

POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

100% Business Rates Retention Systems Design Working Group: 23 September 2016

Safety Net: discussion paper

Purpose

1. The local government representatives of the system design working group have suggested that they would welcome a simple safety net mechanism. This would be based on safety net in the current 50% rates retention system, but set at a higher proportion of baseline funding levels.
2. Having discussed a number of other design elements now, we would like to test whether this ask for a simple safety net still feels right, ahead of undertaking modelling to test likely costs. In particular, we have discussed:
 - Introducing partial resets every 5 years: this would mean that no authority remained on the safety net for longer than 5 years, and possibly fewer local authorities requiring safety net payments.
 - Changes to managing successful business rates appeals that are backdated to the first day of the list: this should reduce the number of local authorities relying on the safety net due to appeals losses.
 - Paper on gearing demonstrates that it is predominantly the most highly geared authorities that are currently on the safety net.

Background

3. Business rates can be a volatile source of income. Unanticipated shocks to local areas such as the closure of large businesses, or a higher proportion of successful appeals from businesses, have the potential to reduce significantly the business rates income of an authority from one year to the next. For this reason, the 50% retention system includes a safety net mechanism to ensure that, should business rates income fall, authorities are still able to provide vital local services. The safety net is set at 92.5% of each authority's Baseline Funding Level (BFL).
4. With an increase from 50% to 100% of business rates being retained, local authorities will rely more upon the business rates income and less upon grant funding to deliver their services. The higher the percentage of retained business rates, the greater proportion of an authority's income is at risk of fluctuation in business rates receipts, and the more an authority would lose should their business rates income fall. Authorities are concerned that the current safety net mechanism will not provide sufficient protection when they move to 100% retention.
5. The Government has committed to piloting 100% retention in a number of areas from as early as April 2017. The pilots give an opportunity to test any propositions for a new safety net in real time, without guaranteeing that any pilot system will be used for the full roll out of the new system. Having a number of pilot sites provides the opportunity to trial more than one approach if useful.

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Issues

6. A safety net could be designed to address one or more of a number of issues:

- a) Support local authorities to fund delivery of services should their business rates income fall below BFL. The current simple safety net based on a % loss below BFL addresses this point.

The current safety net only applies to the business rates element of local authority income. Would there be any merit in exploring a similar style safety net that applies to combined council tax and business rates income?

- b) Under 100% rates retention, we could encourage the building of any growth into budgets to fund core services. Under the current system, an authority could experience a rise in business rates income above BFL as a result of growth in businesses and suffer a sharp fall in business rates in the next year, yet not trigger the safety net. This could mean losing all growth in business rates income and not receiving compensation in any form. To build this growth in income into core budgets would therefore be risky under the current system.

Should the safety net under 100% rates retention incentivise local authorities to build growth in business rates into their core budgets, maintaining a long term growth reward?

- c) There is currently no incentive for an authority that is receiving significant safety net payments to aim to increase their income again. For every £1 increase in their business rates, they simply lose £1 of safety net funding as they are topped back up to 92.5% of BFL. For some authorities, getting back to income above the safety net threshold seems an impossible target.

Should a new safety net system incentivise those authorities on the safety net to grow their business rates income?

- d) The current safety net takes no account of gearing and the level of risk to which an authority is exposed. Analysis [shown in the gearing paper] demonstrates that authorities with gearing of above 2 are much more likely to be on the safety net, with the most highly geared authorities the most likely. It is extremely unusual for authorities with gearing of below 2 to be on the safety net.

Should any new safety net look to address the problem of gearing and be more intelligent to the nuances around differently geared authorities?

7. Addressing any of these issues will make the safety net more complex to administer, but should not have an impact on the local authorities themselves. Is it worth making the system more complex to address any/all of these issues, or do the group prefer simplicity over complexity in this instance?

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Funding a safety net

8. We will need to explore options for funding a safety net. At this point, our assumptions are that a future safety net could be funded via:
 - a) A top slice of business rates income: though note that central government will need to set the total amount available for a safety net each year, and pressure will be on to keep this to the minimum amount required. There is the possibility that in any given year, the top sliced amount is smaller (or indeed larger) than is required.
 - b) An insurance scheme has been suggested by some in local government. This could be a scheme that authorities choose to pay into. This could run separately or alongside a top slice funded safety net – eg the top slice safety net could fund a basic safety net, with authorities choosing to pay into a more generous insurance scheme.

What views and ideas do the group have on funding a safety net?

Next steps

9. Any steers and views given at this group will inform decisions about options to model. We aim to be able to provide a clearer assessment of the impact of appeals on the current safety net usage, and therefore the likely use of a safety net in the future.