

HAMPSHIRE COUNTY COUNCIL**Report**

Committee:	Policy and Resources Select Committee
Date:	19 April 2012
Title:	Business Rates Retention
Reference:	3840
Report From:	The County Treasurer

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1. Introduction

- 1.1. Members will be aware that the Government has been consulting as part of the Local Government Resource Review (LGRR) on the partial retention of business rates income by local government.
- 1.2. Business rates are currently all pooled nationally and redistributed by the Government through formula grant. Billing authorities (district and unitary councils) collect business rates and pay them into the pool and precepting authorities such as the County Council receive their share of these through the formula grant process.
- 1.3. This system means that local authorities do not receive any increased income if business rates grow in their area. The Government believes this should change to incentivise local authorities to encourage local business growth.
- 1.4. This report outlines the Government's proposed business rates retention scheme, due to start in the 2013/14 financial year, and examines its likely impact on Hampshire County Council.

2. The Original Proposals

- 2.1. The Government published a consultation paper about its proposals in July 2011, which Hampshire County Council responded to. In their simplest form, the proposals are quite straightforward.
- 2.2. Firstly, a funding baseline is set for each authority, which is the amount of formula grant it would have received under the old system. Secondly, each authority has a business rates income baseline set, which is its share of the amount of business rates it would receive under the new system.
- 2.3. Councils with a higher business rates baseline than funding baseline pay this difference into a national pool as a 'tariff'. This is redistributed as a 'top up' to

authorities which have a lower business rates baseline than funding baseline, bringing their funding up to the higher level. If an authority grows its business rates it is allowed to keep some or all of the additional income.

- 2.4. This system was designed to try to keep distribution of business rates across the country reasonably stable, at the same time as providing some incentive for authorities to grow their local business rate income. To move to a system of complete retention of local business rates would have a massive redistribution effect across the country, favouring prosperous areas.
- 2.5. However, whilst the basic principles are simple, there are a large range of protections, safety nets and exclusions built into the system which make it almost incomprehensible. A list of the various measures contained within the system are shown in Appendix 1.
- 2.6. Total business rates collected within Hampshire exceeds the grant levels that are redistributed back to Hampshire authorities. Under the original proposals, this would have made Hampshire County Council a tariff authority as its share of the business rates collected in the area would have exceeded the grant it would have received from the Government. Hampshire would have had a high risk and reward position in respect of variations in business rates income.
- 2.7. Other proposals within the consultation included using proceeds from the levy on disproportionate gains (explained in Appendix 1) to help authorities suffering from significant falls in business rates income. Other key features include mechanisms to adjust for business rates revaluation. Local authorities will also be allowed to voluntarily form a pool to share risks and rewards.
- 2.8. Local authorities will not receive all business rates income. The Government will top slice it to fund the police and items such as the New Homes Bonus. After these, business rates income will still exceed the local government funding control totals set by the Government in the 2010 Spending Review. Therefore, the Government decided to top slice the forecast difference, called the set aside, and use it to fund other local government grants. This created an issue of local authorities only gaining from growth if it exceeded Treasury forecasts, which was strongly criticised in many replies to the consultation.

3. The Government's Response to the Consultation

- 3.1. The consultation closed in October 2011 and the Government's response was published that December. Many items were unchanged from the original proposals. However, some key decisions were taken and a few major changes made. These are set out below.
- 3.2. Of most importance was the decision that in two tier areas around 80% of the business rates collected will be allocated to district councils and only 20% to county councils. This has the effect of making all county councils top up authorities. The Government says this will provide some funding stability for adult and children's services, as the top up is increased by RPI each year. However, it means that most of the gains from business rates growth will go to district councils, which the Government feels are more responsible for encouraging business growth.

- 3.3. The DCLG may make a number of technical adjustments to the formula grant calculations which will be used to establish the funding baseline. A consultation about these and other technical matters is expected to be held during summer 2012.
- 3.4. The set aside was renamed the central share and will now be a percentage of business rates rather than a fixed amount. This shares the risk and reward between local authorities and the Government of growth being above or below the Treasury's forecasts. The Government reserved the right to vary the size of its share in future.
- 3.5. It was announced that the Government's "aspiration" was for resets to the system to be held every ten years. Whilst this is welcome it still does mean that local authorities will need to be careful about setting long term budget plans based on expected business rate income, only to potentially see this taken away as part of a reset.
- 3.6. As expected, the police will not be included in the rates retention system but fire services will be, possibly on a similar basis to county councils (i.e. they will receive a percentage share but are likely to be top up authorities so that they benefit from a level of protection of having some income increased by RPI each year).
- 3.7. Many key details about how the system will operate are still unknown. These include the exact share of business rates between county and district councils, the size of the central share and confirmation of exactly how the funding baseline will be calculated.

4. Business Rates in Hampshire

- 4.1. The Hampshire area was expected to pay just under £437 million in business rates to the Government in 2011/12. Hampshire County Council and its districts received back £247 million in formula grant. Appendix 2 contains details of 2011/12 business rates broken down by district. It also provides indicative figures for how much of this would be allocated back to Hampshire authorities and what would be paid to the pool as a tariff.
- 4.2. The table below shows business rates growth in Hampshire between 2006/07 and 2009/10. Business rates are increased by RPI each year so growth is any increase above RPI. 2010/11 has not been included as it was a revaluation year and growth would include the effects of revaluation; councils will not be allowed to keep revaluation gains under the rates retention scheme. A more detailed version of this table with growth broken down by each district is attached as Appendix 3.

Growth in Hampshire's business rates above RPI (%)			
2006/07	2007/08	2008/09	2009/10
1.65	0.45	5.40	-2.53

- 4.3. It will be observed from the table that Hampshire's business rates have tended to grow in times of economic prosperity but there is significant volatility in business rates growth and contraction. The detailed Appendix 3 table also shows that there are significant variations between districts. In 2007/08, for example, Gosport had a reduction of 4.34% compared to an increase in Havant of 5.74%, a spread of 10.08%. The Government's plans to allocate around 80% of business rates to district councils thus hands substantial risks to them.
- 4.4. Risks from volatility increase if a district is particularly dependent on a few major business ratepayers. Hampshire is at less risk from this than other counties as the top five ratepayers in each of our districts mostly consist of supermarkets, offices and military bases, none of which usually make up more than a few percentage points of the rating list of each district. Five districts have a property which makes up more than 5% of the value of their rating list although most of these are only just above 5%. The major exception is New Forest, where Fawley oil refinery makes up 14% of its rating list's value. Details of the top five business ratepayers in each district of Hampshire are shown in Appendix 4.

5. Impact of the Proposals on Hampshire County Council

- 5.1. There are many key parts of the business rates retention system where few or no details about how it will operate have yet been provided by the Government. Therefore, the assessment given below is the best that can be currently forecast with the information available.
- 5.2. The effect of business rates retention is difficult to study by itself between 2013/14 and 2014/15 since the Government still intends to reduce national funding to local government in line with the 2010 Spending Review. The Government will set the system up to reduce funding between these years so it does not exceed the lower control total for 2014/15. Therefore, this analysis examines what funding may be in 2014/15 and how it may change from this in 2015/16.
- 5.3. The table below shows what Hampshire County Council's funding baseline, top up and share of retained business rates may be in 2014/15 based on our own assumptions of grant levels for that year.

2014/15	£M	
Funding baseline	150.5	
Funded by:		
Retained business rates	78.0	52%
Top up	72.5	48%

- 5.4. The funding baseline is based on the Medium Term Financial Strategy assumptions that formula grant will reduce by 9% in 2013/14 and 8% in 2014/15. The retained rates figure comes from modelling of Hampshire's business rates based on current information. The top up amount is the difference between the two, in order to allow the effect of changes between 2014/15 and 2015/16 to be studied from an even starting point. This is unlikely to be the case in practice (as business rates will have diverged from the baseline) but our modelling indicates that the top up is likely to be around this figure.
- 5.5. Retained business rates will increase annually by RPI through (the business rate multiplier) plus or minus any growth or retraction. The top up will be increased by RPI each year. The table below contains a sensitivity analysis of how funding may change in 2015/16, compared to 2014/15 (excluding any other changes the Government may make to the funding system).

		Growth or decline in rates					
		-3%	-1%	0%	1%	3%	5%
RPI increase to rates and top up	0%	£-2.3m	£-0.8m	£0.0m	£0.8m	£2.3m	£3.9m
	1%	£-0.9m	£0.7m	£1.5m	£2.3m	£3.9m	£5.4m
	2%	£0.6m	£2.2m	£3.0m	£3.8m	£5.4m	£7.0m
	3%	£2.1m	£3.7m	£4.5m	£5.3m	£6.9m	£8.5m
	4%	£3.6m	£5.2m	£6.0m	£6.8m	£8.5m	£10.1m

- 5.6. This shows that the planned structure of the rates retention system makes the County Council relatively insulated from changes in business rate receipts, as all funding will receive an RPI increase each year, some via the top up increase and some from the annual RPI increase to the business rates multiplier. At 2% RPI, if Hampshire's business rates grew by 3% we would receive a relatively modest £2.4m more than if business rates had stood still. Even if business rates contracted by 3% we would still receive a small cash increase of £0.6m if RPI was 2%.
- 5.7. Our modelling indicates that the Government will take about 25% of business rates as its central share, which further reduces the gains local authorities can make from business rates growth. However, some have suggested that the central share may be as high as 35%, reducing the benefits even further. If the latter happens, we will receive about £10m less in retained rates and £10m more in our top up, as shown in the next table. This means that less of our future increases or decreases would be subject to business rates growth.

2014/15 with 25% and 35% central shares	25%		35%	
	£m		£m	
Funding baseline	150.5		150.5	
Funded by:				
Retained business rates	78.0	52%	67.5	45%
Top up	72.5	48%	83.0	55%

5.8. The current state of the economy means that a good level of growth in Hampshire's business rates can by no means be guaranteed in the early years of the rates retention system. However, table 4.2 shows that historically in times of prosperity, Hampshire has enjoyed business rates growth, albeit at a somewhat fluctuating rate. The County Council is thus likely to make some financial gains from the new system. Even if business rates (excluding the annual RPI increase to them) did contract slightly the County Council may still receive more of an increase in cash terms from the yearly RPI increase to business rates and its top up than it would have received from the formula grant system.

5.9. In considering the new system, it is also important to remember that for many years before the Government cuts in grant to local authorities, Hampshire did not receive much more than around a 2% increase in its grant each year. Therefore, the new system does provide some capacity for increased revenue, albeit from a much lower base due to the grant reductions.

5.10. The table on the next page compares the difference between the possible results of the business rates retention system and a system where formula grant increased by 2% annually, purely for illustrative purposes. The parts of the rates retention system which increase by RPI use the latest Office for Budget Responsibility forecasts for these years. Growth above RPI to retained rates uses the historic data from table 4.2 e.g. rates in 2015/16 grow by 1.65% above RPI.

Comparison of possible results of business rates retention versus 2% annual increase in formula grant					
	2014/15	2015/16	2016/17	2017/18	2018/19
2% increase (£m)	150.5	153.5	156.6	159.7	162.9
Rates retention (£m)	150.5	155.7	161.8	172.9	177.6
Consisting of:					
Retained rates (£m)	78.0	81.3	84.7	92.7	94.1
Top up (£m)	72.5	74.4	77.1	80.2	83.5
RPI applied to top up (%)	2.6	3.7	4.0	4.1	
Historic above RPI growth (%)	1.65	0.45	5.4	-2.53	
RPI + above RPI growth applied to retained rates (%)	4.25	4.15	9.4	1.57	

Appendix 1

Proposed Protections in the Rates Retention System

Funding baseline – Calculations for this will begin from the 2012/13 formula grant position, thus causing less turbulence than a completely new method of calculating funding. Damping will further reduce volatility as no authority will see its funding decline by more than a set percentage.

Top ups and tariffs – Top up authorities will receive an annual RPI increase to their top up to prevent its value from being eroded by inflation, funded by an annual RPI increase on tariff authorities.

County councils and fire authorities – These are all expected to be top up authorities, thus giving them some protection from business rates volatility.

Police – The police will not be included in the business rate retention system and will receive a fixed allocation of top sliced business rates instead.

Levy on disproportionate benefit – authorities with a high business rates baseline and a low funding baseline will gain a large percentage increase in their income from a small percentage increase to their business rates. The levy will remove some of this disproportionate gain.

Safety net – The proceeds of the above levy will be used to help authorities which have experienced a fall in their income by a set percentage below their baseline funding level. This baseline for the safety net will be increased by RPI each year.

Resetting – The business rates system will be fully or partially reset every ten years to realign business rates income with service needs, which could see gains from growth taken away and redistributed.

Pooling – Authorities will be allowed to pool their business rates to share risks and rewards.

Protections for the Government – The Government will design the rates retention system so that local authorities do not receive more forecast income than the control totals in the Spending Review. This includes a reduction in funding in 2013/14 and 2014/15. It will also top slice business rates to pay for schemes such as the New Homes Bonus. The Government has retained the right to make other adjustments to the scheme in future.

Revaluation – Authorities will make no gains or losses from five yearly business rate revaluations as top ups and tariffs will be adjusted (although not for later appeals). Adjustments will also be made so that authorities do not make any gains or losses from transitional relief for business which have seen a large change in their valuation.

Exemptions – Growth in Enterprise Zones and from a limited number of Tax Increment Financing projects will be exempt from any levy and reset for 25 years.

Appendix 2

Forecast Business Rates in Hampshire's Districts for 2011/12 (£m) and Distribution if Business Rates Retention had been in Operation					
District	Rates	HCC 20% Share	District 80% Share	District Tariff	District Share After Tariff
Basingstoke and Deane	68	14	54	47	7
East Hampshire	25	5	20	16	4
Eastleigh	52	10	42	36	6
Fareham	38	8	30	25	5
Gosport	14	3	11	6	5
Hart	25	5	20	17	3
Havant	29	6	23	16	7
New Forest	55	11	44	35	9
Rushmoor	41	8	33	28	5
Test Valley	43	9	34	28	6
Winchester	47	9	38	33	5
Total	437	88	349	287	62

Appendix 3

Historic Growth in Business Rates in Hampshire Above RPI (%)				
	2006/07	2007/08	2008/09	2009/10
Basingstoke and Deane	-1.81	-4.22	5.53	-1.11
East Hampshire	3.12	1.73	5.38	-2.99
Eastleigh	7.53	2.99	4.85	-2.62
Fareham	4.51	0.87	5.60	-6.94
Gosport	4.46	-4.34	5.03	-2.53
Hart	-4.47	-1.11	4.76	-2.59
Havant	1.56	5.74	6.40	-3.50
New Forest	2.42	1.34	1.53	-2.30
Rushmoor	-1.48	-1.96	8.27	-3.43
Test Valley	3.97	2.69	7.67	-2.60
Winchester	1.47	2.95	5.34	0.76
Hampshire Average	1.65	0.45	5.40	-2.53

Appendix 4

Hampshire District Councils and their Top Five Business Rate Contributors		
District	Current Rateable Value	Percentage of District's Rateable Value
Basingstoke	180,390,275	
Alton Gas Store	5,570,000	3.1%
Basingstoke Sainsbury's	2,910,000	1.6%
Basingstoke Morrisons	2,180,000	1.2%
Basingstoke Asda	1,960,000	1.1%
Basingstoke Supermarket	1,850,000	1.0%
East Hampshire	74,369,626	
Alton Sainsbury's	1,720,000	2.3%
Waterlooville Morrisons	1,710,000	2.3%
Bordon Military Camp	1,600,000	2.2%
Liphook Sainsbury's	1,080,000	1.5%
Alton Brewery	1,010,000	1.4%
Eastleigh	134,867,531	
M&S Hedge End	3,790,000	2.8%
Asda	3,630,000	2.7%
Hedge End Sainsbury's	3,460,000	2.6%
Tesco	3,430,000	2.5%
Southampton Airport	2,630,000	2.0%
Fareham	102,241,609	
Air Traffic Control Centre	5,350,000	5.2%
Military Training Base	3,380,000	3.3%
Fareham Asda	2,600,000	2.5%
Fareham Sainsbury's	2,300,000	2.2%
Fibre Optic Company	2,120,000	2.1%
Gosport	40,381,805	
Military Training Base	2,700,000	6.7%
Aircraft Repair Premises	1,620,000	4.0%
Royal Navy Depot	1,460,000	3.6%
Military Training Base	970,000	2.4%
Supermarket in Gosport	905,000	2.2%
Hart	71,041,505	
Fleet Services	2,695,000	3.8%
Offices	2,320,000	3.3%
Four Seasons Hotel	2,040,000	2.9%
Car Auction Site	2,015,000	2.8%
Bartley Wood Business Park	1,620,000	2.3%
Havant	80,586,116	
Havant Asda	4,180,000	5.2%
Havant Tesco	3,010,000	3.7%
Havant Sewage Works	2,120,000	2.6%
Offices in Havant	1,850,000	2.3%
B&Q Havant	1,180,000	1.5%

District	Current Rateable Value	Percentage of District's Rateable Value
New Forest	158,323,858	
Esso Oil Refinery	22,100,000	14.0%
Marchwood Power Station	6,914,000	4.4%
Marchwood Barracks	2,380,000	1.5%
Fawley Power Station	2,070,000	1.3%
Totton Morrisons	1,670,000	1.1%
Rushmoor	106,778,295	
Quinetiq Laboratory	5,430,000	5.1%
Aldershot Garrison	2,950,000	2.8%
Nokia Offices	2,670,000	2.5%
Aldershot Tesco	2,480,000	2.3%
Farnborough Airport	2,000,000	1.9%
Test Valley	119,703,700	
Warehouse in Andover	3,340,000	2.8%
Andover Tesco	2,790,000	2.3%
Tesco Distribution Centre	2,080,000	1.7%
Offices in Nursling	1,810,000	1.5%
Andover Asda	1,780,000	1.5%
Winchester	127,129,694	
IBM Hursley	3,400,000	2.7%
Winchester Tesco	2,780,000	2.2%
Winchester Sainsbury's	2,460,000	1.9%
Air Traffic Control Centre	2,350,000	1.8%
Zurich Offices	1,410,000	1.1%

CORPORATE OR LEGAL INFORMATION:**Links to the Corporate Strategy**

Hampshire safer and more secure for all:	yes
Corporate Improvement plan link number (if appropriate):	
Maximising well-being:	yes
Corporate Improvement plan link number (if appropriate):	
Enhancing our quality of place:	yes
Corporate Improvement plan link number (if appropriate):	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

DocumentLocation

None

IMPACT ASSESSMENTS:

1. Equalities Impact Assessment:

1.1. Equality objectives are not considered to be adversely affected by the items in this report.

2. Impact on Crime and Disorder:

2.1. The items in this report are not considered to have any direct impact on the prevention of crime.

3. Climate Change:

a) How does what is being proposed impact on our carbon footprint / energy consumption?

No specific proposals.

b) How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific proposals affecting adaptation to climate change.