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Housing, Communities and Local Government Committee

Business rates retention

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Housing, Communities and Local Government Committee

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Summary

We conducted this short inquiry to find out how councils had been affected by the longer than planned implementation period for reforms to local government finance, specifically the move from 50 to 100 per cent retention of business rates revenue in 2019–20 and a 'Fair Funding Review' of the formula determining the amount of business rates revenue councils will retain.

In the event, three key themes emerged from the evidence: the increasingly difficult financial position of many councils, uncertainty over reforms affecting their financial planning, and their wider concerns about the design and operation of the reformed system.

Uncertainty

The evidence that we heard was clear: uncertainty over the future of the reforms had affected councils' financial planning, rendering it "a work of fiction", "at best, guess work" and "extremely difficult". This state of uncertainty has resulted in councils making pessimistic assumptions about their budgets which could unnecessarily impact on service levels. The announcement by the Government part-way through the inquiry that local government would retain 75 per cent retention in 2020–21 did not appear to restore councils' confidence. We have therefore recommended that **the Government should reduce any further uncertainty for councils by taking a range of steps including:**

- **Publishing a timeline for the forthcoming consultations and the key milestones to implementation of 75 per cent retention and the outcome of the Fair Funding Review;**

- **Providing quarterly progress updates to the sector through the Local Government Association-led Steering Group and in writing to all councils; and**

- **Ensuring that councils receive indicative figures for the impact of 75 per cent retention for their individual authority by spring 2019 and final figures by summer 2019 at the latest.**

Issues for further consideration

Although our questions focused on the timeframe for implementation, the evidence extended beyond this and concerns were raised about a range of issues linked to the design and operation of the reformed system. These included:

- The transfer of new responsibilities to local government in return for additional business rates revenue;

- The correlation between growth in business rates revenue and growth in need;
- The relationship between local economic growth and growth in business rates revenue;
- The level and stability of the business rates tax base;
- How the review of the funding formula will balance the competing aims of fairness and simplicity;
- The sufficiency of the overall quantum available to local government;
- The risk to business rates revenue posed by appeals and the capacity of the Valuation Office Agency; and
- The links being made between the reforms to social care funding and the reforms to local government finance.

While much of the technical detail is yet to be consulted on, given the increasingly difficult financial position for councils, **the Government should give further consideration to these issues prior to implementing further business rates retention.** Our key recommendations are as follows:

- **Local government should be allowed to use the additional revenue gained from 75 per cent retention to fund existing cost pressures and not in replacement of Revenue Support Grant, Rural Services Delivery Grant, GLA Transport Grant and Public Health Grant.**
- **Beyond this point, the Government should ensure that further business rates retention is of net benefit to councils by ensuring that new responsibilities are linked to stimulating and promoting local economic growth, such as employment support and skills services.**

75 per cent retention will generate around an extra £6 billion for local government. The Government's intention is that existing grants to local government—Revenue Support Grant, Rural Services Delivery Grant, GLA Transport Grant and Public Health Grant—should be replaced by the additional retained revenue. However, local government is currently facing significant funding pressures, particularly in relation to demand-led services, which the LGA estimates will amount to a gap between funding needs and revenue of £5.8 billion by 2020.

- **The reformed system will need to be underpinned by a system of grants to support councils affected by sudden increases in need and by divergence in**

their business rates revenue and spending needs. Such a system will allow for equalisation of resources between councils while preserving incentives to grow business rate revenue.

Although the system is designed to redistribute revenue between councils using top ups and tariffs, there is scope for divergence in funding between councils as tops ups and tariffs are only 'reset' to reflect need periodically. The Government has reacted in a similar way in recent years with a series of short-term funding measures in response to adult social care funding pressures.

- **Councils should be empowered to raise funding in a wider range of ways and the Government should consider devolving other property taxes to local government and larger-scale, more comprehensive fiscal powers to groups of local authorities.**

The overall quantum of funding available to local government needs to increase to reflect changing demographic trends and ensure sufficient funding for demand-led services and councils' overall financial sustainability.

- **In preparing the social care Green Paper, the Government should give proper consideration to how the ongoing reforms to local government funding will affect the funding available for social care, as well as to how the funding reforms to social care will impact on local government funding.**

There are important and very clear links between the reforms to local government funding and the reforms to the funding of social care, but we were not persuaded that the necessary connections are being made.

1 Introduction

1. This inquiry sought to assess the effect of the longer than planned implementation period for reforms to local government finance on local authorities. It continues the work of our predecessor Committee in scrutinising the ongoing, significant reforms to local government finance; specifically, the retention by local government of 100 per cent of business rate revenue in return for additional responsibilities and a reduction in central government grant, and a 'Fair Funding Review' of the formula determining the amount of business rate revenue councils will retain.

2. Their inquiry, which ran from February to April 2016, provided a platform for discussion and scrutiny of the Government's plans at an early stage in the reform process. Because the Government declined our predecessors' invitation to give oral evidence, preferring to wait until after the first consultation, the Committee decided to publish an interim report[1] and complete the inquiry at a later date. However, the Committee was not able to return to the issue before the 2017 General Election and the dissolution of Parliament.

3. On taking up our predecessors' work in the 2017–19 Parliament, we found that the landscape had changed. The future of the reforms seemed uncertain after the Local Government Finance Bill,[2] which provided the legislative framework for 100 per cent retention, fell when Parliament was dissolved and was not revived in the Queen's Speech. This prompted a senior Ministry of Housing, Communities and Local Government (MHCLG) official to tell sector representatives that 100 per cent retention was "effectively suspended with no current plans for its introduction".[3] Then, when he appeared before us in October 2017, the Secretary of State said that 100 per cent retention "will be delayed from the original schedule. I do not think it is possible because of the Bill and there no longer being that primary legislation in front of Parliament".[4] He suggested that instead it may be brought in "gradually rather than going straight to 100 per cent".[5] With regards to the Fair Funding Review, the then Local Government Minister said he was "not absolutely certain if that will come into effect at exactly the same time as business rates retention".[6] Then, in December 2017, the provisional Local Government Finance Settlement 2018–19 announced that the Government aimed to introduce at least 75 per cent business rates retention in 2020–21.[7]

4. We decided that our work should start with a short, focused inquiry to find out whether councils had been affected by the uncertainty which resulted from the loss of the Local Government Finance Bill and the delay to the implementation of the reforms to local government finance. Our findings in relation to this are set out in chapter one (the text box sets out the progress made to date on implementing the reforms and setting up business rates retention pilots). In the event, the oral and written evidence revealed the sector's wider concerns about issues linked to the design and operation of the reformed

1 Communities and Local Government Committee, 100 per cent retention of business rates: issues for consideration, First Report of Session 2016–17, HC241
2 Local Government Finance Bill [House of Commons] [Bill 142 (2016–17)]
3 Local Government Chronicle (LGC), EXCLUSIVE: 100% rates retention reforms suspended indefinitely, 21 June 2017
4 Communities and Local Government Committee Oral evidence: Work of DCLG 2017, HC 371, Q53
5 Communities and Local Government Committee Oral evidence: Work of DCLG 2017, HC 371, Q60
6 Communities and Local Government Committee Oral evidence: Work of DCLG 2017, HC 371, Q58
7 MHCLG, The provisional 2018–19 local government finance settlement, 21 December 2017

system, several of which were identified by our predecessors in their interim report. With much of the technical detail yet to be consulted on, it is too soon for detailed scrutiny of these issues and, in any case, beyond the scope of this short inquiry. However, we set out the main concerns we heard in chapter two, recommending that the Government gives further consideration to these issues prior to implementing further business rates retention and making specific recommendations where we heard evidence of a pressing issue.

Background

The current system: the 'Business Rate Retention Scheme'

5. Business rates are a property tax paid by occupants of non-domestic properties to 'billing authorities' (district and unitary councils), forming a substantial portion of local authority funding in England. Under the current Business Rates Retention Scheme ('the BRR Scheme'), councils retain 50 per cent of business rate revenue. We understand that the new system of further business rates retention will operate in broadly the same way as the BRR Scheme. We therefore begin by describing how it works and explaining the terminology which appears in this report.

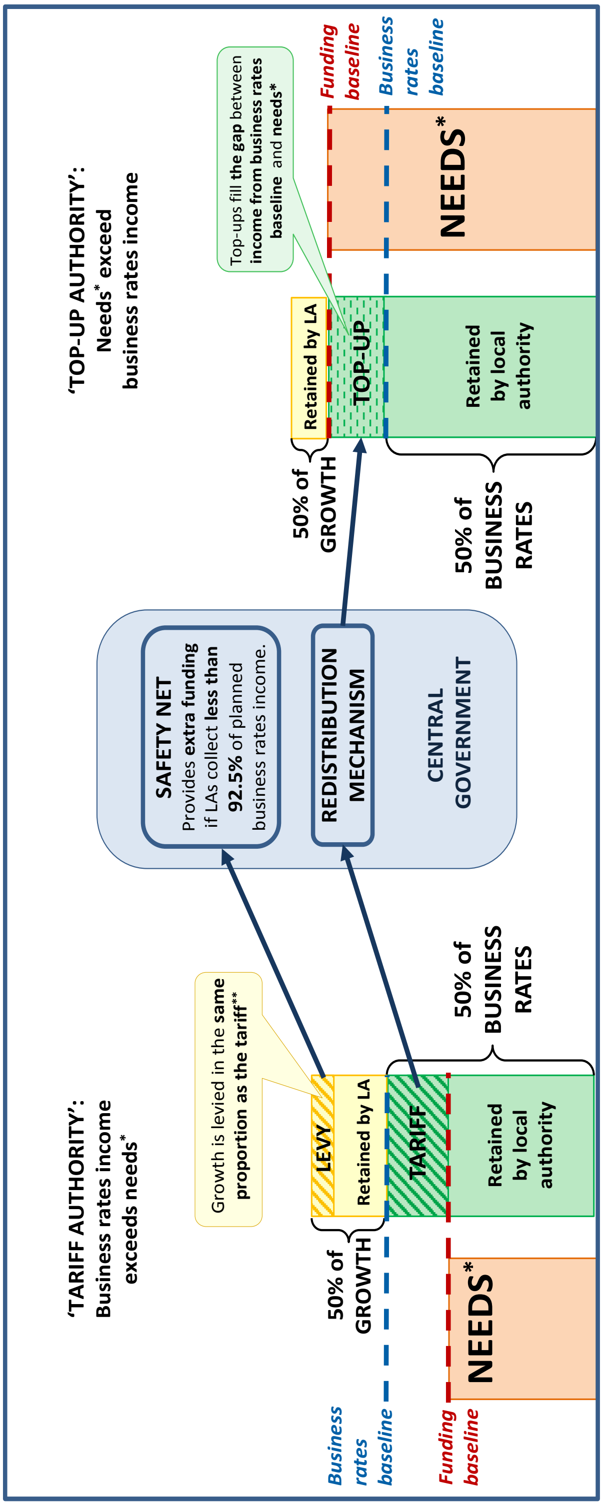
6. When the BRR Scheme was set up in 2012–13, a 'start-up funding assessment' (now known as the 'settlement funding assessment') calculated how much funding each authority required on the basis of an assessment of needs. This funding comes from two sources: Revenue Support Grant (RSG) and funding provided through the BRR Scheme (an authority's baseline funding level, also known as an authority's 'local share' of business rates). The local share, which is 50 per cent, is split 80:20 between district councils and county councils[8] to set an individual authority's 'business rates baseline'. Baseline funding levels are fixed, subject to being uprated by the increase in the Retail Prices Index (RPI), until the system is 'reset'. The reset was originally planned to take place in 2020 and every ten years thereafter.

7. Whether a local authority needs more business rate revenue, or raises more than it needs, is determined by comparing its baseline funding level with its business rates baseline. If the business rates baseline is greater than its baseline funding level, an authority must pay a tariff. If the situation is the reverse, an authority receives a top up. Redistributive tariffs and top ups operate each year to ensure that each authority receives its baseline funding level; however, the amounts of the tariffs and top ups are calculated at the outset of the BRR Scheme, remaining fixed until the reset. The operation of the BRR Scheme is illustrated in Figure 1.

8. 'Additional revenue' is revenue above the business rates baseline, based on the authority's average business rate revenue in 2011–12 and 2012–13. Local authorities will retain up to 50 per cent of the additional business rate revenue that they raise in the period 2013–20. Adjustments for disproportionate gains and losses in business rate revenue are made during the reset period via levies and the safety net. Authorities which experience disproportionate growth in business rates income pay a levy, which reduces the share of growth they actually retain. The levy is then used to fund a safety net to protect authorities which experience a significant decline in their business rate income, for example, as a

8 As well as the Greater London Authority and fire and rescue authorities.

result of the closure of a major business in the area. The safety net guarantees that, each year, local authorities will receive at least 92.5 per cent of their original baseline funding. Therefore, no local authority's business rates income will be more than 7.5 per cent below the baseline funding level.



* This is the need that is funded through business rates income, which can be larger or smaller than actual rates collected in each local authority. This need is referred to as 'baseline funding'.

** Although some authorities pay tariffs above 50%, the levy on growth is capped at 50%.

Local government finance reforms: progress to date

In October 2015, at the Conservative Party Conference, the then Chancellor of the Exchequer announced that local government would collectively retain 100 per cent of business rate revenue by "the end of the Parliament" and, to match the resulting additional revenue, it would take on new responsibilities.[9] Over the same period, Revenue Support Grant (RSG) was to be phased out, effectively being replaced by the additional retained business rate revenue. In February 2016, the Government announced a four-year funding settlement until 2019–20 "as part of the move to a more self-sufficient local government".[10] Progress on reform since then has been as follows:

- In February 2016, the then Secretary of State committed to a 'Fair Funding Review' to revise the underlying assessment of needs, saying that it was "too long since [it] had been updated—it is more than 10 years".[11] The two programmes of reform are closely linked—the outcome of the Fair Funding Review will set the funding baselines for 100 per cent retention, each local authority's share of estimated business rate revenue.
- In May 2016, a 'technical steering group' and several sub-groups comprising representatives from local government were established to provide advice and support, led by the Local Government Association, to the Ministry for Housing, Communities and Local Government (MHCLG) on the setting up and implementation of the new system.
- Our predecessor Committee published their interim report, 100 per cent retention: issues for consideration, in June 2016.[12] Their analysis of the evidence found that there were "specific issues and pitfalls to be avoided in designing and setting up the reformed system" which they presented to the Government along with specific recommendations to tackle particularly pressing issues.
- The interim report was well-timed to feed into the consultation process which began in July 2016 with the publication of calls for evidence on 100 per cent retention[13] and needs and redistribution.[14] Government responses to these and a further consultation on the design of the reformed 100 per cent retention system were published in February 2017.[15] This stated that, subject to Parliamentary approval, the aim was to introduce the new system for the financial year 2019–20.
- Meanwhile, in January 2017, the Local Government Finance Bill began its passage through the House of Commons, completing its Committee Stage in

9 HM Treasury, Chancellor unveils 'devolution revolution', 5 October 2015
10 DCLG, The provisional Local Government Finance Settlement 2016–17 and an offer to councils for future years, December 2015
11 HC Deb, 12 October 2015, col 221WS [Commons written ministerial statement]
12 Communities and Local Government Committee, 100 per cent retention of business rates: issues for consideration, First Report of Session 2016–17, HC241
13 MHCLG, Self-sufficient local government: 100 per cent Business Rates Retention: Consultation Document, July 2016
14 MHCLG, Business Rates Reform: Fair Funding Review: Call for evidence on Needs and Redistribution, July 2016
15 MHCLG, Self-sufficient local government: 100 per cent Business Rates Retention: Consultation: Summary of responses and Government response, February 2017; MHCLG, 100 per cent Business Rates Retention: Further consultation on the design of the reformed system, February 2017

February 2017.[16] The Bill provided for the legislative framework for 100 per cent retention. Most notably, clause 1(2) amended the Local Government Finance Act 1988 to enable 100 per cent retention, clause 1(3) gave effect to the commitment to abolish RSG and clause 2 enabled the Government to make 'loss payments' to local authorities that see their rate revenue reduced as a result of successful appeals.

- The 2017 General Election meant that the MHCLG's work and the meetings of the technical steering group and other sub-groups were put on hold. The Bill fell when Parliament was dissolved and was not revived in the Queen's Speech in July 2017.

- A period of uncertainty followed until the Secretary of State confirmed in October 2017 to the Committee that, although "delayed from the original schedule", the Government was "still very much committed to business rates retention".[17] He continued:

  One of the options that we are looking at [is to] transfer fewer responsibilities but it is not quite 100 per cent. As a result, for the local authorities, you still have a big step towards business rates retention but, by transferring fewer responsibilities, there is no need to take it up to 100 per cent.[18]

- On 19 December 2017, the provisional Local Government Finance Settlement 2018–19 announced that the Government aimed to introduce at least 75 per cent business rates retention in 2020–21—a year later than planned—and that, in return for the additional retained revenue, Revenue Support Grant, Rural Services Delivery Grant, GLA Transport Grant and the Public Health Grant would be funded by retained business rates. The Government also published its response to the February 2017 consultation and a further Fair Funding Review consultation which stated that the Government was "working towards an implementation date for the review of 2020–21, while keeping this under review as work progresses".[19]

Business rates retention pilots

In 2016, areas with agreed devolution deals were invited to pilot 100 per cent retention.[20] A first wave of pilots launched in April 2017, running in 2017–18 and 2018–19, in Greater Manchester, Liverpool City Region, the West of England, Cornwall and the West Midlands. A second wave was announced to test more technical aspects of 100 per cent retention—such as 'tier splits',[21] pooling and administration—in 2018–19.[22] Successful bids were confirmed in the provisional Local Government

16 Local Government Finance Bill [House of Commons] [Bill 142 (2016–17)]
17 Communities and Local Government Committee Oral evidence: Work of DCLG 2017, HC 371, Q53
18 Communities and Local Government Committee Oral evidence: Work of DCLG 2017, HC 371, Q60
19 MHCLG, Fair funding review: a review of relative needs and resources: Technical consultation on relative need, December 2017
20 HM Treasury, Budget 2016, March 2016, p70
21 Currently 80 per cent of rate revenue in two-tier areas passes to district councils, and 20 per cent to county councils. This has different consequences for each tier in terms of the strength of the incentive to grow rate revenue.
22 MHCLG, Invitation to Local Authorities in England to pilot 100 per cent Business Rates Retention in 2018/19 and to pioneer new pooling and tier-split models, September 2017

Finance Settlement 2018–19 in December 2017 as Berkshire, Derbyshire, Devon, Gloucestershire, Kent and Medway, Leeds, Lincolnshire, Solent, Suffolk and Surrey.[23] In addition, as announced in the 2017 Budget, the GLA, the City of London and all the London Boroughs will form a 'pool' and will also pilot 100 per cent retention in 2018–19.[24]

Local government finances

9. We are particularly aware that these reforms are taking place at a time of financial pressure for councils and it is against this backdrop, which we describe in brief here, that we consider the issues raised in this report. Those pressures were frequently emphasised in the evidence we received. We heard in oral evidence that some councils were "getting close to the cliff edge",[25] that some were using "reserves and capital receipts flexibilities […] to balance the books"[26] and that the situation would become "untenable" for some councils in the coming years.[27] Rob Whiteman, the Chief Executive of the Chartered Institute of Public Finance and Accountancy (CIPFA), said that some councils may find themselves in a similarly difficult position to Northamptonshire County Council—which issued a section 114 notice[28] in February 2018—in the next few years.[29] Councillor Carter, Chairman of the County Councils Network, described the combination of funding, demand and cost pressures councils faced:

> There are so many unfunded pressures that are building up across the piece in local government. Those are particularly in people-based services, but there are others, such as the pressure on wage settlements and the unions demanding a 3 per cent plus pay award for local government. There is a whole list of pressures building up that we are having to absorb while at the same time having the revenue support grant diminished virtually to zero in the counties' case, with some in negative RSG.[30]

10. The Local Government Association (LGA) has estimated that these accumulated pressures will lead to councils facing a funding gap of £5.8 billion by 2020, as well as needing £1.3 billion to stabilise the adult social care provider market today.[31] Adults and children's social services, as well as homelessness, were cited as particular areas of pressure by our witnesses.[32] The National Audit Office's assessment of the financial sustainability of local authorities in 2018, published in the weeks after our evidence session, closely reflected what we had heard.[33] It said that, since 2014, the financial position of the sector has "worsened markedly, particularly for authorities with social care responsibilities",

23 MHCLG, The provisional 2018–19 local government finance settlement, 21 December 2017
24 HM Treasury, Autumn Budget 2017, November 2017, p55
25 Q35
26 Q35
27 Q27
28 The chief finance officer of a local authority is required to issue a section 114 notice if there is, or is likely to be, an unbalanced budget in the forthcoming financial year.
29 Q35
30 Q11
31 Local Government Association [BRR 014]
32 Q2, Q10, Q12, Q26, Q44, Local Government Association [BRR 014]
33 National Audit Office, Financial sustainability of local authorities 2018, March 2018

concluding that “the current pattern of growing overspends on services and dwindling reserves exhibited by an increasing number of authorities is not sustainable over the medium term”.[34]

34 National Audit Office, Financial sustainability of local authorities 2018, March 2018

2 Uncertainty over long-term reform

11. In 2016, the four-year settlement, which set out indicative central funding allocations for each of the following four years, gave councils a degree of certainty for their medium-term financial planning and set out a trajectory towards implementation of 100 per cent retention in 2019–20. Councils began to plan for the reforms accordingly. However, a year later, their future was in doubt and the funding situation for councils beyond 2019–20 was unclear (the text box sets out the progress made on implementing the reforms to date). We wanted to find out how councils' financial planning had been affected by this period of uncertainty. Did they feel they were approaching a 'cliff edge' after which point financial planning became extremely uncertain and, if so, what impact was this having?

12. In its written submission, the Ministry said that it expected the change of implementation date to 2020–21 to have a "minimal impact" on councils and their financial planning, essentially because they would "not have begun to make concrete plans post 2020".[35] The written evidence we received from councils, which pre-dated the confirmation by the Government that 75 per cent retention would begin in 2020–21, was at odds with this. We heard that uncertainty over the reforms had rendered their medium-term financial planning "a work of fiction",[36] "at best, guess work",[37] "extremely difficult",[38] and "impossible after 19–20".[39] Any stability provided by the four-year settlement was reducing each year as 2019–20 neared and there were no concrete plans for 100 per cent retention beyond this date.[40] In addition, many councils—and as many as 72 per cent of districts—were facing 'negative Revenue Support Grant (RSG)' positions in 2019–20 as a result of reductions in RSG combined with adjustments to their top ups and tariffs.[41] We note, however, that the Government has since stated that it will formally consult on proposals to deal with 'negative RSG' ahead of next year's settlement.[42]

13. Manchester City Council, part of the Greater Manchester pilot, said that a source of uncertainty for them—likely to be shared by other councils participating—was whether the pilots would continue in 2019–20.[43] Janice Gotts, the council's Deputy Treasurer, said she needed "confirmation about what is going to happen in 2019–20 to help our effective planning".[44] Sheila Little, President of the Society of County Treasurers, pointed out that councils taking part in the pilots could have three levels of business rates retention in three years: "100 per cent in this coming financial year, then […] 50 per cent, and then when retention is introduced at 75 per cent […] That cannot be helpful for long-term financial planning".[45]

35 MHCLG [BRR 019]
36 Lichfield District Council [BRR 001]
37 Gateshead Council [BRR 006]
38 Newcastle City Council [BRR 015]
39 Kettering Borough Council [BRR 007]
40 Lichfield District Council [BRR 001]
41 District Councils Network [BRR 009] and County Councils Network [BRR 008]
42 MHCLG, The provisional 2018–19 local government finance settlement, December 2017
43 Q37
44 Q37
45 Q27

14. We heard that this climate of uncertainty had led to councils taking a “prudent”[46] or “pessimistic”[47] approach to setting budget assumptions which they suggested could impact on service levels. Essex County Council said:

> We have assumed that we will not receive any RSG funding after 2019–20. This effectively means we are planning for a budget which may not be the true funding picture, and the authority could take decisions to reduce services that would impact residents and businesses, especially given long lead in times for certain decisions.[48]

Furthermore, the District Councils Network said that the uncertainty around the reforms was “holding back authorities from investing in long-term growth that would get paid back through extra business rates”.[49] This was echoed by Councillor Finch, Leader of Essex County Council, who said that it meant it would be “imprudent for us to set forth on an ambitious programme for highways or any other major programme”.[50] **We believe that uncertainty about whether 100 per cent retention would proceed following the 2017 general election and the lapse of the Local Government Finance Bill has negatively affected councils’ financial planning. Councils have been either unable to make financial plans for 2020–21 or have understandably made pessimistic budget assumptions that could unnecessarily impact on service levels. They have also taken a cautious approach to investment decisions which potentially has implications for their ability to generate additional business growth and make gains under further business rates retention. Pilot areas also face continued uncertainty over whether they would continue to pilot 100 per cent retention in 2019–20, which has had an impact on their financial planning.**

15. By the time we held our first oral evidence session in February 2018, the provisional Local Government Finance Settlement 2018–19 had announced that the Government aimed to introduce at least 75 per cent business rates retention in 2020–21.[51] This announcement received only a muted welcome from our witnesses who still felt that the situation was uncertain. Rob Whiteman of CIPFA—whose views were shared by the other witnesses—said:

> It is good that there is certainty that it will happen; however, there is complete uncertainty about how it will happen, and […] not enough real certainty yet for [councils] to set out for members the type of difference that it will make in the medium term and to make different plans accordingly.[52]

Sheila Little of the Society of County Treasurers, said “uncertainty makes us 151 officers think that we need to be cautious and prudent”.[53] We welcomed the response of the Minister for Local Government, Rishi Sunak MP, who said “The direction I have given my team is that we want to get to a right answer as quickly as possible”.[54]

46 Southampton City Council [BRR 012]
47 Lichfield District Council [BRR 001]. See also Gateshead Council [BRR 006]
48 Essex County Council [BRR 005]. See also Gateshead Council [BRR 006], Southampton City Council [BRR 012], Lichfield District Council [BRR 001]
49 District Councils Network [BRR 009]
50 Q39
51 MHCLG, The provisional 2018–19 local government finance settlement, December 2017
52 Q10
53 Q10
54 Q51

16. Our witnesses emphasised the challenges and scale of the work ahead. For example, Rob Whiteman of CIPFA said there was "a lot left to be worked on regarding the detail about which responsibilities will switch"[55] and Councillor Fuller, Chairman of the District Councils Network, said that the Fair Funding Review involved "all sorts of contentions and difficulties" in satisfying "different political groups, different tiers of government, different geographies and different areas".[56] Despite the longer implementation period, Sheila Little of the Society of County Treasurers said that implementing 75 per cent retention in 2020–21 presented a timing challenge.[57] She was concerned that councils would not receive the detailed financial information they needed in time to make plans,[58] as was Janice Gotts, Deputy City Treasurer of Manchester City Council, who said:

> Budget setting starts several months before we get to April. There are also the approval routes that it is necessary to go through as part of the democratic process. For the approval of a budget, you are going back several months where you need to have something in place. Whether we are going to see the exemplifications of some of this work to enable a meaningful discussion to take place is something that causes concern.[59]

17. The Minister gave a thorough account of the timeline and key milestones to implementation and suggested that technical consultation papers would be produced in spring 2018 and indicative financial information for councils would be published in spring or early summer 2019 and finalised in autumn 2019. He said:

> On business rates retention, we will be publishing technical papers over the spring in five specific areas […]. Towards the end of this year, autumn or winter, there will be the publication of the broad outlines of the new business rates system. That will not be the numbers but how we think the system ought to work. The technical papers will inform the discussions and will be published transparently and publicly for us to all engage with.
>
> In parallel, the fair funding review process is running. The technical papers will be published after this consultation and at the same time towards the end of this year, autumn or winter, we will publish the broad outlines of the new fair funding formula. Again, that is not numbers but the broad outlines of how the formula will work, the bits and bobs of it, the key drivers and inputs. There will be a period of consultation on that. That will hopefully get us to a period in spring, give or take, or perhaps early summer, where we will be able to publish indicative numbers for both of those two processes. That will be after the spending review, crucially, which is why the spending review timing is helpful […] sometime around autumn, the final numbers will be laid for local authorities in 2019.[60]

55 Q10. See also Cllr Finch at Q41
56 Q49
57 Q5
58 Q5
59 Q49
60 Q52

He was, however, unable to give us a timescale or target date for implementation of 100 per cent retention,[61] but said that it would happen "over time" and "at a pace that makes sense".[62]

18. Several weeks after our evidence session with the Minister, the Secretary of State wrote to us to announce his intention to commission an independent review of the "internal processes and procedures that underpin [the] department's governance of the business rates system".[63] The terms of reference state that "Given their growing importance—as a source of revenue, as a redistributive mechanism across local authorities and as a means of incentivising growth—the system needs to function smoothly, with scope for error minimised".[64] We strongly agree with the sentiment expressed and welcome this development which demonstrates the Government's understanding of the significance of the reforms for local government finances.

19. **The confirmation by the Government in December 2017 of 75 per cent retention in 2020–21 was helpful but we believe that councils' financial planning will continue to be affected until more information is made available. We recognise that the consultation process is ongoing and that there is still a significant amount of work ahead.** ***However, given there has been a significant period of delay, the Government should take steps to reduce any further uncertainty to councils in the run up to implementation of 75 per cent retention and the outcome of the Fair Funding Review. This is particularly important in the context of the ongoing funding pressures that councils are experiencing. To this end, we recommend that the Government:***

- ***Immediately publishes a timeline for the forthcoming consultations and the key milestones to implementation of 75 per cent retention and the outcome of the Fair Funding Review;***

- ***With reference to this timeline, provides quarterly progress updates to the sector through the Local Government Association-led Steering Group and in writing to all councils;***

- ***Ensures that councils receive indicative figures for the impact of 75 per cent retention for their individual authority by spring 2019 and final figures by summer 2019 at the latest;***

- ***Consults local authorities on the arrangements for transitional funding at the earliest opportunity; and***

- ***Makes clear its intention as to whether it intends to reintroduce legislation for 100 per cent retention and, if it does, sets out a clear time frame for implementation of 100 per cent retention so councils can plan accordingly.***

20. As mentioned above, the Local Government Finance Bill would have provided the legislative framework for the introduction of 100 per cent business rates retention. However, we understand that it is still possible for local government to retain almost all—indeed

61 QQq73–75
62 Q70
63 Letter of 12 April 2018 from the Secretary of State for Housing, Communities and Local Government to the Chair, reported to the House on 17 April 2018
64 MHCLG, Local government finance: Review of governance and processes – terms of reference, 11 April 2018

99.9 per cent—of business rates without it.[65] The Minister confirmed this, saying it was possible to do so with a "workaround methodology, as I call it".[66] The additional revenue would have been welcomed by councils: Councillor Finch of Essex County Council, said "To put it simply, we do not have enough money. We need 100 per cent business rates retention".[67] ***Given that the original intention of the reforms was for local government to retain 100 per cent of business rates, the Government should explain the reasons for its decision to allow councils to retain only 75 per cent of business rates in the short term, thereby limiting the potential gains available to them, rather than the maximum amount possible without primary legislation.***

65 Communities and Local Government Committee, Oral evidence: DCLG Annual Report and Accounts 2016–17, HC 553, 15 January 2018, Q99

66 Q79

67 Q37

3 Issues for further consideration

21. The evidence revealed that the sector had wider concerns extending beyond medium-term financial planning to issues relating to the design and operation of the reformed system and the likely financial impact of the reforms on individual councils. In this chapter, we set out the evidence relating to these issues, which are as follows:

- The transfer of new responsibilities in return for additional business rate revenue;
- The link between growth in business rate revenue and growth in need;
- The link between economic growth and growth in business rate revenue;
- The tax base;
- The Fair Funding Review and the needs assessment formula;
- The overall quantum of funding available to local government;
- Appeals and the Valuation Office Agency; and
- The direction of the social care Green Paper.

As highlighted by all our witnesses, and discussed in paragraphs 9 to 10, these reforms are taking place at a time of financial pressure for councils and therefore, in the words of one of our witnesses, "the stakes are now very high indeed".[68] ***We recommend that, prior to implementing 75 per cent business rates retention, the Government gives further consideration to each of these issues and takes specific action where we have identified that it is needed.***

Additional responsibilities

22. In December 2017 the Government confirmed that Revenue Support Grant, Rural Services Delivery Grant, GLA Transport Grant and Public Health Grant would be rolled into the additional revenue generated by 75 per cent retention—which we estimate to be around £6 billion.[69] We heard frequent calls on the Government to allow councils to use the additional revenue to cover their existing funding pressures,[70] which the LGA has estimated will amount to £5.8 billion by 2020.[71] Councillor Carter of the County Councils Network asked for:

> Some additionality given out of the Treasury's headroom to fund those significant demand-led pressures that we have no alternative but to deliver […] Adult social care and children's services would be prime examples of that. The elastic is fully stretched.[72]

Other witnesses were similarly bleak in their assessment of councils' financial positions and we note the National Audit Office's recent finding that the financial position of the

68 Q20
69 Based on the fact that 100 per cent would generate £12–13 billion.
70 Local Government Association [BRR 014], Q14 [Sheila Little], Q20 [Rob Whiteman], Q48 [Janice Gotts]
71 Local Government Association [BRR 014]
72 Q11

sector had "worsened markedly" since 2014, with a growing number of authorities "not manag[ing] within their service budgets and [relying] on reserves to balance their books".[73] ***Given the increasingly difficult financial position of many local authorities, we strongly recommend that, before Revenue Support Grant, Rural Services Delivery Grant, GLA Transport Grant and Public Health Grant are rolled in, local government should be allowed to use the additional revenue gained from 75 per cent retention to fund existing cost pressures.*** This aligns with the position taken by our predecessors who recommended that the additional revenue be used to close any adult social care funding shortfall that exists on implementation of the reforms.[74]

23. Sheila Little of the Society of County Treasurers said that the grants to be funded by additional retained business rates under 75 per cent retention[75] were simply "a different form of funding".[76] She continued:

> When the Government first talked about 100 per cent business rates, they talked about additional new responsibilities to go alongside those. That has slightly changed over time and now the talk is to move to 75 per cent with some additional responsibilities, except that it is not really additional responsibility; it is just a change in the source of funding.[77]

Similarly, Rob Whiteman of CIPFA said that local government wanted to know whether there will be "any net benefit from rate retention or will it be used to cover responsibilities that are transferred in agreement with the Treasury?"[78] As highlighted by Ms Little, when the reforms were first announced in October 2015, the then Chancellor said that they were to come with "new responsibilities"[79] and the first consultation in July 2016 set out several high-level criteria to shape discussions:

- Devolution of a responsibility should build on the strengths of local government;
- Devolution of a responsibility should support the drive for economic growth;
- Devolution of a responsibility should support improved outcomes for service users or local people; and
- Devolution of responsibilities should be made with consideration for the medium-term financial impact on local government.[80]

Respondents to that consultation often stated a preference for any new responsibilities to be linked to economic growth and skills,[81] a theme identified by our predecessors in their interim report.[82] **While the Minister told us that there was "widespread support" for**

73 National Audit Office, Financial sustainability of local authorities 2018, 8 March 2018
74 Communities and Local Government Committee, Adult social care, Ninth Report of Session 2016–17, HC 1103, March 2017
75 Revenue Support Grant, Rural Services Delivery Grant, GLA Transport Grant and Public Health Grant
76 Q4
77 Q14
78 Q4
79 HM Treasury, Chancellor unveils 'devolution revolution', 5 October 2015
80 MHCLG, Self-sufficient local government: 100 per cent Business Rates Retention: Consultation Document, July 2016
81 MHCLG, Self-sufficient local government: 100 per cent Business Rates Retention: Consultation: Summary of responses and Government response, February 2017
82 Communities and Local Government Committee, 100 per cent retention of business rates: issues for consideration, First Report of Session 2016–17, HC241

the grants the Government had decided to transfer,[83] the evidence we heard suggested that local government would prefer to take on new responsibilities which are more closely aligned with the criteria originally articulated by the Government in July 2016. ***As we recommended in paragraph 22, local government should first be allowed to use the additional revenue gained from 75 per retention to fund existing cost pressures. Beyond this point, the Government should ensure that further business rates retention is of net benefit to councils by ensuring that new responsibilities are linked to stimulating and promoting local economic growth, such as employment support and skills services. Responsibilities of this kind should be transferred first.***

Business rate revenue versus need

24. The evidence received by our predecessor Committee and its analysis of the relationship between population growth and business rate revenue led it to conclude that "there is likely to be little or no correlation between changes in business rate revenue and changes in local authority needs".[84] Since then, based on their analysis of tax revenue-raising capacity and assessed spending needs between 2006–07 and 2013–14, the Institute for Fiscal Studies (IFS) has found that:

> The negative correlation and large gaps between tax revenue capacity and assessed spending needs per person suggest that, without significant redistribution of revenues, there would be big divergences in different councils' ability to fund local public services.[85]

Our witnesses frequently referred to this negative correlation, often with reference to the increasing demands placed on authorities' adults and children's social care services.[86] For example, Rob Whiteman of CIPFA said:

> Business rate yield is by nature a property tax on businesses and the yield may follow the economic cycle a little bit, but in a way that some of the pressures we are talking about today—such as care for the elderly, for children and for children going into adult care—are not on the economic cycle.[87]

25. The system is, of course, designed to redistribute revenue—using top ups and tariffs—between councils. However, as these do not increase in real terms and are only updated periodically at a 'reset' and on revaluations, there is scope for divergence in funding between councils. Councillor Fuller of the District Councils Network suggested that over the long term it could be so great "that the wheels will fall off".[88] While more frequent resets would reduce this divergence, they would also lessen the incentives for councils to grow their business rate revenue as the benefits of growth—which some of our witnesses believed needed to be retained for as long as 20 years[89]—would be lost each

83 Q54
84 Communities and Local Government Committee, 100 per cent retention of business rates: issues for consideration, First Report of Session 2016–17, HC241
85 Institute for Fiscal Studies, Spending needs, tax revenue capacity and the business rates retention scheme, March 2018
86 Q20 [Rob Whiteman, Cllr Carter], Q26 [Sheila Little], Q42 [Cllr Fuller]
87 Q12
88 Q41
89 Q46. See also Q15 [Cllr Carter, Cllr Simmonds]

time the system was reset. **We agree with the Minister that there is a "trade off"[90] to be struck over the length of the reset, specifically balancing the need to allow councils to keep business rate growth for as long as possible, thereby preserving incentives, and dealing with divergence in need as frequently as possible.** The research our predecessors commissioned from LG Futures, which compares a five-year reset with an annual reset, illustrated this well; it found that annual resets would allow more up-to-date data to be used and help councils' funding to track assessed need more closely, however the trade-off would be the increased complexity they would bring to the system and the reduced incentive for councils to increase their business rate revenue.[91] The Minister said that more work and consultation was required before the length of the reset, and whether it would be a "hard reset or a partial reset", could be determined, although he did say that there was a "general feeling that the current 10-year reset period is too long".[92] ***As it is a particularly critical feature of the system, we recommend that, at an appropriate point in the consultation process, the Government should publish detailed information for the sector on the design of the reset. It should specifically address how the reset will be designed to ensure that councils with less capacity to grow their business rate revenue and greater potential for growth in needs do not lose out and incentives to grow business rate revenue are preserved.***

26. Councillor Fuller of the District Councils Network suggested that, in the long term, the Government may need to "compensate" councils for demand pressures which increase at a faster rate than business rate revenue.[93] Guy Ware, Director, Finance, Performance and Procurement at London Councils, said the Government needed "either to compensate [councils] or […] to shift some of the powers to raise the resources to do it"[94] (we consider this latter point at paragraphs 37 to 39). We agree, and note that the Government has in recent years provided a series of short-term funding measures to councils in response to adult social care funding pressures, specifically the social care precept, the improved Better Care Fund and the adult social care support grant. ***We believe that similar measures may be required under 75 and 100 per cent retention in response to demand-led funding pressures. Our predecessor Committee recommended that the reformed system will need to be supported by a system of grants for councils affected by increases in need. We also believe that a system of grants will be needed and further recommend that such a system should also support councils which experience significant divergence between their business rate revenue and spending needs. The system may also need to provide grants to councils to take account of any new funding arrangements which result from the reforms to the long-term funding of social care (discussed in further detail in paragraph 44).***

The link between economic growth and growth in business rate revenue

27. As described by Councillor Fuller of the District Councils Network, the ability of authorities to generate and sustain growth in business rates under further rates retention is crucial:

90 Q76

91 LG Futures, Reforming Local Authority Needs Assessment: Paper 4 - Business rates retention and the reset, October 2017

92 Q76

93 Q42

94 Q42

> The article of faith is that if you get the economy going and are quite proactive in managing the market and focused on delivery on your own account as a council, and fingers crossed the Government will allow you, post '20–21, to keep a greater uplift, so we have a forward trajectory of earning cash.[95]

However, the evidence gathered by our predecessors showed that councils were concerned that they would not be able to generate growth due to area characteristics which limited business rate revenue, such as the type of predominant business or the proximity to other established commercial centres.[96] This point was reiterated in evidence to our inquiry; for example, SIGOMA said that there needed to be "a recognition that not all parts of the country are growing at the same pace, in part due to imbalanced infrastructure investment".[97] A comparison by the House of Commons Library of local Gross Value Added (GVA) and the quantity of rateable value in individual local authorities between 2008 and 2015 found the relationship between business rate revenue and local economic growth to be "tenuous".[98] Similar work by the IFS led to their finding that "at least in the recent past, there has not been a clear link between the measure of business rate revenues councils are incentivised to grow and broader local economic growth".[99]

28. When we asked whether the Ministry had any evidence that there was indeed a correlation, the Minister said "we should probably do that analysis over a longer period of time [than the IFS' analysis] and see what the data shows".[100] He said that, for the system to work:

> You need to have a broader view of incentives for behaviour […]. That is important. That is something for us to take away and figure out how best to incorporate […] are we holistically targeting all the things that we would like local authorities to do to drive growth, whether it is broadband connections, or how we fund local enterprise partnerships or the new shared prosperity fund? It is important we get that right. It is a fair point to raise. It is work for us to go away and think about that.[101]

We agree that more work is needed to establish the links between local economic growth and growth in business rate revenue and recommend that, before the end of 2018–19, the Government review the link between the incentives provided by further business rates retention and local economic growth and, as part of this, considers whether councils need to be provided with a wider range of levers and incentives to grow their local economies.

The tax base

29. Under further business rates retention, councils will want to capture the maximum amount of revenue possible from their business rates base. However, as identified by

95 Q42

96 Communities and Local Government Committee, 100 per cent retention of business rates: issues for consideration, First Report of Session 2016–17, HC241

97 SIGOMA [BRR 010]

98 House of Commons Library briefing paper, Property taxation and revenue incentives, 10 February 2017

99 Institute for Fiscal Studies, Spending needs, tax revenue capacity and the business rates retention scheme, March 2018

100 Q65

101 Q65

our predecessors, various factors can affect the level of the tax base—in particular, the application of business rates reliefs and the prevalence of online businesses.[102] These issues were highlighted again in the evidence we received.

30. Various reductions in liability for business rates ('rate reliefs') are available, including charitable relief[103] and Small Business Rate Relief. As of April 2017, the Government made permanent changes to Small Business Rate Relief which, while easing the burden on ratepayers, reduced the amount of business rate revenue available to local government.[104] Alongside this, it announced that, from 2020–21, the multiplier would be uprated by the Consumer Price Index (which is on average lower than the current Retail Prices Index rate). Although acknowledging that the Government has compensated councils for these changes via a section 31 grant, Guy Ware of London Councils made the wider point that these interventions:

> Add up to a deal of complication that comes from a single Treasury trying to manage what will hopefully become a local tax. Up to now, it is not a local tax, but if it is going to be a local tax then Treasury needs to stop trying to intervene at the micro level and reset elements of it, because that makes our life very difficult.[105]

Oldham Council said that, under further business rates retention, the Government needed to ensure that councils would not be "fiscally disadvantaged by decisions taken elsewhere in Government", giving the example of "the transfer of schools to Academy Status triggering an 80 per cent reduction in Business Rates liability for those schools".[106] Janice Gotts of Manchester City Council also highlighted the ongoing claim by NHS Trusts for charitable relief, saying that, if successful, it would "completely wipe out a significant part of [councils'] funding".[107] We note it has been reported that the combined tax rebate claimed, which covers the last six years, amounts to £1.5 billion.[108]

31. **Under further business rates retention, the level and stability of the business rates tax base becomes increasingly important.** ***Given this, we believe that actions by the Government which reduce the amount of business rates available should be limited. In the event that an intervention is necessary, the Government should compensate local government for any resultant loss of business rate revenue. Where an appeal made by a class of ratepayers results in a significant reduction to councils' business rate revenue, the Government should consider providing additional funding to compensate for this.***

32. Online businesses, which usually occupy premises with a low rateable value and of which there are an increasing number, often pay low business rates in proportion to their turnover. The LGA said that consideration needed to be given by the Government to modernising business rates "to ensure that sectors such as online businesses make a fair contribution".[109] Our predecessors also identified this as an issue that needed further

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102 Communities and Local Government Committee, 100 per cent retention of business rates: issues for consideration, First Report of Session 2016–17, HC241

103 Charitable relief entitles properties occupied by charities or used for charitable purposes to an 80 per cent reduction in their business rates.

104 HM Treasury, Budget 2016, March 2016, p46

105 Q46

106 Oldham Council [BRR 016]

107 Q45

108 Local Government Chronicle, Landmark case could save NHS trusts millions in business rates, 16 October 2017

109 Local Government Association [BRR 0014]

consideration in the run up to implementing 100 per cent retention, suggesting that a transaction levy on online retailers could be explored.[110] In his 2017 Budget speech, the Chancellor appeared to indicate that the Government would look at the issue, saying "we have to find a better way of taxing the digital part of the economy—the part that does not use bricks and mortar".[111] However, no announcement has been made as to whether this work has begun. ***Given that business rate revenue will form an increasing share of councils' funding in the coming years, we recommend that the Government considers, without further delay, how to capture revenue from online businesses with a view to strengthening the business rates tax base prior to implementation of 75 per cent retention in 2020–21. The Government should announce how it intends to undertake this work, and the timescales for it, within the next three months.***

The Fair Funding Review

33. The review of the needs assessment formula (the 'Fair Funding Review') is closely linked to the business rates retention reforms. The new formula will set new baseline funding levels[112] for local authorities at the start of 75 per cent retention and each time the system is reset thereafter. For the reasons discussed in paragraphs 24 to 26, ensuring that the needs assessment formula accurately captures current spending needs and can take into account how they change in the future is critical. However, increasing the number of 'cost drivers' in the formula in pursuit of fairness in the allocation of funding leads to greater complexity and less transparency. The charge levelled by witnesses at the current formula was that it was "opaque" and understood by very few people,[113] and therefore potentially open to manipulation by the Government.[114] Councillor Fuller of the District Councils Network said that having a "well known and understood" funding formula would be a "significant advance on where we are, and [...] worth fighting for".[115]

34. Based on feedback to its first consultation, the Government has said that the principles of "simplicity" and "transparency", among others, will guide the work of the Fair Funding Review.[116] Our witnesses emphasised the need to balance the aim of achieving simplicity with ensuring fairness. Councillor Simmonds, Vice Chairman of the LGA, said:

> For me, the key thing is to achieve something that, broadly speaking, as a country we can look at and say, "It may be a bit complex in some areas, and there may be areas that we will have a debate about, but broadly speaking we all agree that it is a fair way of divvying up that cake."[117]

Guy Ware of London Councils said that transparency and simplicity were:

> Ambitions that we would share, but recognising [...] there is a trade-off between simplicity and fairness, if by fairness we mean a recognition of the need to spend in a given area, balanced with the resources that that

110 Communities and Local Government Committee, 100 per cent retention of business rates: issues for consideration, First Report of Session 2016–17, HC241
111 HM Treasury, Spring Budget 2017, 8 March 2017
112 These will determine the amount of business rate revenue councils will retain.
113 Q49
114 Q20
115 Q49
116 MHCLG, Fair funding review: a review of relative needs and resources: Technical consultation on relative need, December 2017
117 Q26

> area can possibly raise. As soon as you have got to that point there is quite a lot of complexity there already […] There has to be some balance, so the key question is whether we can reduce the complexity rather than try to eliminate it, and how robust are the measures that we are going to use to drive the formula?[118]

We note, however, that the research commissioned by our predecessors from LG Futures and published in November 2017 indicated that it may be possible to simplify the needs assessment formula without reducing its precision.[119] They identified a potential method for simplifying the formula which, for five key services, would reduce the number of indicators by almost half while ensuring that half of all authorities would only see their needs assessment result change by 1 per cent or less. The Minister said that the work "illustrated the point perfectly that you can reduce complexity without sacrificing accuracy".[120] **In the interests of increasing transparency, we support the Government's aim for a simpler formula.** ***However, the Government, in consultation with the sector, must balance the competing aim of achieving fairness in the allocation of funding through a comprehensive and accurate assessment of needs and this may necessitate some complexity. We would welcome a full response from the Government in relation to the research undertaken by LG Futures. We believe that their method for reducing the formula's complexity offers the possibility of properly balancing the aims of simplicity and fairness***

35. Witnesses frequently emphasised the need to ensure that the data underlying the needs assessment formula is kept up-to-date and can capture diverging trends across authorities. Sheila Little of the Society of County Treasurers said that the new formula needed to be "futureproof", citing rising pressure on children's services as an example of increasing cost.[121] Guy Ware of London Councils said that, from a London perspective, it was particularly important to keep data on deprivation and population up-to-date.[122] We were therefore pleased that the Minister said he hoped the new formula would be "much more dynamic, to keep in line, potentially every year or over a time period we choose, with changing needs",[123] and we note that the longer implementation period for the Fair Funding Review means that it will be able to take into account the refreshed Index of Multiple Deprivation. However, he pointed out that:

> It is a question of how often we want to do that […] There is a direct trade-off between making it as dynamic as possible, and providing local authorities with some degree of medium term certainty over their funding. Updating it every single year means you cannot do multi-year planning.[124]

We recognise that there is a balance to be struck between the frequency with which the underlying data is updated and maintaining stability for councils' financial planning. ***However, we believe it is essential that the underlying data is reviewed and updated at***

118 Q49
119 LG Futures, Reforming Local Authority Needs Assessment: Paper 1 – Simplifying the Needs Assessment Formula, October 2017
120 Q100
121 Q26. See also Cllr Finch at Q48
122 Q49
123 Q82
124 Q101

reasonably regular intervals to ensure that changing needs are quickly captured and recommend the Government considers whether the beginning of each Spending Review period might be the appropriate point at which to do this

36. Some councils will see their funding change as a result of the Fair Funding Review. Councillor Fuller of the District Councils Network said that "With an apparently constant sum of money on the table, which you have to cut in different ways, there will be winners and losers".[125] Guy Ware of London Councils suggested that, to smooth the impact on some councils which could see "very, very huge changes", there will need to be "some fairly major transitional funding".[126] When we asked the Minister whether this would be available, he said "I would say, of course, there need to be sensible transition measures in place that are fair, transparent and affordable to get us from A to B".[127] We note that, as a result of the education sector's strongly expressed concerns, reform of the national school funding formula has been delayed and the Government has announced that no local authority would see a reduction in their per pupil school or high need block funding in 2017–18. ***To ensure the successful implementation of the Fair Funding Review, we urge the Government to consider, in consultation with the sector, how it will balance the competing demands of councils at this point and, at the earliest opportunity, consult on the mechanism it will use to support councils that see their funding decrease as a result.*** **We note that reallocation of resources is, of course, easier when the overall quantum of funding available is increasing.**

Overall quantum and fiscal devolution

37. Our witnesses often stated that overall quantum of funding available to local government was not sufficient,[128] and SIGOMA suggested that the Fair Funding Review was the opportunity to assess this.[129] To support his argument, Councillor Simmonds of the LGA pointed to children's services: "the rate of referrals has doubled in the last decade as the population has grown, and that is not reflected anywhere in the way that funding is distributed".[130] In addition, he cited working age adults in receipt of social care from the age of 18 onwards as the largest growing pressure. We note the National Audit Office's findings that, from 2010–11 to 2016–17, the number of households entitled to temporary accommodation increased by 33.9 per cent; the number of looked-after children grew by 10.9 per cent; and the estimated number of people in need of care aged 65 and over increased by 14.3 per cent.[131]

38. Rob Whiteman of CIPFA pointed out that local government was currently being funded from a "a very narrow tax base" and that:

> Ultimately local government in England, compared to local government in other parts of the world, actually needs more plurality of resourcing. In other words, it needs to raise its money from a wider range of ways. Tourist tax would favour one area; it doesn't favour another. Being able to have the benefits of stamp duty would help one area; it wouldn't help another. At

125 Q49
126 Q43
127 Q105
128 Q21 [Rob Whiteman], Q49 [Janice Gotts]
129 SIGOMA [BRR 010]
130 Q9
131 National Audit Office, Financial sustainability of local authorities 2018, 8 March 2018

> the moment, these couple of taxes—business rates and council tax—are the only show in town. It isn't the proper way to fund the state locally into the medium and long term.[132]

Furthermore, to counter the risk of divergence between spending needs and business rate revenue in the future (which we discussed at paragraphs 24 to 26), Guy Ware of London Councils said that councils needed:

> A broader tax base in terms of a basket of taxes and a range of ways in which local authorities can raise money, some of which would be transferred from central Government at the moment, either by devolving the tax themselves or by sharing a percentage of the take of those taxes.[133]

This view was shared by our predecessor Committee which, as part of its inquiry on devolution to local government, concluded that fiscal devolution needed to go further than business rates retention, advocating the transfer of further fiscal powers to groups of local authorities.[134]

39. **We believe that the overall quantum of funding available to local government needs to increase to reflect changing demographic trends and ensure sufficient funding for demand-led services, in particular adult and children's social care, and councils' overall financial sustainability. We note that a greater level of overall funding may also be needed in the long term to take account of any extra funding sources which result from the forthcoming reforms to social care, and to establish a system of grants (referred to in paragraph 26) to support councils with divergent business rate revenue and spending needs, Furthermore, as further business rates retention is implemented, councils' main sources of funding will increasingly be business rates and council tax, which are unlikely to grow at the same rate as spending needs.** ***To counter this, the Government should empower councils to raise funding in a wider range of ways. As recommended by our predecessor Committee, we recommend the Government considers devolving other property taxes to local government and larger-scale, more comprehensive fiscal powers to groups of local authorities, including borrowing powers and the future examination of the potential merits of the apportioning of taxes, such as income tax and VAT, set and collected at a national level.***

Appeals

40. Appeals by ratepayers against their business rates bills are a significant concern for many local authorities which are required to set aside part of their business rate revenue as provision for potential revenue losses. Janice Gotts of Manchester City Council said that out of "business rates of £370 million in Manchester […] we have to set aside £37 million for the risk of appeals. It is not an insignificant figure".[135] Some councils with one or a small number of large ratepayers are particularly exposed; as identified by Councillor Simmonds of the LGA, in such cases, "a single decision […] can have a massive impact of the viability of local services".[136] Our predecessor Committee identified appeals as a major challenge

132 Q30

133 Q49

134 House of Commons Communities and Local Government Committee, Devolution: the next five years and beyond, First Report of Session 2015–16, HC 369

135 Q45. See also SIGOMA [BRR 010]

136 Q17. See also Cllr Fuller at Q48

to 100 per cent retention and recommended the issue be resolved before implementation of the reforms.[137] The Local Government Finance Bill would have provided a mechanism for this. It would have empowered the Secretary of State to make regulations concerning 'loss payments' for reductions in rating income resulting from appeals. These would have been funded by top-slicing an amount of funding from the business rate system before tariffs and top-ups were set.

41. We asked the Minister how appeals would be dealt with in the absence of the Bill. He said that there was "strong appetite"[138] from the sector for "some form of centralised risk sharing",[139] the detail of which would be outlined in a technical paper to be published in the spring. He outlined the approach:

> What the sector has proposed, which is a sensible idea, is to develop some form of centralised risk sharing. Rather than you, as a local authority, taking the risk individually of what may or may not happen with business rate appeals, which are largely out of your control, those should be centralised for the sector, so that there is a common insurance pool and local authorities individually will not bear the brunt of an adverse set of opinions that they had nothing to do with. They all seem to want that. As an industry, they will self-insure themselves.[140]

We note that Councillor Fuller of the District Councils Network suggested that the central list could "act as a bit of a co-responsibility pot" with "some sort of central mechanism to split it".[141]

42. **We believe, as our predecessors did, that appeals pose a significant risk to councils' business rate revenue and a major challenge to further business rates retention.** ***The Government should therefore provide immediate assurances to local government that the risk from appeals will be significantly reduced before further business rates retention is implemented. We welcomed the provisions in the original Bill which would have established a mechanism for dealing with appeals but appreciate that a different approach is now needed. Given the change of approach and in the interests of clarity and transparency, the Government should explain how the new mechanism for dealing with appeals will work, how it differs from the mechanism set out in the Bill and what the relative merits of each approach are. To reassure the sector, the Government should publish this information within the next three months.***

43. The Valuation Office Agency (VOA) sets rateable values at revaluations and manages appeals. According to the Institute of Ratings, Revenue and Valuation (IRRV), councils are "totally reliant on the VOA to value and process new properties on the valuation list so that they can maximise income and cash flow".[142] We heard concerns about the VOA's ability to manage its volume of work and its poor service resulting from lack of investment and reduced staffing,[143] also considered recently in the trade press.[144] Councillor Finch of

137 Communities and Local Government Committee, 100 per cent retention of business rates: issues for consideration, First Report of Session 2016–17, HC241
138 Q57
139 Q86
140 Q86
141 Q48
142 Institute of Revenues, Rating and Valuation [BRR 004]
143 Institute of Revenues, Rating and Valuation [BRR 004]
144 Local Government Chronicle, Tony Travers: Tax workforce cut bodes ill for local reform, 11 October 2017

Essex County Council said that as many as 250,000 appeals had been unresolved since 2010 which he said was a "significant issue in terms of what impact it may have on local government funding".[145] The Minister's response to these concerns was that:

> It is important for me that we clear that backlog of appeals as quickly as possible. My expectation is that, by the time we get to the new system, that whole backlog will have been cleared. That, I think, is the VOA's expectation as well.[146]

He also said that the new 'Check, Challenge, Appeal' process, which was introduced in April 2017 to manage the flow of cases through the system, should "reduce the call on [the VOA's] resources".[147] However, the evidence we received suggested that, at least in its first year, this had not been the case; Janice Gotts of Manchester City Council said that there were "teething difficulties" with the process,[148] SIGOMA said that it was "not capturing appeals in a timely manner"[149] and the IRRV said that "very low numbers of checks [had been] undertaken by ratepayers and their agents, due to the difficulties in using the system".[150] We were reassured by the letter we received from the Minster on 12 April 2018 following his recent meeting with the Chief Executive of the Valuation Office Agency in which he described its efforts to improve its performance and reduce the backlog of appeals.[151] **However, we emphasise that the Valuation Office Agency must be able to meet the demands of the reformed system.** ***We recommend that the Government should work with the Valuation Office Agency to ensure that the backlog of appeals is eliminated by April 2020 and consider whether it is sufficiently resourced to cope with the demands to be placed upon it. The Government should also monitor the extent to which Check, Challenge, Appeal is reducing the volume of appeals, and by May 2018 provide the Committee with an evaluation of its performance over its first 12 months.***

The adult social care Green Paper

44. Adult social care is currently councils' largest area of discretionary spend, comprising over a third (36.9 per cent, £14.4 billion) of their spending in 2017–18.[152] As further business rates retention is implemented, councils' main sources of funding for social care will increasingly be council tax and business rates, with the latter distributed according to need as determined by the outcome of the Fair Funding Review. At the same time as reforming local government funding, the Government has embarked on a process of reforming social care funding and plans to publish a social care Green Paper by the 2018 summer recess.[153] A parallel programme of work will focus on "issues specific to working-age adults with care needs".[154] Our witnesses emphasised the links between these work streams. Councillor Carter of the County Councils Network said that the reforms to local government funding must "most importantly—marry together with the social care Green

145 Q48
146 Q58
147 Q90
148 Q45
149 SIGOMA [BRR 010]
150 Institute of Revenues, Rating and Valuation [BRR 004]
151 Letter of 12 April 2018 from the Minister for Local Government to the Chair, reported to the House on 18 April 2018
152 Association of Directors of Adult Social Care, Budget Survey 2017, June 2017
153 HCWS258, 16 November 2017
154 HCDeb, vol 632, col 1235, 7 December 2017

Paper […] The two are so inextricably linked".[155] He said that, in this respect, the longer implementation period for the Fair Funding Review was beneficial, highlighting again how closely linked the reforms were:

> We also need to consider what is going to be in the Green Paper on adult social care, and what the changes to entitlements may be. If the thresholds change fundamentally for being able to access state-supported domiciliary care provision and so on, my answer to your question will be, "It's a good job we haven't worked out a whizzo-bang formula", because suddenly a massive grenade will have gone off. It will mean having to superimpose a new method of funding social care on those potentially changing entitlements.[156]

When we asked the Minister whether the connections were being made, he said "Not that I am aware of. The Green Paper process is separate to any of this".[157] However, he also said that the outcome of the Green Paper would "feed into how we design our business rates system or what the prospect of retention in future might be"[158] and that it would "obviously have implications for local authorities' future rates of retention, etc.".[159] **We believe that there are important and very clear links between the reforms to local government funding and the reforms to the funding of social care.** ***The Government should therefore ensure that, in preparing the social care Green Paper, proper consideration is given to how the ongoing reforms to local government funding will affect the funding available for social care, as well as to how the funding reforms to social care will impact on local government funding. This should be reflected in the contents of the Green Paper itself.***

155 Q2. See also Cllr Simmonds at Q10
156 Q27
157 Q108
158 Q108
159 Q109

Conclusions and recommendations

Uncertainty over long-term reform

1. We believe that uncertainty about whether 100 per cent retention would proceed following the 2017 general election and the lapse of the Local Government Finance Bill has negatively affected councils' financial planning. Councils have been either unable to make financial plans for 2020–21 or have understandably made pessimistic budget assumptions that could unnecessarily impact on service levels. They have also taken a cautious approach to investment decisions which potentially has implications for their ability to generate additional business growth and make gains under further business rates retention. Pilot areas also face continued uncertainty over whether they would continue to pilot 100 per cent retention in 2019–20, which has had an impact on their financial planning. (Paragraph 14)

2. The confirmation by the Government in December 2017 of 75 per cent retention in 2020–21 was helpful but we believe that councils' financial planning will continue to be affected until more information is made available. We recognise that the consultation process is ongoing and that there is still a significant amount of work ahead. *However, given there has been a significant period of delay, the Government should take steps to reduce any further uncertainty to councils in the run up to implementation of 75 per cent retention and the outcome of the Fair Funding Review. This is particularly important in the context of the ongoing funding pressures that councils are experiencing. To this end, we recommend that the Government:*

    - *Immediately publishes a timeline for the forthcoming consultations and the key milestones to implementation of 75 per cent retention and the outcome of the Fair Funding Review;*

    - *With reference to this timeline, provides quarterly progress updates to the sector through the Local Government Association-led Steering Group and in writing to all councils;*

    - *Ensures that councils receive indicative figures for the impact of 75 per cent retention for their individual authority by spring 2019 and final figures by summer 2019 at the latest;*

    - *Consults local authorities on the arrangements for transitional funding at the earliest opportunity; and*

    - *Makes clear its intention as to whether it intends to reintroduce legislation for 100 per cent retention and, if it does, sets out a clear time frame for implementation of 100 per cent retention so councils can plan accordingly.* (Paragraph 19)

3. *Given that the original intention of the reforms was for local government to retain 100 per cent of business rates, the Government should explain the reasons for its decision to allow councils to retain only 75 per cent of business rates in the short term, thereby limiting the potential gains available to them, rather than the maximum amount possible without primary legislation.* (Paragraph 20)

Issues for further consideration

4. *We recommend that, prior to implementing 75 per cent business rates retention, the Government gives further consideration to each of these issues [referred to in paragraph 21] and takes specific action where we have identified that it is needed.* (Paragraph 21)

5. *Given the increasingly difficult financial position of many local authorities, we strongly recommend that, before Revenue Support Grant, Rural Services Delivery Grant, GLA Transport Grant and Public Health Grant are rolled in, local government should be allowed to use the additional revenue gained from 75 per cent retention to fund existing cost pressures.* (Paragraph 22)

6. While the Minister told us that there was "widespread support" for the grants the Government had decided to transfer, the evidence we heard suggested that local government would prefer to take on new responsibilities which are more closely aligned with the criteria originally articulated by the Government in July 2016. *As we recommended in paragraph 22, local government should first be allowed to use the additional revenue gained from 75 per retention to fund existing cost pressures. Beyond this point, the Government should ensure that further business rates retention is of net benefit to councils by ensuring that new responsibilities are linked to stimulating and promoting local economic growth, such as employment support and skills services. Responsibilities of this kind should be transferred first.* (Paragraph 23)

7. We agree with the Minister that there is a "trade off" to be struck over the length of the reset, specifically balancing the need to allow councils to keep business rate growth for as long as possible, thereby preserving incentives, and dealing with divergence in need as frequently as possible. *As it is a particularly critical feature of the system, we recommend that, at an appropriate point in the consultation process, the Government should publish detailed information for the sector on the design of the reset. It should specifically address how the reset will be designed to ensure that councils with less capacity to grow their business rate revenue and greater potential for growth in needs do not lose out and incentives to grow business rate revenue are preserved.* (Paragraph 25)

8. *We believe that similar measures may be required under 75 and 100 per cent retention in response to demand-led funding pressures. Our predecessor Committee recommended that the reformed system will need to be supported by a system of grants for councils affected by increases in need. We also believe that a system of grants will be needed and further recommend that such a system should also support councils which experience significant divergence between their business rate revenue and spending needs. The system may also need to provide grants to councils to take account of any new funding arrangements which result from the reforms to the long-term funding of social care (discussed in further detail in paragraph 44).* (Paragraph 26)

9. *We agree that more work is needed to establish the links between local economic growth and growth in business rate revenue and recommend that, before the end of 2018–19, the Government review the link between the incentives provided by further business rates retention and local economic growth and, as part of this, considers whether councils need to be provided with a wider range of levers and incentives to grow their local economies.* (Paragraph 28)

10. Under further business rates retention, the level and stability of the business rates tax base becomes increasingly important. *Given this, we believe that actions by the Government which reduce the amount of business rates available should be limited. In the event that an intervention is necessary, the Government should compensate local government for any resultant loss of business rate revenue. Where an appeal made by a class of ratepayers results in a significant reduction to councils' business rate revenue, the Government should consider providing additional funding to compensate for this.* (Paragraph 31)

11. *Given that business rate revenue will form an increasing share of councils' funding in the coming years, we recommend that the Government considers, without further delay, how to capture revenue from online businesses with a view to strengthening the business rates tax base prior to implementation of 75 per cent retention in 2020–21. The Government should announce how it intends to undertake this work, and the timescales for it, within the next three months.* (Paragraph 32)

12. In the interests of increasing transparency, we support the Government's aim for a simpler formula. *However, the Government, in consultation with the sector, must balance the competing aim of achieving fairness in the allocation of funding through a comprehensive and accurate assessment of needs and this may necessitate some complexity. We would welcome a full response from the Government in relation to the research undertaken by LG Futures. We believe that their method for reducing the formula's complexity offers the possibility of properly balancing the aims of simplicity and fairness.* (Paragraph 34)

13. We recognise that there is a balance to be struck between the frequency with which the underlying data is updated and maintaining stability for councils' financial planning. *However, we believe it is essential that the underlying data is reviewed and updated at reasonably regular intervals to ensure that changing needs are quickly captured and recommend the Government considers whether the beginning of each Spending Review period might be the appropriate point at which to do this.* (Paragraph 35)

14. *To ensure the successful implementation of the Fair Funding Review, we urge the Government to consider, in consultation with the sector, how it will balance the competing demands of councils at this point and, at the earliest opportunity, consult on the mechanism it will use to support councils that see their funding decrease as a result.* We note that reallocation of resources is, of course, easier when the overall quantum of funding available is increasing. (Paragraph 36)

15. We believe that the overall quantum of funding available to local government needs to increase to reflect changing demographic trends and ensure sufficient funding for demand-led services, in particular adult and children's social care, and councils' overall financial sustainability. We note that a greater level of overall funding may also be needed in the long term to take account of any extra funding sources which result from the forthcoming reforms to social care, and to establish a system of grants (referred to in paragraph 25) to support councils with divergent business rate revenue and spending needs, Furthermore, as further business rates retention is implemented, councils' main sources of funding will increasingly be business rates and council tax, which are unlikely to grow at the same rate as spending needs. *To*

counter this, the Government should empower councils to raise funding in a wider range of ways. As recommended by our predecessor Committee, we recommend the Government considers devolving other property taxes to local government and larger-scale, more comprehensive fiscal powers to groups of local authorities, including borrowing powers and the future examination of the potential merits of the apportioning of taxes, such as income tax and VAT, set and collected at a national level. (Paragraph 39)

16. We believe, as our predecessors did, that appeals pose a significant risk to councils' business rate revenue and a major challenge to further business rates retention. *The Government should therefore provide immediate assurances to local government that the risk from appeals will be significantly reduced before further business rates retention is implemented. We welcomed the provisions in the original Bill which would have established a mechanism for dealing with appeals but appreciate that a different approach is now needed. Given the change of approach and in the interests of clarity and transparency, the Government should explain how the new mechanism for dealing with appeals will work, how it differs from the mechanism set out in the Bill and what the relative merits of each approach are. To reassure the sector, the Government should publish this information within the next three months.* (Paragraph 42)

17. However, we emphasise that the Valuation Office Agency must be able to meet the demands of the reformed system. *We recommend that the Government should work with the Valuation Office Agency to ensure that the backlog of appeals is eliminated by April 2020 and consider whether it is sufficiently resourced to cope with the demands to be placed upon it. The Government should also monitor the extent to which Check, Challenge, Appeal is reducing the volume of appeals, and by May 2018 provide the Committee with an evaluation of its performance over its first 12 months.* (Paragraph 43)

18. We believe that there are important and very clear links between the reforms to local government funding and the reforms to the funding of social care. *The Government should therefore ensure that, in preparing the social care Green Paper, proper consideration is given to how the ongoing reforms to local government funding will affect the funding available for social care, as well as to how the funding reforms to social care will impact on local government funding. This should be reflected in the contents of the Green Paper itself.* (Paragraph 44)

Formal minutes

Tuesday 17 April 2018

Members present:

Clive Betts, in the Chair

Mike Amesbury	Mr Mark Prisk
Helen Hayes	Liz Twist
Andrew Lewer	Matt Western

Draft Report *(Business rates retention)* proposed by the Chair, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 44 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Monday 23 April at 3.45 p.m.

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Monday 5 February 2018

Councillor Paul Carter, Chair, County Councils Network, **Sheila Little**, President, Society of County Treasurers, **Councillor David Simmonds CBE**, Vice Chairman, Local Government Association, and **Rob Whiteman**, Chief Executive, Chartered Institute of Public Finance and Accountancy Q1–35

Councillor David Finch, Leader, Essex County Council, **Councillor John Fuller**, Chairman, District Councils Network, **Janice Gotts**, Deputy City Treasurer, Manchester City Council, and **Guy Ware**, Interim Director, Finance, Performance and Procurement, London Councils Q36–50

Monday 5 March 2018

Rishi Sunak MP, Minister for Local Government, Ministry of Housing, Communities and Local Government Q51–119

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

BRR numbers are generated by the evidence processing system and so may not be complete.

1 County Councils Network (BRR0008)

2 Department for Communities and Local Government (BRR0019)

3 District Councils Network (BRR0009)

4 Doncaster Council (BRR0013)

5 Essex County Council (BRR0005)

6 Gateshead Council (BRR0006)

7 Hft (BRR0017)

8 Institute of Revenues, Rating and Valuation (BRR0004)

9 Kent County Council (BRR0011)

10 Kettering Borough Council (BRR0007)

11 Lichfield District Council (BRR0001)

12 Local Government Association (BRR0014)

13 Manchester City Council (BRR0018)

14 National Organisation of Residents Associations (BRR0002)

15 Newcastle City Council (BRR0015)

16 Oldham Council (BRR0016)

17 Sedgemoor District Council (BRR0003)

18 SIGOMA (BRR0010)

19 Southampton City Council (BRR0012)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2017–19

First Report	Effectiveness of local authority overview and scrutiny committees	HC 369 (CM 9569)
Second Report	Housing for older people	HC 370
Third Report	Pre-legislative scrutiny of the draft Tenant Fees Bill	HC 583
Fourth Report	Private rented sector	HC 440
Sixth Report	Pre-legislative scrutiny of the draft Non-Domestic Rating (Property in Common Occupation Bill)	HC 943