Coventry City Council

Briefing note

To: **Finance and Corporate Services Scrutiny Board 1** **Date: 18th April 2018**

Subject: Business Rates and the Local Government Funding

1 Purpose of the Note

1.1 Business Rates play a significant part in the overall funding of local government and the level of Business Rates generated in Coventry is a major component in funding the Council's budget. The local government funding model is due to be overhauled in 2020/21 with much of the detail of these changes yet to be agreed. The purpose of this note is to explain what is known currently, what remains unclear at this stage and what some of the potential implications are for the Council of any future changes.

1.2 It is worth stating that some of the analysis of future developments can only be speculative at this stage. It is based on an assessment of previous announcements but could be subject to future changes in policy direction and the political environment. Whilst the note attempts to inform the debate on the timing of regeneration plans in the city, caution is urged on drawing any firm conclusions in this regard.

2 Recommendations

Scrutiny Board 1 is recommended to:

1) Consider the content of the note and identify any specific information requests or recommendations arising for the consideration of the Cabinet Member for Strategic Finance and Resources and the Director of Finance and Corporate Services.

2) Continue to receive updates on developments in the local government funding environment as they become available.

3 Information/Background

3.1 Scrutiny Co-ordination Committee (Scruco) has received 3 updates on the subject of Business Rates in the past two years including an outline of the existing scheme and consideration of the Council's responses to several consultations on the design of future schemes. The chairs of Scruco and Scrutiny Board 1 have now agreed that Business Rates is a subject that should be considered by Scrutiny Board 1.

3.2 Business Rates has gained greater significance for Local Government since 2013/14 when the move to a 50% Business Rates Retention scheme gave local government a stake in the growth of local Business Rates for the first time in the modern era. This is set to change again in 2020/21 following the Government's announcement of an intention to move to a 75% retention scheme (scaled back from previous plans for a 100% scheme).

3.3 It is fair to say that the whole subject of local government funding is not well understood. This note provides a starting point for Scrutiny 1 members to better understand the local government finance system and, in particular, how Business Rates fits within it.

3.4 Part of the complexity that exists currently results from the Council's participation in the 100% West Midlands Business Rates Pilot. Although this has some current and short-term impact on the Council's funding position, it should not have a fundamental effect on the Council's long-term financial position. For the sake of simplicity, this note assumes that the Pilot will not continue when the funding system is overhauled in 2020/21.

4 Business Rates and the Local Government Funding Environment

The following analysis explains the fundamental elements and recent trends for Local Government Funding and Coventry's position.

4.1 The Central Feature of Local Government Funding is Allocation on the Basis of Need

The amount of funding allocated to each local authority area is driven by a funding model that, at its outset, was informed by the assessed needs in each area. These needs were based on data such as the number of children, the number of adults over 65 and the length of highways. The model is complicated and non-transparent and there have been arguments over the role of factors such as deprivation and sparsity. In addition, most of the data within the model has not been refreshed for a number of years such that the resulting allocations are no longer likely to be an accurate measure of need in each area.

4.2 Local Government Funding is made up of Government Revenue Support Grant, Council Tax and Business Rates

The historical context is that the two main local sources of funding (Business Rates and Council Tax) have not generated sufficient resources to pay for the assessed needs of local government. Therefore, the Government has allocated a further general grant to supplement these, referred to as Revenue Support Grant (RSG). Part of this RSG in effect represents the recycled Central Share element of Business Rates that councils pay over to Government.

4.3 Ability to Generate Local Funding is Reflected in the Allocation of General Grant

The level of Council Tax and Business Rates in each local authority area is factored into the model that determines the level of RSG that each council receives. Areas that have relatively low levels of Council Tax and Business Rates compared to their assessed spending needs will get higher levels of RSG and vice versa. Therefore, two authorities with identical spending needs will still receive different levels of RSG if their local levels of Council Tax and Business Rates are different. In this sense this is a redistributive model. However, data relating to the level and growth of local resources is not kept up to date in the model so more recent trends will not have been reflected in current funding allocations.

4.4 Redistribution Under 50% Business Rates is Achieved Via a System of Tariffs and Top-Ups

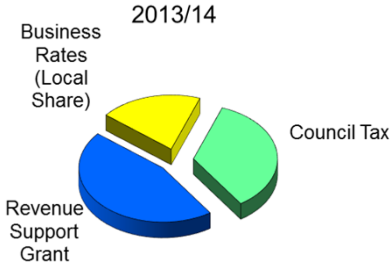
In 2013/14, 50% Business Rates Retention was introduced. Without a system of redistribution this would have benefitted areas with relatively high levels of Business Rates and penalised areas with relatively low levels of Business Rates. Therefore a system of self-balancing adjustments was introduced. The areas that would have benefitted were required to pay a tariff and the areas that would have been penalised were paid a top-up. Under the 50% retention scheme Coventry was a top-up authority.

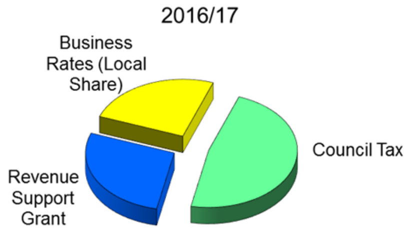
4.5 The Overall Level of Resources in the Model is Reducing

The reductions in Government spending since 2010 have affected Local Government. The overall amount that Councils have had made available to them in the form of Council Tax, Business Rates and RSG has reduced year on year and will continue to do so up to 2019/20. One impact of austerity is that the link between spending need and funding allocated has become increasingly remote over time.

4.6 The Balance of Resources Available Has Changed Over Time

Since 2010 the overall cash amount of Council Tax and Business Rates has increased due to a combination of underlying growth and inflationary increases. At the same time Government has reduced the amount of RSG that it provides. Using a like for like position (under the 50% Business Rates Retention scheme), the balance of resources for Coventry between two points in this period was as follows.





The movement over this period shows a dramatic reduction in RSG as a proportion of Coventry's funding with a modest increase in the % raised from Business Rates and a more significant increase in the proportion raised by Council Tax.

4.7 Government will Reset the Local Government Financial Envelope in 2020/21

The 2018 Spring Budget announced that a Government spending review will take place in 2019. This will affect the total amount of funding available to the local government sector and all other Government Departments from 2020/21. The Council's current financial plan assumes the continuation of austerity in 2020/21 but there is no clear evidence for this at this stage.

4.8 Government Will Reset the Allocation of Funding between Local Authorities in 2020/21

The current model for how the total level of resources will be allocated between local authorities (referenced above in sections 4.1 and 4.3) will be replaced for financial year 2020/21. This has been and continues to be subject to a number of consultation exercises. Given the complexity and non-transparent nature of the funding model and the length of time since the model and some of its data were refreshed, it is impossible to predict whether Coventry will be a winner or a loser from this exercise.

4.9 The Business Rates Retention Model Will Move From 50% to 75% in 2020/21

The Provisional 2018/19 Local Government Finance Settlement announced the Government's intention to move from 50% Business Rates retention to 75% retention in 2020/21. All other things being equal, the impact of this is that in totality, local authorities would retain a greater share of their locally raised Business Rates and receive an equal and opposite reduction in the level of RSG. One potential variation on this is that the Government would include new services to be incorporated within the model (e.g. Public Health) with funding nominally passported in order to pay for this.

4.10 The Move to 75% Retention Should Have a Neutral Effect on Coventry

On day 1 of the new system, Coventry should be no worse off or better off as a result of moving to 75% Business Rates Retention. The table below shows the impact in 2020/21 under the current 50% scheme and the new 75% scheme (NB this assumes that the current 100% Business Rates Pilot is not operating). It is based on current projections but these are indicative only at this stage and take no account of changes that will occur under 4.7 and 4.8).

	50% Retention £m	75% Retention £m	Memorandum 100% Retention £m
Council Tax	(132)	(132)	(132)
Business Rates	(60)	(90)	(120)
(RSG and Top-Up) or Tariff	(35)	(5)	25
Total	**(227)**	**(227)**	**(227)**

This projection of what will happen in 2020/21 shows that any additional retained Business Rates will be compensated for by a reduced level of RSG and Top-Up. The memorandum column shows the equivalent position if a 100% scheme were to exist. In this case Coventry would have to pay a tariff back to Government – but the overall level of resources available to the city would remain constant. This memorandum column is similar to the position that has occurred under the West Midlands Pilot – in 2018/19 with the Pilot in operation, Coventry is subject to a tariff of £10m.

4.11 Councils Will Retain Business Rates Growth Over and Above a Reset Baseline
Sometime, probably during 2019, the Government will assess a new baseline level of Business Rates applicable in each local authority area. Councils will, in subsequent years, be able to retain 75% of any growth above this level until Business Rates are next reset. Equally, Councils would have to bear 75% of any decrease in Business Rates. These gains or losses would continue to be reflected in local resource levels until the following reset. It is not yet known when further resets are planned to occur.

4.12 Councils May Be Able To Retain Business Rates Growth on a Permanent Basis
It is possible that at the time of future resets (including that due to take place for 2020/21), Councils may be able to retain a proportion of the growth that has occurred since the previous baseline. This can only be speculation at this point but this would be consistent with the Government's overall messaging on incentivising local authorities to play a greater long-term role in growing local economies. The level and timescale for which any such growth could be retained on a semi-permanent basis will not be determined for some time.

5 Future Implications for Coventry

5.1 Coventry is witnessing some exciting development plans which will affect the future of major parts of the city. The Council is playing a major part in bringing forward these developments which include City Centre South, Friargate and the Battery Development facility. The regeneration, economic and employment benefits of such schemes are such that they are fully justified on their own merits and the Council's financial input into these and other schemes are supported by business cases or funding packages that make no assumptions about Business Rates.

5.2 Given the future anticipated role of Business Rates in Local Government funding it appears likely that the city will benefit from some significant Business Rates growth from these developments in the years following the current assumed reset. The Council has never included future projections of Business Rates growth into its financial plans and it is not intended that any future growth will be assumed ahead of realisation. Indeed there are good reasons for being cautious about such assumptions including: whether the developments actually proceed locally; the timescale and pace with which they develop; whether Business Rates retention goes ahead; the timing of the baseline being set and any future resets occurring; and the negative impact of other movements (reductions) in local Business Rates.

5.3 At this stage given the best estimate that the initial baseline will be set in 2019, none of the strategically significant property based developments are planned for completion by that point. However, if the setting of the baseline is delayed this could have an impact on the financial benefit that the Council could derive from the Business Rates growth of such developments. This is one of the key elements that will need to be monitored as the Council approaches the next financial planning period.

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