ITEM 17

Report – Policy & Resources and Finance Committees

Pilot Scheme for Business Rates Devolution in London

To be presented on Thursday, 11th January 2018

To the Right Honourable The Lord Mayor, Aldermen and Commons of the City of London in Common Council assembled.

SUMMARY

The Government, the Greater London Authority (GLA) and London Councils have negotiated a pilot scheme for business rates devolution in London for the financial year 2018–19, involving the establishment of a business rates pool. The proposal requires the unanimous agreement of the borough councils and the Court of Common Council to proceed. Your Policy and Resources and Finance Committees have both considered the proposal and are supportive.

The scheme would have a financially neutral starting-point but enable any year-on-year growth in rates revenue to be retained in London – a dividend projected to be worth £240 million in 2018–19. Some of this would be used to establish a new strategic investment fund and the rest would be shared among the participating authorities (with the Common Council's projected share £8.2 million).

If these projections were not to materialise, the Government would guarantee that no individual authority would be worse off as a result of participating in the pool. The Common Council will therefore not face any risk to its current allocations, including the City Premium and the City Offset.

The scheme would carry no commitment beyond 2018–19 but could offer a platform for a further-reaching devolution settlement.

In addition to this the City Corporation has been invited to act as lead authority under the scheme and undertake the main administrative responsibility for operating the pool and the strategic investment fund.

RECOMMENDATION

Members are asked to agree that:-

i) the Court of Common Council participate in business rates pool pilot scheme for the 2018-19 financial year together with the Greater London Authority and the London borough councils;

ii) the arrangements for the distribution of revenue within the pool should, subject to recommendation (iii), be as described in the body of this report;

iii) the Chairman of the Policy and Resources Committee be authorised, in consultation with the Chairman of the Finance Committee, to agree to minor variations in the arrangements, if agreed by the other participants in the pool;

iv) the City of London Corporation act as the lead authority for the pool and for the strategic investment fund to be established under the pooling arrangements;

v) the Town Clerk, the Chamberlain or the Comptroller & City Solicitor (as appropriate) should be authorised, in consultation with the Remembrancer on matters of constitutional or legislative relevance, to take all necessary legal and practical steps for the establishment and administration of the pool and the strategic investment fund, in accordance with the preceding recommendations;

vi) the Chamberlain be authorised to draw upon the City Fund reserve to meet the additional costs incurred in the administration of the pool and the strategic investment fund, including those arising from the Common Council's role as lead authority, up to one full-time equivalent post, with the amounts drawn down being refunded, and any future costs met, from additional revenue retained under the scheme as it becomes available; and

vii) oversight of the City Corporation's work in connection with the pool and the strategic investment fund be referred to the Policy and Resources Committee so far as concerns governance and the distribution and deployment of resources, and to the Finance Committee so far as concerns financial administration.

MAIN REPORT

Introduction

1. The programme of further local devolution initiated by the Coalition Government prompted many in London government to press for further devolution in the capital, aimed at securing greater local control over revenue, services and investment. The City Corporation has taken a supportive position in relation to these efforts. The unique position of London did not, however, fit easily into the Government's programme, which was focused on 'City deals' for areas yet to have elected mayors.

2. The Government's pursuit of reform to local government finance—and in particular moves to increase the local retention of business rates revenue—has created an opening for progress in this agenda. Legislative proposals for a general move to a 100% retention scheme were abandoned following the last General Election. The Government remains keen, however, to undertake local pilot schemes for 100% retention. Several such schemes are already in place and the Government is seeking to negotiate more.

3. These political developments have converged on the idea of a London pilot scheme for 100% retention whereby the GLA, the boroughs and the Common Council form a business rates pool in the 2018–19 financial year. In exchange they will be allowed to retain 100% of growth in business rates revenue in the capital in that year. The need to enter into a pooling arrangement reflects the Government's policy that greater devolution should be accompanied by greater regional co-operation among local government bodies. Negotiations with the Government have been led by the GLA and London Councils.

4. In September the Policy and Resources Committee and the Finance Committee both expressed 'in principle' support for the proposed pilot scheme. This support was conveyed in October at the Congress of London Councils, where it was

matched with that of the GLA and the boroughs, enabling the negotiations to proceed to a more detailed stage.

5. These negotiations proved successful and led to confirmation by the Chancellor in the Autumn Budget that the scheme would go ahead, subject to the necessary approvals. Further details have also emerged as to how the scheme would operate, including a change to the distribution model previously suggested and a proposed administrative role for the Common Council.

6. The pilot scheme now requires the agreement of the Common Council and all London boroughs if it is to proceed. The commitment would only be for the 2018–19 financial year, with detailed evaluation to follow. If successful, it is envisaged that a business rates pool could form part of a longer-term devolution settlement.

Proposed arrangements

7. The proposed arrangements build on the system of partial rates retention introduced in 2013. This system allows local authorities to retain a share of growth in the rates revenue they collect over a given cycle, while exposing them to a share of the risk of any fall in revenue over that cycle. A fuller description of the operation of the current system is given as an appendix to this report.

8. Arrangements for the governance of the pool and, in particular, the distribution of revenue within it, are set out in a Memorandum of Understanding between the Government, London Councils and the GLA, which reflect the arrangements described below.

Main features

9. The effect of a business rates pool is to make the participating authorities jointly liable for a single tariff payment (assuming, as will be the case in London, that the area's revenue exceeds its assessed need). This enables the authorities, by agreeing individual contributions to that payment, effectively to determine the distribution of rates revenue across the area they cover.

10. The proposed pooling arrangements in this case involve the following main elements. The retained share of business rates will be increased to 100%. To counteract this, London will no longer receive revenue support grant, and its joint tariff payment will be calculated to ensure that its aggregate spending need is matched to its aggregate business rates base. The levy payment will be removed, but the safety net will be retained and adjusted to provide an equivalent level of protection as at present (*i.e.* 97% of total expected revenue).

11. In practical terms the main effect is that, while the arrangements will be financially neutral at the start, any increase in business rates revenue in 2018–19 will be wholly retained within London. At present, over one third of such growth is sent to the Treasury, in the form of the national share and levy payments.

12. Rates revenue is currently projected to increase significantly in the financial year 2018–19. The ability to retain the entirety of this growth, as proposed under the pooling arrangements, is likely to be of considerable financial benefit.

13. In case these projections do not materialise, the Government will guarantee that London will not be worse off as a result of entering into the pilot scheme. In other words, while London will have a greater opportunity to benefit from an increase in growth, it will not face any greater risk from a decrease in revenue than the total risk that participating authorities would face under the current system.

14. This ‘upside-only’ model is intended to encourage participation in the pilot scheme and is unlikely to be carried over into any longer-term scheme.

Distribution of revenue

15. The first principle to be applied in working out the distribution of revenue within the pool is that each participating authority will end up with at least the equivalent rates revenue to that which it would have received had the pilot not been initiated. This is made possible by the Government guarantee referred to above. So far as the City is concerned, the principle encompasses revenue from the City Premium and the City Offset in addition to the standard formula allocation.

16. In order to meet this principle, additional retained sums from areas which see an increase in their rates revenue will first be used to compensate areas which see a decrease in their revenue and which therefore would stand to lose out from 100% retention. Only if the former is insufficient to cover the latter will the Government guarantee be called upon.

17. It is anticipated, however, that growth in revenue in London will be sufficient to leave a significant financial dividend even after worse-performing areas have been compensated. On current projections the dividend will total approximately £240 million in 2018–19.

18. It is proposed that this dividend be distributed as follows:-

- 15% will be allocated to a strategic investment fund, to support projects which contribute to the sustainable growth of London’s economy;
- 31% will be allocated to the GLA (36% of the total after the strategic investment fund is accounted for, reflecting its share of retained rates under the current system);
- 54% will be shared among the boroughs and the Common Council, of which:
    - 10% will be distributed according to where the additional revenue was generated, thereby enhancing the incentive to generate growth;
    - 22% will be distributed accordingly to residential population as measured by the Office for National Statistics;
    - 22% will be distributed according to spending need, as assessed under the Government’s standard formula.

19. So far as the direct financial consequences for the City are concerned, this is a less favourable distribution mode than the various options suggested at the time the City Corporation gave ‘in principle’ support to the scheme in October. The weighting has been shifted away from retention of growth where it is generated

(a factor which tends to benefit the City) in favour of a more redistributive approach. This change arose in the negotiating process and was put forward by London Councils to improve the prospect of obtaining the necessary unanimous support for the scheme. As explained below, it does, on current projections for revenue growth, still leave the Common Council as the largest single beneficiary except for the GLA.

Governance

20. The proposal requires unanimous agreement by the Common Council and the boroughs to proceed. It is proposed that the pool will be governed by a Memorandum of Understanding with all the participating authorities. This will set out the applicable principles for the operation of the pool but will not be legally binding. London Councils consider that there is insufficient time to put in place a more formal contractual arrangement.

21. The Memorandum will determine the distribution of revenue within the pool, in accordance with the principles set out above. It may only be amended with the consent of all participating authorities. This means that the funding model cannot be changed to the detriment of any authority without its consent.

22. The Memorandum will also govern the process by which decisions are taken about the deployment of the strategic investment fund. Proposals for investment from the fund will be assessed for their contribution to sustainable growth in the capital, and for their ability to attract private sector funding (thus exerting maximum leverage). Any expenditure will require the approval of a majority of two thirds of the billing authorities (the London borough councils and Common Council). In addition, billing authorities in any one sub-region will be able to veto a proposed expenditure. The City will for this purpose form part of a ‘Central’ sub-region along with Westminster, Kensington & Chelsea, Camden, Islington, Southwark, Lambeth and Wandsworth.

Lead authority

23. When a business rates pool is created it is necessary to appoint a statutory lead authority to exercise the administrative functions. Principally, this will involve calculating and collecting the share of each participating authority to the joint tariff payment. In order to do this, the lead authority will be required to set up a separate collection fund for the pool, and to establish information-sharing mechanisms with the other participating authorities to form estimates of their rates revenue and consequent entitlements or liabilities under the pool. It is likely that the system will mirror to some extend the ‘National Non-Domestic Rates’ system operated by the Government, whereby revenue forecasts will be submitted at the beginning of the financial year and reconciled at the end of it.

24. A lead authority will also be required for the strategic investment fund referred to above, to hold and disburse the fund in accordance with its governing arrangements. As well as accounting requirements, this will call for the operation of a process for the making and consideration of proposals for spending from the fund, in accordance with the assessment criteria and voting rules described above.

25. The City Corporation is being asked to act as the lead authority in both of these respects. The implications of this request are included in the following assessments.

Financial implications

26. As explained above, the pilot scheme will see the retained share of business rates set at 100% and levy payments abolished, in exchange for an increase in tariff payments and the removal of revenue support grant. On current projections for revenue growth in 2018–19, the net effect will be an additional £240 million of revenue retained in London. Of this, under the distribution model described above, £36 million will be put into a strategic investment fund, £74 million will go to the GLA, and £130 million will be divided among the boroughs and the Common Council.

27. Of this £130 million, the City Corporation will receive £8.2 million—the largest of any individual billing authority share. This arises mainly from the 10% share of the total dividend which is to be retained where revenue growth occurs, and reflects the fact that projected growth in the City in the next financial year is expected to outpace that in London as a whole, at 15% compared to 6%.

28. To put the matter in context, business rates revenue generated in the City is projected to rise from £945 million in 2017–18 to £1,093 million in 2018–19, an increase of £148 million. Under the current system, of this £148 million, 15% would be retained by the City, 37% would go the GLA and 48% would go to the Treasury. Under the proposed pilot scheme, 20.5% would be retained by the City, 48.8% would go to the GLA, 7.2% would be contributed to a pan-London strategic investment fund, and 30.7% would be distributed among the London boroughs.

29. The Government guarantees underpinning the proposal mean that there is no down-side risk for the City Corporation should the projected increase in revenue growth fail to materialise in the next financial year. In other words, the City Corporation will receive at least an equivalent amount to that which would have resulted from the operation of the current system in 2018–19. Specific assurances have been received, and are reflected in the proposals, that the City Premium and the City Offset will continue to be recognised in the pooling arrangements.

30. If the pool were to become a longer-term arrangement, it is unlikely that the Government would continue to underwrite a one-sided approach to risk and reward. Accordingly, the City Corporation, along with the other participating authorities, could become more exposed to volatility in its own rates revenue and to that of London as a whole. On the other hand, participation in a pool could offer a means of spreading risk, which might benefit the City as an area which is liable to significant fluctuations in rates revenue. These considerations would need to be assessed in the context of a detailed proposal and conditions at the time.

31. The proposed role of the City Corporation as the lead authority would entail additional staffing costs. These are estimated at no more than one full-time-equivalent senior accounting role. It is proposed that these costs be met in the first instance through drawing on City Fund reserves, with the amount drawn

down being refunded, and any future costs met, through the expected additional income from the scheme once it becomes available.

Strategic implications

32. The proposed pilot scheme is currently the best available vehicle for securing meaningful further devolution to the capital. This is in keeping with the City Corporation's stated policy and should enable greater local influence to be brought to bear on decisions about public services and investment.

33. Furthermore, the pilot scheme is an opportunity to demonstrate that further devolution to London can be achieved without the creation of new sub-regional corporate structures such as combined authorities, which the Government has insisted on elsewhere in the country under its 'City deals'. Such structures may offer a potential starting-point for wider-ranging local government reorganisation but their establishment in the capital is not perceived to be in the interests of the City Corporation.

34. The Government has made clear that unanimous agreement within London will be required if it is to agree to the establishment of a pool. This means that the City Corporation's failure to participate would frustrate the scheme. Such an outcome would risk undermining the City Corporation's political standing and its stated support for devolution.

35. If the pilot scheme were to mature into a longer-term pooling arrangement, this would mean, in effect, that the amount of rates revenue available to the City Corporation would depend on agreement within London local government from time to time, rather than an allocation set in Whitehall. This would make it necessary to give careful consideration to the parameters of any more permanent proposal.

36. The proposal for the Common Council to act as lead authority would enhance its existing role in facilitating regional co-operation (for instance through hosting the London Councils Summit, holding the London Government Dinner, and providing the secretariat and 'accountable body' function of Central London Forward). It would be a useful demonstration of its ability to provide services for the benefit of Greater London as a whole.

Legal implications

37. The operation of a business rates pool is governed by Schedule 7B of the Local Government Finance Act 1988, as inserted by the Local Government Finance Act 2012. This makes each participating authority jointly and severally liable for the joint tariff payment under the scheme, although if it were to act as the lead authority the Common Council would in practice be responsible for discharging the payment and collecting contributions to it. The Common Council's consent is required for the Coty Corporation to be included in a pooling arrangement. Beyond joint liability for the tariff, the legislation contains little detail about the operation of a pool and leaves much to the voluntary arrangements made by the participating authorities.

38. The proposal that the pool be governed by a non-binding Memorandum of Understanding, rather than a more detailed contractual arrangement, means that the Common Council will be largely reliant on mutual trust and confidence

in carrying out its proposed role as the lead authority. It will, in particular, depend on the London borough councils providing timely and accurate information about their rates revenue and to make the required payments promptly. A Memorandum of Understanding is the mechanism which governs the operation of Central London Forward and the City Corporation's role in it, under arrangements which have been in place for some ten years.

39. It is possible that, in administering the pool or the strategic investment fund, the Common Council will have to exercise certain functions on behalf of the borough councils, for instance when disbursing the investment fund outside the City. The need for such delegations will be assessed on a case-by-case basis and will be arranged under the Local Government Act 1972, which applies to the Common Council in its capacity as a local authority for this purpose. The exercise of such functions would remain legally the responsibility of the delegating council.

Conclusions

40. The proposed scheme offers an opportunity to advance the devolution agenda in London and strengthen collaboration among the different organs of local government in the capital. On current projections, it will create an additional source of funding for strategic investment and deliver a financial dividend to the Common Council and the other participants. The proposals do not expose the Common Council to any additional risk of volatility in 2018–19, and they are designed to respect the current arrangements in place to cater for the special position of the City within the local government finance system. The proposed role of the Common Council as the lead authority, meanwhile, would enhance its supportive role in wider London government.

41. If successful, the scheme could lay the ground for a more permanent devolution settlement. It carries, however, no commitment beyond the initial financial year, and would not prejudice consideration of any longer-term proposal.

Appendix

- Description of the current system of partial rates retention

All of which we submit to the judgement of this Honourable Court.

DATED these 12th and 14th days of December of 2017.

SIGNED on behalf of the Committees.

Catherine McGuiness, Deputy
Chairman, Policy & Resources Committee

Jeremy Paul Mayhew
Chairman, Finance Committee

Appendix

Current system of partial rates retention

Partial rates retention was introduced in 2013 under the Local Government Finance Act 2012. Generally, under this system, 50% of rates revenue is retained within local government (subject to a system of redistribution) and 50% is sent to the Treasury, to fund the revenue support grant and other expenditure related to local government.

In London, the position has been modified to allow for the TfL capital budget to be funded from retained rates. Under the current arrangements, 67% of rates revenue is retained in local government: 30% by the billing authorities (the boroughs and the Common Council) and 37% by the GLA. The remaining 33% goes to the Treasury.

A system of redistribution operates in respect of the retained share of rates. The system operates on a cyclical basis (generally expected to be five years). At the beginning of each cycle, an annual 'top-up' or 'tariff' payment is calculated for each authority—a top-up being an amount received from the system and a tariff being an amount paid into it. This is designed to match, at the start of the cycle, each authority's formula-assessed spending need to the amount of rates revenue it will end up with at its disposal.

Critically, the top-up or tariff amount remains constant over the course of the cycle. This, coupled with the retention of a percentage share of revenue, gives local authorities the opportunity to benefit financially from any increase in rates revenue in their areas. Conversely, if rates revenue falls, the local authority loses out. This mechanism is designed as an incentive for councils to retain and increase business activity in their areas.

The system is adjusted to neutralise the effects of business rates revaluations (such as that undertaken earlier this year). This means that councils do not gain from increases in property values in their areas, or suffer from falls in value. The incentive is effectively confined to 'physical' changes such as the construction of new office space or the renovation of existing space.

Two mechanisms serve to limit the incentive effect. First, a 'levy' is charged on councils which see high increases in revenue. Second, a 'safety net' ensures that councils cannot see the amount of rates revenue at their disposal diminished beyond a certain amount (currently 92.5% of the 'baseline' level).

Growth in revenue in recent years means that the Common Council is currently both a 'tariff' and a 'levy' authority.

On the introduction of the modern rating system in 1990, special arrangements were put in place to recognise the City's uniquely low council tax base relative to the level of services it had to provide. These arrangements—the City Premium and the City Offset—enable the Common Council to charge a slightly higher rate and retain an additional share of rates revenue. During the passage of the Bill for the 2012 Act which introduced the partial retention system, the Government recognised the continuing justification for these arrangements and agreed to their application in the new system.