REFORM OF BUSINESS RATE LOCALISATION
Challenges & Priorities

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The paper recently circulated by Paul Wildsmith from Darlington provides a very useful summary of some of the key directions we will need to agree on in order to then be able to work up detailed proposals for system reform. As such I fully endorse its proposal that we attempt to address these issues at the earliest opportunity.

To add to that discussion, I think there would be benefit if we also took a moment to consider some of the key asks and milestones that will have a bearing on what we must, want or can achieve by certain set moments in time and to take stock of the issues we are wishing to resolve.

Key Asks

Any reform of the system that opportunity allows ought to aim to fulfil the achievement of local government's "key asks". We see these as being:

- Removal of appeals losses against the original List valuation;
- Right balance of growth reward versus losses risk & protection;
- Retention of an element of revaluation growth;
- Fair distribution delivered following System Re-set

We need to be realistic as to what we can expect to be resolved within certain key timeframes bearing in mind the scale of adjustment required and the political appetite within central government to deliver on these key asks. We are better focusing in the short term on what we can reasonably need or expect to achieve for the start of 2017/18, whilst not losing sight of the longer term vision.

Key timelines

Whilst we probably all believe that the current system of business rate retention is far from ideal, it is a base that, all other things being equal, we could conceivably continue to work with and financially plan for the future.

All other things are not however equal, we have a number of critical milestones ahead of us, that will necessarily change our existing status quo – matters that will need addressing if they are not to inadvertently change the funding distribution and create further anomalies to the system. Most critically, we face the following changes, each of which brings its own set of problems that will require resolution

- 2017 Revaluation (and potential fresh appeals issues)
- 2020 Move to 100% Localisation (possibly phased beforehand)
- 2020 System Re-Set

2017 Revaluation

The 2017 Revaluation will take effect from the 1st of April 2017 – this is an absolute fact given the political fallout that would ensue were it to be delayed.

The consequences of the 2017 Revaluation should, in theory, be fiscally neutral on the finances of local authorities – with Tariffs and Top-ups being appropriately adjusted to re-balance the system at the national level. Those Tariffs need to be determined by December in time for the Draft Finance Settlement. We have very limited time available in which to resolve and agree the technical difficulties surrounding this change and it is something that cannot be left on the backburner for a later date.

Appeals

Coupled with the Revaluation is the appeals impact caused by valuations on the initial List that are subsequently proved to be changed. Experience against the 2010 Revaluation has found a number of authorities in the Safety Net due to these errors, and probably all authorities at a lower position than they would otherwise have been. To bring back a degree of fairness to the system, it is imperative that this problem be resolved in the immediate future – having already suffered four years of funding losses, we ought not be expected to wait another three years until 2020/21 to fix it.

In principle, the multiplier should be recalibrated at a level which delivers fiscal neutrality from the Revaluation. Any solution will inevitably require some form of funding to compensate for appeals losses – I would strongly argue for this to be funded via a correctly set 2017/18 Multiplier, rather than the current system that sees business gain and local authorities lose.

Safety Net Arrangements

The current Safety Net system provides a floor of 92.5% of Baseline Funding. Given that the RSG element within Settlement Funding Assessment has relatively declined, this has effectively devalued the protection it offers.

At the same time, some authorities have found individual and specific heraditaments removed from their List having a dis-proportionate impact on their net yield. Discussion around moving particularly high value assets into the Central List has taken place as a means of removing this risk. This however seems contrary to the ethos of full localisation and would potentially remove the direct benefit a local authority sees from, for instance, seeing new high-value business premises being built in an area. Rather specific high value deletions from a local list might be better dealt with by a nuanced general Safety Net system

The Safety Net arrangements (over and above any protection that might be brought in for appeals against the initial List) are worthy of a fresh review in time for the next Finance Settlement. Whilst we believe that appeals against the opening List should be funded from a correctly calibrated Multiplier (pooled via a net Tariff and distributed according to auditable claims), any general Safety Net would need to be funded by some form of top slice from Baseline or growth. The degree to which it could come

from either will be dependent upon the degree to which we wish to incentivise growth.

Move to 100% Localisation

The move to 100% localisation would see at the national level a negative RSG distribution. In theory this could be addressed through a future negative RSG allocation or by the more likely route of rolling in other grants or responsibility for services.

Should local government be asked to take on additional responsibility for certain functions, we ought to consider the timing of these additional burdens. Sufficient time needs to be factored into the timetable to allow effective planning to deliver the new services, and perhaps a phased implementation would be better than a full 20/21 big-bang approach. If local government were to begin to transition to full localisation from 2018/19, this means that some of the services that might be transferred would need to be determined within the next six to nine months.

Clearly we would continue to have concerns over the potential to take on activities which brought with them future demand-led pressures that outstripped growth in localised business rate yield

System Re-Set

The existing system is based on the 2013/14 Four-Block model (with certain elements of the data used in the model being considerably older). Considerable thought will need to go into defining what the redistribution system should fund when it is refreshed in 2020/21, but as a starting point we ought to be able to see how the existing model would look if it were to be simply re-populated with contemporaneous data. With an updated model, we would be then able to consider the consequences and implications of potential options to change the factors and weightings within any revised model, and to address the way significant losers might (or ought) to be dealt with.

The model itself will in part potentially need to consider the costs associated with new burdens that might be rolled in as part of the move to 100% localisation. We probably need greater clarity over the services to be rolled in before we could formulate a definitive view on the operation of the full new model.

Revaluation Growth

The current model for localised business rates specifically discounts the impact of revaluation growth within any one area by adjusting the Tariff or Top-Up to leave the net retained yield unchanged. Such a system fails to reward individual local authorities who invest heavily in their infrastructure to raise the attractiveness of their area (and by implication the value of business properties). If commercial rents bear any relationship to the ability to generate profits within a particular locale, the current recalibration of the multiplier is also reducing the overall tax burden generated by

business rates as a percentage of potential profits – something we would wish to see redressed.so that local authorities receive a fair share of economic growth.

An opportunity exists in the very short term to address this dis-incentive to grow business rates in an area as the 2017 Revaluation is almost upon us. The Multiplier could be set at a level to fund some retained revaluation growth. In reality, given the commitments already made by central government this should be seen as highly unlikely to be achieved in the short term

In setting out the above, I am suggesting that, as well paying regard to recently circulated Darlington paper which focuses our minds on the big questions as to what we want from system reform in overall terms, that we plan the activities of the various working groups around the above critical milestones and asks.

For the start of 2017/18, we ought to have revised the system so that:

- The impact of the Revaluation has been modelled within the Draft Finance Settlement announced in December so that we have certainty over our position for the latter stages of the budget setting process in Dec/Jan;
- Errors against the original 2017 List which subsequently result in appeals losses are mitigated within the system – such costs to be absorbed within the multiplier calibration;
- The operation of the Safety Net system be reviewed to reflect its growing proportion as a share of total SFA, and that account is taken of how specific and one-off “shocks to the system” (e.g. closure of a steel works) might be factored into it

Whist other issues in an ideal world would be also dealt with to the same timeframe, I suspect that realistically they will need to wait until beyond the start of 2017/18 to agree a satisfactory solution. These include:

- Reward for revaluation growth;
- Phased implementation of additional service responsibilities as we move towards 100% localisation;
- Updating the data and calculations within the 2013/14 Formula Funding Model, and then considering the correct factors and weightings which should be included in the new model for 2020/21 (and how we deal with likely significant variances to current allocations).

I recognise that some of the above strays across the remit of the differing working groups, but think it is important that this group reminds itself of how its own work fits into the overall picture and the inter-related nature of the key issues we are facing.