

<b>Committee:</b>	<b>Date:</b>
Finance Policy and Resources	12 September 2017 21 September 2017
<b>Subject:</b> Pilot Scheme for Business Rates Devolution in London	<b>Public</b>
<b>Report of:</b> Chamberlain and Remembrancer	<b>For decision</b>
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## SUMMARY

London Councils is seeking an ‘in principle’ view from its constituent authorities about a possible pilot scheme for business rates devolution in London. Depending on the progress of talks with the Government, it could begin in the 2018–19 financial year. The scheme would involve the Greater London Authority, the London borough councils and the Common Council forming a business rates ‘pool’, which would pay a single joint tariff into the national system. The retained share of business rates would be increased from 67% to 100%, meaning that any growth in rates would be retained within London, rather than a share being fed into the national system as at present. It would be guaranteed, by London Councils and ultimately by the Government, that no authority would lose out financially from taking part in the scheme—meaning that existing individual allocations, including those under the City’s special arrangements, would be preserved.

On current projections for business rates revenue growth, the scheme would unlock significant financial benefits in the next financial year, estimated at £229 million for London as a whole and £10–£20 million for the City Corporation. The precise method of distribution is open for discussion, but it is proposed to take account of the location in which growth is generated, residential population, and formula-assessed need, as well as creating a collective investment fund to support strategic economic development projects in London. It is envisaged that a business rates pool could, if it became permanent, provide a platform for further devolution to London in the future. Participation in the pilot scheme would not, however, commit the City Corporation to any longer-term pooling arrangement.

The scheme is subject to negotiation with the Government, as well the agreement of all London boroughs. In the event of a successful negotiation, a full proposal will be put before Members for a final decision on whether or not to participate.

## RECOMMENDATIONS

It is recommended that:

- the Finance Committee endorse the following recommendation to the Policy and Resources Committee;
- the Policy and Resources Committee authorise the Chairman (or her representative), at the next meeting of the London Councils Congress of Leaders, to—
  - express ‘in principle’ support for the rates retention pilot scheme set out in London Councils’ Draft Prospectus, on condition that the final arrangements include sufficient protection for the position of the City Corporation, so that revenue attributable to the City Premium, the City Offset and the City’s formula allocation are unaffected and remain under the City’s sole control;
  - support a method of distribution of any financial dividend from the scheme which either gives relatively high weight to the retention of revenue growth where it is generated, or gives equal weight to that factor alongside those of population, need, and collective investment.

## MAIN REPORT

### Background

1. London Councils and the Greater London Authority have long been exploring ways of bringing about further devolution to London government, including fiscal devolution. A significant development occurred in the spring of this year, when a Memorandum of Understanding was agreed with the Government, committing the parties to further discussions in a number of areas. Among these was the devolution of business rates.
2. Prior to the General Election the Government was taking forward a Local Government Finance Bill (previously reported to the Committee) which would have led to the 100% retention of business rates within local government by 2019–20. In anticipation of this, a number of local pilot schemes were set up to test elements of the 100% retention scheme. They included, in London, the devolution of the TfL capital budget.
3. These lines of work converged on the idea of an expanded London pilot incorporating the most significant features of the 100% retention scheme. This would involve London retaining the entirety of any growth in its business rates during the pilot period in exchange for forming a business rates ‘pool’. Once in place, the pool would have the potential to become a vehicle for further devolution to the capital. Discussions took place with officials from the Department for Communities and Local Government with a view to putting a pilot scheme in place for the 2018–19 financial year.
4. The Local Government Finance Bill was left stranded when Parliament dissolved ahead of the Election. It was then omitted from The Queen’s Speech in the new Parliament. The Government has since reaffirmed its

commitment to the principle of greater devolution, but declined to offer any more detail about its policy. This leaves it unclear whether 100% retention is still in prospect, and, if so, what form it might take. In a recent letter to the Mayor of London and the Chair of London Councils, the Chancellor of the Exchequer has, however, reiterated the Government's commitment to the Memorandum of Understanding, and seemingly kept open the possibility of a 100% retention pilot scheme in London.

5. Against this uncertain backdrop, London Councils has taken the view that it should proceed on the basis that a pilot scheme along the lines being discussed prior to the Election remains possible. It has therefore drawn up a Draft Prospectus which will form the basis of the next stage of discussions with the Government. In order to keep alive the possibility of the scheme's taking effect in the coming financial year, London Councils has requested that each of its constituent authorities give an 'in principle' view on the Draft Prospectus at the meeting of the Congress of Leaders on 10<sup>th</sup> October. The support of the City Corporation and all of the London boroughs will be required if the scheme is to proceed. Accordingly the view of Members is now sought.

## **Proposals**

6. The full Draft Prospectus is reproduced as an Appendix to this report. The main features of the proposed pilot scheme are summarised in the following paragraphs.

### *Basic elements*

7. The pilot scheme proposed in the Draft Prospectus would involve the Greater London Authority, the London borough councils and the Common Council forming a business rates 'pool'. Legally, this means that a single 'tariff' payment into the national system will be worked out for London as a whole, by comparing its aggregate need with its total business rates base. The distribution of retained business rates among the participating councils will then be determined by the pooling agreement rather than by a Government formula as at present.
8. A key principle of the Draft Prospectus is, however, that no authority will be worse off as a result of participating in the pool. This 'no loss' guarantee will first be met through any additional revenue that is retained in London under the scheme, but, as encouragement to take part in the pilot, will be underwritten by the Government in the case that London as a whole suffers a fall in revenue. The effect is that each authority will retain all of its individual allocation under the present system—including, in the case of the Common Council, the special funding made available through the City Premium and the City Offset, as well as the City's formula allocation. Any actual 'pooling' of resources will be confined to the additional money retained in London by virtue of the scheme.
9. This additional money results from the other main feature of the proposed scheme, whereby any growth in business rates revenue above current baselines during the currency of the scheme will be retained locally within

London, rather than a share being fed into the national distribution system as at present. This will be achieved through increasing the retained share of business rates from 67% to 100% (with a corresponding increase to the 'tariff' payment flowing from London to other areas), and abolishing the 'levy' payment which currently serves as an upper limit on the amount of revenue growth which can be locally retained.

10. Additional retained revenue arising from the scheme will first be used to give effect to the 'no loss' guarantee by compensating any authority which has seen a decrease in its rates revenue and thus would otherwise lose out from the move to 100% retention. Assuming (as is currently projected) that there has been sufficient growth in revenue to leave a surplus after this, it will be distributed among the participating authorities.

#### *Distribution of benefit*

11. London Councils has identified four principles which should inform the distribution formula for any surplus arising from the pilot scheme. First, as the benefits from the proposed scheme can only be 'unlocked' with the participation of all London authorities, all should receive a share of any benefit resulting from the scheme. Second, the role of individual authorities in generating growth for the benefit of the pool should be recognised and incentivised by allowing a share of the additional revenue to be kept where it is generated. Third, the distribution should recognise different levels of need in London. Fourth, the wider devolution agenda can be served by dedicating a portion of the surplus to collective investment in London's economic development.
12. On the basis of these principles, London Councils has suggested that four notional 'pots' will be used to distribute any surplus. The first pot will be distributed according to where the growth in business rates revenue has occurred. The second will be distributed according to formula-assessed need. The third will be distributed on the basis of residential population. The fourth pot will be a collective investment fund, to fund strategic investments in projects which promote economic development.
13. London Councils has suggested four alternative options whereby different weightings are given to the four pots. These are shown in Appendix A to the Draft Prospectus (appended to this report). London Councils has asked for views on the distribution model at October's meeting of the Congress of Leaders.

#### *Governance*

14. The Draft Prospectus makes clear that both the formation of a business rates pool and the framework governing its administration will require unanimous agreement on the part of the constituent authorities of London Councils and the GLA. Moreover, if the pilot scheme were to continue beyond the 2018–19 financial year, each participating authority would have the option to withdraw. The Draft Prospectus does not give any details as to how day-to-day decision-making would operate, although it accepts that minority interests will

need to be protected. This aspect will require more work (and careful scrutiny) as the proposal advances from the 'in principle' stage.

## **Financial implications**

15. As noted above, the Draft Prospectus guarantees that no authority will be worse off as a result of participating in the proposed business rates pool. This will ensure that the Common Council receives at least what it would have received under the current system, including the funding made available to it through its arrangements as a 'special authority' for business rates (*i.e.* the City Premium and the City Offset), as well as the City's formula allocation.
16. This 'no loss' guarantee, underwritten by the Government, is likely to be limited to the duration of the pilot scheme, rather than something which could be carried forward into any longer-term pooling arrangement. However, as noted elsewhere, participation in the pilot scheme would not commit the City Corporation beyond the initial year.
17. The main implication of the scheme is that it will enable the full proceeds of any growth in business rates income to be retained within London. While some of the resulting additional revenue will be subject to redistribution within London and some will be put to collective purposes, a significant share will be retained by the individual authorities in whose areas the growth is generated. Given that substantial growth in business rates revenue is currently forecast for the City, the ability to retain a greater share of this growth is likely to be of direct financial benefit.
18. The size of this benefit will depend both on actual receipts in the relevant years and on the model of distribution adopted in the pilot scheme. London Councils' current modelling estimates that the proposed pilot scheme would unlock an additional £229 million in revenue for London in the 2018–19 financial year. Depending on the distribution model adopted, the City Corporation could expect to receive from around £10 million to around £20 million of this. As the City is an area of high projected growth in revenue, the Corporation benefits from a formula weighted more towards the retention of growth where it is generated and less towards redistribution. Assuming an intermediate scenario where equal weight was given to the four principles, the projected gain would be around £12.4 million. A fuller illustration is given in Appendix A to the Draft Prospectus (appended to this report).

## **Strategic implications**

19. The City Corporation is committed to supporting further devolution in London. Despite the fresh uncertainty surrounding the Government's policy, a business rates pilot currently appears to offer the most promising avenue for progress on this. If it were to go ahead, the proposed pilot scheme would offer the opportunity to demonstrate successful collaboration among London's local government bodies in matters of finance and governance. This could build confidence in London's ability to take on further funding and responsibilities in the future, as well as putting in place some of the structures that will be necessary for devolution to succeed. Furthermore, this approach to devolution would not involve the 'combined authority' model on which the

Government's devolution policy has been based elsewhere in the country. It is not considered to be in the City Corporation's wider interests to see this model introduced in the capital.

20. The formation of a business rates pool would, in theory, mean that the amount of funding available to the Common Council depended on agreement within London government, rather than solely a decision by national Government as at present. It is clear in the current proposal that the current level of funding is guaranteed, including that flowing from the City's special arrangements. If the pool were to develop into a permanent arrangement, however, this dependency on a local agreement could be a potential source of strategic risk. It is considered that such risk is minimised by two main factors. The first is that the City Corporation's participation in a pilot scheme would not commit it to any longer-term arrangement. The second is that the City Corporation will, as a pre-condition of its participation in any longer-term arrangement, be able to insist on suitable consent requirements for any change to the funding model within the pool.

## **Conclusions**

21. The prospects of a successful negotiation with the Government are unclear, in the light of the uncertainty which has arisen since the Election about its policy towards business rates devolution. Nevertheless, a pilot scheme along the lines set out in the Draft Prospectus would unlock potentially considerable financial benefits from projected growth in business rates revenue. It would also provide a platform for further progress on London devolution. It would not expose the City to increased financial risk. Officers are satisfied that the proposals are compatible with the City's unique interests, particularly those relating to its arrangements as a special authority for business rates, and will work to ensure that those interests are effectively safeguarded in the detailed design of the scheme. Accordingly, it is recommended that the City Corporation offer 'in principle' support for the pilot scheme set out in the Draft Prospectus, on condition that the final arrangements include sufficient protection for the position of the City Corporation. This means that revenue attributable to the City Premium, the City Offset and the City's formula allocation must be unaffected and remain under the City's sole control.
22. As to the distribution of the expected surplus, a formula weighted more towards the retention of growth where it is generated would be the most financially advantageous for the City Corporation. Unlocking any financial benefit at all, however, depends on securing consensus throughout London government, and this may require a more balanced approach to the competing considerations. It is also considered that the creation of a collective investment fund for projects to support London's economic development would align with the City Corporation's wider priorities. On balance, it is recommended that the City Corporation be prepared to support either an option which gives relatively high weight to growth-generation (Option B or C in the Draft Prospectus), or one which affords equal weight to each of the four proposed 'pots' (Option A in the Draft Prospectus), according to which appears the more politically viable. Even the latter would, on current projections, still see the City receive the largest individual benefit from the pilot scheme, at some £12.4 million in the next financial year.

23. If Members decide to give 'in principle' support, officers will continue to engage in detailed work on how the scheme would operate, as well as supporting London Councils in its discussions with the Government and the GLA. In the event that negotiations were successful, a full proposal would be put before Members for a final decision on whether or not to participate.

## **Appendix**

- London Business Rates Pilot Pool 2018-19 – Draft Prospectus

## **Background Papers**

- Policy and Resources Committee, 16 February 2017, Item 16, and Finance Committee, 21 February 2017, Item 12: Report of the Chamberlain and Remembrancer on the Local Government Finance Bill;
- Finance Committee, 18 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.

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