Systems Design Working Group: 2 September 2016
Resets update

Paper prepared by Department for Communities and Local Government

1. The Systems Design Working Group discussed a paper setting out a proposition on partial resets on 25 July. The group were strongly in favour of partial resets, and agreed with the modelled scenario in which partial resets of growth occurred every five years, through which 50% of achieved growth was redistributed.

2. The Needs and Resources Working Group discussed a paper on partial resets on 4 August. This working group discussed a paper (that can be accessed on the LGA website) that used our discussions on partial resets as a starting point, and added in a full reset of the needs formula at each partial reset. The group recognised that there was a trade-off between the frequency of resets and the strength of the growth incentive. They felt that updating the needs baseline regularly to reflect changing demands was more important than the growth incentive, and were therefore supportive of five year resets. The group felt that 'cliff-edges' should be avoided, and were therefore not supportive of a full reset being built into the system. They also discussed the need for a transitional scheme to be put in place after each reset, to be unwound before the next reset.

3. The work so far on resets has cut across both workstreams, and is also being tested by the Accounting and Accountability Working Group to check for accounting concerns. As such a cross-cutting issue, we intend to share these discussions with the Steering Group at their meeting on 7 September.

4. The working group discussions have provoked a number of issues that remain outstanding in relation to partial resets. We would welcome your steer on these now ahead of discussions with Steering Group and further work within DCLG:

<u>Full resets</u>

5. Both working groups have expressed a preference for partial resets of growth, with no full reset of the system in place. Concerns have been expressed that any full reset in the system would eradicate the growth incentive and could lead to a significant 'cliff edge' of funding.

6. If we fix a set proportion of growth to be retained at all partial resets (eg the 50% that we have been discussing), there is a risk that the overall business rates income may diverge from need over time.

7. Instead of building a full reset into the system, we could build in a safety valve – eg the ability for government to reset the whole system if it diverges too far from matching resources to need.

- **Does the group remain opposed to full resets?**
- **How might a 'safety valve' option work?**

Fixed proportion of retained growth at resets vs variable

8. One way to mitigate against resources diverging from need would be to move to a much lower proportion of retained growth (eg 20%). This would reduce the growth incentive at resets (though local authorities would continue to retain all growth achieved year on year between resets), but would aim to maintain enough funding in the 'redistribution pot' at resets to match funding more closely to need.

9. An alternative would be to keep a variable – rather than fixed – proportion of growth at a reset. In this situation, the first aim would be to ensure minimum pot of funding available for redistribution at a reset– for example, of the same amount as at the set-up of the system. It is likely that a portion of the growth in business rates income would be needed to 'top up' this redistribution pot to the desired level. Authorities that had experienced growth in business rates income would then retain the proportion left once the redistribution pot had been 'topped up' as needed. Depending on how business rates income had changed across the country in the previous period, the proportion retained by authorities could vary at resets. This approach would not give individual authorities certainty over future income and would therefore weaken the growth incentive, prioritising instead the need to ensure that the overall pot to be redistributed at resets was maintained at a minimum level.

- **What are the group's views on these options?**

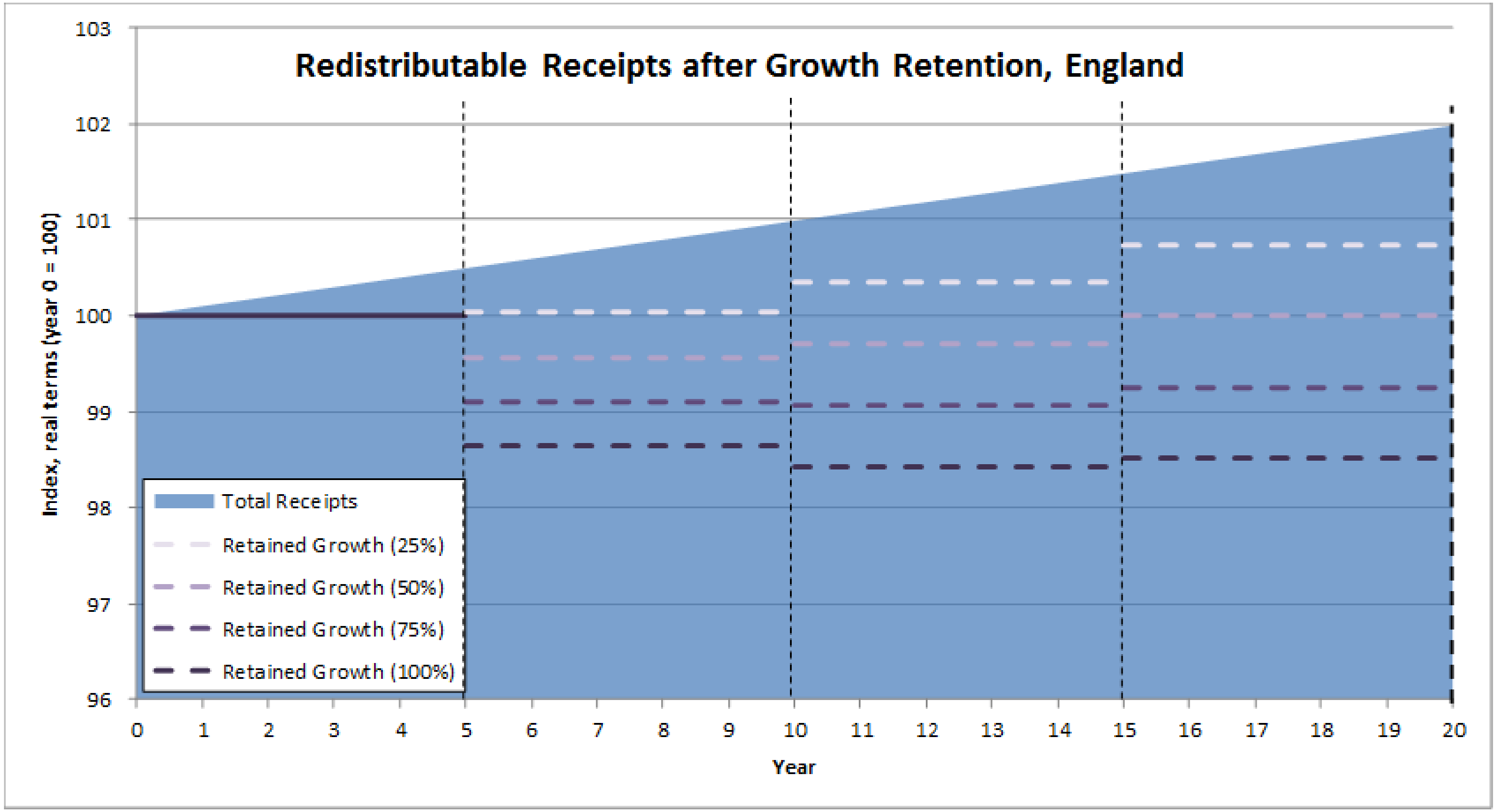
Changes of baseline funding and income at resets

10. Depending on how significantly 'need' changes across the country over a five year reset period, changes of baseline funding level as a result of changing relative need at a reset could be significant.

11. To help handle this, a transitional scheme may be required after a reset to help move local authorities more gradually to their new business rates income (thereby avoiding cliff edges). The Needs and Resources Working Group have expressed a view that any transitional scheme should be unwound before the next reset – ie to transition local authorities over a 3-4 year period – to avoid authorities being in perpetual transition over reset periods.

- **What are the group's views on using a transitional scheme to help avoid cliff edges in income?**
- **What principles should guide a transitional scheme?**

Illustrative modelling: redistributable receipts at resets



Assumptions:

- 5 year partial resets
- OBR forecast of 0.1% real growth in business rates per annum

Outputs are designed to illustrate the effects of design choices at a system level rather than forecast business rates growth or local authority income.