100% Business Rates Retention
Systems Design Working Group

Introduction to gearing issues

<u>Local authority "gearing"</u>

1. Gearing refers to the amount of local business rates that a council is able to raise, compared to the amount it is assessed to 'need' as its baseline funding level. The closer that local tax resource is to baseline funding level, the better the balance of risk and reward from growth for a local council. Where there is 1:1 gearing between a council's tax base and their baseline funding level, every additional pound raised in increased business rates results in an additional pound of local spending.

2. For example, under the current 50% rates retention system, the share of business rates retained by North Somerset Council closely equates to their need (they have a very small tariff), meaning that they are fairly evenly geared.

3. As we move away from 1:1 gearing:

   i. *Where a council raises a much higher amount in business rates than they "need":* the more business rates income we tariff from them as part of the redistribution, and the greater the risk (and reward) to their income from small changes in business rates. Under the current system this is most frequently the case for district councils, who raise high levels of revenue via local taxes but are not responsible for delivering the most costly local services (eg adult social care).

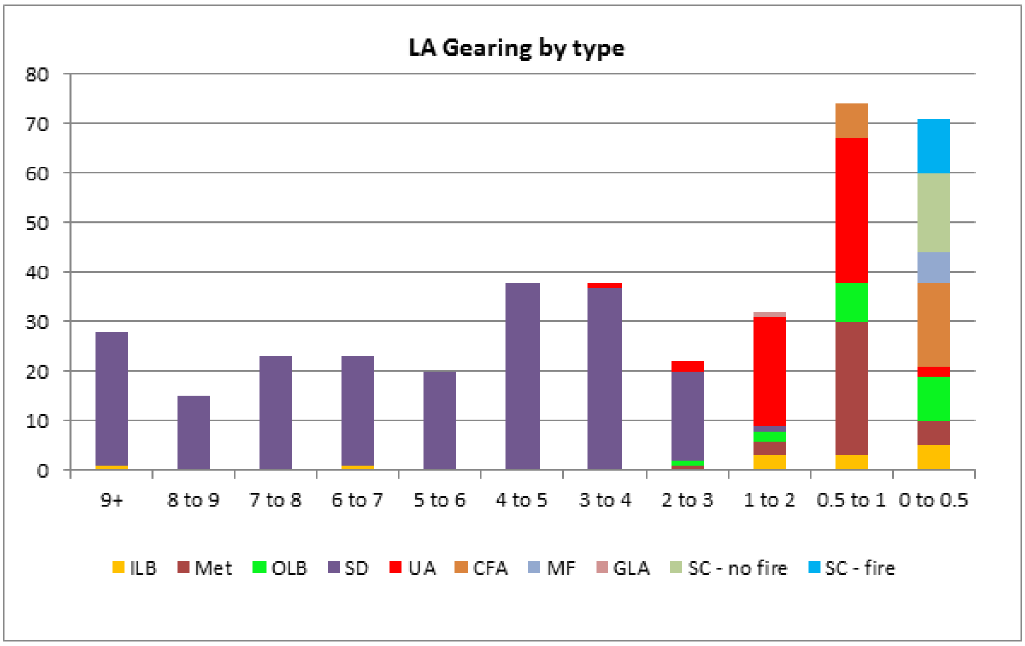
   Or

   ii. *Where a council raises a much lower amount in business rates than they are determined to need:* the more funding we have to give them through redistribution – ie top ups, and the lower reward (and risk) the area gains from any growth in business rates. This is generally the position that county councils find themselves in under the current system, where their revenue is not heavily based on receipt of local taxes but are responsible for delivering high-cost local services.

4. The government will need to determine the level of risk and reward that we are willing to tolerate in the 100% rates retention system, and therefore what level of gearing is acceptable. At this stage, this paper seeks the views of the Systems Design Working Group on the issues raised by gearing, and if/how they could be addressed through the introduction of the 100% rates retention system.

<u>How does gearing look under 50% BRR?</u>

5. The chart below sets out the different levels of gearing that local authorities have under the 50% rates retention system. In this paper, gearing is determined as:
   Business rates income / Baseline funding level



6. This chart clearly demonstrates that the vast majority of district authorities are geared at the higher end of the scale, and that the vast majority of highly geared authorities are districts. This is the result of district councils being the billing authority for business rates in two tier areas, and the distribution of funding between tiers means that all districts will be tariff authorities (ie will have a part of their business rates income redistributed). At the other end of the scale, and for the same reason, shire counties are inevitably top up authorities and therefore lowly geared.

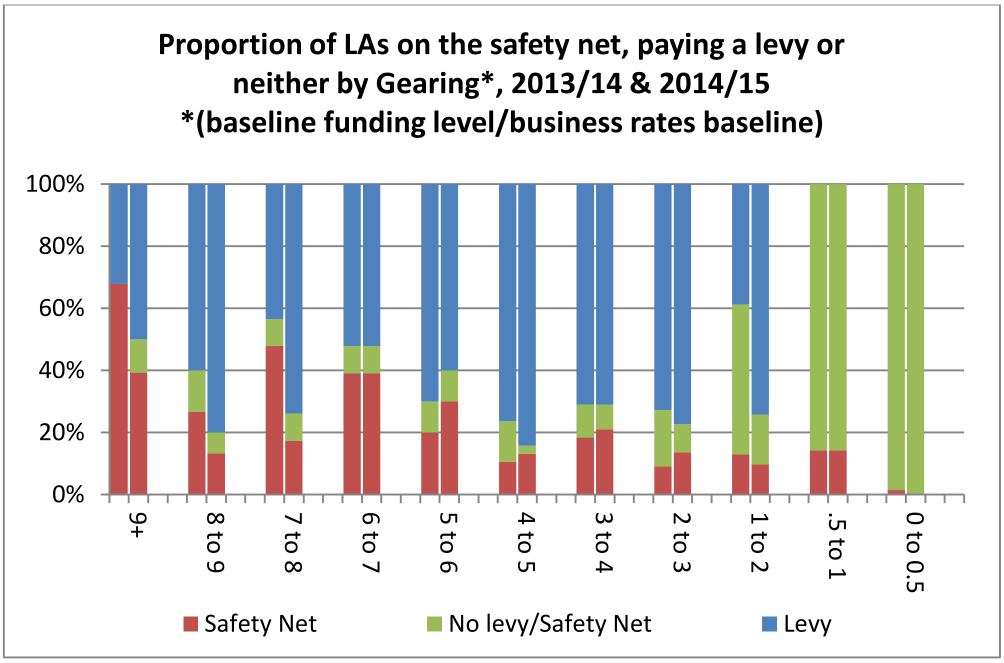
7. The majority of unitary authorities are geared at 2 and below, though with a couple of exceptions. The majority of metropolitan districts are very lowly geared – although they are the billing authority, they generally have a high level of 'need' and therefore result in being a top up authority.

<u>Impact of gearing under 50% BRR</u>

8. As set out above, the more highly geared an authority, the greater level of risk and reward they can achieve from changes in their business rates income. The lower geared an authority, the more difficult it is to achieve significant reward in their business rates income, but they also carry a much lower level of risk.

9. Using the two years of data that we have from the 50% BRR system, this can be demonstrated by the proportion of differently geared authorities either paying a levy, or receiving a safety net payment, as set out in the chart below.[1]

[1] For the purpose of this analysis it is assumed that all local authorities are individuals and do not form part of a pool.



10. The data that we have used for these charts (drawn from NNDR3 returns) is likely to be somewhat skewed as a result of provisions for appeals – especially as some authorities spread their provision, and others made the provision in the first year of the new scheme. However, we think the broad picture given by this data is correct – ie more highly geared authorities are much more likely to either be paying a levy (ie experiencing growth in business rates income), or receiving a safety net payment (ie experiencing a significant loss of business rates income).

11. Two tier areas feel a further impact from the tier split that was set up at the introduction of the 50% business rates retention system. Through this, districts retain 80% of any increase in business rates income, with the relevant county council getting a 20% share of that increase. The system works the same for losses of business rates income – districts retain 80% of that loss, and counties only 20%. When the system was set up, Ministers felt this was the right level of tier split to both:
    - incentivise and reward districts, as the tier of government with most control over planning decisions
    - protect counties from taking on higher levels of risk as the tier of government providing high demand services in social care

<u>Areas to explore to gearing and 100% BRR</u>

12. The level of gearing of an authority is mainly the result of the top up and tariff system. For single tier authorities, the options to adjust the gearing effect are fairly limited, but could include:

    - Considering the responsibilities accorded to each tier of government, which is part of the work of the devolution of responsibilities workstream. The work on responsibilities to date has predominantly identified responsibilities to the upper tier authority level, though the consultation asks for further suggestions.

    - Considering how the business rates retention system could work over larger geographic areas. In some cases, devolving rates and responsibility over a larger area (ie a number of local authorities) should lead to a change in gearing for those authorities.

13. In addition to these options, adjusting the tier splits would also have an impact on gearing in two tier areas. Under the 50% BRR system, district authorities retain 80% of the local share of business rates, with counties broadly retaining 20% (with some minor differences for fire authorities). We should test how the tier split could be adjusted to impact on the gearing of authorities. There is then a separate question about whether any changes this causes to the levels of risk and reward of authorities is acceptable.

14. Different types of authority have also highlighted specific issues, including:

    a. Unitaries have highlighted that they are responsible for the same services as upper tier county authorities, and yet are not as protected from risk as counties. The charts above demonstrate that this is partly true, but the vast majority of unitary authorities have a gearing of two or less, and approximately half of unitary authorities have a gearing of less than one. This would suggest that they are at fairly low risk of requiring safety net support under the current system.

    b. Lowly geared authorities have highlighted the challenges they face in making significant increases to their budgets through business rates growth. The size of their top-up is such that any increases in business rates income translate to a much less significant increase as a proportion of their funding levels. However, this also means that any reduction in business rates income translates to a smaller loss as part of their overall business rates funding.

    c. Some highly geared authorities have highlighted the challenges they face due to the higher levels of risk that they shoulder. We expect there to continue to be some form of safety net mechanism under the 100% rates retention system, which should continue to provide support to those authorities that see a significant decline in business rates income.

Questions

- **Have we identified the issues that exist as a result of gearing within the 50% rates retention system?**

- **What opinions do the group have on looking to make changes to gearing levels under the 100% rates retention scheme?**

- **Do the group have suggestions for how to address the challenges raised by gearing?**