Subject:	**BUSINESS RATES RETENTION PILOT 2018/19**
Meeting and Date:	**Overview and Scrutiny – 9th December 2019**
Report of:	**Strategic Director (Corporate Resources)**
Portfolio Holder:	**Cllr Manion, Portfolio Holder for Finance and Governance**
Purpose of the report:	To brief the Overview and Scrutiny Committee, as requested, on the outcome of the 2018/19 Business Rates Retention Pilot
Recommendation:	It is recommended that Overview and Scrutiny Committee note the report.

1. Summary

1.1 At its meeting on 14th October 2019 the Overview and Scrutiny Committee requested a report on the outcome for Dover District Council of participation in the 2018/19 Buisness Rates Retention (BBR) pilot. This report has been produced to satisfy that request.

1.2 Overall, participation in the BRR pilot was a success for DDC with an additional £2.4m of income retained by the Council.

1.3 However, BRR is hugely, disproportionately and unreasonably complex and is not an effective method of local government finance.

1.4 A simple outturn figure for the Business Rates (BR) pool and pilot does not provide Members with sufficient context, so this report has been drafted to provide a simplified explanation of the BRR system.

2. Introduction and Background

2.1 BR are a tax on the occupation of commercial / non domestic property. The Rateable Value (RV) is set by the Government's Valuation Office Agency (VOA) based on the assessed rental value of the property. The government then sets a multiplier (or "Rate in the Pound") which is applied to the rateable value to produce a charge. The multiplier for 2019/20 is £0.491 - £0.504, so businesses are charged approximately half the rateable value. There is also a complex system of reliefs covering empty properties, smaller properties, Enterprise Zones (like Discovery Park at Sandwich), rural post offices, charities, discretionary reliefs etc.

2.2 The system of BRR was introduced in 2013/14. Before that time BR (sometimes referred to as National Non Domestic Rates or NNDR) were collected by councils, passed to government and redistributed by government back to local authorities pro rata to population, with Revenue Support Grant (RSG) making up the balance of "resource equalisation" between councils. This was a simple system.

2.3 BRR was intended to create a link between the amount councils collected, the amount of BR growth in their areas and the amount they retained, in order to incentivise councils to promote commercial growth. This was based on the assumption that councils would not promote growth sufficiently without this incentive and that growth is attributable, to a significant degree, to the efforts of local councils rather than other factors.

2.4 Councils still have no role in setting the valuation or the multiplier. These are functions of government, so council's incentive was simply to grow the overall tax base.

2.5 In practice, the amount collected can be heavily impacted by successful valuation appeals, business closures, local geographic factors, decisions made at (remote) company headquarters etc. over which local authorities have little if any influence.

2.6 The BRR system is extremely complex, to the point that it is difficult to support informed discussion without first providing a general explanation of the system and its outcomes within the overall context of local government finance. This report therefore sets out:

(a) How the BRR model works

(b) The Kent BRRP Pilot and Pool

(c) Pilot and Pool Outcomes

3. How the BRR Model Works

3.1 The following notes provide a simplified explanation of the BRR model.[1]

3.2 There are a number of significant aspects to the current business rates regime:

(a) Business Rates Retention and the System of Local Government Finance

(b) Changes to RSG

(c) DDC Financing for 2019/20

(d) The Basic BRR Model

(e) "Real" Growth

(f) The Levy, Pool, Pilot and Safety Net

(g) The DDC BR Profile

(h) Future Changes

Business Rates Retention and the System of Local Government Finance

3.3 Local Government finance has, for many years, been based upon three main elements, BR and RSG from government and Council Tax raised locally. In recent years a fourth element, New Homes Bonus (NHB), was added.

3.4 BR was collected locally by billing authorities (district and unitary councils, London boroughs, metropolitan boroughs, the Isles of Scilly and the Common Council of the Corporation of London) remitted to government and then redistributed to councils pro rata to the population.

[1] The Budget and Medium Term Financial Plan, published in February / March and presented to Cabinet, Scrutiny and Council every year includes a summary of the BRR model. This has been truncated in the interests of brevity, but a fuller explanation was included in the 2013/14 Budget and MTFP and can be provided to Members if required.

3.5 This simple mechanism was not intended to reflect performance by councils, or to equalise resources in any way.

3.6 The second element in this system is RSG. This was intended to equalise resources across authorities and was based on complex formulae which attempted to measure the needs and resource capability for each council. The needs were based upon a range of measures such as population, deprivation, sparsity (i.e. population density) etc. Government haven't, in recent years, updated the data or formulae used for this, nor have they made the formulae available to councils or the public.

3.7 The third element is Council Tax. The RSG formulae assumed that councils were charging the average Council Tax (for their class) and benefiting from the level of income that this would generate. For councils like Dover who are below this Council Tax level, the capping / referendum criteria meant that they could never achieve the income levels that the RSG model assumed they were generating and they were always having to work with a resource shortfall. Councils can reduce Council Tax if they choose, but the referenda criteria means they have only limited ability to increase it.

3.8 The fourth element, NHB was introduced when the RSG pool was top-sliced by government to create the funds for NHB. Initially NHB rewarded councils for every new home for a period of 6 years, by giving councils an additional income (actually, councils were earning back the RSG that had been top-sliced) for every additional house built or brought back into use. DDC received 80% of the national Band D average (£1,591) for each house for 6 years.

3.9 The original 6 year pledge was then cut to 4 years.

3.10 The 4 year pledge has been further modified by requiring councils to achieve housing growth above trend rates before they qualify for any NHB.

Changes to RSG

3.11 RSG has been reduced in value over the years. In 2010/11 the combined value to DDC of Business Rates and RSG was £10.21m. In 2019/20 the combined value is £6.89m, with RSG making up just £56k.

3.12 This places more pressure and importance on the other three income streams. The RSG model has also, in theory, taken some councils (including some Kent districts) into "negative" RSG where the councils have to "pay" government. In effect, they would become franchisees, paying a fee in order to operate.

3.13 In practice negative RSG has not been enforced and is unlikely to be.

DDC Financing for 2019/20

3.14 The 2019/20 budget approved by Council shows DDC's total budget requirement being financed as follows:

	Financed by:	2019/20 £000

1	Business Rates	6,838[2]
2	Revenue Support Grant	56
3	Council Tax	7,328
4	New Homes Bonus	1,729
5	Total Financing	15,951

The Basic BRR Model

3.15 Government determines DDC's "district baseline" reflecting the amount of BR that they estimate that DDC needs to retain, after taking into account their overall budget requirements (based on the RSG calculations) and income that can be generated from Council Tax. For 2019/20 for DDC this baseline was £4.2m (see line 8, Table One below).

3.16 A simplified illustration of the mechanism for the "50%" BR retention system is set out in Table One below, based on draft 2019/20 data (before adjustment for S31 grant funding of reliefs).

	Table One	
1	**Attribution of BR Income (Indicative)[3]**	**£m**
2	**Dover district net rate yield**	**(40.8)**
3	Less	
4	50% to Government	20.4
5	9% to KCC and 1% to Fire	4.1
6	Retained balance of 40%	(16.3)
7	Less: **tariff to Government**	12.1
8	**Balance retained by DDC**	**(4.2)**

3.17 From the 40% retained (line 6), if the baseline amount that remains with the council is greater than the council's baseline budget requirement, then the council pays the excess to government in the form of a "tariff". For Dover this means the bulk of the 40% is also paid to government. Once the tariff is set, a district will have to continue to pay this amount to government until the system is re-set[4].

3.18 If actual collection is lower (for example, due to demolition at Discovery Park, successful appeals by doctors surgeries, etc.) the council has to continue to pay the tariff, and bear the loss itself, as well as bearing the costs of the appeals refunds, which may stretch back over many years and may even pre-date the current system.

3.19 If the council suffers excessive losses then a safety net payment from the government is triggered to cap the losses.

[2] In addition to the basic BR, this includes additional BR and s31 grants related to the Enterprise Zone, renewable energy etc.
[3] These are indicative numbers – not the latest numbers.
[4] If the amount retained is less than that required, DDC would receive a top-up from Government. In practice all districts pay a tariff, all counties get a top-up.

3.20 If actual income is higher, then councils retain a percentage of the increase.

Real Growth

3.21 The Dover district has seen significant real growth in developments during 2016/17 – 2018/19 including:

- St. James Retail & Leisure Park, Dover
- Dover District Leisure Centre
- Combined Heat and Power Plant at Discovery Park
- Supermarket (Lidl) at White Cliffs Business Park
- Lok'nStore self-storage facility at White Cliffs Business Park
- Maritime Skills Academy
- Betteshanger Park
- Discovery Park
- Two new restaurants on Beach Street, Deal
- The new Dover Leisure Centre, White Cliffs Business Park
- Further units at White Cliffs Business Park
- Business Rates Incentive Scheme providing grants to improve high street premises.

3.22 The district also benefits from an Enterprise Zone (EZ) at Discovery Park which has major benefits to businesses in terms of BR relief (generally up to £55k maximum per annum per business for five years) and the employment and economic activity this brings locally and regionally.

3.23 All of these projects will have a positive impact on the tax base of the district and therefore on the total income collected by DDC and the amount retained by the Council for its own purposes.

3.24 This level of growth is vital to DDC since it helps to offset the significant erosion of the tax base and BR income from BR appeals, or from unexpected downward revisions by the VOA.

The Levy, Pool, Pilot and Safety Net

3.25 Taking the figures in Table One as a starting point, if DDC delivers £1m of BR growth we can see how this impacts on the balance retained.

	Table Two	
1	**Attribution of BR Income (Indicative)**	**£m**
2	**Dover district net rate yield (increased by £1m)**	**(41.8)**
3	Less	
4	50% to Government	20.9
5	9% to KCC and 1% to Fire	4.2
6	Retained balance of 40%	(16.7)
7	Less: **tariff to Government**	12.1
7A	***Less 50% levy on the growth to be retained by DDC***	0.2
8	**Balance retained by DDC**	**(4.4)**

3.26 The table shows that of the £1m extra business rates, 50% is passed straight to government (line 4), a further 10% to KCC and Fire (5) and then a levy of 50% is charged by government (7A) so of the additional £1m, DDC retains £200k. This is called the "50% BRR" model because of the 50% levy.

3.27 The purpose of forming a Kent "pool" is to reduce this 50% levy rate by including KCC in the pool[5]. This is taken a step further in the "pilot" where the levy rate is dropped to 0% and all growth is retained. These are key concepts in the BRR model.

3.28 The government's future reform of BRR is based on moving to a levy rate for all authorities of 25%, meaning 75% **of growth (after the tariff)** is retained, although the exact methods for sharing the 75% locally retained elements, including growth, and the impact on individual tariffs and other elements, are still being determined and discussed by working groups in conjunction with central government, so the exact ramifications of the new system from April 2021 are not yet known.

3.29 The government uses the bulk of the funds collected by the levy to operate a "safety net", which is used to compensate councils who have collected less BR rather than more. Naturally any reduction in the levy rate means that the safety net will, ceteris paribus, be less generous.

DDC BR Profile

3.30 The BR profile for DDC is unusual in three main respects. First, a very high proportion of the income is concentrated in a small number of sites (hereditaments). That means that a change at just one site can have a significant effect on DDC's income.

3.31 Second, some of these, including the Channel Tunnel, Dover Port and the Enterprise Zone (EZ)/ Discovery Park are unique and their RVs are very hard to predict when revaluations are undertaken by the VOA. For example the Channel Tunnel's RV was set at £15.5m in the 2010 revaluation. When the VOA opened the 2017 valuation the VOA proposed a value of £68m[6], before reducing it to £35m then £28m. This large margin of error illustrates the volatility and fragility of the VOA's valuations, particularly in more complex cases.

Table Three		
Dover's Rateable Values	**Rateable Value [7] £000**	**%**
Channel Tunnel	28,000	26
Discovery Park	9,382	9
Dover Harbour Board	2,720	2
Tesco, Whitfield	2,390	2
Sub Total	**42,492**	**39**
Remainder[8]	65,650	61
Total	**108,142**	**100**

[5] This works because the tariff rates of the pool members are averaged out, and KCC has a very low tariff rate, thus reducing the average.
[6] The initial starting point has been reported as £100m, but this has not appeared on any official documentation seen by DDC.
[7] Note – These figures are based on 2017 valuations. Rateable Value is not the same as the Business Rates paid. RV is multiplied by a government set multiplier (49.3p in 2018/19 increasing to 50.4p in 2019/20 for the standard multiplier) to determine the amount payable and this may be subject to BR reliefs.
[8] The next largest site is just 1% of the total.

3.32 It is also worth noting that where businesses successfully appeal against their RV, DDC will have to pay a refund on BR collected. This could go back to 2010, even though DDC hasn't retained the income from 2010, since that was handed over to the government and redistributed.

3.33 Third, the table below shows the volatility in DDC's share of BR since the local retention of BR was introduced. The majority of this volatility is due to how the BR retention scheme operates, it is not due to "real" changes.

NNDR/Business Rates (exc. EZ Grant)	DDC Share of Income £000	Reduction/ (Increase) £000	Reduction/ (Increase) %	Cumulative Change £000	Cumulative Change %
2012/13[9]	3,348				
2013/14	2,994	354	10.6	354	10.6
2014/15	4,682	(1,688)	(56.4)	(1,334)	(39.8)
2015/16	4,296	386	8.2	(948)	(28.3)
2016/17	2,805	1,491	34.7	543	16.2
2017/18	4,097	(1,292)	(46.1)	(749)	(22.4)
2018/19 Projected[10]	5,660	(1,563)	(38.1)	(2,312)	(69.1)
2019/20 Estimated	5,642	18	0.3	(2,294)	(68.5)

3.34 Despite the extreme volatility, the estimated outcome for 2019/20 is still favourable for the DDC compared to prior years (with the exception of 2018/19 which included additional one-off income while in the '100% growth retention' pilot scheme).

The Collection Fund, BR Forecasting and Accounting Treatment

3.35 When DDC collects BR they are not simply credited to the council's own accounts. They are credited to a separate statutory account called "the Collection Fund" (CF. There is also a CF for Council Tax).

3.36 When the Council sets its budget it has to make an estimate of how much it can precept on the CF in the coming year. That has to take into account a number of factors which affect the tax base. These include (but are not limited to) :

(a) New builds and when they will be completed and come into rating.

(b) The valuations of new builds by the VOA.

(c) Appeals to the VOA by the occupier / owner against the valuation – there are still appeals outstanding from 2010.

(d) Additional (or reduced) appeals provision.

(e) Bankruptcies / closures of businesses.[11]

(f) Collection rates and the economic climate.

[9] Split for 2012/13 based on proportion of RSG: NNDR for 2013/14 excl. Council Tax Support Funding.
[10] Not yet finalised. Includes £770k est. additional income from '100% growth retention' pilot scheme in 2018/19 ('Financial Sustainability Fund' element only).
[11] The closure of Aylesford News Print put Tonbridge and Malling into the safety net for a number of years. Dover's BR are concentrated in fewer, larger sites, so closure of one of these would have a major impact.

3.37 The accounting treatment of BR introduces another level of complexity.

3.38 If DDC collects less income than expected and does not meet its baseline, that impacts on the precept for the following year, but government pay safety net compensation that is recognised in the accounts in the current year. This has the perverse effect that "bad" years look "good" in the accounts for that year, and "good" years look "bad".

3.39 The DDCl uses reserves to smooth this effect between years, but this does create even more complexity.

Future Changes

3.40 Future changes in local authority finance are likely to focus on three main areas. These are:

(a) The Comprehensive Spending Review (CSR)

This is a Treasury led government review of the resource requirements of the various government departments and their agencies. It decides on the size of the government cake and the slice given to each department. The slice that goes to MHCLG constitutes the whole cake for local government.

The CSR for 2019 was postponed and the financial settlement was a single year "same as last year" settlement. This means that local government has a one year planning horizon and subsequent years are a "best guess".

(b) Fair Funding Review (FFR)

The FFR is MHCLGs review of how to distribute resources to, and between, local authorities. Like the CSR it was planned to take effect from 2020/21, but has been put back by at least one year. The aims are to simplify the current model, while providing stability and a reasonable measure of resource equalisation.

(c) BRR Review

The BRR review has also been put back by at least one year. It includes a number of elements under consideration as set out below.

Retention Rate – the aim is to move from the general 50% retention (of growth only) to 75% for all councils. The higher the retention rate the lower the safety net provision will be, so there is a trade off.

Appeals – the costs of successful appeals (mainly refunds of past collection and a lower tax base for the future) are born by the council and add further volatility to BR forecasting[12]. There is an option to place the costs of all appeals into a central pool, so the risks are shared. This is a move back towards the old national pool before local BRR was introduced and would be beneficial.

[12] A current live appeal case is a class action for the majority of NHS hospitals to be treated as charities and receive 80% relief. If the appeal is successful it will reduce BR income and also create significant refunds.

Given the speed with which appeals are currently resolved (some are still outstanding from the 2010 valuation) we may see appeals spanning several valuations, further undermining certainty.

Revaluations – The VOA have struggled to deliver 5 yearly revaluations, but government wish to increase the frequency of revaluations to 3 yearly. Revaluations are intended to be fiscally neutral and so the council's baseline is adjusted to neutralise any "growth" or loss arising purely as a result of the revaluations.

Resets – although the benefits of growth are to be retained locally, this is to be for a limited period only, after which the baseline is to be re-set, so that some or all of the benefits of growth are lost and the authority has to start again. It may well be that the re-sets are aligned to the revaluations and become 3 yearly. This would mean that authorities get the benefit of growth for, on average, just 18 months, before losing some or all of it.

Election manifestos – election promises have been made to reduce BR for the high street. It is not clear if this will be offset by increased BR for other types of premises. The change is likely to have negative effects for councils with a significant level of high street BR. If there is an overall reduction in the BR generated, it is not clear whether that will be made up from Council Tax, general taxation to fund RSG or s.31 grants from government or a reduction in council funding. Nor is it clear how baselines will be adjusted to reflect this.

As a result of all these factors, it is difficult for councils to incorporate into their budgets the additional income from growth, since it is subject to appeals and re-sets etc. Such additional income should be treated generally as "one-off" and authorities need to maintain reserves to cope with the changes and the volatility.

3.41 The original and simpler BR attribution system based on population, has been replaced with a much more complex and politicised one. The mitigations that are required to limit the more extreme impacts of the new complex system also undermine the principles of local retention and question the real benefits of all the additional complexity.

4. The Kent Business Rates Pilot and Pool

4.1 The basic model of levy, pool, pilot and safety net are set out above. To re-iterate, in addition to the tariff that DDC pays to government, if the Council generates growth above its baseline, then it will also pay a levy of 50% of the additional BR that the Council would have retained after paying the first 50% to government and the 10% to KCC and Fire. So at this point, growth of £1m would generate £200k additional retention for DDC. The levy is used by government to provide a safety net payment to councils who experience reduction rather than growth.

4.2 To improve incentives for councils the government enabled them to set up BR "pools".

4.3 This is where authorities group together[13] and pay an "average" levy rate. In 2 tier areas the upper ties has a much lower levy rate and so by grouping the Kent districts and KCC together we will all only pay a levy rate of 3-4% on our individual growth.

4.4 However, in order to agree to be in the pool KCC insisted on a model where the gains from the levy is split:

(a) 30% to KCC

(b) 30% to a joint "regen" pot

(c) 30% to DDC

(d) 10% to contingency

4.5 The contingency is required because by joining a pool, councils forgo access to the government's safety net and have to make joint provision to protect the weakest performing of the pool members. In the Kent pool, the closure of Aylesford Newsprint put Tonbridge and Malling into the safety net and, in accordance with the pooling agreement, they were supported.

4.6 DDC was a pool member for the first year of the pool but then withdrew as its BR forecasts suggested it would fall into the safety net and so by withdrawing it avoided being a drain on the other pool members.

4.7 DDC did, however, join the Kent Pilot application in 2018/19 (thus successfully improving the chances of the Kent pilot application being approved by government) and one of the conditions DDC set for participating in the Kent pilot application was that we would be permitted by the other districts to re-join the Kent pool if, and when, the pilot ended. As the pilot operated only for 2018/19 DDC re-joined the pool for 2019/20.

4.8 A quirk of the pool levy rate calculation means that the pool is better off if DDC (and Sevenoaks) are treated as shadow members of the pool – so we enjoy the benefits of membership, but we are not formally members. The other pool members have honoured this informal arrangement.

5. Pilot and Pool Outcomes

5.1 In 2018/19 The benefits to DDC of the Kent pilot were £1,983k. In addition, the benefits of the pool were £463k, so totalling £2,446k. As the pilot closed and DDC returned to the pool for 2019/20 the benefit of the pilot <u>is a one-off gain in 2018/19 only</u>.

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[13] Technically any Council can agree to pool with any other Council, so DDC could agree to pool with, say, Liverpool City Council. In practice pooling is undertaken with neighbouring councils and districts pool within their county areas.