POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

100% Business Rates Retention

Systems Design Working Group: 27 June 2018

Technical paper 6: Pooling arrangements

Introduction

1.1 On 5 July 2016, the Department for Communities and Local Government (DCLG) published a consultation paper, Self Sufficient Local Government: 100% business Rates Retention. Following this, on 15 February 2017, DCLG, published a further consultation paper, 100% Business Rates Retention: Further Consultation on the Design of the Reformed System.

1.2 These set out proposals for a rates retention scheme to replace the current local government finance system, under which local authorities pay a central share of 50% of their business rates income to be redistributed as grants.

1.3 The consultation papers outlined the principal features of the proposed greater rates retention scheme. A summary of responses received to the Further Consultation was published alongside the 2018/19 Provisional Settlement on 19 December 2017.

1.4 Following the fall of the Local Government Finance Bill, MHCLG (formerly DCLG) will be developing a package of reforms, in close collaboration with the sector, that further the manifesto commitment to continue to allow local government greater control over the money it raises. Reforms to the design of the system will seek to make improvements to the functionality and stability of Local Government Finance.

1.5 A commitment was made to the Steering Group and Technical Working Group that a series of technical papers would be shared with the Technical Working Group for discussion and published on the Local Government Association (LGA) website. A suggested forward look of these was shared with the Working and Steering Groups in November 2017.

1.6 Taken together these technical papers will raise a number of questions about the proposed rates retention scheme, on which the Government is seeking views.

1.7 This is one of seven core technical papers. The full list is:

Paper 1: The Central and Local Rating Lists

Paper 2:	The Safety Net, Levy & Tier Splits - Risk and Gearing
Paper 3:	Appeals and Loss Payments
Paper 4:	Resets
Paper 5:	**Pooling**
Paper 6:	Transitional Arrangements
Paper 7:	Proposed Overall Short Term Package and Future Reform Using Primary Legislation

1.8 We expect that these will be supplemented by other papers in response to Technical Working Group discussions. Additional papers will be announced as need for them arises.

Background and benefits of pooling

2.1 A business rate pool is a voluntary arrangement between a group of local authorities in England whereby their combined business rates income and any growth is collected as one common fund or 'pool'. The pooling process which is a statutory mechanism is based on powers conferred by Part 9 of Schedule 7B to the Local Government Finance Act 1988 (inserted by Schedule 1 to the Local Government Finance Act 2012). Broadly the Act provides a mechanism for two or more authorities to pool business rates and that pools will start in each financial year from 1 April.

2.2 The rationale as to the benefits of pooling has been stated by the Government in previous pooling prospectuses since 2013-14. The Government believes that pooling can deliver a range of benefits for local authorities:

- The act of setting up pools can help further the process of joint working and could result in wider benefits that go well beyond the immediate scope of pooling;
- The pooling of business rates across a wider and economically coherent area ensures that all authorities in the pool can benefit. This can mean that the strategic decisions that are needed about economic growth and infrastructure investment are easier to make;
- Pooling can help authorities manage the volatility of income through business rates retention by spreading this risk across a wider geographical area.

2.3 There is a strong incentive to pool because, in many cases, authorities that pool can be better off collectively. This is because the levy rate for a pool as a whole can be lower than that for individual pool members if they remained outside the pool.

2.4 Both figures 1 and 3 on pages 3 and 5 respectively illustrate there has been a large increase in the number of authorities pooling since 2013/14.

Overview of this paper

2.5 This paper will cover:

1. The benefits and effectiveness of pooling to date.

2. The system design elements which can further incentivise pooling in the light of future changes to business rates retention.

3. Potential requirement central government could make in regard to enhanced pooling arrangements as we move to increase business rates retention and reform the system.

3. Pool formation and membership

3.1 This section illustrates the uptake of pooling arrangements by authorities between 2013/14 and 2018/19, the process which underpins this and certain factors which influence membership. The formation of pools occurs on an annual basis and pool participation has increased in each year of the scheme. **Figure 1** demonstrates that some 70% of authorities are now part of a pool, up from 17.4% in pooling's first year of inception.

Figure 1: English Local Authorities Pools 2013/14 – 2018/19

BRR Pools 2013 - 2019

Year	Number of pools	Number of English Local Authorities in a Business Rates Pool	Percentage of English Local Authorities in a Business Rates Pool
2013/2014	10	67	17.4
2014/2015	18	111	28.8
2015/2016	27	192	49.9
2016/2017	29	209	54.2
2017/2018	27	194	50.4
2018/2019	30	268	69.6

3.2 Ultimately the power to designate or revoke pools rests with the Secretary of State. The limitations on this power are that a pool cannot be designated without the consent of all the authorities, and a pool must be revoked if an authority requests that it is revoked. The Secretary of State does have the power to revoke (discontinue) pools, but has never used these powers[1]. To date the Government has never rejected a pooling proposal from a group of authorities. The designation has effect for the year after it is made and for each subsequent year, unless the designation is revoked.

3.3 The membership of business rate pools is confirmed prior to the provisional local government finance settlement each December.

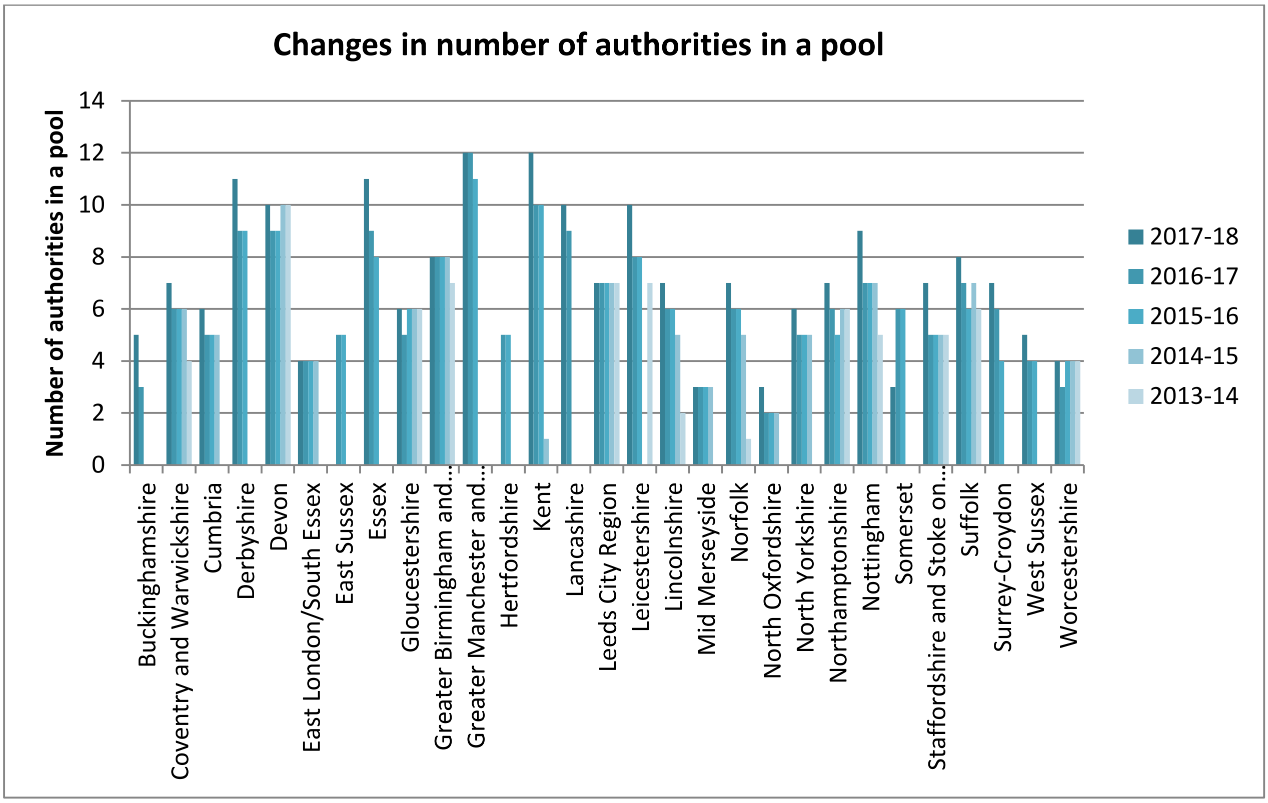
3.4 Governance agreements are formalised in a memorandum of understanding between the authorities concerned. These address the management of the pool, the distribution of pool income and how payments to central government are to be funded by the lead authority as well as the arrangements for the treatment of any liabilities or balances post dissolution of the pool.

3.5 The membership of pools year on year is relatively stable (Figure 2); however, there is anecdotal evidence to suggest that authorities most likely not to be in a pool share the same characteristics. Generally these authorities have the following characteristics:

[1] The Secretary of State must revoke a designation if any authority covered by it asks the Secretary of State to do so.

1. Smaller, rural, lower tier authorities;
2. Perceived as having a higher level of risk through valuation loss;
3. Rely upon a relatively small number of hereditaments for a disproportionately large portion of their business rates income;
4. Have a longer history of calling on the safety net .

Figure 2 below illustrates the changes in pools memberships over the last five years.



3.6 Local government has demonstrated strong appetite to enter into pooling arrangements. This paper will look into options to further incentivise this uptake and remove any barriers or disincentives.

4. Operation, performance and newer governance

4.1 This section analyses the operation and performance of business rate pools and details the newer governance arrangements employed by pools and proposed by 2018/19 pilots.

4.2 When a group of local authorities pool their safety net and levy payments are calculated for the pool as a whole, rather than as individual authorities. This has the effect of averaging out tariff and top-ups; leading to lower levy rates when calculated for the pool as a whole, compared to calculations for the same authorities treated individually.

4.3 **Figure 3** illustrates the difference in safety net and levy payments for pooled authorities as compared to payments for the same member authorities when treated individually for 2013/14 – 2016/17. Local authority members of pools saved over £100m in levy payments in 2016/17. This has clearly provided a strong incentive for local authorities to form pools. Safety net payments have also reduced as a consequence of pooling, however the net impact of reduced levy and safety net payments is for a reduction in Central Government income. This is against a wider backdrop of increased levy payments and reduced safety net payments over time (common for pooled and non-pooled authorities).

Figure 3: Pool Levy and Safety Net Savings

Year	Total post Pooling **Levy** payments £ Million	Total Post Pooling **levy** savings £ Million	**Safety net** payment to all pools by the Government £ Million	**Safety net** saving to LAs post pooling £ Million	Number of pools	Number of Local Authorities
2013-14	25.0	15.1	197.0	2.4	10	67
2014-15	52.5	29.3	115.5	9.1	18	11
2015-16	67.6	66.7	113.9	2.7	27	192
2016-17	95.8	101.2	12.7	0.77	29	209

(Source NNDR 3)

4.4 Applications to be part of the expanded 2018/19 pilot programme have also demonstrated the scope and appetite for pooling to go beyond sim. Pilots are in the process of instigating increased communication and cooperation between members from knowledge sharing and financial management to increasing collection and reducing fraud.

4.5 Pool budget monitoring reports allow financial projections to be monitored by all members and shared; participant authorities appear to be sharing best practice to maximise business rates income within their own authorities to contribute to the overall benefit of the pool. Closer working between the member authorities may be helping to develop further expertise, capacity and best practice across the pool area to improve performance, collection rates and maximise income.

4.6 Overall, pooling arrangements may have had some effect of spreading the risk presented by business rates income volatility. However safety net payments have primarily reduced as a consequence of other reasons, such as the rate of growth experienced by many local authorities. Reward in the form of reduced levy payments has been experienced by pooling authorities. No clear data has been collected regarding the economic growth or increase in business rates income due specific investment decisions at a pool wide level. However, some business rates pools have gone further than the simple administration of the pool, i.e. through strategic investment of growth. This direction of travel for pools was also demonstrated by many of the applications from pools to become 2018/19 business rates.

Q1: What do you think the impact of pooling has been?

5. Previous discussion on pooling - previous papers, options, feedback and consultations

5.1 The Government has sought the sector's views on the future reform of the business rates retention system through two consultations. The first being "**Self sufficient government: 100% business rates retention running between July 2016** and the second launched in February 2017 consultation: "**100% Business rates retention: Further consultation on the design of the reformed system**"

5.2 The July 2016 consultation asked: *Would pooling risk, including a pool-area safety net be attractive to local authorities?*

Nearly half of all authorities were in favour of pooling preferring a voluntary approach and emphasising that both risk and reward must be shared. Those who did not favour pooling – the most significant concern was that it may add more complexity to the system.

5.3 The second 2017 consultation asked: *What are your views on the Government's plans for pooling and local growth zones under the 100% business rates retention system?*

79% of the sector was opposed to the Secretary of State having the power to designate pools (without local authority agreement) as it was contradictory to the principle of localism. 3% were in favour of this power as it would prevent the exclusion from pools of authorities perceived as high risk. 48% of responses were in favour of greater pooling incentives but were of the opinion that more detail would be needed. Some noted that the removal of the levy would remove the incentive to pool.

Regarding the introduction of local growth zones the majority stated there needed to be more information before they could commit to a firm response; in principle it was felt that local growth zones would promote investment. Concerns were raised that LGZs could displace growth/investment from other areas.

6. Future reform of pooling

6.1 Earlier sections of this paper summarised some of the benefits some local authorities have received from pooling, both directly from the way the system was set up (through the incentive of a reduction in levy payments for local authorities that pool) and indirectly through the sharing of risk.

6.2 This section of the paper will explore possible reforms to the business rates retention system from 2020/2021. In doing so it will address two questions:

a) What are the potential incentives to encourage local authorities to form business rates pools?
b) Should business rates retention pooling be reformed to encourage local authorities to collaborate even more closely and, if so, how?

a) What are the potential incentives to encourage local authorities to form business rates pools?

6.3 There are three main considerations in deciding how pooling can potentially be incentivised from 2020 onwards, Firstly, any incentive has to be provided for within the current legislative framework. As noted in previous working group discussions, the Government has indicated that it has no intention to bring forward primary legislation to implement reform to the local government finance system before 2020.

6.4 Secondly, the previous Government had indicated that it was minded to scrap the levy on business rates growth when 100% business rates retention was implemented. The working group has previously discussed possible reform to the levy, noting this commitment and also the legislative constraints to reforming the levy in such a way. One of the working group's suggestions is reform of the levy could be directed so that any future levy only targets 'excessive growth'. MHCLG officials are considering this proposition further, but reforms to the levy are likely to considerably weaken the current incentive to pool.

6.5 Finally, the current incentive to pool (through the reduction of levy payments on growth) is fiscally neutral and is funded from within local government's share of the business rates quantum. This requirement for fiscal neutrality is a consideration for future potential incentives too.

Designated areas and local growth zones

6.6 In the 2017 consultation on the design of the reformed business rates retention system the Government consulted on the idea of **local growth zones**. The proposition was for a pool to be able to designate a geographical area as a 'local growth zone' and for the pool to be able to keep any business rates growth generated in that area for a longer period of time than normal without that growth being ‘reset’. This was consulted on as the primary way of incentivising pooling once 100% business rates retention was implemented. As conceived at the time local growth zones required primary legislation in order to be implemented, and therefore could not be implemented as part of the planned reforms from 2020.

6.7 The Government has the power to create **designated areas** by means of Part 10 Schedule 7B of the Local Government Finance Act 2012, granting the Secretary of State the power to designate geographical areas in Billing Authorities. These are currently created to incentivise existing businesses to relocate into these areas of economic opportunity, as well as to promote the creation of jobs and businesses. All growth income derived from the designated area is exempt from any reset for the duration of its existence.

6.8 By allowing growth from a certain geographical area to be retained for a longer period of time there are similarities between current designated areas and the proposed idea of local growth zones. However several operational differences would need to be considered further if designated areas were to be used to promote pooling:

- Disregarded rates associated with a designated area are retained by the billing authority which owns that particular designated area. There is no policy obligation for that disregarded amount to be shared within the pool.

- Pooling is currently a year by year arrangement, should the billing authority that owns the designated area decide to leave the pool they would retain the disregarded amount (presuming a designated area is in place for longer than on year).

- The question arises as to the entitlement to disregarded amounts of new entrants to a pool, if the membership of a pool were to change.

6.9 One way in which these obstacles could be overcome would be to set certain operational parameters within a pool’s Memorandum of Understanding (i.e. around membership of the pool and the length of time the pool is active). It should be noted that the Government does not have powers to obligate any specific pooling MOU provisions.

6.10 The System Design Working Group has also been asked to consider what possible reforms could be brought forward via primary legislation (not for implementation in 2020 but at a later date). Consideration could be given as to whether the original proposals for Local Growth Zones could be enshrined through primary legislation in future.

Q2: Do you think an approximation of the previous policy of 'local growth zones' would provide an incentive for local areas to pool?

Q3: What are you views on what requirements would need to be in place for pooled local authorities to be satisfied that designated areas were to the benefit of all pool members?

Retaining more growth

6.11 The current incentive for pooling works by offering a potential financial benefit for those local authorities that decide to form business rates retention pools. There are two possible mechanisms by which growth achieved in business rates income could be utilised to encourage local authorities to form pools in future, after the levy is reformed:

- A pool could retain a greater percentage of growth than non-pooling local authorities over a **full or partial reset.** For example, if all local authorities were to keep 50% of the growth that they had achieved over a reset period in a partial reset[2], pools of local authorities could be able to keep more.

- Pools could retain a higher **percentage of total growth** achieved during a reset period compared to non-pooling authorities, as currently happens in 100% BRR pilots.

6.12 The Government has previously discussed with the sector several different options for the future of resets and is also bringing a technical paper to the system design working group and steering group detailing modelling undertaken exploring the impact of different approaches to resets. Therefore it should be noted that the effectiveness of treating growth in pooled areas differently at a reset point is wholly dependent on future approach to resets overall.

6.13 Consideration should also be given to what preconditions in the characteristics of a pool would need to be in place for such an approach to work. A **stable membership of the pool**, in line with a recognised geography of a functional economic area, alongside the **continuation of the pool for a minimum time period**, in line with the future approach to reset periods, could be minimum requirements. There is also a broader question as to what other expectations and opportunities should exist for a pool if such an incentive was provided for.

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[2] The Government, in its 2017 consultation on the future of business rates retention, sought views partial reset periods. The sector was largely supportive of the approach and 5 years being a sensible partial reset period. However, it has also been proposed that it would be beneficial for resets to align with the future cycle of business rates revaluations.

6.14 Further modelling work needs to be undertaken to understand the cost implications of incentivising pools through either of the above two options. Depending on the design of the overall system, the costs of such incentives for pools might need to be borne by the overall system and therefore constrain resources available for non-pooling authorities. As a consequence it should be stressed that the Government has no plans to necessarily implement either of these options and we are seeking the working group's views on the potential effectiveness of these as incentives and to consider any operational considerations.

Q4: Would retaining an additional amount of growth over a partial reset or retaining a higher percentage of growth be an incentive to pooling?

Q5: What are your views on the requirements for a pool that would need to be in place for these incentives to work?

Other potential incentives

The concept of an 'area list'

6.15 Through consultation and discussion at working groups, the concept of **area or regional lists** has been considered, alongside reform of the criteria by which hereditaments are included on the Central List. The technical paper on potential reforms to the Central List[3] set out that reform in this area could be desirable as a small number of large and often volatile (in terms of Rateable Value) hereditaments pose a disproportionate risk to some local authorities, particularly if that hereditament represents a relatively large proportion of the local list of a particular local authority. However there is the possibility that the concept of area lists could be used to incentivise pooling too.

6.16 The creation of area lists would require primary legislation; however there is the mechanism through secondary regulations to move hereditaments from the Central List to a local list. For example, the Government could take a decision to move a hereditament to a local list (under the VOA's normal practices) only if a pool had been established and if certain other requirements (e.g. stable pool membership over a period of time). By meeting this pre-established requirements would mean that the hereditament moved to the local list would benefit the whole pool.

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[3] The Technical paper on the Central List and other system design working group papers can be found on the LGA website.

6.17 For the concept of an ‘area list’ to provide an effective incentive to pooling it would be predicated on the possibility of income from growth in a number of Central List hereditaments being moved to a virtual ‘area list’ for the benefit of the pool. The System Design Working Group and Steering Group have indicated that they believe that large scale movement of hereditaments from or to the Central List would not be desirable.

Safety Net

6.18 One final element of the system that could be reformed in order to provide a potential incentive to pooling is the **safety net**. A potential incentive to pool could be generated if a higher safety net level was provided for pools opposed to individual local authorities. However this may be a weak incentive, particularly as the Government is looking at introducing measures to mitigate the risk that valuation losses caused by appeals and by other means.

Q6: Do you have any views on these or any other possible incentives to pooling?

b) Should business rates retention pooling be reformed to encourage local authorities to collaborate even more closely and, if so, how?

6.19 This paper has already asked for consideration of what operational expectations would need to be in place for certain incentives for pooling to operate efficiently and fairly. There is also a broader question as to whether in providing an incentive to pool the Government should require pools to meet particular criteria, such as:

- Whether there are specific governance or strategic decision making arrangements that should be in place;
- Whether pools should be expected to provide further information and data on how the pool is being run and the benefits of pooling.

6.20 Under current legislation, the Secretary of State does not have the power to require any particular arrangements for pools. However, the Secretary of State does have the power to *refuse* applications to pool and therefore could put in place requirements that would need to be fulfilled before a pool application was accepted.

Governance and strategic decision making

6.21 There is evidence from existing pools, and also through the evaluation of 2017/18 pilots and the bids to be 2018/19 pilots that pools are often establishing deeper governance and strategic decision making processes beyond the simple administration of the pool.

6.22 For example some pools have set arrangements by which certain proportion of growth achieved is spent on strategic investment projects upon agreement of all the members of the pool and have established varying governance arrangements to do this.

6.23 Recognising that some of the potential incentives to pooling summarised in this paper could provide significant financial benefit to the local authorities we wish to explore further with the working group whether certain requirements in terms of collaborative governance arrangements and strategic decision making structures should be in place in order for a pool to be formed. There may also be the opportunity to explore how pooling can operate in parallel with other policy agendas and structures such as devolution and combined authorities.

Information requirements

6.24 Currently there is no requirement for pools to provide any information on how the pool is operating or any data about how growth achieved is distributed and utilised. There is an opportunity, if setting broader requirements for pools, to also explore whether pools should provide further information on the benefits of pooling and how additional income is being utilised. For example, pools could be required to provide detail of how growth is distributed amongst pool members or to indicate what proportion of growth achieved is invested to try and generate further growth.

Q7: What are your views on these potential requirements on pools?