The Association of North East Councils – response to Her Majesty's Treasury National Business Rates review discussion paper

The Association of North East Councils (ANEC) is the representative voice for local government in the North East. It represents all 12 local authorities in the North East, throughout Northumberland, Tyne & Wear, Durham and the Tees Valley on issues of concern to them and the communities they serve. It is a cross-party organisation, with all of its members democratically elected and accountable politicians. We welcome this opportunity to contribute to the review of the Business Rates process. This response focuses on a number of high level issues on behalf of our member authorities, some of whom will also be submitting individual responses.

Main issues and 'asks'

ANEC authorities recognise the rationale for local government being more self-sufficient financially, by retaining and re-distributing the taxes which they collect. We agree that local authorities that succeed in growing their local economy should be entitled to retain a portion of the revenue generated. Growing the economy and wealth will enable greater self-sufficiency to fund local services (but also supported by the principle of resource equalisation to meet need) and should in the future also reduce demand pressure and costs currently linked with deprivation and poverty. However, in its current form, this key income stream for local authorities is beset by complexities, uncertainty and factors beyond their control or direct influence.

In framing our response we have focused on a key review principle as stated in the ministerial introductory foreword in that… "The tax system, including business rates, should provide stable and sustainable revenues to fund public services in the least distortive way". The key issues of concern to ANEC are summarised below but additional supporting information is provided in the attached Annex A.

1. A better functioning business rates system

The review needs to create greater incentives for areas facing the greatest challenges to grow their economies. In particular the review should recognise the following:

- The local retention of Business Rates, while meant to be an incentive, has in fact (based on DCLG data) resulted in a reduction in income for North East authorities;
- Differential rateable values for the manufacturing sector have an adverse impact for areas like the North East which has a strong manufacturing base. In the North East commercial and retail rates can generate £0.8 to £1+ million per hectare compared to £0.1 to £0.2 million per hectare for manufacturing and small business sites. The fact that Business Rates is a zero-sum

arrangement with the amount collected nationally not to increase by more than inflation creates 'winners and losers' at local level - with the losers more likely to be those authorities that are more deprived. We are calling for Business Rates retention of up to 100% from the manufacturing sector to redress the imbalance with the commercial and retail sector, and also to provide an incentive bonus to enable a more level playing field; and

- Business Rates is a key funding stream for local authorities. Those authorities with the highest growth will benefit most in terms of business rate retention. Fundamental to Business Rates being a source of income to all authorities is the requirement for fairness in the system, and as such there needs to be a mechanism to ensure that the more deprived authorities do not lose out on funding required for essential services.

2. A reformed safety net

There is a need to address the way in which the Safety Net is funded and operated in order to make it fairer and more sustainable with specific reference to:

- How the Safety Net is funded requires overhaul, in that it is currently funded via the top-slicing of £120 million from core funding, moving funding away from statutory services. Instead it could be funded from the additional central share collected nationally, or by a cash flow arrangement which balances out the costs and benefits to individual councils over a medium term period;
- Changing the way the Safety Net is funded would avoid councils having to make upfront decisions affecting service provision even though unused funds may be returned later;
- There is a perverse incentive in the system which may encourage the frontloading of appeals costs estimates to secure a Safety Net payment;
- We would advocate that the Safety Net is set too low, with local authorities being required to accommodate very significant reductions in income before triggering the safety net. One council in the North East, based on the current system, would need to lose approximately £5m before the Safety Net is activated; and
- The Safety Net system does not recognise the financial impact on an individual authority's financial position of a reduction in Business Rates from a single business from either a successful appeal, or business closure, both situations outside an authority's control. One North East council faces a significant income loss from a 48% (£16M) reduction in a single successful appeal against the 2010 rateable value, which was only determined in May 2015.

3. A fairer and more stable appeals process

The appeals system creates a significant level of financial uncertainty, the drivers of which are beyond the control of local authorities, and often leads to negative financial impacts for them and affects their ability to plan for service provision. The review therefore needs to:

- Address the appeals backlog which has worsened with the recent Government deadline in March 2015 for submitting backdated appeals to 2010; and

- As with the Safety Net, fund the cost of appeals relating to issues that arose prior to the introduction of local business rates retention in 2013 from the additional central share collected nationally.

4. Better information and data sharing

Data Sharing remains an issue and whilst the Valuation Office Agency (VOA) can request information from local authorities this does not work in reverse. Better information sharing needs to be tackled because:

- There is a consensus that pooling and sharing information would provide a seamless assessment and collection service, avoid errors in billing and create a single, local point of contact for assessments, appeals, billing and collection; and
- The creation of a statutory gateway to permit information sharing by the VOA would be fundamental to improving the appeals process.

Summary

These issues reflect the main on-going concerns of our authorities which have been represented in previous responses to government in the context of local government finance, previous consultations and the National Budget setting process. We note that the Treasury review team will continue its evidence gathering and analysis beyond this consultation with the findings not to be reported until Budget 2016. We would therefore like to take this opportunity to invite them to meet with colleagues in the North East to further explore the issues we have highlighted and to share the evidence and experiences on which these are based.

A better functioning business rates system

In the context of councils' ability to raise income, the introduction of a system of localised business rates retention (while in theory giving a financial 'incentive') has so far resulted in a reduction in income to provide core services in the North East and this will continue. The 2014/15 National Non Domestic Rates (NNDR) and Revenue Account (RA) budget returns to DCLG show that retained business rate income outside of Enterprise Zone/New Deal areas are less than the Government's baseline assumptions and the region has had to pay over £7m to fund the business rates safety net. This appears to be due to the impact of appeals and the lack of growth outside of Enterprise Zones/New Deal areas. In contrast, at the end of the first year of business rate retention, figures show that business rate growth in Enterprise Zones and in the New Deal areas is running slightly ahead of cautious estimates, reflecting the focused effort in these priority areas and opportunities to fund infrastructure. This income is effectively ringfenced however to help fund investment in economic growth initiatives.

NNDR figures provided to DCLG appear to show a lower retained localised business rate income levels than the baseline assumed by DCLG of - £37m for England overall and - £15m for the North East. Gains and losses at a regional level do vary, with losses in the North East, South East and South West. In addition, RA Budget returns for 2014/15 for the 12 NE councils show an overall reduction in localised business rates income compared with 2013/14, which is £41m less than the baseline assumption used by DCLG in their forecast of the region's spending power. This may be partly offset by potential safety net receipts.

Business rates are not an ideal proxy for economic growth as they include rates on public buildings and differential rateable values with much lower rateable values for manufacturing facilities than offices or retail premises. This could lead, for example, to small businesses and manufacturing companies being less attractive than retail growth in an area.

To illustrate the point, business rates from retail or commercial developments are significantly higher than manufacturing in an equivalent area. In the North East commercial and retail rates can generate £0.8 million to over £1 million per hectare compared to £0.1 million to £0.2 million per hectare for small business and manufacturing sites. The importance of the manufacturing sector, which currently contributes £7.5 billion to the North East economy, cannot be underestimated particularly as manufacturing in the North East currently exports more than it imports.

Manufacturing needs to be part of a long term national strategy helping to re-balance the economy through production and exports. Under business rate localisation, manufacturing developments could be seen as less attractive propositions, despite the wider economic benefits such as exports, supply chain industries, jobs and skills compared with retail developments, which have the capability to secure greater levels of business income. Allowing business rate retention to a higher level of up to 100% from this sector would partly help redress the imbalance and consideration should be given to further incentives such as an additional manufacturing 'bonus' to provide a more level playing field. This would provide an important and more balanced incentive to local councils to secure and grow this type of business.

Another issue is that the Government has made clear the Business Rates is a zero-sum game with the national amount raised increasing only by inflation, or by some lower figure picked by Government. As such there will be winners and losers with the losers more likely to be deprived authorities with less potential for increased rates income, the same authorities who have lost most in finance settlements in recent years.

Those authorities with the highest growth will benefit most and those with growth lower than the average will lose more money. The importance of Business Rates as a source of income for local authorities must be considered and that if low rated authorities are likely to lose out then the top-up must remain or some other resources will need to be provided through the upcoming Spending Review in order for those councils to carry out their statutory functions.

A further concern within the current system is the revaluation and multiplier adjustments which create significant differences in rates income at an individual local authority level. This potentially creates a system of ‘winners and losers’ and adds further uncertainty around future resource levels affecting the ability of councils to properly plan service provision.

Any reform of the system should also include the first reset being brought forward from 2020, at it would make sense to reset as soon as appeals are sorted and the Government is committed to resolving 95% of the appeals backlog by June 2015.

A reformed Safety Net

The Safety Net mechanism should be reformed both in the way it is funded and operated. This could be resolved by funding the Safety Net (and outstanding appeals) from the additional central share of Business Rates collected nationally or by a cash flow arrangement which seeks to balance out the costs and benefits to individual councils over a medium term period (5 – 7 years).

This would then remove the need for the £120 million top-slice for the Safety Net – a change to this would help all councils across the country. The current grant holdback for the Safety Net is implemented by a percentage reduction in grant, which has a much greater adverse impact on grant dependent authorities in the most deprived areas in the country, including the North East. Top-slicing for the Safety Net also forces councils to have to make the decision upfront of whether to cut service provision even though any unused Safety Net may be returned to councils at a later date if not called upon.

Outstanding appeals are impacting on the call on the Safety Net which we would urge the Government to address due to the negative financial impact on council budgets and the wider economy. The current system includes a perverse incentive that some councils can take advantage of by frontloading their estimated cost of appeals and securing a Safety Net payment upfront while making surpluses in future years.

In addition, the Safety Net is set too low, with local authorities being required to accommodate very significant reductions in income before the Safety Net would be triggered. As an illustration, one council in the North East, based on the current system, would need to lose around £5m before the Safety Net is activated.

A fairer and more stable appeals process

The appeals system creates a significant level of financial uncertainty, the drivers of which are beyond the control of local authorities. To illustrate this, two of our member authorities have been notified by the Valuation Office Agency that a very high level of appeals had been lodged in March 2015 (prior to a government imposed deadline) equating to approximately 10 times their normal monthly levels. This now presents the difficult task of assessing the likelihood of success of these appeals and the backdated and future funding impacts should they be successful. Financial planning in such an environment is very challenging. The impact of appeals has meant that any growth has been offset by the financial impact of those appeals, meaning that the intended incentives and benefits to local government, based on this example, have not materialised.

Better information and data sharing

Data Sharing is a problem in general. Whilst the Valuation Office Agency (VOA) can request information from local authorities this does not work in reverse. The VOA holds information which would enable local authorities to bill ratepayers correctly but are not allowed to share it. The sharing of data would result in the number of appeals being reduced and in appeals being settled more quickly. This should bring gains both to local authorities and to the Exchequer and to reputations all-round.

Information flows from the VOA to local authorities need to improve significantly – recent examples of issues include significant delays in the issuing of appeals lists.
The previous business rates administration consultation, as reflected in the discussion paper, disclosed a consensus between local authorities and businesses for pooling and sharing information to provide a seamless assessment and collection service, avoid errors in billing and create a single, local point of contact for assessments, appeals, billing and collection. The creation of a statutory gateway to permit information sharing by the VOA would be fundamental to this happening.