any further assistance.

Yours faithfully,

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City Mayor

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Needs & redistribution questions

Question 1: What is your view on the balance between simple and complex funding formulae?
Question 2: Are there particular services for which a more detailed formula approach is needed, and – if so – what are these services?
Question 3: Should expenditure based regression continue to be used to assess councils' funding needs?
Question 4: What other measures besides councils' spending on services should we consider as a measure of their need to spend?
Question 5: What other statistical techniques besides those mentioned above should be considered for arriving at the formulae for distributing funding?
Question 6: What other considerations should we keep in mind when measuring the relative need of authorities?

The 2013 funding formula uses over 150 separate "needs" indicators, several of which are closely correlated with one another (and therefore add little to the final result) and / or allocate very small amounts of funding.

Moreover, the 2013 formula is not, as a whole, closely based on statistical techniques. Although the individual RNF sub-formulae are largely based on regression techniques, the overall aim of the formula must be to fairly allocate total funding between authorities as a whole, rather than to individual elements within the formula. Under the 2013 formula, the total funding is the result of many layers of judgement including the weighting of indicators in various sub-blocks (particularly EPCS); the division of total RNF between the sub-blocks; and the split between relative needs, relative resources and the central share. The complexity of the indicators and the various levels of judgement make for a complex formula that is difficult to understand for finance professionals, and virtually impossible to explain to the wider public, without any consistent evidence basis for the final formula.

This complex formula may indeed be more "nuanced" – but this is not an aim in itself. There is no agreement on how to assess the "success" or "fairness" of any proposed formula, and adding a veneer of statistical validity to the system does not improve the results.

We would propose a radical simplification of the formula:

- A model involving 12-15 key indicators[1] covering the main cost drivers for authorities.

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[1] One model developed uses total population; child health; population aged 65+; older people in rented accommodation; attendance allowance; visitor nights; recipients of income support; country of birth; sparsity; incapacity benefits; and area cost adjustment, and produces results for 95% of upper-tier authorities within -3.3% / +4.3% of the previous RNF formula. This shows that a greatly simplified formula could be introduced without causing turbulence greater than that seen in previous years' funding reforms.
It is not suggested that this is the "best fit" possible from any selection of indicators; nor that precisely replicating the 2013 formula is a worthwhile aim in itself. However, it would be possible to select a similar number of indicators that give the required amount of flexibility.

- Explicit judgement used to adjust the weights given to these indicators in the formula. This would be more transparent than the current system where the impact of judgements is hidden within a complex formula system, and would facilitate a meaningful debate about the priorities given to different elements.

- After the first year, avoiding fundamental changes to the structure of the formula. The formula weights can be adjusted to take account of changing government priorities, and authorities will be able to clearly see how their funding allocations have been affected by data and formula changes.

Question 7: What is your view on how we should take into account the growth in local taxes since 2013-14?

Since 2013, income from local taxes (particularly council tax) has not been equalised in the new system. To enable the new system to start from a robust baseline, we suggest that it should start from a new baseline for all elements of the funding formula (needs, council tax and business rates). While this would mean that authorities would not retain the benefit of growth since 2013, it would allow a level playing field for the new system.

Question 8: Should we allow step-changes in local authorities' funding following the new needs assessment?
Question 9: If not, what are your views on how we should transition to the new distribution of funding?

Given the short timescales involved for implementation, some damping arrangements are likely to be required where authorities would otherwise see a large step downwards in their funding.
The key, however is that (unlike in the system since 2013) this damping must be allowed to unwind in a predictable way in subsequent years, with the aim being to eliminate damping and let all authorities reach their assessed funding levels before introducing significant further turbulence into the system. The purpose of damping is to protect authorities from sudden changes in funding and allow them time to adapt, not to permanently lock in a historical level of funding.

Question 10: What are your views on a local government finance system that assessed need and distributed funding at a larger geographical area than the current system – for example, at the Combined Authority level?
Question 11: How should we decide the composition of these areas if we were to introduce such a system?
Question 12: What other considerations would we need to keep in mind if we were to introduce such a system?

Above all, the finance system needs to distribute resources on a consistent and fair basis across the country. Distributing funds at a combined authority level would only be feasible in the situation where all areas of the country were covered by Combined Authorities, with broadly similar responsibilities. This type of "one-size-fits-all" approach is directly opposed to the devolution aim to allow local solutions to be developed to meet specific local needs.

Combined authority areas should (clearly) be able to pool any or all funding elements, but this should be based on a local assessment of priorities and the benefits of managing budgets across a wider area.

Question 13: What behaviours should the reformed local government finance system incentivise?
Question 14: How can we build these incentives in to the assessment of councils' funding needs?

Incentivising authorities to achieve growth and manage risk requires a wider range of powers to raise income locally (see attached letter).

The system design should also consider the impact of the gearing effect, where (depending on historic circumstances) an authority increasing its business rates baseline by 1% may see its spending power increase by greater or less than 1%. The current system uses levies on growth to partially mitigate this effect; without an alternative mechanism to offset the gearing effect, there is a stronger incentive for growth in wealthier areas of the country.

Rates Retention Consultation

Question 1: Which of these identified grants / responsibilities do you think are the best candidates to be funded from retained business rates?

An additional criterion to those proposed should ensure that devolution of a function to local areas should be accompanied by genuine discretion. Where authorities are required to provide a national priority with little or no discretion, the full cost should continue to be met by the relevant government department, outside the retained business rates scheme.

Revenue Support Grant	Yes
Rural Services Delivery Grant	Yes
Greater London Authority Transport Grant	No comment
Public Health Grant	Yes
Improved Better Care Fund	Yes
Independent Living Fund	Yes
Early Years	It is unclear how this proposal interacts with the current DfE consultation on EY funding for 3 and 4 year olds, where the proposed national formula would require a continued grant stream. The consultation also proposes a further restriction of local discretion in using EY funding, making it less suitable for funding from business rates.
Youth Justice	No comment
Local Council Tax Support Administration Subsidy and Housing Benefit Pensioner Administration Subsidy	In principle, yes. The transfer should ensure that the full ongoing cost is funded, allowing for the loss of economies of scale in joint council tax / HB claims.
Attendance Allowance	This would need very careful consideration before being transferred, and is generally a poor fit to the criteria set out: - There are no links to economic development or resilience; - Ongoing demographic changes will increase costs after the transfer date. It is not clear how to ensure sufficient funding is available in future years; - If current recipients are protected, it will take many years for full devolution of the function to be implemented, with a long period of two parallel systems for authorities to manage; - With no detail on the longer-term discretion to be given to local authorities, it is not possible to comment on any hypothetical benefits from alignment with other social care services.

Question 2: Are there other grants / responsibilities that you consider should be devolved instead of or alongside those identified above?

Adult Skills funding: This has a close and obvious link to economic development. It is not clear why this cannot be localised in all areas, not just as part of a devolution deal.

Question 3: Do you have any views on the range of associated budgets that could be pooled at the Combined Authority level?
See covering letter.

Question 4: Do you have views on whether some or all of the commitments in existing and future deals could be funded through retained business rates?
There would be significant technical problems with a system where business rates fund a different range of services in different areas, which could change as new deals are agreed. It would be necessary to avoid the situation where a devolution deal agreed in one area would affect the funding available to other areas.
See also attached letter.

Question 5: Do you agree that we should continue with the new burdens doctrine post- 2020?
We see this as a crucial requirement. See attached letter.

Question 6: Do you agree that we should fix reset periods for the system?
Yes – authorities need certainty on timing to be able to plan and enter into longer-term commitments for infrastructure. See attached letter.

Question 7: What is the right balance in the system between rewarding growth and redistributing to meet changing need?
Resets need to address increasing "need to spend" in different areas, caused by (e.g.) population growth and demographic changes, as well as protecting authorities with declining business rates taxbases. To achieve this, the system should be able to distinguish between incentivising economic growth by being able to retain revenues from business rates (and, preferably, other income from a broader local taxbase) and changing need, which largely comes about as a result of demographic changes that are outside the direct control of local government.

In a system designed so the elements relating to these demographic drivers of need are clearly identifiable and separate from the elements intended to reward economic growth, the aims of rewarding growth and meeting changing need are not mutually exclusive. The data used for "needs" elements can be reset relatively frequently (on grounds of stability and predictability, frequent changes to the underlying methodology should be avoided), while the additional income from business rates growth can be retained for a longer period.

Question 8: Having regard to the balance between rewarding growth and protecting authorities with declining resources, how would you like to see a partial reset work?

Any system will need to take account of assessed "need to spend" as well as resources available from council tax and business rates. As long as these elements are clearly identifiable within the system, each can be updated or reset on a different basis.

The system should (as far as possible) treat council tax income in the same way as business rates in terms of retaining growth and equalisation within the system. The current system has largely failed in this regard, as the equalisation for council tax income has been eroded by the way funding cuts have been applied since 2010 (although this has been recognised and partly addressed in the most recent settlement).

Question 9: Is the current system of tariffs and top-ups the right one for redistribution between local authorities?
Question 10: Should we continue to adjust retained incomes for individual local authorities to cancel out the effect of future revaluations?

Yes the government should continue to adjust as suggested. Without such an adjustment, it is likely that Councils in the North or Midlands would be penalised even if they had generated physical growth in their areas.

Question 11: Should Mayoral Combined Authority areas have the opportunity to be given additional powers and incentives, as set out above?

We do not agree that the additional powers should only be available to combined authority areas. Individual authority elected Mayors have a similar democratic mandate and should have comparable powers.

Question 12: What has your experience been of the tier splits under the current 50% rates retention scheme? What changes would you want to see under 100% rates retention system?
No comment

Question 13: Do you consider that fire funding should be removed from the business rates retention scheme and what might be the advantages and disadvantages of this approach?
We agree that fire funding should be removed:
- The links between fire and rescue functions and economic regeneration are remote;
- Fire authorities are exposed to risks from business rates income that they are not in a position to accurately forecast or control;
- Removal of fire funding would provide a welcome simplification to the system.

Question 14: What are your views on how we could further incentivise growth under a 100% retention scheme? Are there additional incentives for growth that we should consider?
The current system only (realistically) rewards growth in the council taxbase and the physical NNDR taxbase, and yields differ greatly depending on the type of development, e.g. rates income from retail development is higher than from industrial sites. This is liable to create unhelpful incentives to concentrate activities on (for example) new supermarket developments at the expense of supporting businesses to become more productive or profitable within their existing physical premises.

In an economic climate where a significant proportion of employment growth is from small businesses, new start-ups and self-employment (often from residential addresses), a far wider definition of economic growth is needed than the NNDR taxbase. To incentivise this will require more radical changes in funding and a substantial widening of the local tax base – possibilities would include a local sales tax or fuel duty. This would also help authorities to mitigate some of the risks associated with full business rates retention, as authorities will be less reliant on any one income stream.

The system also needs a means to even out the incentive across different areas. With no adjustments, a 1% growth in business rates is a far greater boost to an area with a high pre-existing business rates taxbase, which will further increase the gaps between richer and poorer areas. At present, the levy system reduces (although does not eliminate) these uneven incentives. The issue of how to even out growth incentives in the new system requires urgent consideration.

Question 15: Would it be helpful to move some of the 'riskier' hereditaments off local lists? If so, what type of hereditaments should be moved?
It is not clear how "risky" hereditaments would be identified in a fair and consistent way across the country. One category is where a single large business contributes a significant proportion of business rates income within an authority. However, removing this from the local list would create the situation where similar hereditaments are treated differently depending on the size of the authority; and would necessarily undermine the incentive effect in that area.

Other types may be difficult to predict in advance – health trusts would not have been identified as particularly risky five years ago, but are currently one of the biggest areas of risk on local lists.

Question 16: Would you support the idea of introducing area level lists in Combined Authority areas? If so, what type of properties could sit on these lists, and how should income be used? Could this approach work for other authorities?

See the attached letter.

Question 17: At what level should risk associated with successful business rates appeals be managed? Do you have a preference for local, area (including Combined Authority), or national level (across all local authorities) management as set out in the options above?
See the attached letter

Question 18: What would help your local authority better manage risks associated with successful business rates appeals?

1. VOA. should settle appeals much quicker
2. More information from the VOA as to the nature of appeals so that authorities can make a better estimate of provisions.
3. Indication from the VOA of likely "big hits" before appeals are finalised on a without prejudice basis.

There is also a strong case that the backdated element of appeals should be met by the Exchequer, particularly as this is, in effect, a design issue.

Question 19: Would pooling risk, including a pool-area safety net, be attractive to local authorities?
See the attached letter

Question 20: What level of income protection should a system aim to provide? Should this be nationally set, or defined at area levels?

The level of income protection (and therefore risk) that an authority can manage depends on the tools it has available to address any budget shortfall. Authorities would be able to take on a greater level of risk if a wider range of income streams were controlled locally.

The main level of income protection should be nationally set and consistently applied across the country. If particular areas choose to provide additional protection (e.g. through pooling appeals risks) this should be the result of local agreement.

The current safety net does not distinguish between protecting authorities from a sudden shock to their income, e.g. from appeals or from the loss of a major business in the area, and areas with a general decline in income over several years. This will become a greater issue over time, as authorities' actual income diverges from the baseline used to calculate the safety net.
For example, after several years of growth, an authority could face losing 10% of its rates income from a sudden business failure in year 10 of the system – but if this does not bring it below the original baseline, it will receive no protection from the safety net. Conversely, an authority seeing 1% decreases on baseline each year will receive safety net funding by year 10, but is in a better position to plan for and manage the reduction over time.

Question 21: to Question 31: Local tax flexibilities.
See the attached letter

Question 32: Do you have any views on how to increase certainty and strengthen local accountability for councils in setting their budgets?
Local accountability for councils is limited by the small proportion of income that can be directly influenced locally. The main structure of both council tax and business rates, and the majority of discounts and reliefs, are set centrally and cannot be changed locally; the business rates multiplier is prescribed; and, while council tax is set locally, it is effectively constrained by historic rates, with only the increase being decided locally up to a 2% limit. In addition, in recent years, significant changes to business rates reliefs have been imposed centrally – while authorities have to date been compensated by additional grant funding, it is not clear how this will continue under 100% rates retention.

The only direct local decisions around these main income streams are at the margins – discretion on discounts and reliefs, on business rates levies, and on the increase in council tax.

While 100% rates retention will increase the proportion of expenditure that is funded from locally-retained income, it will do little to increase local decision-making over this income. To increase local accountability, elected local decision-makers need more ability to control their main income streams. This could include more local decision-making over the business rates multiplier, rates reliefs and further discretion over council tax discounts; and also local control and retention of a broader range of taxes (see q.14)

The timing of the local government financial settlement adds to the problems of local accountability. In recent years, key decisions by central government have not been known until late December, while local authority budgets merit consultation and a transparent political process before the budget is formally set by early March.

Question 33: Do you have views on where the balance between national and local accountability should fall, and how best to minimise any overlaps in accountability?
Question 34: Do you have views on whether the requirement to prepare a Collection Fund Account should remain in the new system?

For council tax, and for business rates in two-tier areas, there will still be a requirement to account for payments between billing and precepting authorities, although the accounting and reporting requirements could be simplified.

The main practical impact of removing the Collection Fund in its current form would appear to be a timing difference around when a surplus or deficit is recognised in the accounts, and (depending on new legislation) around the way a surplus or deficit is apportioned between billing and precepting authorities, and could lead to greater uncertainty in managing budgets. We do not see that the abolition of the Collection Fund would improve financial management.

Question 35: Do you have views on how the calculation of a balanced budget may be altered to be better aligned with the way local authorities run their business?

We are unclear on the purpose of altering the current calculation. Authorities should be able to show that they have sufficient resources available (including the use of reserves) to meet their spending requirements, as the alternative would involve borrowing funds for revenue purposes. It occurs to us that this question implicitly recognises that funding cuts have gone too far.

Question 36: Do you have views on how the Business Rates data collection activities may be altered to collect and record information in a more timely and transparent manner?

No comment