Gedling Borough Council

Report to Cabinet

Subject: Business Rates Pooling in Nottinghamshire

Date: 8th November 2012

Author: Corporate Director and Chief Finance Officer

Wards Affected

Borough Wide

1. **Purpose**

To inform Members of the business rate retention scheme and potential pooling arrangements within Nottinghamshire; and to recommend that Gedling Borough Council participates in such a scheme.

2. **Key Decision**

This is a key decision because it is likely to result in the Council incurring savings which are significant having regard to the budget for the service or function concerned (Gedling's Constitution currently defines this as £500,000) and it is likely to be significant in terms of its effect on communities living or working in an area comprising two or more wards of the Borough.

3. **Background**

3.1 The business rates retention scheme will be introduced in April 2013 under the provisions of the Local Government Finance Bill currently going through Parliament. Under the new system, central government will estimate the total business rates that will be collected by **all** local authorities in 2013/14. This is termed the "Estimated Business Rates Aggregate" (EBRA).

3.2 Central government will retain 50% of the EBRA (termed the "central share") and the remaining 50% will be for the "local share". The central share will be used to fund local government through the Revenue Support Grant or other specific grants outside of the business rates retention scheme e.g. the New Homes Bonus payments.

3.3 Central government will then calculate the "proportionate share" for each billing authority based on historic business rates collection, and will apply this to the local share of EBRA to work out each billing authority's business rates baseline

3.4 In two tier areas, this billing authority business rates baseline will then be split between the billing authority and its major precepting authorities to determine individual authority business rates baselines. In two tier areas the stated intention is that the

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major precepting shares should be 80% for district councils, 18% for the County Councils, and 2% for the single purpose fire and rescue authorities.

3.5 Central government will then calculate for each authority a baseline funding level for the start of the business rates retention scheme by applying an updated 2012/13 formula grant calculation to the local share of the EBRA...

3.6 “Tariffs” and “top-ups” are then calculated. Local authorities that have an individual authority business rates baseline that is higher than their baseline funding level will pay a tariff. Local authorities that have baseline funding levels greater than their individual authority business baselines will receive a top-up. Because of the 80:20 split to districts, all districts will be tariff authorities and all county councils will be top-up authorities.

3.7 Once operational, the system will utilise a “safety net” and “levy” system. The safety net will protect local authorities from significant negative shocks by guaranteeing that no local authority will see its retained business rates income fall beyond a set level (to be somewhere between 7.5% and 10%) below the authority’s index-linked baseline funding level.

3.8 The safety net will be funded by a levy on the disproportionate benefits to baseline funding levels that some authorities will experience as a result of growth in business rates caused by the uneven distribution of individual authority business rates baselines and different baseline funding levels.

3.9 Central government intends to set a proportional levy ration and proposes to set this at a 1:1 level. This means that for every 1% increase on the individual authority business rate baseline the authority would see no more than a corresponding 1% increase against its baseline funding level. At the 1:1 ration only tariff authorities would be levied. However, all tariff authorities will pay some levy on growth as by definition a 1% increase in growth rates will by definition always exceed 1% of their funding baseline.

How Pooling Arrangements Work

3.10 Under the new system, local authorities will be able to come together to voluntarily pool their business rates income. The pool will be treated as a single body for the purposes of the scheme, with local authorities being free to distribute retained business rates income amongst members using their own local discretion.

3.11 Government believes that pooling offers local authorities the scope to generate additional growth through collaborative effort and to smooth the impact of volatility in rates income across a wider economic area.

3.12 A lead authority will be nominated and all payments due to or from the pool will be channelled through the lead authority. They will also be responsible for supplying information on behalf of the pool in connection with the operation of the business rates retention scheme. Each member of the pool would, however, be jointly and severally liable for any payments required to central government.

3.13 Once designated as such, a pool will be treated as a single body for the purpose of calculating its tariff or top-up, and this would be the sum of all the tariffs and top-ups of the individual authorities within the pool. This will help local authorities better manage the volatility in business rates income, and it could also place authorities in a more beneficial collective position than if they had not pooled. This is because the authority's tariff or levy rate will be reduced as a result of joining the pool.

3.14 It will be for the pool itself to decide how to distribute aggregate revenues, allowing members of the pool to decide how best to support shared economic priorities or to manage volatility. Pools could decide to adopt a "no worse off" approach where members would be treated no worse than if they hadn't pooled, or perhaps a weighted contribution approach depending on the benefit received.

3.15 If a pool is dissolved, members of the pool would return to their individual tariff, top up and levy amounts, and this would take effect from the following financial year once the scheme is in operation.

3.16 To ensure pools are able to come into effect in time for the rates retention scheme in April 2013, the key date is 9th November 2012. This is when the potential pool members need to confirm their intention to pool for 2013/14. As part of the submission the Chief Executive and Chief Finance Officer of each Council are required to sign off the proposal. Whilst this is not a requirement of the submission, it would also be appropriate to obtain sign off from the respective Leaders of each Council. After this date there is still the opportunity to withdraw from the pool if the financial benefits do not materialise when the provisional local government finance settlement is announced in December 2012.

3.17 However, if **any** Council withdraws from the pool after this date and before mid-January 2013 when the consultation period of the finance settlement ends, the pool ceases to exist and the ability to pool in 2013/14 would not be available. However an application to pool could be made again for 2014/15.

3.18 With the County Council being a top-up authority, there could be benefits to pooling within Nottinghamshire as this would reduce the overall levy paid over centrally. However, the risks and the detail of how such a proposal would operate would need to be carefully examined.

3.19 No information is available regarding the amount of business rate appeals which are either currently outstanding or can generally be expected in a year. This is a major concern to local authorities as under the new scheme they will be vulnerable to any appeals upheld, and the resultant effect on their business rate values and collectable Non-Domestic Rates (as appeals always result in a lower tax base).

Potential Advantages and Disadvantages

3.20 Becoming a member of a pool offers three potential benefits to local authorities, namely:

- Volatility management
- Levy reduction

- Economic efficiency

Each of these issues is discussed in turn below.

(a) Volatility Management

3.21 Pooling could serve as an insurance mechanism against income volatility. Under the business rates retention scheme, authorities receive a share (50%) of any income in business rates receipts, subject to a "levy" on what the government defines as disproportionate growth. However, authorities are equally vulnerable to a reduction in income, following on from a contraction in their tax base (for example, the closure or relocation of a major local business), and would be liable for 50% of the resulting reduction in business rate income.

3.22 The current Formula Grant system features a "floor damping" mechanism, which minimises year-on-year changes in councils' funding. From April 2013, this protection will be replaced with a "safety net" under the business rate retention scheme. However, the safety net will not have an effect until the authority's income falls by 7.5% to 10.0% below its baseline funding level (the exact percentage is still to be confirmed by central government). Authorities therefore face the risk of any potential reductions in income from 2013/14 onwards that are not covered by the safety net.

3.23 CLG compares each authority's baseline funding level with its anticipated business rates income at the outset of the scheme. Those councils with a baseline funding level higher than their business rates income receive a "top-up" from central government, while those with a baseline lower than their business rates income pay a "tariff". For tariff authorities, a 1% reduction in the local tax base corresponds to a larger proportional reduction in their baseline funding levels, as compared to top-up authorities. The level of exposure to income volatility is therefore dependent on whether a council is a top-up or tariff authority.

3.24 Pooling provides insurance against tax base volatility by spreading this risk across all members of the pool. The exact level of protection will depend on the method used to distribute business rate income, which must be agreed by members of the pool at the outset. One option is for business rate income to be distributed in proportion to each authority's baseline funding level. This way, every authority's income will increase at the same rate as the pooled average, smoothing out the expected variation in individual authorities' tax base growth, although there are also a range of alternative methods.

3.25 Pooling as an insurance mechanism also means that authorities could see a financial benefit from rapidly-growing members of the pool. On the other hand, authorities experiencing rapid tax base growth will be required to subsidise other pool members experiencing lower or negative growth. Authorities should therefore consider the volatility (both positive and negative) associated with other potential pool members.

(b) Levy Reduction

3.26 The second major advantage of pooling is that it can reduce the overall levy obligation of the pool. Under certain circumstances, the levy payment of the pool (in £ terms) can be less than the sum of the individual levy payments that would have been due if the authorities had acted individually. This means that pooling is not necessarily a zero-sum game, but can result in a net increase in resources, which are available for redistribution amongst its members. Pooling can reduce combined levy obligations in two ways:

- By reducing or eliminating the levy

- By reducing total levy obligations if one or more members of the pool experience a reduction in their Business Rate tax base.

3.27 There is, however, also the risk that pooling will lower authorities' combined income by reducing their eligibility for safety net payments. Different Business Rate growth rates experienced by different members of the pool can also have a positive or negative impact on the benefits of pooling. These factors are discussed in further detail below.

(i) Reduction in the levy rate

3.28 Forming a pool can reduce or eliminate the levy that would otherwise have been paid to central government on retained Business Rate growth. The levy (expressed as pence in the pound) will be calculated so that a 1% increase in an authority's retained business rates will correspond to a 1% increase in their baseline funding level. The levy rate will vary from authority to authority, and will increase in proportion to the ratio of the Council's Business Rate income to its baseline funding level. Top-up authorities are not required to pay a levy.

(ii) Reduced levy obligations in the case of negative growth

3.29 Pooling can also reduce levy obligations by offsetting the Business Rate reductions of one authority against the positive gains of another. The levy is only applied to positive business rate growth, so, for an individual authority, the lower its Business Rate income growth, and the lower its levy obligation will be. Once the authority's Business Rate growth has reached zero, any further reductions will not yield further benefits to the individual authority in terms of reduced levy obligations. However, under a pooling arrangement, the fall in Business Rate receipts can be offset by the growth achieved by other authorities in the pool, so that the full reduction is reflected in the pool's levy obligation.

iii) Reduction in safety net eligibility

3.30 There is a risk that forming a pool may reduce members' combined income by affecting their eligibility for the safety net. A lone authority that saw a reduction in its income below 10% of its baseline funding level would be eligible for safety net funding. However, if business rates income was pooled, then this reduction in funding may be offset by the increase in Business Rate income amongst other members of the pool. As a result, the safety net threshold might not be reached.

iv) Differential growth rates

3.31 Finally, differential growth rates among member authorities can enhance or diminish the benefits of pooling. The pool levy is the weighted average of each individual member's levy (including top-up authorities, for whom the levy is zero). As a result of pooling, Business Rate growth in any authority could be levied at a greater or lower rate than it would have been had the authority remained outside the pool. If tax base growth happens to be concentrated in authorities that would otherwise have paid a lower levy, then pooling will decrease the combined income of the member authorities. If it is concentrated in authorities that would have paid a higher levy, then pooling will increase combined income.

(c) Economic Efficiency

3.32 Pooling could have positive effects on local authorities' incentives to pursue optimal investment strategies. Investments that promote tax base growth are likely to spill over administrative boundaries. Pooling would help "internalise" the benefits that accrue from the investment (in the form of increased business rates growth), as the investing authority will receive a share of the benefit through growth in the pool.

3.33 Pooling would mean that the geographical location of local authorities' investments will be based on the greatest financial returns, rather than being constrained by administrative boundaries. If authorities shared pooled NDR growth, they would have an incentive to invest in growth-enhancing initiatives, wherever they yield the greatest return, in terms of enhanced NDR growth. The fact that they share in the NDR growth of other authorities means that an authority's efforts to promote business rates growth would not need to solely be constrained to opportunities in the local area.

3.34 Pooling could also diminish the incentive for neighbouring councils to compete with one another to attract businesses. Under the business rates retention scheme, councils are incentivised to attract new businesses to their local area, rather than increase the rateable value of existing ones. Without a pool, local authorities may find themselves expending resources in a competition for businesses, at the expense of neighbouring councils. Pooling will incentivise councils to cooperate in ways that draw additional businesses to the region, with a benefit to all member authorities, rather than competing for business rates locally.

The Potential for Pooling in Nottinghamshire

3.35 Because all of the Nottinghamshire District Councils are "tariff authorities", and the County Council is a "top-up" authority, there is a potential advantage of the Nottinghamshire authorities entering into a pooling arrangement. This is because the expected top-up for the County Council will exceed the expected sum of the tariffs charged against the districts, leaving a net top-up requirement, which ultimately results in a 0% levy on the pool for any growth that may occur in Nottinghamshire.

3.36 Ashfield District Council and Mansfield District Council previously put in an expression of interest for pooling based largely on their view that this could provide advantages for economic development. Discussions have been taking place about whether this pool could be expanded to include other Nottinghamshire Authorities, although a pool would not need to include all of the Authorities.

3.37 It is a requirement that a proposal for pooling arrangements has Governance arrangements agreed by all authorities by the date of submission. It is considered that the current arrangements in Nottinghamshire consisting of the Nottinghamshire Leaders Group, the Nottinghamshire Chief Executives Group and the Nottinghamshire Financial Officers Association could fulfil the necessary reporting and management arrangements. The Governance arrangements would also need to include an agreement for sharing of gains and losses. If possible, this should protect any authority that would fall into the Government's safety net arrangements and be on a "no detriment" basis. If a submission is to be made for pooling in 2013/14 it is necessary to submit draft management arrangements as part of the application to central government, which must be made by the deadline of 9th November 2012.

The Implications of Pooling

3.38 The baseline funding for the district councils in Nottinghamshire is expected to range from £8m for Gedling BC (smallest) to £18m for Bassetlaw DC (largest). The impact of a +/- 1% change in Gedling's baseline figure would have the least impact; conversely a change in Bassetlaw's baseline figure would therefore have the greatest impact on the pool. Changes to be funding in all cases are as follows:

- 1% growth – individually Authorities' would make a levy payment to central government of circa 76%, and only retaining 24% of the growth in tax base. However, it is expected that the combined pool would attract a 0% levy, so all of this growth would be retained in Nottinghamshire, with an individual authority's share being on the basis of the agreed distribution methodology.

- 1% reduction – individually an Authority would lose all of this income until the safety net limit is reached. However under the pool arrangements, depending on the agreed distribution methodology, this reduction may be shared across all of the authorities within the pool.

3.39 The scheme gives freedom to individual local authorities to determine the pool's geographical coverage, including wider than within a county-region, although government will have the ability to refuse pooling proposals where they perceive that there is no clear rationale for the proposed pool.

3.40 CLG has indicated that local authorities will be relatively free to leave the pool. The Pooling Prospectus states that *"pooling should be voluntary, and this means that members should be able to leave the pool should they decide it is no longer in their interests to be a member of it."* However, CLG also states that a member cannot leave the pool part way through a financial year, and that it must make its request to leave within 28 days of the draft Local Government Finance Report being published.

4. **Proposal**

4.1 There are potential significant advantages in entering into a pooling arrangement for business rates, in particular with the potential for a reduction in the combined levy, although it needs to be recognised that there are also some risks.

4.2 There is considerable uncertainty about the Local Government Finance Settlement for 2013/14 and regulations that may be issued under the Local Government Finance Bill once it has completed its passage through Parliament. Consequently, the financial implications cannot be quantified with any certainty at this stage.

4.3 If the Council is to enter into pooling arrangements for Business Rates, it is important that the final agreement is in the best interests of all partners, and the timetable makes it difficult for such arrangements to be in place in time to meet the deadline. Nevertheless, given the potential advantages outlined in the report, it is considered beneficial that a proposal is submitted for 2013/14 if detailed arrangements can be agreed by the interested Nottinghamshire councils by the deadline. In order to do this, it will be necessary to give delegated authority to the Chief Executive and Corporate Director and Chief Finance Officer to approve participation in a pooling scheme.

4.4 As far as the current arrangements are understood, one option could be for local authorities to delay entering into pooling arrangements, subject to Government approval, until 2014/15 or even in future years. This would give time for the current uncertainty about the implications of the Finance Settlement and the Local Government Finance Bill to be overcome and for robust governance arrangements to be put in place. It would also reduce the risk of a partner withdrawing from the pooling arrangement, causing the pool not to proceed.

5. Alternative Options

5.1 The alternative options include not joining a pool, or looking to join a pool with a different set of Local Authorities.

6. **Financial Implications**

6.1 As reported, all local authorities are awaiting the announcement of the Local Government Finance Settlement in December, before any financial impacts for Gedling can be assessed.

6.2 However, the County Council have commissioned LG Futures to undertake some review work based on the pooling of authorities option, and their forecasts are that there may be additional funding for Nottinghamshire as a whole of £8.4m in 2013/14 and £9.0m in 2014/15 based on the tariffs of the districts being integrated with the top-up element of the County Council.

7. Background Papers

7.1 None identified.

8. **Recommendation(s)**

It is recommended that:

8.1 Cabinet agrees in principle to participate in a business rates pool for Nottinghamshire Authorities, subject to the final arrangements being in the best interests of the Council.

8.2 Delegated authority be given to the Chief Executive and Corporate Director and Chief Finance Officer to approve the participation of Gedling Borough Council in the initial submission of a pooling arrangement for 2013/14 involving other Nottinghamshire Authorities, provided that it is considered in the best interests of the Council.

8.3 Delegated authority be given to the Chief Executive and Corporate Director and Chief Finance Officer, in consultation with the Leader of the Council, to confirm the Council's participation in the proposed pooling arrangement following the announcement of the Local Government Finance Settlement in December 2012, provided that it is considered in the best interests of the Council.

8.4 Further modelling work is undertaken as additional information becomes available to determine the financial advantages of pooling arrangements.

8.5 If it is not possible to agree pooling arrangements for 2013/14, further work is carried out to determine whether or not it is appropriate to make a submission for pooling arrangements in 2014/15.

9. **Reasons for Recommendations**

9.1 To increase the likelihood that resources are retained in Nottinghamshire and Gedling Borough Council.

9.2 To minimise the risks of reduced funding caused by any reductions in the Business rates baseline.