LONDON COUNCILS

GREATER**LONDON**AUTHORITY

"Self-sufficient local government: 100% Business Rates Retention"
A joint consultation response by London Councils and the Greater London Authority: Summary

1. This paper summarises the joint position on how London Government believes the 100% business rates retention reforms should be implemented in London in order to benefit not just the capital but the local government sector – and the UK economy - as a whole. It summarises the (much longer) accompanying full consultation response. This develops a set of key principles that were agreed by London Councils Leaders' Committee and the Mayor of London in June, and formally submitted to the Chancellor of the Exchequer and the Secretary of State for Communities and Local Government on 1st July.

Rationale for London devolution

2. The Government's proposals to localise business rate income create an opportunity to secure devolved responsibility for an important strand of local government funding – to which London has a long-standing commitment. Developing a successful London approach will help protect and promote economic growth in the capital - and therefore in the UK as a whole - will secure funding for public services and strategic infrastructure investment, and will support local public sector reform and enhance the accountability of London Government to its business taxpayers.

3. In order to achieve this, however, it will be necessary to recognise that London's circumstances may require different solutions to other parts of the country, and that those solutions require joint and collective approaches by all parts of London Government. It will also be important to overcome some of the key flaws of the existing business rates system.

4. London's economy is vital to the success of the UK as a whole. Maintaining London's growth during a period of uncertainty in which the UK will leave the EU will be a huge challenge. In 2014-15 London generated around £140 billion in tax – exceeding the cost of public services in the capital by an estimated £45 billion. But London's economy – and its business rate tax base – is different to the rest of the country: with only 16% of England's business premises, it currently generates around 30% of business rate income; 68% of those rates come from office and retail premises, compared to only 43% elsewhere.

5. London's population will grow at double the rate of the rest of England (24% compared to 12%) by 2039 – to over 11 million. This brings opportunities and challenges not only in the successful management of the capital's economic growth, but also in securing a sustainable financial future for its public services. In considering the future assessment of relative needs and the services to be transferred, it will be essential that any London deal secures genuinely devolved control over a level of resources sufficient to manage the financial risks involved.

6. Devolving business rates (and other revenue streams) will help build a joint, city-wide approach that can incentivise, prioritise and manage the public services and

infrastructure investment London needs to continue its contribution to the public life and economic success of the UK.

7. Two key elements of the current system could undermine the Government, and London's, ambition to use business rates to provide incentives and rewards for promoting growth: appeals and revaluations.

8. The effect of appeals – particularly in London – has been to undermine the benefit of growth, to introduce an unacceptable degree of uncertainty in funding and to tie up vast amounts of resources in provisions for successful appeals.

9. Under the current system, where the total business rates yield is fixed at the national level, revaluations act as a redistribution mechanism over and above the resetting of business rates and funding baselines. This will be brought home in the impact of the revaluation due to come into effect in April 2017. In areas in which property values rise faster than the national average, rates paid by businesses will rise, while those paid in other areas will fall. This has two interrelated consequences which potentially undermine the Government's policy objective. Firstly, the burden of business rates will fall on a smaller and smaller number of businesses (we estimate that, under current arrangements, London businesses' contribution would double from 30% to 60% of the total). Secondly, the taxbase in areas with lower rates of property market growth is artificially depressed, thus leaving local authorities in those areas increasingly reliant on top-up funding and increasingly unable to benefit from the economic growth they are seeking to promote.

10. The difficult balance between rewarding growth and reflecting needs in local government funding is also made harder by a national approach which seeks to address the issues of authorities of hugely different scale, geography, demography and economic activity. The result is complex, opaque and promotes unhelpful division. A more devolved approach could improve clarity and accountability.

11. London's proposals, as set out in the fourteen "asks" summarised below, would help address these problems in ways that would not only help London manage its future sustainable economic growth, and the financial sustainability of its local public services, but would benefit local government in the country as a whole.

Retention level

12. The level of rates retained is inextricably linked with the additional responsibilities to be funded (see Ask 2 below). Following the 2017 revaluation it is likely that London's rates will exceed current spending responsibilities (including those agreed for transfer in April 2017) by around £4 billion. Transferring additional spending responsibilities to match these resources would maintain "fiscal neutrality" ensuring that neither the government nor the rest of the local government sector is financially disadvantaged. It could also provide the opportunity to pilot devolution approaches across a range of services. The headroom anticipated would be sufficient to fund all of the grants and services London would seek to transfer (see Ask 2).

13. If however, the agreed national approach requires a lower level of transfer and a continued contribution from London, this should be calculated as a single aggregate tariff for London, based on regional business rate and funding calculations (see Ask 7). London Government would then take responsibility to manage top-ups and tariffs to balance to zero *within* London.

Ask 1 – London Government seeks to explore full retention of the business rates collected in the capital by 2020; if London does not retain 100 per cent of its business rates, we ask that the tariff is one single payment at the aggregate London level

Additional responsibilities

14. The Government consultation identifies a list of grants and services for potential transfer. London would seek the transfer of those responsibilities which best support its ability to promote economic growth and implement local public sector reform. As stated above, the future level of business rates in London would be sufficient to fund all of these within the capital (see Annex 1 for details); but the same is not true for the country as a whole. If the level of transfers has to be scaled to match the national total of business rates (rather than, say, Government identifying additional budgets to devolve) London's priorities would be to transfer those responsibilities which best support its ability to promote growth and implement local public sector reform.

Ask 2 – London Government would prioritise the transfer (over and above what has already been decided) of:

- ***Skills - 16-19 funding***
- ***Adult Education Budgets***
- ***Careers Service***
- ***Work and health programme***
- ***Capital funding for Affordable Housing; and***
- ***Early Years funding***

15. Devolution should be an on-going process, not confined to those services which can be funded by current business rates. Any future transfers should be accompanied both genuine transfer of control of the services concerned as well as clarity about future funding – whether through increased business rates yield, other devolved taxes or government grant.

Ask 3 - London Government would wish to agree prior to the start of the 100 per cent retention system a robust mechanism for negotiating and agreeing with central government any new responsibilities that are to be delivered in the capital beyond 2020

Revaluations and Resets: balancing needs and resources

16. As indicated in paragraph 9, the current revaluation system distorts both the economic effectiveness of the tax and the tax base of local authorities around the country: in future that tax base should rise or fall in line with economic performance. London believes that sub-national areas that can show to government they are willing and capable of delivering devolved control of business rates should be allowed to benefit from increases, and manage the risk of decreases, in their tax base arising from changes in valuation. Breaking the link between revaluation and the fixed quantum of tax yield benefits both those areas where commercial property markets are strong and

those where they are not. Where values rose, local authorities would be able to fund additional investment or services, or reduce the multiplier while maintaining current expenditure levels. This would both underpin devolved local government and improve local political accountability.

Ask 4 - London Government asks that the Government considers ending the principle of "fixed yield" revaluations, and that London's business rates be "de-coupled" from the national valuation system.

17. Government is considering changes to the frequency of valuations and the appeals process they inevitably generate. However, accountability for the accuracy and timeliness of decisions would still not be aligned with their impact on local authorities' finance. Once London's rates were "de-coupled" from the national valuation system, greater alignment could be achieved by a corresponding devolution of the valuation process to match devolved control and accountability for raising rates.

Ask 5 - London Government calls for the ability to determine its own valuation system to be administered by a regional valuation office for London.

18. Finding the appropriate balance between risk and reward - meeting need and incentivising growth - is perhaps the biggest challenge in setting up the 100 per cent retention system. We believe that, within a London retention system, the frequency of resets of business rate and funding baselines should be determined locally by London Government. We would seek to manage future resets taking into account the overall balance between spending need, council tax base, the speed of change and the desire to maintain incentives within a devolved system. We think that it may be possible to reset funding and business rates on different timetables, for example with business rates baselines being set over a longer period (10 years for example) and funding baselines being reset more frequently (every 3 years for example), and would explore options around this.

Ask 6 – London Government calls for the ability to manage future resets of business rate and funding baselines, and their impact, within London.

19. Measuring relative need to spend will be a key factor in any reformed system that balances authorities' capacity to spend and raise tax. There is common agreement across the sector that any new needs assessment system should be less complex and more responsive to changes than the current system. A potential solution could involve a two-stage approach to assessing need. The first stage would be an assessment of needs at a suitable sub-national level, followed by a more local/sub-regional approach to allocate within these areas.

20. Such an approach would:
    - be less complex and therefore more transparent;
    - be more responsive to population changes; and
    - give London boroughs and the GLA more collective ownership over the process and therefore would build trust that the system is fair.

Ask 7 – London Government proposes a two-stage process in which a regional needs assessment for the capital would be combined with the ability to vary a needs formula within London over time to reflect local circumstances.

Determining the allocation of resources between tiers of London Government

21. The allocation of resources in London should follow the responsibilities to be funded. The starting point should therefore be the agreed transfer of responsibilities: any future revisions should be periodically agreed and managed by London Government.

Ask 8 – London Government asks for the ability to decide collectively for itself how business rates are shared between the boroughs and the GLA.

Setting Business Rates – flexibilities

22. London Government would wish to explore options for either a collectively agreed single multiplier across London, or two separate multipliers with the Mayor of London being granted the ability to set a proportion of the rate on a London wide basis, and boroughs collectively setting the rest of the multiplier.

23. Following successful implementation of a London scheme, however, we would want to explore with Londoners how this could be developed towards full control of rate setting – including the safeguards that would be required to prevent a disproportionate tax burden on business – along with a broader range of fiscal devolution as envisaged by the London Finance Commission.

Ask 9 – London Government initially seeks the flexibility to determine the business rates multiplier(s) in London, agreed collectively between the Mayor and London's borough Leaders over a defined period

24. In the short term, it will be important that the 2% infrastructure levy opportunity offered to Combined Authority areas should also be available in London, over and above the existing Business Rate Supplement that funds Crossrail.

Ask 10 – London Government asks that the 2% infrastructure levy is made available to the Mayor of London.

25. Mandatory reliefs awarded in London will amount to around £650 million in 2016-17, and are currently set by central government. London Government believes these could be used more constructively to improve local economies and to encourage greater dialogue and engagement between councils and local businesses. London Government should have the collective ability to set the qualification criteria and thresholds of the existing mandatory reliefs currently set by central government (and the discretionary elements of those schemes), as well as determining new mandatory relief schemes periodically when deemed necessary. This would include the small business rates relief threshold. Where individual boroughs or the Mayor wished to offer additional discounts over and above a collective scheme agreement, this could be achieved through adjustments to their retained rates.

Ask 11 – London Government seeks the flexibility for all parts of London Government to determine all business rates discounts and reliefs, including scheme parameters and thresholds

Distributing the benefits of growth

26. Within a devolved system, any business rate growth could be retained by boroughs and the GLA in line with their overall share. However, London's economy is a complicated system in which different parts of the capital will have different, but inter-related, roles to play. For the economy to keep growing in a sustainable manner, we need to expand the overall business premises capacity, but also to find ways to house, train, transport and provide access to leisure and culture for millions of people around the capital. We may therefore want to use some of the proceeds of growth to facilitate additional investment, and to create targeted rewards that incentivise contributions to the capital's overall success beyond hosting new business properties.

27. This could be achieved by retaining a central pool for distribution according to collective priorities. Ultimately, however, this should be a matter for London Government to determine.

Ask 12 – London Government asks for the ability to determine collectively how the proceeds of growth are shared within London

Managing risk: safety nets and the Central List

28. If the move to 100% retention is to be successful then the need to share and manage risk effectively will be essential. However, the balance between central and local responsibility cannot be separated from the questions of the overall proportion of rates retained, and the degree of local control allowed.

Ask 13 – Under a devolved retention system, London Government asks that the safety net mechanism and thresholds are determined locally by London Government

29. The central list has been identified as a potential source of funding for future safety net arrangements. Where responsibility for such arrangements is devolved, it would be appropriate also to maximise local access to the rates derived from properties currently held on the central list. This would also increase opportunities and incentives to maximise the value and use of such assets where possible.

30. London local government considers that, unless there is a clear case for an assessment to be on the central list, it should be on either a local list or regional list.

Ask 14 - London Government would seek to transfer central list properties to either a local or regional list wherever possible, including the transfer of TfL's separately identifiable assessments potentially as a single TfL operational assessment.

Governance

31. A regional approach to managing business rates in London will require appropriate mechanisms to ensure that robust, timely and accountable decisions can be taken to

raise and distribute tax revenues. In return for the level of devolution and autonomy London Government is asking for, central government will require reassurance that London is capable of governing such a system collectively.

32. London Government is well placed to develop a collective governance model to enable a devolved business rates retention system. London is the only region in England with a regional tier of government, and the 33 local authorities and the Mayor of London have developed a mature relationship that has gradually evolved since 2000.

Decisions required to set up and run a devolved retention system

33. The proposals set out in this paper generate three classes of decisions for London to Government address:

    - ***Initial set-up:*** decisions and agreement with Government on the scheme design, including the level of retention, responsibilities transferred, the basis and frequency of revaluations, and resets, the allocation of resources between GLA and boroughs, the multiplier(s), the framework for discounts and reliefs, the distribution of growth proceeds, the operation of a regional safety net and a regional list. Such decisions would need to be taken collectively – and unanimously – by the Mayor of London and Leaders.

    - ***On-going tax-setting and resource allocation:*** annual decisions such as setting the multiplier(s) and allocating the collective growth pool; periodic decisions such as agreeing revised baselines and changes to the needs formula. These decisions would need to be taken collectively by the Mayor and Leaders, building on the existing Congress arrangements, with appropriate voting and other principles consistent with the London Finance Commission in 2013, built in to ensure the appropriate protection of minority interests within London.

    - ***Technical underpinning and review:*** it may require two independent technical commissions to manage on-going work around valuation (including the performance of a regional VOA) and the operation of the tax, and around maintaining the needs formula and distribution model. Political oversight of these commissions could be undertaken by the Governance structures described above.

Existing principles

34. The London Finance Commission identified a set of principles upon which such governance could be based. These were expanded in evidence submitted to the CLG Committee inquiry into fiscal devolution in April 2014. These governing principles are as follows[1]:
    - **Each element of London government should have a stake:** Elected leaders of all London local authorities and the Mayor of London must be able to feel confident about the governance arrangements for the new finance system

[1] Extract from a joint letter from Boris Johnson, Mayor of London and Mayor Jules Pipe, Chair of London Councils to Clive Betts MP, Chair of the Communities and Local Government Committee, 10 April 2014, submitted as evidence to the Committee's review of Fiscal Devolution

- **No exclusion:** No one borough or group of boroughs can be excluded from the benefits of London's success or become disempowered from addressing local needs.
- **No over-riding:** Interests of the Mayor cannot be overridden by the boroughs or vice versa.
- **No deadlock:** Arrangements must prevent or break deadlock. We believe that this can be achieved through suitable voting arrangements and clarity about which tier of government is responsible for decision-making, as reflected in the principles below.
- **Enforcement:** The system must enforce binding decisions and these decisions must reflect a clear initial consensus – even if there are disagreements from time to time about individual decisions.
- **Simplicity and clarity:** The reformed system should be as simple as possible. It should avoid the need for annual decision-making between different sections of London government. It should seek to distinguish clearly the responsibilities of the GLA, Boroughs and London Assembly.
- **Stability…** Existing responsibilities should be maintained where possible.
- **… But potential for reform.** Provisions in the 'devolution settlement' should enable, by agreement, periodic property tax reform and changes to any within-London distribution arrangements. Such reforms would be distinct from the 'Day 1' operation of a devolved system. There should also be a presumption that the more significant reforms were proposed, the longer they would be phased in.
- **Practical operations:** decisions would be taken by the Mayor or Borough politicians as appropriate. However, a joint GLA and London Councils Officer Group would provide standing technical advice and support for politicians to decide matters where there is significant joint interest under the above arrangements. This might be independently chaired.
- **Decision rules:** Any new system would require a set of decision rules, some of which would be reflected in legislation. For instance, Parliament might legislate for periodic property revaluations to be carried out by devolved authorities. There are various options for the rulebook governing changes within London following devolution but here is one example:
    - Mayor would need to agree any decision and by converse would have a veto
    - Boroughs would need to agree to any decision by their own rules (e.g. two-thirds majority)
    - The London Assembly would retain its existing powers to amend or reject the Mayor's tax and spending decisions, which would be enhanced commensurate with the increase in the Mayor's powers.

35. The Mayor of London has re-formed the London Finance Commission to review, refresh and revise its original recommendations in light of the changed circumstances, following the UK's vote to leave the European Union. It will report by the end of 2016. We will follow the work of the commission closely, and anticipate that it will re-visit the

governance principles outlined above in the context of recommendations on broader fiscal devolution.

London Government will work with government collectively build on these principles to define and establish appropriate governance arrangements to manage a devolved business rates system.

Annex 1: Additional Responsibilities

1. London Government believes, when determining the existing grants and new responsibilities that should be funded by business rates, priority should be given to responsibilities that maximise London Government's ability to improve the life of Londoners, the effectiveness and efficiency of its public services, and the future economic success of the capital.

2. We would therefore wish to prioritise the transfer of grants and responsibilities that:
   - have a direct relationship to business;
   - help tackle key infrastructure challenges, including housing and transport; and
   - have a compelling public service reform case to be delivered more efficiently and effectively by local government.

3. We believe the government should first consider the outcomes the sector is aiming to achieve, and then design local public services around them. This will require greater exploration of the funding necessary to deliver those outcomes. However, the list set out in the consultation is a helpful starting point, which we have used to identifying grants and responsibilities we feel are suitable candidates to be transferred in Table 4.

4. The grants and responsibilities listed below are grouped by whether they are a new responsibility or existing grant, and then by which of the three principles set out above they meet. Estimated values for London in 2019-20 are set out in the fourth column.

Table 4 – Existing grants & new responsibilities - Suitable candidates for transfer in Addition to TfL Capital Grant

	Existing grant or responsibility	Reason(s)	Estimated London value in 2019-20 (£bn)
Skills - 16-19 funding	New responsibility	Business link/PSR	0.499
Adult Education Budget	New responsibility	Business link/PSR	0.400
Careers Service	New responsibility	Business link/PSR	0.097
Work and health programme	New responsibility	Business link/PSR	0.014
Youth Justice	New responsibility	PSR	0.054
Valuation Office Agency	New responsibility	PSR	0.032
Affordable Housing capital funding	Grant	Infrastructure	0.417
Transport capital (outside London)	Grant	Infrastructure	n/a
Early Years funding within DSG	Grant	PSR	0.748
Public Health Grant	Grant	PSR	0.628
Revenue Support Grant	Grant	PSR	0.538
Improved Better Care Fund	Grant	PSR	0.247
Housing Benefit Admin Subsidy	Grant	PSR	0.033
Independent Living Fund	Grant	PSR	0.019
CT Support Admin Subsidy	Grant	PSR	0.015
Rural Service Delivery Grant	Grant	PSR	n/a
Total grants & responsibilities			**3.741**
Total "headroom" in 2019-20			**3.975**
Remaining capacity			**0.234**

NB: RSG here is net of the GLA's RSG which is expected to be funded from business rates from April 2017. TfL Capital grant is also excluded as the government has confirmed this will be transferred in 2017-18. Estimates for 16-19 skills funding excludes 6th form and academy providers at this stage.