Resets: Business Rates Income Model

POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

100% Business Rates Retention

Systems Design Working Group: 27 June 2018

Technical paper 4: Resets

1 Introduction

1.1 On 5 July 2016, the Department for Communities and Local Government (DCLG) published a consultation paper, Self Sufficient Local Government: 100% Business Rates Retention. Following this, on the 15 February 2017, DCLG, published a further consultation paper, 100% Business Rates Retention: Further Consultation on the Design of the Reformed System.

1.2 These set out proposals for a rates retention scheme to replace the current local government finance system, under which local authorities pay a central share of 50% of their business rates income to be redistributed as grants.

1.3 The consultation papers outlined the principle features of the proposed greater rates retention scheme. A summary of responses received to the Further Consultation was published alongside the 2018/19 Provisional Settlement on 19 December 2017.

1.4 Following the fall of the Local Government Finance Bill, MHCLG (formerly DCLG) will be developing a package of reforms, in close collaboration with the sector, that further the manifesto commitment to continue to allow local government greater control over the money it raises. Reforms to the design of the system will seek to make improvements to the functionality and stability of Local Government Finance.

1.5 A commitment was made to the Steering Group and Technical Working Group that a series of technical papers would be shared with the Technical Working Group for discussion and published on the Local Government Association (LGA) website. A suggested forward look of these was shared with the Working and Steering Groups in November 2017.

1.6 Taken together these technical papers will raise a number of questions about the proposed rates retention scheme, on which the Government is seeking views.

1.7 This is one of seven core technical papers. The full list is:

Paper 1:	The Central and Local Rating Lists
Paper 2:	The Safety Net, Levy & Tier Splits - Risk and Gearing
Paper 3:	Appeals and Loss Payments
Paper 4:	**Resets**
Paper 5:	Transitional Arrangements
Paper 6:	Pooling

Paper 7: Proposed Overall Short Term Package and Future Reform Using Primary Legislation

1.8 We expect that these will be supplemented by other papers in response to Technical Working Group discussions. Additional papers will be announced as need for them arises.

2 The model

2.1 The Department (MHCLG) has created an analytical model to inform the policy development of the business rates retention system. The Business Rates Income Model (BRIM) provides an illustrative analytical output for the implication of certain business rates retention design options, for example:

- Types of resets
- Safety net types and thresholds
- Varying tier splits

2.2 It does not aim to predict any individual local authority's income from the scheme, but rather demonstrate the relationships between scheme choices and local authority income. The focus of the model should therefore be on how income changes in response to different choices about how the scheme operates, rather than the monetary value of income for particular authorities. The Department will not use the model to share individual authority outputs. This paper summarises the key issues emerging from the analysis to inform discussion of the system design options.

2.3 The BRIM creates business rates receipts forecasts which are based on many simulations using historic business rates receipts data. The historic data is split into local authority groupings using statistical analysis based on the degree of past business rates volatility. These statistical groupings are used to generate 1000 simulations of forecast receipts at the local authority level. We then select a few of those simulations to represent different growth scenarios.

3 Reset options

3.1 The policy options considered by our analysis have been chosen to reflect a broad range of reset options and are not indicative of the Government's intentions. This paper does not consider how options might be operationalised. Previously, the Government has consulted on partial resets and the sector generally supported that option. A 50% partial reset was analysed for illustrative purposes, but decisions about whether to use a partial reset and how much would be retained if it was used have not been taken and will require more work, including discussion at this group.

3.2 The analysis explored the relationship between resets policy and income from the rates retention scheme. We have developed a model that uses historic data on rates receipts to simulate many different receipts growth scenarios. Discussion here focusses on the effects by type of authority, rather than named authorities since the model does not predict outcomes for particular authorities. Rather, it illustrates the sensitivity of incomes to different policy choices for different types of authority.

3.3 The reset options covered by our analysis so far are as follows:

a. **No reset**: Covered as a benchmark to compare other reset options against. Business rates baseline (BRBs) and Baseline Funding Levels (BFLs) are held constant over the whole period.

b. **5 yearly full resets:** BRBs and BFLs are held constant for five years and then reset such that all growth retained over the previous period is redistributed to the sector, rather than remain with local authorities.

c. **5 yearly partial resets:** BRBs and BFLs are held constant for five years and then reset such that half of growth retained over the previous period is redistributed to the sector, with the other half remaining with local authorities. Where authorities experience decline in their rates they do not retain this between resets.

d. **Phased (or lagged) resets:** Authorities retain each year's growth in rates for five years and thereafter that growth is redistributed to the sector on the basis of need.

e. **Rolling reset:** BRBs and BFLs are reset each year reallocating any growth on the basis of need. BRBs are based on the average receipts from the previous five years.

3.4 The actual receipts retained by local government at resets would in practice be determined at future spending reviews, and therefore this modelling is purely illustrative. Because we cannot anticipate the outcome of future spending reviews we have taken the simplifying assumption that all business rates receipts will be retained by the sector. This is a modelling assumption only.

4 Desirable criteria

4.1 The chosen reset policy should strike the correct balance between the following desirable criteria:

- **Conceptually simple**: How easy is it for LAs to understand how the resets work? Is the policy intention clear and would the calculations be transparent enough to allow LAs to check them?

- **Operationally simple**: How easy is it to implement the reset for Local and Central Government? Is there an extra burden placed on LAs in terms of collecting data or following the changes to baselines?

- **Rewards growth**: To what extent do LAs keep the proceeds from growth? How much growth in rates stays with the local authority that raised it and for how long?

- **Stability/certainty**: By how much does income from rates retention vary year-on-year and at a reset?

- **Minimises gaming**: Remove the benefit from artificially delaying growth or altering appeals provisions to manipulate business rates baselines.

- **Resources available for need**: How much resource is available to be redistributed on the basis of need?

- **Sensitivity to receipts growth**: How much does income vary depending on receipts growth?

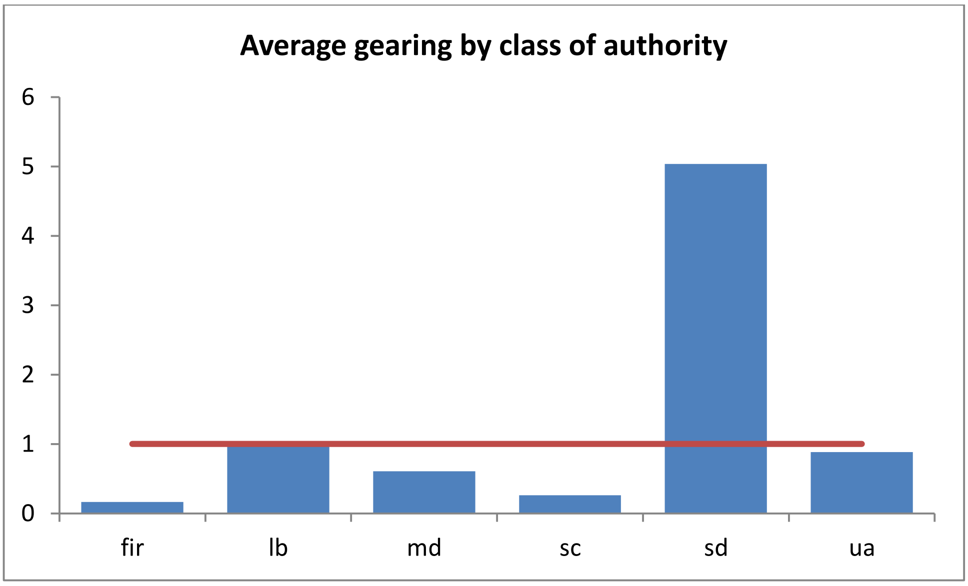
5 Issues emerging from initial analysis

<u>Gearing</u>

5.1 The level of gearing is more important in determining how authority incomes vary with business rates receipts than the choice of reset option. Regardless of reset option, the income of highly geared authorities is much more responsive to changes in business rates receipts than lowly geared authorities.

5.2 Gearing is calculated as an authority's Business rates baseline divided by their Baseline Funding Level. If an authority's gearing is > 1 (i.e. their BRB is higher than their BFL) they pay a tariff and if gearing is < 1 (i.e. their BRB is lower than their BFL) they receive a top-up. Chart 1 shows that Shire Districts are highly geared, London Boroughs are next highest (albeit due to two large outliers) but that all other classes of authority are top-ups on average. This then means that Shire District incomes are very responsive to changes in receipts but that Counties and Fire & Rescue Authorities are not.

Chart 1



5.3 This gearing effect means that lowly geared authorities are likely to do better from reset options that allocate more receipts on the basis of need, rather than rewarding growth. Similarly, highly geared authorities that are expecting growth would benefit more from options that are more balanced towards rewarding growth.

Redistribution vs. rewarding growth

5.4 The various reset options are more or less weighted to redistribution as opposed to rewarding growth in receipts. Partial resets and phased resets reward growth more than full and rolling resets. However, with the exception of no resets where all growth is retained locally, the majority of receipts are redistributed according to need regardless of the reset option. This balance between redistribution and rewarding growth can be adjusted for partial resets by changing the amount retained at reset or by extending the number of years for which you retain growth for the phased reset option.

Differences between authorities of the same type

5.5 As expected, there is significant variation in Non-domestic rating income (NDRI) between growth scenarios. However, there is still significant variation in NDRI between authorities for a given growth scenario. For London Boroughs and Shire Districts, NDRI varies quite significantly between the authorities with highest and lowest NDRI. For Unitary Authorities, Shire Districts and

London Boroughs the strongest growing authorities seem to be large outliers, whereas for the other classes the authorities are more evenly spread.

Safety net payments

5.6 Whilst safety net payments are highest in the very low growth scenarios, the lowest safety net payments are not necessarily associated with the highest growth scenarios. This indicates that the distribution of growth (i.e. whether it is highly or lowly geared authorities that are experiencing growth) is as important as the level of growth in determining safety net payments.

6 Questions for the group

6.1 Does the working group believe the criteria presented in this paper are correct? Which criteria are missing?

6.2 Which criteria do the working group consider the most (and least) important?

6.3 How well do the reset options presented above fare against these criteria?