**PAPER NO. 18**

# REPORT TO THE COUNCIL MEETING OF 22nd October 2012

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| **Meeting:** | **Council** |
| **Date:** | **22nd October 2012** |
| **Subject:** | **Business Rates Retention – Pooling Proposition** |
| **Report of:** | **Jim Holden - Section 151 Officer** |
| **Portfolio Holder:** | **Cllr Grahame Spendlove-Mason – Finance. Efficiency and Assets Portfolio Holder** |
| **Status:** | **Public** |

## 1 Purpose of the Report

1.1 To set out for approval a proposition to set up a business rates pool within the Leicestershire sub-region.

## 2 Recommendations:

2.1 Council is requested to approve:

a) The proposal to pool business rates with Leicestershire County Council, Leicester City Council, all Leicestershire District Councils and Leicester, Leicestershire and Rutland Fire Authority as set out in this report.

b) The delegation of authority to both the Chief Executive and the Section 151 Officer in consultation with the Leader and the Finance, Efficiency and Assets Portfolio Holder to agree the pooling governance arrangements, including the legal agreement, and to withdraw from the pool if information in the Local Government Finance settlement in December indicates that continued pooling would not be in the best interest of this Council;

## 3 Summary of Reasons for the Recommendations

3.1 To enable a pooling proposal to be agreed that would ensure that additional financial resources are retained in the sub region (Leicestershire) to support economic development.

## 4 Impact on Communities

4.1 The potential benefit for the community is that additional financial resources may become available to the District as a result any future growth in the rateable value (and therefore business rate income) arising from either new businesses locating within the District or existing businesses expanding.

Conversely any reductions through closures and or relocations outside the District may result in a reduction in income to the authority.

This places a greater emphasis on the District engaging with and understanding the needs of existing businesses in order to support their economic viability and making Harborough an attractive location for new businesses.

## 5 Key Facts

### 5.1 Background

At present, local Councils receive funding from three main sources: grants from central government, council tax and other locally generated income (such as fees and charges for services). Central government grants can be received as 'specific grants', which can come with restrictions on what they can be spent on, or through 'formula grant', which has no restrictions and can be used for any purpose. Formula grant is currently distributed to local authorities using a complex formula known as the Four Block Model.

One of the main components of formula grant is National Non-Domestic Rates (NNDR), commonly known as business rates. Business rates are collected by local authorities from businesses, but they are currently paid into a central pool to be redistributed as part of the formula grant. This current system means that local authorities does not have any financial incentive to promote business growth in their area, as they will not receive any of the business rates receipts from new development.

### 5.2 Proposed Rate Retention Scheme

The Government plans to change the current system by enabling Councils to retain a share of the growth in business rates in their area. The Statement of Intent on central and local shares included the Government's decision to set the shares on a 50%:50% basis. The Government will provide Revenue Support Grant to make up the difference between the local share of business rates at the outset of the scheme and the spending control totals for local government in 2013/14, 2014/15 and subsequent years. Spending control totals are expected to fall, leading to reduced amounts of Revenue Support Grant.

The proposed new system will, to a degree, allow Councils to keep growth in business rates in their local area. If Councils keep all of their business rates some would have a much larger amount than they need to deliver services and others would have too little. Those with more business rates income than their funding allocation will pay a "tariff" and those with too little income will receive a "top-up". Tariffs and top-ups will be inflated each year according to the retail price index factor applied to business rate bills.

Councils will potentially be able to retain 50% of the real terms growth in business rates. Conversely, Councils face the risk of having to absorb 50% of potential real terms decreases. The proposed system includes a levy on disproportionate increases and a safety net to provide support to limit the impact of significant decreases.

The Government proposes to set the proportional levy at a 1:1 level, i.e. for every 1% increase in an individual authority's business rates baseline the authority would see no more than a corresponding 1% increase against its baseline funding level. As such, only tariff authorities are potentially affected by the levy.

## 5.3 Pooling Proposition

The Local Government Finance Bill allows local authorities to form pools for the purposes of business rate retention. The modelling undertaken indicates that in periods of real terms rising business rates (ie increases over and above the rate of inflation) it would be beneficial for the sub region (Leicestershire) to pool business rates as this means that the levy paid by the District Councils will be reduced and these resources can be retained in the sub region. Under the proposed governance arrangements Districts would receive the funds they would have received were there not a pool. ie net of the levy The balance of the funds received would, subject to appropriate governance arrangements, be available to support growth generally across the sub-region. The table below, which based on broad estimates, shows that if there was a real terms 1% increase in business rates and if there was pooling in place an additional £740,000 could be retained in the region.

Pooling illustration

| **1% real terms increase** | **Rates Baseline £'000** | **Spending Baseline £'000** | **Tariff/ Top-Up £'000** | **Inc in Rates £'000** | **Spending Increase Limited to 1 to 1 £'000** | **Levy £'000** |
|---|---|---|---|---|---|---|
| County | 20,000 | 59,000 | 39,000 | 200 | 590 | 0 |
| Leicester | 49,000 | 85,000 | 36,000 | 490 | 850 | 0 |
| CFA | 3,000 | 8,000 | 5,000 | 30 | 80 | 0 |
| Blaby | 16,000 | 2,000 | -14,000 | 160 | 20 | 140 |
| Charnwood | 18,000 | 4,000 | -14,000 | 180 | 40 | 140 |
| Harborough | 14,000 | 2,000 | -12,000 | 140 | 20 | 120 |
| Hinckley & Bosworth | 11,000 | 2,000 | -9,000 | 110 | 20 | 90 |
| Melton | 5,000 | 1,000 | -4,000 | 50 | 10 | 40 |
| NW Leics | 19,000 | 2,000 | -17,000 | 190 | 20 | 170 |
| Oadby & Wigston | 5,000 | 1,000 | -4,000 | 50 | 10 | 40 |
| Total | 160,000 | 166,000 | 6,000 | 1,600 | 1,660 | 0 |
| | | | | | | 740 Retained Levy |

## 5.4 Resource Implications

The model above shows that, if business rates across all Districts were to increase by 1% in real terms, a pool would generate an additional £740,000 retained with the county and city area due to no levy being payable. (A real terms 2% increase would generate £1.5m etc). This would increase in each year that real terms growth continued, i.e. if there was real terms growth of 1% per annum up to the 2020 reset, pooling could generate c£5m in the last year. This is shown in Appendix A. However, there is a downside risk as the safety net will operate at the pool level.

The safety net will operate in the -7.5% to -10% range and is based on the spending baseline. As a result of the highly geared nature of Districts i.e. we have a high rates baseline and low spending baseline, a small real terms drop in rates would trigger the safety net at an authority level. However, this would not be the case if business rates were pooled.

As the safety net operates at a pool level there would have to be a very large fall in business rates before as a pool in the national safety net kicks in. Modelling shows that if the safety net was -10% of spending baseline (£16.6m) business rates would need to fall by £16m before the national safety net kicked in. In this worse case position the pool collectively would be £8m worse off than if authorities operated individual safety nets.

This level of decline is obviously extremely unlikely. Even large business closures are generally signalled well in advance, for example Astra Zenica in Charnwood. If there was a -2% real terms reduction in business rates the pool would be c£400k worse off than if authorities had not pooled (based on a -10% safety net).

The Pool includes risk sharing between the participating authorities. The detail is still subject to agreement amongst partners however the proposals under discussion are set out in **Appendix A**. These proposals set out that in the first instance surpluses generated in the pool would be used to fund a pool safety net. However, there is a possibility that a loss could be made in the first year or the reserve will not be sufficient in later years.

**Appendix B** shows the County, City, Districts and Fire Authority share at various reductions in the rate baseline. Harborough's share at a 2% real terms decline in the rates baseline and -10% safety net would be circa £35,000

The modelling to a large extent need to be caveated as both the rates and spending baselines have not been publicised (and will not be publicised until December with the finance settlement). The figures in this paper are based on broad assumptions. However, the broad principle of the benefits (and risks) of pooling are generally accepted across local government. Following the publication of the draft finance settlement authorities will have until the end of the consultation period in which to withdraw, however if any partner wished to withdraw the pool in its entirety would cease to exist. This period will allow further modelling to be undertaken on the published figures.

**5.5 Proposed Scheme Detail**

Principles

- Risks remain (as far as possible) with the individual authorities

- Additional resources, (over and above that which would be due to Districts were they not in a pool) would be used to fund the pool safety net in the first instance and thereafter to fund economic development. This could be used by the Leicester, Leicestershire and Rutland Economic Partnership (LLEP) or an equivalent organisation with the City Council acting as the accountable body

The scheme would operate along the following lines:

- Where the pool has generated additional resources, all authorities would receive the resources they would if there was no pooling i.e individual authorities will be no worse off as a result of pooling but they will not necessarily be better off

- A calculation would be undertaken to identify the individual authority safety net threshold and any losses up to this level would be the responsibility of each authority (as it would be without pooling)

- Early year surpluses would be kept as a reserve to fund a safety net for years in which the pool did not generate additional resources (so that the pooled scheme would operate as if the national scheme was in place)

- In the event that a loss was made in the first year or the reserve was not sufficient in later years to fund the operation of the pooled safety net the deficit would be funded by each authority in proportion to their rates baseline

- Leicestershire County Council to act as responsible body (receive funding and make payments)

- Notice to leave the pool would need to be made in line with national guidelines. Pool members cannot leave mid-year and notice must be given by December in the preceding year

A legal partnership agreement would need to be drawn up and agreed between all partners.

5.6 **Timing**

There could be real advantage in establishing a scheme in the first year as the rates baseline may have some 'head room' as it is based on a five year average. This would help meet concerns about risk. If the baseline is higher than expected and/or future growth forecasts are lower this could mean it will not be financially beneficial to pool. The report involves delegation to the Chief Executive and Section 151 Officer, in consultation with the Leader and Finance and Assets Portfolio Holder to exit the pool if this is the case. The delegation is needed as this may need to take place at relatively short notice. Under DCLG guidelines it will be possible to exit the pool in December. If one authority exits, the pool will cease for all authorities.

The latest Department of Communities and Local Governments (DCLG) timetable for pooling is set out below:

- $9^{th}$ November – lead authority to submit final pooling proposals including governance arrangements

- December – Local Authorities can notify DCLG of their intention not to proceed (once they have seen the Local Government Finance Settlement which will include the business rates baseline)

The Pooling of Business Rates – Draft Heads of Terms are attached at **Appendix A** and the illustration of sharing a potential deficit at **Appendix B**

5.7 **Conclusion**

Whilst currently there are undoubtedly a number of uncertainties surrounding the exact operation of a pooling arrangement and it is difficult to precisely forecast the potential rewards and risks nevertheless the underlying rationale is that, based on the known facts available, the sub-region would be better off financially as a whole operating as a pool rather than as individual authorities.

The governance arrangements will be key to ensuring that authorities participating in the pool have confidence that there is an open, transparent and democratically accountable decision making process to determine the most economically advantageous approach to the utilisation of the additional funding generated.

6.0 Equal Opportunities Implications

There are no direct implications.

7 Legal Issues

7.1 There will need to be a formal legal agreement setting out the agreed governance and financial arrangements for pooling.

8 Resource Issues

8.1 As set out in the body of the report

9 Equality Impact Assessment Implications/Outcomes

9.1 None arising from this report

10 Impact on the Organisation

10.1 As set out in the body of this report

11 Community Safety Implications

11.1 None arising from this report

12. Carbon Management Implications

12.1 None arising from this report

13. Risk Management Implications

13.1 As set out in the body of the report

14 Consultation

14.1 Not applicable

15 Options Considered

15.1 To not give consideration to entering into a pooling arrangement

16 Background Papers

DCLG Technical Consultation on Business Rates Retention
DCLG Statement of Intent – Business rates retention scheme : The central and local share of business rates
DCLG Business rate retention scheme : Pooling Properties

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**Previous report(s): None**

**Information Issued Under Sensitive Issue Procedure: No**

**Ward Members Notified: N/A**

**Appendices:**

- **A.** Pooling of Business Rates – Draft Heads of Terms
- **B.** Illustration of sharing a potential deficit in proportion to the rates baseline

**APPENDIX A**

# Pooling of Business Rates – Draft Heads of Terms

## 1. Introduction

1.1 These heads of terms document the proposed governance agreement between Leicestershire authorities in respect of pooling of business rates.

1.2 The statutory basis of these heads in terms is *(the relevant section of the Local Government Finance Bill, once enacted)*

## 2. Commencement

2.1 The agreement takes effect on 1s April 2013, subject to the pool being designated by the Secretary of State. If the pool is not designated (or designation is revoked prior to 1st April 2013), the agreement shall never take effect.

## 3. Termination

3.1 This agreement is continuous, until:

(a) The pool is dissolved by the Secretary of State, in which case the pool ceases to exist on the effective date of dissolution;

(b) The parties unanimously agree to dissolve the pool at the end of a specified financial year, and (if necessary) the Secretary of State's consent is obtained.

3.2 The above is without prejudice to the right of individual authorities to withdraw from the pool under paragraph 8 below.

## 4. Parties to This Agreement

Blaby District Council;
Charnwood District Council;
Harborough District Council;
Hinckley and Bosworth Borough Council;
Leicester City Council;
Leicestershire County Council;
Leicester, Leicestershire and Rutland Combined Fire Authority;
Melton Borough Council;
North West Leicestershire District Council;
Oadby and Wigston Borough Council;

## 5. Definitions

5.1 An *authority* means one of the parties to this agreement (including the lead authority).

5.2 A *business rates baseline* for a given financial year in respect of any authority is the figure stated in the Local Government Finance Settlement as that authority's individual authority business rates baseline for that year.

5.3 The *contingency* is intended to ensure there are sufficient funds in years when pooled income is less than the income the authorities would have received had there been no pool. The authorities regard £400,000 as the optimum balance of the contingency.

5.4 *Income* is all rates income within the ambit of the Business Rates Retention scheme (i.e. rates income to which a percentage is applied to determine the local and central shares and therefore excluding transitional relief); plus top-up payments and safety net payments; minus tariff payments and levies.

5.5 The *lead authority* is Leicestershire County Council.

5.6 The *Local Government Finance Report* is the annual report presented to the House of Commons, prior to the financial year to which it relates, pursuant to section 78A of the Local Government Finance Act, 1988.

5.7 *Pooled income* is the income (as defined above) receivable by the authorities who are party to this agreement, and which is likely to be different from the sum of each authority's income had this agreement not been entered into.

5.8 The *pool* is an account of pooled income, and its distribution, which is maintained by the lead authority.

## 6. Responsibilities for Authorities

6.1 The lead authority is responsible for:

(a) receiving payments from central government and making payments to central government, where such payments are the responsibility of the lead authority;

(b) after the end of each financial year and by no later than ……, determining the amounts due to or from each member of the pool, in order to discharge obligations to central government, and to each member of the pool in accordance with paragraph 7 below;

(c) before the start of each financial year and by no later than ……, estimating the amounts which will be due to or from each member of the pool, and preparing a monthly schedule of payments on account to be made to/from each member of the pool to/from the lead authority. The schedule shall be constructed to ensure that (to the extent possible) no authority incurs or earns interest as a consequence of pooling;

(d) keeping accounts, providing management information to all authorities, publishing a year end account of the pool, completing statements and submitting Government returns in respect of the pool as a whole;

(e) complying with statutory regulations and any requirements of DCLG relevant to the operation of pools.

6.2 Each authority shall be responsible for making payments as specified by the lead authority, and for providing information needed by the lead authority to fulfil its obligations.

## 7. <u>Income</u>

7.1 After the end of each financial year, the lead authority shall calculate:

(a) the pooled income for the year, plus the balance of the contingency (A);

(b) the sum of the income which would have fallen due to each authority had this agreement not existed (B);

7.2 Each authority shall be due from the pool a sum equal to the income it would have received had this agreement not existed (after taking into account payments made during the course of the year).

7.3 Should (A) exceed (B) by less than £400,000, the excess shall form the balance of the contingency carried forward to the following financial year.

7.4 Should (A) exceed (B) by more than £400,000:

(a) the first £400,000 shall form the opening balance on the contingency for the following financial year;

(b) the remainder shall be paid to Leicester City Council in its capacity as accountable body for the Leicester and Leicestershire Enterprise Partnership, and will be available for priority economic projects across the LLEP area.

7.5 Should (B) exceed (A), the difference will be made up by all the authorities, with each authority contributing a sum pro rata to its business rates baseline for the financial year in question.

## 8. Exit Arrangements

8.1 Any authority can give notice of its intention to leave the pool at the end of the financial year.

8.2 Such notice shall be given no later than 28 days after the date of publication of the draft Local Government Finance Report for the following financial year.

8.3 An authority leaving the pool shall have the same rights and responsibilities in respect of its final year of membership as if it were a continuing member.

8.4 An authority leaving the pool shall be entitled to receive a proportion of the contingency (if any), as it stands once all the income for the year has been distributed. The share shall be calculated pro rata to its business rates baseline in the final years of membership.

8.5 If, in the view of the lead authority, an authority would be likely to receive a safety net payment in the current or subsequent financial year (had this agreement not existed), the parties to this agreement may determine that the authority should leave the pool at the end of the financial year. Such a decision shall be taken no later than 28 days after the date of publication of the draft Local Government Finance Report for the following financial year. The effect shall be the same as if the authority had given notice on the date of the decision.

## 9. Dissolution of the Pool

9.1 Any authority may approach the DCLG requesting that the pool is dissolved. In such circumstances, the DCLG is obliged to dissolve it.

9.2 Prior to approaching the DCLG, the authority shall give notice to the other pool members in writing, by no later than *{date to be determined but probably around October prior to the end of the year – whatever is needed for other pool members to decide to submit a new application, which will depend on DCLG's future timetable}.*

9.3 Dissolution of the pool shall have the effect of terminating this agreement from the last day of the financial year of its existence (except for provisions in paragraph 10 below).

## 10. Consequences of Termination

10.1 If this agreement is terminated, each authority shall have the same rights and responsibilities in respect of the pool's final year of existence as if the agreement were continuing.

10.2 Each authority shall be entitled to receive a proportion of the contingency (if any), as it stands once all the accounts for the final year of the pool have been closed and all pooled income has been distributed. Each authority's share shall be calculated pro rata to its business rates baseline in the final year of the pool's existence.

## 11. Governance Arrangements

11.1 All decisions in respect of the pool shall be made by majority decision, with each authority having one vote.

11.2 Each authority shall decide who is responsible for representing the authority in matters affecting the pool. The identity of the nominee shall be communicated in writing to the lead authority, who shall keep a record of all nominees.

11.3 A nomination shall remain in force until it is revoked by the authority in question.

## 12. Interest

12.1 No interest shall be paid by or to the lead authority from the other authorities in the pool.

**APPENDIX B**

**Illustration of sharing a potential deficit in proportion to the rates baseline**

Sharing potential deficit pro rata to rates baseline – based on a 10% safety net.

| Share of Deficit | | | |
|---|---|---|---|
| | **2% decrease in rates £'000** | **3% decrease in rates £'000** | **4% decrease in rates £'000** |
| County | -50 | -155 | -265 |
| Leicester | -123 | -380 | -649 |
| CFA | -8 | -23 | -40 |
| Blaby | -40 | -124 | -212 |
| Charnwood | -45 | -140 | -239 |
| Harborough | -35 | -109 | -186 |
| Hinckley & Bosworth | -28 | -85 | -146 |
| Melton | -13 | -39 | -66 |
| NW Leics | -48 | -147 | -252 |
| Oadby & Wigston | -13 | -39 | -66 |
| | -400 | -1,240 | -2,120 |