Committee:	Date:
Policy and Resources Finance	16 February 2017 21 February 2017
Subject: Local Government Finance Bill	**Public**
Report of: Chamberlain and Remembrancer	**For information**
Report author: Sam Cook, Assistant Parliamentary Affairs Counsel	

Summary

This report informs the Committee of the relevant provisions of the Local Government Finance Bill recently introduced in Parliament. The Bill will enable 100% of business rates to be retained within local government, subject to a mechanism for distribution among councils. It will give individual councils a greater incentive to maximise the amount of rates they collect. The 100% retention scheme will be accompanied by a new needs assessment formula, the devolution of additional responsibilities to local government, and the abolition of the Revenue Support Grant. Provision is included in the Bill to address concerns about the effect of valuation appeals within the current system, which should alleviate a significant down-side risk in the retention model.

The Bill will make a number of other changes. These include a power for the Greater London Authority to impose an 'infrastructure supplement' to fund particular projects, the ability of individual councils to offer discounts on rates, and a new relief intended to encourage the installation of fibre broadband. The Bill is also likely to prompt wider discussion of how the devolution agenda can be taken forward in London, in the light of the Government's need to devolve additional responsibilities and various proposals which have been raised in the London local government arena for greater fiscal autonomy.

Recommendation

The Committee is invited to receive this report, and to note the provisions of the Bill and the actions anticipated in paragraph 28 in respect of them.

Main report

1. The Government's Local Government Finance Bill has been introduced in Parliament. Its main purpose is to pave the way for the 100% retention of business rates within local government—a policy first announced by the then Chancellor of the Exchequer at the Conservative Party conference in October 2015. Under the current system, introduced in 2013, rates are split 50-50

between the Treasury and local government. To offset the increase in retained rates, the Revenue Support Grant will be abolished and additional responsibilities will be devolved to local government. The changes are expected to take effect in the 2019–20 financial year.

100% retention: main features

2. Rates retention does not mean that each individual billing authority gets to keep whatever rates it generates. A sophisticated mechanism is in place to distribute revenue among councils having regard to their differing levels of need. This mechanism will remain in place under the 100% retention scheme.

3. The system provides an incentive for billing authorities in the following way. At the beginning of each cycle the distribution mechanism is set up so that each authority will receive income in line with its formula-assessed spending need, assuming that the amount of rates it collects remains constant throughout the cycle. If an authority manages to increase the amount it collects over the course of the cycle, it keeps the benefit. Conversely, if its yield decreases, it bears the loss. The Bill will increase the 'stake' of each authority in these movements in its rating yield from 50% to 100% (setting aside the role of precepting authorities—see paragraph 6 below). The length of the cycle is five years under the current system but has not yet been announced in relation to the new system.

4. The scope of the incentive does not extend to movements in local property values. The distribution mechanism is adjusted to strip out their effects. It is only physical changes—such as the construction of new office space, the demolition of old properties, major refurbishments, or changes in the occupation rate—which affect an authority's level of retained income.

5. There are currently two further mechanisms which serve to cap the gains or losses which an individual authority can encounter as a result of the retention system. The Bill will remove the upper cap while retaining the lower one. Set at its current level, this lower cap ('safety net') means that no authority can see an income reduction of more than 7.5% below its assessed need as a result of the system.

6. In areas with more than one tier of local government, the local share of rates must be distributed between billing authorities and precepting authorities. In London, 20% of revenue is passed to the Greater London Authority (in addition to the 50% passed to the Government), meaning that the 'stake' of London boroughs and the City in their rating yield is 30%. It is not yet known what the division will be under the 100% retention scheme; this will depend in part on the distribution of additional responsibilities between the two tiers. As part of a pilot scheme, the Greater London Authority is already set to receive an additional proportion of rates revenue from this year (taking its share to 37%) to allow it to take over responsibility for Transport for London's capital spending.

The City's arrangements

7. Under the current rating legislation, special arrangements apply to the City in recognition of the unique disparity between the level of services it provides and its ability to raise revenue through council tax. The 'City premium' enables it to set a slightly higher multiplier and to retain the proceeds (which are currently applied for security purposes). The 'City offset' enables it to withhold a certain sum from the distribution mechanism. These arrangements were preserved, with necessary adaptations, when the current 50% retention scheme was introduced under earlier legislation. They will not be disturbed by the move to 100% retention.

Valuation appeals

8. Under the current 50% retention scheme, billing authorities (together with their precepting authorities) bear 50% of the risk from successful valuation appeals. The risk can be considerable, as appeals may result in refunds stretching back over several years. This aspect of the system is unsatisfactory, as valuations are not within the control of billing authorities and to make them bear the cost of incorrect valuations undermines the incentive which the scheme is intended to provide. The lack of predictability of appeal outcomes also makes it difficult for billing authorities to predict their income from year to year. These problems have borne significantly on the City owing to a high level of appeals in recent years, and have led to the City making substantial provision of around £200 million. They have been subject of discussions with officials over a considerable period.

9. The Government has responded to this concern by including a power in the Bill to make compensatory payments to billing authorities which suffer appeal losses. While the way in which this power will be used is not yet settled, its inclusion is (from the City's perspective) encouraging, and could alleviate a significant down-side risk from the retention model as well as enabling more reliable financial projections. Discussions with officials indicate, however, that compensation may not be available until the next valuation cycle starting in 2022.

Needs formula

10. As noted above, the distribution mechanism is underpinned by an assessment of each authority's spending need. Currently this need is calculated on the basis of a complex formula which determines the allocation of the Revenue Support Grant as well as the distribution of the local share of business rates. As part of the move to 100% retention, the Government intends to introduce a new formula for the assessment of need. It has consulted on the principles which should underlie such a formula but has not yet revealed its preferred approach.

11. Given the uncertainty about the nature of the new formula, it is not possible to anticipate its implications for the City, which could be positive or negative. The significance of the formula for the City is, however, limited in comparison with other authorities, as the arrangements referred to in paragraph 7 above already recognise that a general formula does not capture the full range of

demands in the City. Around one third of the City's retained rates revenue is currently derived from the formula assessment.

Additional responsibilities

12. The move to 100% retention, even when set off against the abolition of the Revenue Support Grant, with leave local government with a net 'surplus' over its current funding level. In order to absorb this surplus funding, the Government intends to devolve additional responsibilities to local government (making the changes 'fiscally neutral'). London Councils has estimated London's aggregate surplus at around £4 billion per annum.

13. It is not yet known what the content of the additional responsibilities will be. They may vary from area to area. Following discussions led by London Councils (and supported by the City Corporation), it is likely that they will, in London, include functions in relation to work and health and adult education. The City has argued that additional responsibilities in London should also focus on matters of interest to business ratepayers, such as skills, infrastructure and housing. As noted in paragraph 6 above, London's package is set to include the devolution of TfL's capital expenditure to the Greater London Authority.

Infrastructure supplements

14. The Bill will allow the Greater London Authority (or, outside London, a mayoral combined authority) to impose an 'infrastructure supplement' on rating bills to raise revenue for specified projects. Despite the name, use of the supplement is not confined to infrastructure, but can be for any project thought to promote economic development in the area concerned (so long as it does not fall within a list of core local government services). The Government is expected to cap the supplement at 2%.

15. The new power is very similar to, but apparently will sit alongside, the Business Rate Supplement currently used to help to fund Crossrail. Unlike with the Business Rate Supplement, however, there will be no potential requirement to hold a ballot of ratepayers. Instead, the authority proposing the supplement will have to publish and consult on a prospectus.

Other changes

16. The Bill will allow the Secretary of State to change the national indexation measure for business rates. This is intended to bring about a change from the Retail Prices Index to the Consumer Price Index, as announced in the 2016 Budget. On normal trends this will reduce the amount of rates collected by local government over time.

17. The Bill will allow the Secretary of State to introduce mandatory rates relief for telecommunications infrastructure. The Government intends to use this to give a five-year tax break for new fibre broadband installations, as announced in the 2016 Autumn Statement. The costs will be met by the Government. The Bill will also allow billing authorities to grant discretionary relief for local authority toilets.

18. The Bill makes technical changes to the local government finance settlement and the council tax referendum requirement, intended to support the Government’s policy of offering multi-year financial settlements to individual councils. For instance, the Secretary of State will in future be able to require a council tax referendum if proposed increases exceed a cumulative threshold over a number of years; at present the threshold relates only to year-on-year increases.

19. The Bill will allow the Secretary of State to require billing authorities (including the Common Council) to offer ratepayers the option of electronic billing. It is not yet clear whether, and if so when, such a requirement will actually be introduced. The Secretary of State will also be empowered to give detailed guidance to billing authorities about the appearance and layout of rates bills.

20. The Bill will provide a general power for billing and precepting authorities to reduce rates in their areas by up to 2%. Similar flexibility already exists in the City by virtue of the arrangements referred to in paragraph 7 above.

London devolution matters

21. In advance of the publication of the Bill, London Councils and the Greater London Authority submitted to the Government a far-reaching devolution proposal in respect of business rates, going beyond the changes envisaged by the Government. This proposal would see London government collectively determining both the level of business rates and the distribution of rating revenue within the capital. The City has supported the principle of further devolution, while making clear that the arrangements referred to in paragraph 7 above will need to be preserved as part of any devolved package.

22. The Government has not yet made any public announcement in response to the London proposal. The Bill as introduced does not, however, include the legal changes which would be needed to give effect to important elements of the proposal. There will be opportunities to press this matter further as the Bill moves through Parliament.

23. The need to identify additional responsibilities to devolve to local government (as mentioned in paragraphs 12 and 13) offers a connection between the Bill and the efforts being undertaken in London to agree ‘devolution deals’ with the Government, currently focused on healthcare and employability. It may also reawaken the discussion about governance arrangements for devolved functions in London. In the devolution deals struck elsewhere in the country, the Government’s strong preference has been to devolve to multi-authority structures, mainly through the ‘combined authority’ model. This model, which effectively creates a new tier of local government, is not available in London and there is little appetite for its introduction. Efforts to establish looser collaborative vehicles for devolution in London (involving the London boroughs, the City and the Greater London Authority) have, however, foundered on Government concerns about permanence and accountability. This issue was explored, but not resolved, during the passage of the Bill for the Cities and Local Government Devolution Act 2016. It may be revisited during the passage of the present Bill. The Government’s current view, however, is that it does not require provision in primary legislation in order to

devolve additional responsibilities. It remains to be seen what arrangement the Government has in mind for London.

24. In 2013 the London Finance Commission, established by the then Mayor under the chairmanship of Professor Tony Travers, published a report calling for greater fiscal autonomy for London. This focused largely on property taxes such as rates, council tax and stamp duty. The present Mayor has reconvened the Commission to consider the case for further devolution in the wake of the EU referendum. The reconvened Commission recently reported. It proposes even further-reaching tax devolution, including a share of income tax and VAT. Both reports of the Commission go significantly wider than the measures proposed in the current Bill, or any hitherto contemplated by the Government as part of its devolution agenda. The latest report may, however, add momentum to the efforts to secure further devolution for London.

Wider business rates matters

25. The Bill comes at a time of controversy surrounding the 2017 rates revaluation, which sees businesses faced with a year-on-year increase in bills of up to 43%. London is particularly badly affected owing to the relative strength of its property market in the seven years since the last revaluation. The City has been among the many bodies calling for greater transitional relief to be put in place. There is also wider political discussion about the suitability of the rates system now that much business has moved online. While the Bill does not address these matters, it is likely to provide the opportunity for parliamentary discussion and debate about them.

Conclusion

26. The Bill will give billing authorities, including the Common Council acting in that capacity, a greater stake in the growth or reduction of business rates collected in their areas. For the City, this could bring significant benefit from any increase in office space in the Square Mile over the course of the next retention cycle (likely to begin in 2019–20). Conversely, it will make the City more vulnerable to any market downturn which results in less rating revenue being collected over the cycle. The new provisions on valuation appeals should remove a significant down-side risk for the City under the current scheme, and reduce uncertainty as to its future finances.

27. The Bill sets out a broad legal framework for the new scheme. A number of significant details will be determined by regulations or as a matter of policy. These include the formula by which relative spending need will be assessed and the additional responsibilities that are to be devolved to local government to absorb the additional funding. High-level consultation has taken place on some of these matters (to which the City Corporation has contributed) and further consultation and announcements are expected as the Bill moves through Parliament.

28. Both the parliamentary passage of the Bill and the Government's policy announcements will be closely followed and examined in liaison with the Chamberlain, as will wider discussions concerning devolution in London, and

this may lead to the tabling of amendments. Members will be updated on any relevant developments.

Background Papers

- Finance Committee, 18th October 2016, Item 16 (delegated actions report on responses to Government consultations on rates retention and fair funding).
- Policy and Resources Committee, 24 September 2015, Item 10 (report of the Town Clerk and the Remembrancer on the London devolution settlement).

Sam Cook
Assistant Parliamentary Affairs Counsel, Remembrancer's Office

020 7332 3045
sam.cook@cityoflondon.gov.uk