Business Rate Retention – Proposed Basis **Appendix 3**

This document informs Cabinet and Council of the key terms agreed with Government relating to the opportunity to retain 100% of regional Business Rates for the next 10 years. It also indicates the historic performance of the current pilot on which proposals are based, together with the protections sought from government to mitigate potential risk

Background

In 2017, the seven Constituent Local Authorities of the West Midlands Combined Authority (WMCA) entered into a pilot agreement with Government allowing them to benefit from retaining 100% of the Business Rates generated within their respective regions, compared with 50% nationally, in exchange for forgoing Revenue Support Grant ('RSG'). 1% of local business rates income under both the national and pilot schemes was retained by the West Midlands Fire and Rescue Authority.

Other Mayoral Combined Authority areas also adopted 100% pilot arrangements over time.

Whilst initially expected to be a short-term pilot in advance of the national roll-out of 100% business rates retention, the arrangement has been rolled forward under the same terms and conditions annually and remains in effect during 2023/24.

As part of the West Midlands Deeper Devolution Trailblazer Deal, Government has offered to Local Authorities forming both West Midlands and Greater Manchester Combined Authorities only, the opportunity to extend the arrangement on a more permanent basis; for ten years commencing April 2024.

2017 Pilot Background and Performance

As detailed above, the pilot was expected to be in place for only one or two years and represented a fundamental change to the pre-2017 arrangements, where 50% of business rates were retained locally and the remainder was remitted centrally to HM Treasury; whilst RSG was also received from Central Government by each West Midlands authority.

The pilot arrangements essentially meant RSG was foregone, in exchange for the remaining 50% Central Share of business rates now being retained locally, rather than remitted to HMT.

Given this fundamental shift in the Local Authority financing mechanism, Government provided a “no detriment guarantee” which would be triggered if the resources generated for West Midlands authorities under the national business rates retention arrangements in effect at the time (50% retention) would have yielded a higher value of funding at pilot level (being all 7 constituent Local Authorities as a collective) compared with the 100% retention arrangements under the pilot. In the event of a collective-level detriment Government agreed it would directly reimburse the pilot as a whole.

If, however, there were instances of isolated detriment (i.e. some Local Authorities worse off), the collective no detriment clause would not be triggered, and so no compensating funding from Government would be received. However, the arrangement agreed with Central Government stipulated that those Authorities in a gain position would directly reimburse those in a detriment position .

The pilot also contained an enhanced “safety net” level for each West Midlands authority of 97% of its Baseline Funding Level, compared with 92.5% nationally, to reflect the increased exposure to Business Rates risk by way of 100% retention. The safety net is the level below which Government guarantees an authority’s income from business rates will not fall.

WMCA Share

The 2016 Devolution Deal with Government (which was effectively the catalyst for the WMCA and the associated Investment Programme) included an arrangement whereby the Combined Authority would benefit from a share of Business Rates Growth in the region. Whilst the Devolution Deal itself suggested this was for a term of five years, it is considered HM Treasury consented to principles underpinning the 30-year arrangements.

At the time of the 2016 Devolution Deal, Local Authorities were in the national retention system (50% retained, 50% remitted centrally) and HM Treasury agreed to remit back to the Combined Authority any growth within the 50% Central Share that was due from the region to Central Government under the national arrangements in effect at that time.

The Combined Authority was initially expected to generate £3bn of income to fund the regional Investment Programme. This would facilitate £2bn of investment (with the remainder used for capital financing) and would be funded from Gainshare (a 30-year Government Grant), Mayoral Precept, Mayoral Business Rates Supplement and Business Rates Growth.

The move from the national 50% arrangements to the 100% retention arrangements complicated the calculations of Business Rates Growth and hence the amount due to the Combined Authority. Nevertheless, Local Authorities agreed to fund from Business Rates gains, the Combined Authority Investment Programme income profile in line with the original financial modelling expectations; that being £1.5m in year one growing incrementally by £1.5m each year. This arrangement, which is subject to annual agreement, remains intact and the sum due to the Combined Authority for 2023/24 totals £12.0m for the region.

The WMCA share profile was originally intended to be used against the Investment Programme to meet the costs of capital financing, but due to this income stream not being solid and secure over the long term, no borrowing was undertaken against the funding stream and instead, the receipts have helped meet the costs of operating the WMCA portfolios in recent years.

The increasing profile of the contribution is included in WMCA Medium Term Financial Plans which are discussed with West Midlands Finance Directors at each planning cycle; with the in-year amount agreed and confirmed annually.

The annual share is currently distributed between the seven Local Authorities based on the total rateable value of each area (pro-rata). West Midlands Finance Directors have agreed to review the equitability of the arrangements in due course as some Local Authorities experience a disproportionate impact (relative to the actual gain) when funding the WMCA share in this way.

For local purposes, the WMCA share has been deducted in the gain/detriment calculations before the “no detriment” assessment is carried out.

Ten Year Retention Process

As detailed above, Government is offering to those Local Authorities forming Greater Manchester and West Midlands Combined Authorities, the ability to retain 100% of Business Rates for a ten-year period.

The process for entering into this arrangement will require agreement to a new MoU, the current draft for which is attached at Appendix 4.

Technically, the MoU is not a legally binding document, but it will set firm parameters for how this funding stream will be managed over the period for which it is effective.

If the region is not able to reach a timely agreement with DLUHC on the contents of the MoU, then DLUHC have confirmed the existing pilot arrangements will continue for a further year (2024/25) with the opportunity to enter into a 9-year arrangement from April 2025. Whilst there may be no financial implications in 2024/25 for not agreeing the MoU, there is a risk that if Government policy does change in the next 12 months, the region would lose an opportunity which Greater Manchester are likely to accept.

Ten Year Retention Offer Details

WMCA, West Midlands authorities and the Department for Levelling Up Housing and Communities (DLUHC) have been negotiating the content of the MoU over recent weeks. WMCA officers have been supported fully in all discussions by officers from Solihull Metropolitan Borough Council (SMBC) who were nominated by the West Midlands Finance Director Group to represent the interests of Local Authorities in the negotiations.

In addition, during the negotiation period, the frequency of the Technical Rates Group meetings (of officers administering business rates arrangements from all Local Authorities) has been increased to ensure proper communication and support is provided as the technical details are worked through and all positions are properly considered.

As detailed above, the MoU which requires formal approval is attached as Appendix 4.

Some of the key factors to highlight are:

- **Term** : The ten-year arrangement represents a fundamental improvement over the rolling one-year term of the pilot. This should allow Authorities to assemble financial plans with more confidence and where enhanced incomes are projected, Authorities may be enabled to make longer term investment decisions given the arrangements have a degree of longevity.

- **No Detriment** : In discussions with DLUHC, they have been clear that the existence of the "no detriment" protection will not carry over to the ten-year arrangement. Details about how WMCA and SMBC officers have sought to mitigate the impact of the removal of this protection are detailed in the next section of this report.

- **Impact of a Reset** : Unlike the proposed Growth Zone or Levelling Up Zone Business Rates Retention arrangements, the ten-year arrangement would be affected by any national resets to Business Rates baselines. At the point of any re-set, at a national level the resources available to LA's are unchanged in aggregate. However, a reset would likely change how Government distributes these resources nationally and as such, some LAs could benefit from a reset whilst the reverse will be true for other Authorities. All core funding systems underpinned by Business Rates (the pilot, the national 50% scheme and the ten-year arrangements) are exposed to this issue but the MoU describes how WMCA and the LAs ensure protection from potential adverse outcomes associated with the reset, as far as is possible given the detail of how a reset will be undertaken has yet to be determined.

- **Safety Net** : The safety net is a protection within the system for local authorities which guarantees that reductions in Business Rates income is limited to a minimum percentage of the Baseline Funding Level. Under the pilot arrangements, each authority had an enhanced safety net level of 97%, compared with 92.5% nationally. WMCA and Solihull MBC have successfully negotiated for this enhanced level of protection to remain unchanged, at an individual authority level, under the proposed 10-year arrangements.

- **Grants Rolled In:** There is no change to the grants rolled in compared with the pilot arrangements. West Midlands authorities will continue to forgo RSG only in exchange for increased business rates retention.

- **Additional Levy:** The levy for the pool will remain at Nil, unchanged from the pilot arrangements.

- **WMCA Share:** A share of regional business rates due to the Combined Authority is required to remain in place.

No Detriment

As detailed above, DLUHC are not willing to retain the “no detriment” protection that existed under the pilot arrangements, whereby Government will reimburse the West Midlands authorities where they are collectively in a net deficit position. DLUHC’s view is the removal of this protection creates a more equitable balance of risk and reward for both Local and National Government.

As detailed in the main body of this report, the pilot has performed above the 50% scheme at both a regional and local level, such that the no detriment protection has not been called upon, indicating it is unlikely that the proposed new pool arrangements encounters a net detriment. However, the region is yet to experience the impact of a baseline re-set which could make the overall position more marginal, particularly in the early years following a re-set.

It is important to note that DLUHC have indicated there will not be a re-set until 2025/26 at the earliest. Additionally, it is as yet unclear what form a reset will take – for example whether it will be a full or partial reset, whether baseline funding levels will be updated in addition to business rates baselines (and if so on what basis) and which year(s) will be used to set the new baselines. These technical details are likely to have a significant influence on the outcome / impact of this national event. Nevertheless, the negotiating team have sought to agree appropriate protections which are acceptable to both sides.

Protections sought

A reset presents particular risks for the size of the WMCA share because in the year(s) immediately following a reset when business rates baselines are higher, the likelihood of there being insufficient business rates growth from which to fund the expected contribution is increased. Local authorities were concerned that in that scenario they might be expected to mitigate this risk from core resources, in which case they could be financially better off (particularly in the immediate year/s post re-set) in the national 50% scheme.

Through the negotiations with DLUHC steps have been taken to mitigate the loss of the no detriment protection. Firstly, the MoU includes a commitment from Government that, in the event a reset has adverse, unintended consequences on the West Midlands authorities’ ability to fund the WMCA share at the level expected, Government will work with the region to protect the substance of the WMCA share and secondly; it provides a means of reviewing and modifying the arrangements throughout the ten-year term with the agreement of all Parties.

Outside of the MOU, locally-agreed no detriment protections (i.e. where Authorities in a gain position may compensate Authorities in a detriment position) are able to remain in place and it is recommended that these principles are maintained, with the precise details and mechanics to be worked through with the WM Finance Director Group and local technical group.

Post Reset

Following a national re-set, the region will need to assess how best to use the financial tools at its disposal to ensure that an appropriate share of business rates continues to be provided to assist with the sustainability of the Combined Authority in the most effective and equitable manner. The MoU is clear in stating that these decisions can be made locally.