Sunderland City Council

Item No. 12

CABINET MEETING – 5 OCTOBER 2011

EXECUTIVE SUMMARY SHEET – PART I

Title of Report:

Local Government Resource Review Consultation

Author(s):

Executive Director of Commercial and Corporate Services

Purpose of Report:

This report provides details of the government's consultation paper on the local retention of business rates which is the main thrust of the Local Government Resource Review and sets out:

- the main features of the government's Local Government Resource Review proposals as set out in the consultation document released on 18th July 2011 and the eight technical papers released on 19th August 2011 which require responses by 24th October 2011;
- the potential impact of these proposals on the Council;
- how the Council intends to respond to the consultation paper (Appendix 2), and
- that the Council is to feed in comments to both ANEC and SIGOMA to support their individual responses to the consultation.

Description of Decision:

Cabinet is requested to:

- Note the contents of this report;
- Add any additional points or comments to the draft response;
- Note that the Council is to help inform the responses to the consultation of both ANEC and SIGOMA.

Is the decision consistent with the Budget/Policy Framework? No

If not, Council approval is required to change the Budget/Policy Framework

Suggested reason(s) for Decision:

To respond to the government's consultation on the Local Government Resource Review.

Alternative options to be considered and recommended to be rejected:

No alternative options are proposed.

Is this a "Key Decision" as defined in the Constitution? No **Is it included in the Forward Plan?** No	**Relevant Scrutiny Committee:** Management

Cabinet – 5th October 2011

Local Government Resource Review Consultation

Report of the Executive Director of Commercial and Corporate Services

1. Purpose of the Report

1.1 This report provides details of the government's consultation paper on the local retention of business rates which is the main thrust of the Local Government Resource Review and sets out:

- the main features of the government's Local Government Resource Review proposals as set out in the consultation document released on 18th July 2011 and the technical papers released on 19th August 2011 which requires responses by 24th October 2011;
- the potential impact of these proposals on the Council;
- how the Council is to respond to the consultation papers (Appendix 2); and,
- that the Council is to feed in comments to both ANEC and SIGOMA to support their individual responses to the consultation.

2. Description of Decision

2.1 Members are requested to:

- Note the contents of this report.
- Add any additional points or comments to the draft response.
- Note that the Council is to help inform the responses to the consultation of both ANEC and SIGOMA.

3. Background

3.1 The government announced last October in their Spending Review 2010 (SR10), which covered the period 2011/12 to 2014/15, that it was to reform the way local government revenue expenditure is financed as the current Formula Grant system was regarded as too complex, lacked transparency and was criticised by most councils that it did not allocate resources to where they were most needed.

3.2 The government, following on from this, announced in December 2010 a 2 year local government finance settlement which covered the years 2011/12 and 2012/13 with the intention of introducing a new funding system from 1st April 2013. The system will have to be reviewed in some way from 1st April 2015 however to incorporate the separate and specific arrangements for non billing authorities such as Police and Fire and Rescue authorities which have been excluded from the proposed changes in 2013/14 and 2014/15.

3.3 In the SR10 the combined effect of projected business rates growth and the planned reductions in government funding means that from 2013/2014 business rates income nationally is projected to be sufficient to fund total local government spending with excess funds anticipated which are also being consulted upon . This fact together with the criticisms of the present system, LGA pressure for business rate to be localised, and options presented by various think-tank groups has meant that the government has decided to implement this option and is therefore no longer a proposal up for discussion. The consultation is more about the detail of how the new system will operate.

3.4 A summary of the main changes proposed in the consultation document is set out in Appendix 1 for information.

4. Impact on the Council

4.1 The current proposals could adversely impact upon the Councils funding levels from 2013/14 as:

- Details of the final scheme to be implemented by the government could still produce significant winners and losers across the country and the Council will not know the true impact until the scheme is finalised and fully exemplified despite claims by the government that no council will be any worse off under the new system.

- The scheme may not be fair in terms of resource equalisation, as it needs to ensure that those councils with high spending needs and with the least ability or opportunity to generate increased business rates in the most deprived areas of the country, is fully recognised within the new system.

- The Council has incurred most of the government cuts in funding in the first two years of the finance settlement which were front loaded and this also saw the council facing significantly greater cuts compared to both the national average and the more affluent parts of the country. If the new system starts at this point then this will perpetuate the current unfairness in the current funding system which will effectively widen the resources gap between the deprived and affluent councils across the country.

- If the Formula grant baseline is fixed at 2012/2013 levels and additional income generated through business rate growth is utilised to support economic growth only, then this will impact on the amount of funding available for future additional service needs especially on the more deprived areas of the country.

- Whilst the Council welcomes incentives for economic growth such as Enterprise Zones to be introduced to enable business rate income to be used to support repayment of investment in infrastructure costs, this will mean that service needs, for example adult social care increased costs due to increased elderly population, will need to be recognised through special grant or alternative funding arrangements – otherwise the Council will have to reduce services to pay for increases due to demographic changes that it has little control over.

- The Council needs to ensure it has systems in place to be able to administer the new system and its requirements and that other related developments such as the proposed localised housing and council tax benefits changes can also be accommodated from 1st April 2013.

4.2 The government published an additional set of 8 technical papers on 19th August with an extra set of 36 questions to help further inform the consultation covering the following areas, which are still being considered and include:

- Establishing the baseline position
- Measuring business rates
- Dealing with non billing authorities such as police / fire and rescue authorities
- Business rates administration
- Tariff, top up and levy options
- Volatility
- Revaluations and Transitional arrangements
- Renewable Energy

4.3 The delay and timing of the release of these technical papers results in a much reduced time frame in which to properly consider the government's proposals.

4.4 The Council has considered the details and the specific issues raised by the 33 questions set out in the original consultation document and the proposed draft response is set out in Appendix 2 for member's information.

4.5 The Council will also help to inform the responses from ANEC and SIGOMA as appropriate as well responding to the consultation in its own right.

The headlines and key issues from a Sunderland perspective will be highlighted when making the submission to government.

5. Reasons for Decision

5.1 To respond to the government's consultation on the Local Government Resource Review.

6. Alternative Options

6.1 No alternative options are proposed

6. Background Papers:

Local Government Resource Review: Proposal for Business Rate Retention Consultation

The main changes proposed in the Consultation document

1. Summary of the proposals

- The main change relates to the planned introduction of incentivising councils to grow business rate income by allowing them to retain a certain percentage of their Business rates growth each year above a predetermined quantum. This will replace the current Formula Grant mechanism.

- Business Rates will still be determined nationally by the government however the consultation paper sets out various issues to be considered on how the new system will operate, what the starting point will be and also addresses particularly where councils do not currently generate enough business rate income to finance their spending / budget. This situation applies to Sunderland which receives £58.3m in re-distributed rates and additionally RSG of £20.6m from the government to add to the amount it currently collects in business rates of £79.3m. The combined figure of £158.2m forms the Council's Formula Grant allocation for 2011/2012.

- The New Homes Bonus Grant directly interacts with Formula Grant because Formula grant is to be top sliced to help fund the New Homes Bonus in addition to the £1 billion set aside in the SR10 over the 4 year period. As Formula grant will end in 2012/13 this area also needs to be consulted on to ensure sufficient funding is in place to finance this initiative for future years.

- Tax Increment Financing and Enterprise Zones are also being consulted on in the paper as these will also be affected by the introduction of the retention of business rates proposals.

- There are also a number of other related issues covered in the consultation dealing with areas such as: pooled arrangements, the Central List, Local Authority Central Services Education Funding (LACSEG) to help fund statutory services transferring form LEA's to Academies, Business Rates Relief and other functions funded by the local government finance settlement.

- It is evident that the Government intends to implement these changes in full and that the consultation is to inform or tweak the final system being consulted upon.

2. Features of the Consultation

2.1 Principles for Reform

The consultation states the key principles for reform as:

- To build into the local government finance system an incentive for local authorities to promote local growth over the long term
- To reduce local authorities' dependence upon central government , by producing as many self sufficient authorities as possible
- To maintain a degree of redistribution of resources to ensure that authorities with high need low tax-bases are still able to meet the needs of their areas

- Protection for businesses and specifically no increases in locally imposed taxation without the agreement of local businesses

2.2 A scheme for business rate retention

There are seven core components that the government has highlighted in the consultation document, these include:

2.2.1 *A fair starting point…*
Component 1: Setting the baseline
To establish a fair starting point for all local authorities and ensure that no-one loses out at the outset of the system the proposal is to set a baseline position in 2013-14 for each local authority, within the overall envelope of the expenditure control totals set out in the 2010 Spending Review. This means that a proportion of business rates revenues will be set aside and directed to local government through other grants.

2.2.2 Component 2: Setting tariffs and top ups
In order to achieve this fair starting position, government would calculate a tariff or top up amount for each local authority. Those authorities with business rates in excess of their baseline level of funding would pay a tariff to government; those authorities with business rates yield below their baseline would receive a top up grant from government. The tariff and top up grants would be self funding and remain fixed in future years.

2.2.3 *A strong growth incentive…*
Component 3: The incentive effect
In future years, local authorities would keep a significant proportion of increases in their business rates. So, authorities whose business rates grew would retain a significant proportion of that growth in revenues, while those whose rates declined or grew at a lower rate would experience lower or negative growth.

2.2.4 *A levy recouping a share of disproportionate growth to ensure sufficient stability in the System...*
Component 4: A levy recouping a share of disproportionate benefit
To manage the possibility that some local authorities with high business rate taxbases could see disproportionate financial gains, government would recoup a share of disproportionate benefit through a levy. The proceeds would, in the first instance, be used to manage significant negative volatility in individual authorities' business rates and so ensure stability in the system. Depending on the amounts raised, resources could also be redistributed to, for instance, authorities with lower growth, or for example, to fund regeneration schemes, in areas with high growth potential.

2.2.5 Component 5: Adjusting for revaluation
The system would be adjusted to take account of changes in the distribution of business rates yield resulting from five yearly revaluations, while ensuring that the incentive to promote physical growth in the business rates base remained in place for all authorities.

2.2.6 *An ability to reset to ensure levels of need are met…*
Component 6: Resetting the system
Government would have the option of resetting the system if it was felt that resources no longer met changing service pressures sufficiently within individual local authority areas. The longer the period between resets, the greater the incentive effect and level of certainty for local authorities about the funding system.

2.2.7 *And a mechanism for collaborating.*
Component 7: Pooling
Local authorities, for example those in local enterprise partnerships, or districts and counties, could choose to form voluntary pools within the system, allowing them to share the benefits of growth and smooth the impact of volatility over a wider economic area.

2.2.8 Technical papers were provided in late August (e.g. 'Tariff, top up and levy options') allowing local authorities to see the effect of the options within the key components upon the balance between maximising the growth incentive and offering sufficient protections in order to help inform local authority's views on the proposals.

Summary of consultation questions and draft responses

Chapter 3: A scheme for rate retention

Component 1: Setting the baseline
Q1: What do you think that the Government should consider in setting the baseline?

Proposed Draft Response
A number of issues need to be considered in setting the baseline that are not adequately reflected in the 2012-2013 formula grant settlement, which is the proposed basis for setting the baseline for the new system. The government should consider setting the baseline using a method that takes into account the socio economic needs of deprived areas and areas with an increasingly aging population, commencing this initiative on a fairer and more transparent basis.

Q2: Do you agree with the proposal to use 2012-13 formula grant as the basis for constructing the baseline?

Proposed Draft Response
No. The more deprived areas of the country have generally received a poorer grant settlement because of the many changes to the formula grant system introduced from 1st April 2011. There was also a raft of other changes that impacted upon the level of formula grant from 2011/12 onwards that were either not fully included to correctly inform the true baseline position reduction e.g. education grants removed from Area Based Grant (for this authority this amounted to a loss of grant of £4.5m) and this was in addition to the significant in year cuts of £5.150m to revenue grant funding or where adjustments / deductions were made that could not be fully supported (e.g. Academies top slice).

If so, which of the two options at paragraphs 3.13 and 3.14 do you prefer and why?
Neither. The Council does not agree with the proposed starting point of 2012/2013 as set out in the consultation paper both options sets the baseline by adjusting the 2012/013 formula grant allocations using the national baseline. The proposed national baseline includes adjustments for New Homes Bonus and other initiatives that we believe should be funded centrally outside of this new grant regime.

Component 2: Setting the tariffs and top ups
Q3: Do you agree with this proposed component of tariff and top up amounts as a way of re-balancing the system in year one?

Proposed Draft Response
Yes – this seems appropriate so that the system can commence on an agreed and fair basis. The Council has concerns however that this position must be agreed and is fully reflective of the particularly high needs (deprivation) and resources (resource equalisation) of councils especially those currently net recipients of business rates.

Q4: Which option for setting the fixed tariff and top up amounts do you prefer and why?

Proposed Draft Response
The Council would prefer option 1 which up-rates the tariff and top up amounts by the RPI each year to reflect the annual RPI increase applied to business rates each year. (The alternative option is to retain the cash amounts and not up-rate by RPI which would have the effect of creating as strong incentive for growth but offers less protection to authorities with low tax bases and high needs).

Component 3: The incentive effect
Q5: Do you agree that the incentive effect would work as described?

Proposed Draft Response
Yes both options will work however as previously mentioned full recognition and safety net funding will be required to protect those not able to generate sufficient or targeted growth because of their location / circumstances.

Component 4: A levy recouping a share of disproportionate benefit
Q6: Do you agree with our proposal for a levy on disproportionate benefit, and why?

Proposed Draft Response
Yes - the system must be fair and sustainable especially in order to provide funding for those councils with little opportunity to grow their tax base because of their location or because of other prohibiting factors such as the levels of deprivation and other socio-economic factors that impact on their ability to grow their economy faster or higher than in high growth / self sufficient areas. The level at which the recoupment commences will need to be transparent and fair, the technical papers are unclear on this point as it will depend upon whether tariffs and top-ups are index linked.

Q7: Which option for calculating the levy do you prefer and why?

Proposed Draft Response
The third option is preferred to allow the retention of growth in an equivalent proportion to its baseline revenue e.g. 1% growth in business rates income equalling retention of up to 1% revenue growth. This would mean that where a 1% growth is achieved it will not exceed 1% of an authority's baseline revenue. This way the gearing effect that exists is addressed and means a more equal incentive to all authorities. It is noted that this option could be flexed to either increase or reduce incentives by changing the percentages accordingly. (e.g. retain a 2% revenue increase means councils would keep more of their growth etc.).

Q8: What preference do you have for the size of the levy?

Proposed Draft Response
The levy must be fair and appropriate so that it generates sufficient funding to provide adequate protection to those that require it. The Council appreciates that this will be a difficult balancing act as the greater the size of the levy the lower the potential incentive for growth however in the interests of fairness the council would prefer the government to ensure fairness is inherent in the system and that high need low tax base councils are adequately and properly funded – the risk is that they are not which could impact detrimentally on services particularly in deprived areas where there may be less opportunity to increase business rates. .

Q9: Do you agree with this approach to deliver the Renewable Energy commitment?

Proposed Draft Response

The Council supports the approach in principle that local authorities can retain the full business rates revenues from new renewable projects which means this income is excluded form the business rates top up and levy calculations each year. However, the proposal is that this would only apply new schemes from 1st April 2013, we believe that all renewable energy schemes should have the same exemptions applied to them regardless of the implementation date. The current proposals penalise those areas that have been at the forefront of renewable energy initiatives.

Q10: Do you agree that the levy pot should fund a safety net to protect local authorities:
- i) whose funding falls by more than a fixed percentage compared with the previous year (protection from large year to year changes); or
- ii) whose funding falls by more than a fixed percentage below their baseline position (the rates income floor)?

Proposed Draft Response
i) and ii) Yes to both questions - variations and fluctuations in business rate income are unavoidable and are usually beyond the control of local authorities in most cases as they tend to arise because of economic conditions or where a major industry ceases trading. This protection is considered essential to the fairness of the system. The level of the floor will need to be considered carefully and may need to take into account the impact on a councils net revenue budget requirement as well as the impact on its business rate income to ensure the impact is not disproportionate to its funding.

Q11: What should be the balance between offering strong protections and strongly incentivising growth?

Proposed Draft Response
The Council would support a system that offers appropriate protection or constraint that means a council can not experience a drop or increase in its business rate funding beyond a set percentage of its revenue budget by type or by banding (eg low tax base). Councils need some certainty to be able to set their budgets each year.

Q12: Which of the options for using any additional levy proceeds, above those required to fund the safety net, are you attracted to and why?

Proposed Draft Response
All income generated by business rates should be retained for local authority spending. The Council would support the view that some funds must be set aside in higher growth years to ensure sufficient funding is available to fund the safety net in lower growth years. It is also recognised that to rebalance the economy, one of the government's aims that it would also be appropriate to provide additional revenue support to areas of lower growth and to target projects to unlock growth and prosperity in these low growth areas.

Q13: Are there any other ways you think we should consider using the levy proceeds?

Proposed Draft Response
To create more Enterprise zones particularly targeted in low or low tax base areas or to provide grants or low / zero interest loans (this could be linked to TIF's) for infrastructure development those areas.

Component 5: Adjusting for revaluation
Q14: Do you agree with the proposal to readjust the tariff and top up of each authority at each revaluation to maintain the incentive to promote physical growth and manage volatility in budgets?

Proposed Draft Response
Yes this seems reasonable as this would then remove the volatility caused by revaluation changes.

Q15: Do you agree with this overall approach to managing transitional relief?
Proposed Draft Response
We support the principle to strip out from the rates retention scheme the impact of transitional relief but would need to see the impact this will have on the new system.

Component 6: Resetting the system
Q16: Do you agree that the system should include the capacity to reset tariff and top up levels for changing levels of service need over time?

Proposed Draft Response
Yes this would seem fair and reasonable as changes will inevitably need to be made to the system over time to address changes in spending patterns, income generation etc.

Q17: Should the timings of reset be fixed or subject to government decision?

Proposed Draft Response
The timings should be fixed and could coincide with each Spending Review period. There should be sufficient funding in the system to be able to deal with any in-year volatility over the period.

Q18: If fixed, what timescale do you think is appropriate?

Proposed Draft Response
See above.

Q19: What are the advantages and disadvantages of both partial and full resets? Which do you prefer?

Proposed Draft Response

A full reset should be carried out periodically to reflect changes in circumstances across the country – 4 years which reflects the spending review period is considered appropriate for this purpose.

Q20: Do you agree that we should retain flexibility on whether a reset involves a new basis for assessing need?

Proposed Draft Response
Yes as with any national funding mechanism a reset should retain the flexibility to include a new basis for assessing need.

Component 7: Pooling
Q21: Do you agree that pooling should be subject to the three criteria listed at paragraph 3.50 and why?

Proposed Draft Response
Yes – they seem relevant and appropriate. It is important that any pooling has clear governance arrangements and that each party can return to their original position if required.

Q22: What assurances on workability and governance should be required?

Proposed Draft Response
Those who part-take would need to ensure that the scheme and the conditions agreed to are clear, transparent and clarify the actions in all situations by way of a signed agreement to ensure all parties are fully aware of the working and reporting arrangements put in place.

Q23: How should pooling in two tier areas be managed? Should districts be permitted to form pools outside their county area subject to the consent of the county or should there be a fourth criterion stating that there should always be alignment?

Proposed Draft Response
The Council is a unitary metropolitan council and is responding on this basis. Districts should only be allowed to pool within their county boundary for ease of administration and accountability reasons. The fourth criterion is therefore supported.

Q24: Should there be further incentives for groups of authorities forming pools and if so, what would form the most effective incentive?

Proposed Draft Response
No, pooling should be a matter for individual or groups of authorities to consider on their merits.

Impact on non-billing authorities
Q25: Do you agree with these approaches to non-billing authorities?

Proposed Draft Response
Yes it seems reasonable to exclude the police and fire authority until 2015/16 and base grant allocations on the control totals set out in the SR10. However it is important that the method of grant allocations to these authorities is further exemplified and agreed as soon as possible to assist them with their longer term financial plans both in the interim period and to show how they would be affected from 2015/16 if included in the new system.

Chapter 4: Interactions with existing policies and commitments
New Homes Bonus
Q26: Do you agree this overall approach to funding the New Homes Bonus within the rates retention system?

Proposed Draft Response
No. The council is opposed to local government funding the government's initiative as this should be funded by central government outside of this system. The proposal will also remove more New Homes Bonus funding than required in the early years of the new scheme, the Council would agree in principal to returning this funding to local government however using the proposed baseline as a method of allocation would be unfair due to the reasons discussed earlier in this consultation response.

Q27. What do you think the mechanism for refunding surplus funding to local government should be?

Proposed Draft Response
Not applicable see response above Q26.

Any surplus should be targeted to low growth areas as an alternative to simply redistributing sums in proportion to each councils' baseline position.

Business rates relief
Q28: Do you agree that the current system of business rates reliefs should be maintained?

Proposed Draft Response
Yes.

Chapter 5: Supporting local economic growth through new instruments
Q29: Which approach to Tax Increment Financing do you prefer and why?

Proposed Draft Response
Option 2 is preferred however the government would have to limit the number of schemes as otherwise it would impact on the amount nationally available to fund the levy pot (this funds the protection / safety net for net recipients). Preference should be given to TIF applications from low growth / low tax base authorities.

Q30: Which approach do you consider will enable local authorities and developers to take maximum advantage of Tax Increment Financing?

Proposed Draft Response
Option 2 has more certainty as business rates are then not included in the national rate retention scheme.

Q31: Would the risks to revenues from the levy and reset in option 1 limit the appetite for authorities to securitise growth revenues?

Proposed Draft Response
Yes.

Q32: Do you agree that pooling could mitigate this risk?

Proposed Draft Response
No difficult to see how pooling would work here.

Q33: Do you agree that central government would need to limit the numbers of projects in option 2? How best might this work in practice?

Proposed Draft Response
Yes. Priority must go to the low tax base authorities.