

HAMPSHIRE COUNTY COUNCIL**Decision Report**

Decision Maker:	Cabinet
Date:	25 June 2012
Title:	Medium Term Financial Strategy Update
Reference:	3979
Report From:	Director of Corporate Resources

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1. Executive Summary

- 1.1. The purpose of this paper is to update Cabinet on a number of emerging issues that will impact on the Medium Term Financial Strategy (MTFS) which was approved last Summer and then updated as part of the budget setting process.
- 1.2. This report is in effect a holding report that reflects the changing state of public finances at the present time. The next key date will be the release of Government grant figures for both 2013/14 and 2014/15, which are not anticipated until December this year. At that point a further update of the MTFS will be produced leading into the setting of the 2013/14 budget.
- 1.3. Despite these uncertainties, the County Council's strategy of broadly achieving 4 years of worth of savings over two years, puts it in a strong position to deal with the financial difficulties to come.
- 1.4. It is also proposed as part of the forward strategy to review, consolidate and rationalise earmarked reserves whilst also giving due consideration to the need for a 'volatility reserve' and a 'losses on appeal' reserve to reflect the transfer of risks from Government. The aim will be to divert further resources to the Grant Equalisation Reserve and other reserves as appropriate, in order to support the revenue budget and protect the County Council from significant short-term volatility, during a period of further grant reductions after 2014/15.

2. Contextual information

- 2.1. The Medium Term Financial Strategy that was approved last Summer and then updated as part of the budget setting process in February set out a medium term forecast up to the 2015/16 financial year based on the following assumptions :-

- Revenue Support Grant losses of 9%, 8% and 8.7% in 2013/14, 2014/15 and 2015/16 respectively. The 2015/16 reduction makes the assumption that the first council tax freeze grant will drop out in that year.
 - No assumed additional income arising from the business rates retention scheme that will be introduced in 2013/14.
 - Specific grant losses of 6% and then 5% in 2013/14 and 2014/15, matched by assumed reductions in Departmental expenditure.
 - Council tax increases of 1.9% per annum from 2013/14.
 - Pay increases of 1% for 2013/14 and 2014/15 and 2% for 2015/16
 - Adults and Children's social care cost pressures of £11m per annum (cumulative year on year)
 - Annual Efficiency Target of 2% per annum.
- 2.2. Taking all of these factors into account, produced a cumulative deficit in the annual revenue budget of £31.2m by 2015/16, although it was noted in the report that assumptions in respect of grant reductions were considered prudent, given that the County Council had already had grant reductions of over 24% in the first two years of the current Comprehensive Spending Review period.
- 2.3. Since this time, one major change is the Government's response to the consultation exercise on the localisation of Council Tax Benefits (CTB) which is explored in more detail in the next section.

3. Localisation of Council Tax Benefits

- 3.1. The Government had previously announced its intention to localise council tax benefits by getting billing authorities to introduce their own schemes,
- 3.2. The Government consulted on changes to the current scheme last year and initial indications were that the proposed 10% reduction in national funding for the new local schemes would fall on billing authorities as the implementers and administrators of those schemes.
- 3.3. Despite the fact that the consultation contained no proposals or questions for sharing this burden with major preceptors (County Councils, Police and Fire Authorities) the Government's response to the consultation meant that the loss of funding would in effect be shared by all authorities in proportion to the value of council tax income they receive.
- 3.4. This puts major preceptors in the position of having to pick up the financial consequences of new local schemes over which they have no control. In designing the new schemes, District and Unitary Councils must consult with major preceptors, but we have no right of veto and final scheme design is still down to the billing authorities to approve.

- 3.5. Based on current council tax benefit payments across Hampshire, the County Council's share of the 10% loss of funding equates to £4.8m from 2013/14. Whilst it is likely that most schemes will incorporate some reduction in the benefits paid to some vulnerable groups (bearing in mind pensioners are protected) and there is also the option to reduce other council tax discounts currently granted, it is unlikely that software changes can be implemented in time for the 2013/14 financial year and therefore the full £4.8m loss has been assumed for that year. Government have also effectively transferred the 'volatility risk' regarding changes in benefit uptake and non-collection, the aim will be to avoid 'in year changes' although this will create the potential for significant changes between years. It is therefore prudent to consider a 'volatility reserve' in order to smooth the potential impact
- 3.6. From 2014/15 onwards, it has been assumed that changes will be made to schemes that will significantly reduce if not eliminate the burden. As well as reducing costs through the scheme design, savings can also be achieved by varying existing discounts such as second homes or empty property. Other factors, such as the fact that the Government has not yet decided on how it will distribute grant funding in respect of the schemes and the concern that national coverage of the changes to the schemes will encourage greater take up by eligible individuals cast further uncertainty over the potential impact of this change.
- 3.7. There is a Chief Financial Officer working group across Hampshire and the Isle of Wight working together on a collaborative technical basis which will ensure everyone is using the same data and working to similar timetables. Whilst a 'single system' is an aspiration, each scheme is determined locally in each billing area by each billing authority. Appendix 1 to this report provides further detail regarding this issue and the joint working approach being taken which the Finance Department is closely involved in.
- 3.8. As part of the initial scheme design and preliminary consultation, the CFO's from billing authorities in Hampshire have written jointly to the Director of Corporate Resources to ask for a number of initial views on a number of issues. A copy of the letter is contained in Appendix 2 and the proposed response is attached at Appendix 3.
- 3.9. The Director of Corporate Resources will continue to liaise with local authorities in order to represent the County Council's interest. The response in Appendix 3 makes the Council's position clear that it expects 'billing' authorities to amend their schemes in order to try to close the funding gap in 2013/14 and future years. There is a requirement for 'billing' authorities to consult on the new proposals with 'preceptor' authorities. This formal consultation will be considered at a Cabinet meeting on 24 September 2012.

4. Business Rate Retention Scheme

- 4.1. During 2011, the Government began to explore various issues as part of the local government resource review (LGRR). One of the key elements of this was to examine the scope to allow local authorities to retain a proportion of business rate income that was generated locally.
- 4.2. A major part of the reasoning for this was that the government wanted to incentivise local authorities to encourage economic growth in their areas, thereby generating additional business rate income from which they would gain some financial benefit.
- 4.3. The Policy and Resources Select Committee asked for a report and presentation on this topic as part of their April meeting. The report is attached as Appendix 4 to this report and provides significantly more information on the proposed operation of the scheme, its limitations, and the financial impact on the county council and district councils.
- 4.4. The report explains that as part of the Government's response to the consultation exercise, the retained business rates are to be shared 80% to District Councils and 20% to County Councils. This means that all County Councils become 'top up' authorities, in that the amount of income they will retain from local business rates will be less than their baseline grant funding requiring a 'top up' from central Government funds. Hampshire County Council's baseline funding in 2014/15 is expected to be £150.5m.
- 4.5. The Government is also intending keeping some of the national business rate income as a 'central share' to pay for a number of other items such as police funding. It was originally thought that this might be set at the level of 25%, which would have meant that HCC would have retained £78m of locally generated business rates, requiring a top up of £72.5m to achieve our baseline level of funding.
- 4.6. Since the P&R Select Committee report was prepared, the Government has announced that it intends to retain 50% of all business rate income across the country as a central share of the revenue generated. This means that significantly less business rate income than originally anticipated will be retained by local authorities and that Revenue Support Grant will still be paid to most Authorities even under the new system.
- 4.7. For the County Council, based on the forecasts of revenue support grant for the 2014/15 financial year of £150.5m, this change to the central share announced by Government would have the following impact on the split between retained business rate income and the top up that will be received from central government.

Central Share =	25%		50%	
	£m		£m	
Funding baseline	150.5		150.5	
Funded by:				
Retained business rates	78.0	52%	49.8	33%
Top up	72.5	48%	51.4	34%
Revenue Support Grant			49.3	33%

- 4.8. The reason that the split between the retained business rates, the top up from the central pool and RSG is important, is that there is more risk and reward associated with the retained business rate income. In effect, since the business rate multiplier increases by RPI each year, and the new scheme guarantees that the top up from the central pool also increases by RPI, the £101.2m relating to these two items will increase by an inflationary amount. However, the retained business rate income will also be affected by growth or decline in the business rate base in the area. The element relating to RSG will obviously not be inflated at all.
- 4.9. The Government has just released a number of ‘statements of intent’ (prior to the release of more detailed consultation) on how the scheme will operate for the remaining 2 years of the current CSR and as a result of the 50% central share, most authorities, will become ‘Top Up’ authorities and in most cases will still receive Revenue Support Grant in order to bring them up to the grant levels assumed in the CSR. In effect therefore the Government is controlling local authority expenditure within the national control totals previously set and have reduced the opportunity to benefit from business rate income growth at least for the next two years. There also still remains a risk transfer from Government related to the outcome of rating appeals, whereby these changes will result in a financial impact on local authorities. The prudent approach would be to consider a ‘losses on appeals’ reserves in order to smooth the potential impact that this could create.
- 4.10. This recent announcement on the Business Rate Retention Scheme is disappointing news as it now means that the County Council will have more limited opportunity to benefit from any business rate growth achieved in 2013/14, 2014/15 and beyond. Whilst it is difficult to predict what this potential growth might be, it is recommended that Cabinet consider investing some of the recurring revenue from this growth to address the long standing pressure of the level of annual resources being employed on Economic Development activity within the County Council. A potential solution to this uncertainty, in order to provide time to assess future business rate growth, is to provide for a minimum of two years one off funding to bridge this gap with a view to providing permanent funding once the grant and business rates

growth position is more clear. This will be considered as part of the budget preparation for 2013/14.

- 4.11. The recent publications also requested submissions from Authorities who wanted to put forward proposals for business rate income pooling arrangements within a geographic area. The response date for proposals is 27th July, which is an incredibly tight timescale, particularly as details of governance arrangements around the schemes would also have to be submitted.
- 4.12. Given the complexities of any pooling arrangements and the long lead in time that would be required to discuss and agree those arrangements, it is recommended that the County Council formally agree not to enter into any pooling arrangements at this stage, although this would not preclude us from considering such an arrangement in the future.
- 4.13. A Councillors briefing is arranged on 21 June between 11:45am and 12:30pm to cover the localisation of council tax benefits and business rate retention scheme.

5. Other Potential Funding Issues

- 5.1. Cabinet will be aware, that local authorities are due to take on responsibility for Public Health Services from 1st April 2013. Significant work has been undertaken with Health colleagues to establish a baseline spend for Public Health Services (PHS) in the County and this information was used by the Government to provide a 'shadow' funding allocation for 2012/13 of £26.8M
- 5.2. Since the shadow funding allocation was announced, further work has been undertaken to refine the figures and to include certain PHS activities that were not in the original baseline, including smoking cessation and sexual health services.
- 5.3. Updated information has now been provided to the Department of Health that indicates that we now believe there is a potential gap in funding of £5.7M between the latest baseline estimate for PHS spending and the shadow funding allocation. Therefore, whilst the County Council will continue to work with Health colleagues and lobby the Government to ensure that adequate funding is provided to meet the full cost of these transferred responsibilities, this will remain a risk within the budget for 2013/14 and future financial years. Should a funding gap remain upon transfer, service options will be presented for decision as part of the budget setting process in order to ensure that the PHS is established within the overall transferred cash limit.
- 5.4. In addition, as part of the Welfare Reform Act 2012, the Department for Work and Pensions (DWP) will be transferring to local authorities funding that previously made up part of the Social Fund. This transfer will be effective from April 2013. The elements of the current social fund that make up the funding allocation are Community Care Grants and Crisis Loans.

- 5.5. DWP have been clear in discussions to date that there is no expectation that authorities replicate the current system; however, there is an expectation that whatever authorities put in place addresses the need for a crisis response.
- 5.6. The funding from DWP will not be ring fenced, however, there will be a settlement letter outlining expectations and the department are planning to monitor a number of authorities' use of the funding in 2014/15.
- 5.7. The allocation to Hampshire County Council will be £1,293,500. This figure is based on actuals for 2005/06 Social Fund expenditure, and does not reflect current fund levels that the DWP consider to be excessive.
- 5.8. Current estimates of spend on these items in Hampshire is some £332,000 above this allocation and despite the fact that the DWP have stated that they will drive down this 'artificially high demand' prior to the transfer, this still remains a risk in the forecasts for 2013/14 and future years. Work has already commenced regarding the options for the future provision of this service in order to ensure that the costs can be contained within the cash limit transferred from Government.

6. Medium Term Forecast 2015/16

- 6.1. There have been strong indications from the Government that the next CSR period from 2015/16 onwards could be just as tough as the last, particularly the first two years. The economy is currently experiencing a double dip recession and growth rates are lower than forecast, which concurs with the Government's message regarding a need for further reductions going forward. The Budget for 2012 also includes an annex that shows a 2.8% reduction in total Government spending between 2014/15 and 2016/17, although distribution of this is very unlikely to be even across Departments.
- 6.2. Appendix 5 provides one scenario for the 2015/16 forecast, giving rise to a cumulative deficit by that year of £34.2m based on council tax increases of 1.9% per annum and a 8.7% loss of grant in 2015/16 (equivalent to the fall out of the first Council Tax Freeze Grant that was only promised for the four years of the current CSR).
- 6.3. The County Council will need to address the deficit of £9.4 million in 2014/15 as it cannot set a deficit budget, it will therefore be necessary in that year to close the gap through further savings in expenditure and / or increases in council tax in excess of the 1.9% assumed in 2013/14 and 2014/15.
- 6.4. This would give rise to a revised gap for the 2015/16 budget of £24.9 million based on the assumptions of a 1.9% increase in Council Tax and an 8.7% loss in Government Grant. The table below provides alternative scenarios for the deficit in 2015/16 based on revised assumptions.

	0.0% Council Tax 2013/14 £m	1.9% Council Tax 2013/14 £m
4% loss of grant 2015/16	27.6	18.9
8.7% loss of grant 2015/16	33.6	24.9

- 6.5. The forecasts are based on council tax increases of 0% or 1.9% across the years 2013/14 to 2015/16, which must be set in the context that the Retail Price Index is currently running at 3.5% and council tax has been set at the same level for the last three years.
- 6.6. It is also worth remembering that this includes the cumulative impact of assumed grant reductions of 9% and 8% in 2013/14 and 2014/15, which are still considered prudent, even after allowing for the announcement in the autumn statement regarding further pay restraint in those two years which will be recovered by the Treasury through adjustments to the Departmental Expenditure Limits.
- 6.7. Overall, however, given the huge uncertainties over the last two years of the current CSR, the impact of the new CSR and further talk of reduced funding to the public sector from 2015/16 onwards, this mean that the forecast for that year is highly speculative. Possible political priorities around the level of council tax in the future, will also have a significant bearing on the forward forecast. By way of illustration:
- A council tax increases of 2.5% from 2013/14 to 2015/16 would reduce the cumulative deficit by £10 million compared to increases of 1.9%
 - increasing the Annual Efficiency Target by 1% would for one year would reduce the deficit by £5 million
- 6.8. Whilst the forecasts paint a negative picture about the outlook from 2015/16 onwards it must be set in the context of some very high-level assumptions from 2013/14 onwards which have a major impact on the bottom line. The previous paragraph demonstrates what a big impact small changes to the assumptions can have.
- 6.9. However, given the uncertainties over grant levels in 2013/14 and 2014/15 and the potential impact of the next CSR, it is sensible at this time to simply note these forecasts positions. In reality the time to begin to address the gap that appears in 2014/15 onwards will be after we have received details of our grant reductions for 2013/14 and 2014/15, which will be announced in December of this year. This will provide a much firmer basis upon which to produce a revised MTFs for the period and begin to develop a strategy for

balancing the budget in the longer term. It is clear however that the decisive action taken by the County Council during the first two years of the current CSR period has put the Council on a very solid financial footing from which to face any future financial challenges that may arise.

- 6.10. What is clear, as part of the forward strategy, as the County Council moves from a programme of cost reduction and efficiency to re-design and transformation, is that these new programmes must begin to deliver substantial savings in time for the 2015/16 financial year in order to close the significant funding gap that will inevitably arise.

7. Capital Investment

- 7.1. Last year, the County Council developed a series of capital investment proposals as part of the Open for Business planning arrangements introduced within the Council.
- 7.2. These were categorised under key themes that are repeated for Members information in Appendix 6. Whilst the programme was enhanced for a two year period, with new capital investment totalling £244 million it is still appropriate to re-evaluate capital investment and infrastructure requirements at the present time, in order to capture longer term and more immediate priorities.
- 7.3. Options for funding of any new capital investment priorities can be explored alongside the development of these proposals for consideration by Members later in the year.

8. Recommendation(s)

It is recommended that Cabinet :

- 8.1. Notes the uncertain position regarding the medium-term financial strategy, particularly regarding the Government spending announcement which is expected in December 2012 and the decisions of billing authorities relating to the Government's decision to localise council tax benefits.
- 8.2. Notes the risks and issues highlighted within the report and the programme of work designed to continue to develop proposals in preparation for closing the funding gap.
- 8.3. Approves the response to initial queries raised by billing authorities on the localisation of council tax benefit attached at Appendix 3 and notes that the response to formal consultation by billing authorities will be presented to the Cabinet on 24 September 2012.
- 8.4. Approves that no proposals for business rate income pooling arrangements will be submitted by the County Council at this time.

Ms C Williamson
Director of Corporate Resources
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25 May 2012

Dear Carolyn

CHANGES TO COUNCIL TAX BENEFIT

As we have recently discussed, the DWP are proposing changes to the Council Tax Benefit Scheme, with replacement by a Council Tax Support Scheme. This requires local authorities to design and introduce a Council Tax support scheme from 1st April 2013.

On behalf of Hampshire District and Borough Councils this initial letter sets out the current issues, as envisaged at present:-

- District Councils in Hampshire have been a very effective and efficient administrator of the Council Tax Benefit Scheme, with high performance to meet the customer needs.
- The requirement to design a scheme is a fundamentally different task which Council's have not undertaken before.
- The DWP has set limitations on the design of the scheme, in particular protection for people of pensionable age and a requirement to incentivise work.
- The timescale for implementation is very tight and the chance of a smooth implementation by the 1st April 2013 is very risky.
- Universal Credit implementation commences in October 2013. The full implementation will be staged between 2014 and 2017. During this transition period authorities will be processing joint claims for Council Tax Support and Housing Benefit.
- The proposals include a reduction in the grant for this function (initial indications are for a cut of 10%).
- The changes in the approach to this mean that in the case of two-tier areas, the majority impact of grant loss will fall on the County Council, but will also be shared by the Police and Fire & Rescue authorities as preceptors.

I think it might be useful if I set out Hampshire District and Borough Council's thinking on the changes as an initial step in the consultation process.

- It is unlikely that we will be in a position to develop a totally new scheme for implementation by April 2013, and may consider designing over a longer period with implementation to coincide with the introduction of the Universal Credit, although we understand that the dates for implementation of Universal Credit may vary for local authorities according to their size, to spread the workload etc.
- In looking at the options for the interim period prior to a complete redesign, District Council's will be considering options and their impact on both billing and precepting authorities. These options include:
 - a) Absorbing the loss of grant and maintaining the benefit/support received by residents.
 - b) Passing on all or part of the reduction in grant by adjustments to the factors in the existing Council Tax Benefit Scheme, in particular we would consider using a maximum Council Tax liability of 90% or 80% therefore requiring a minimum contribution to the Council Tax from residents currently paying little or no Council Tax.
 - c) Restricting the upper Council Tax band at which the Council Tax support is calculated.
 - d) Amending elements of the scheme to use income types previously disregarded from the calculation.
 - e) Adjusting the savings and capital levels at which someone may or may not qualify for support.

The proposals for the Council Tax Support scheme require consultation between billing authorities and the precepting authorities.

At this initial stage, billing authorities would be interested in the comments and views from the County Council, the Fire & Rescue and Police authorities on the following issues:

1. Acceptance that a complete redesign will not be possible for 2013.
2. Delaying complete redesign to coincide with the implementation of the Universal Credit.
3. The views of precepting authorities on the loss of grant and the impact on precept levels.
4. Protection to any particular groups within the community from changes to the Council Tax Benefit Scheme during an interim period.
5. Protection for any groups within the community once the scheme redesign has been carried out.

6. Any principles the preceptors would like to see considered in the scheme redesign.
7. Any merit in discussing potential for risk sharing models in the event of unexpected changes in benefit caseload.
8. Any other issues of concern to precepting authorities.

Our outline timetables identify that our plans are to consult further with precepting authorities on a draft scheme in August of this year.

We look forward to any comments the precepting authorities may have at this initial stage.

Yours sincerely

A handwritten signature in black ink, appearing to be 'RJ' with a stylized flourish underneath.

Bob Jackson
New Forest District Council

On behalf of:

Peter Gardner - Rushmoor Borough Council
Jane Eaton - Havant Borough Council & East Hampshire District Council
Andrew Wannell - Fareham Borough Council
Peter Wilson –Gosport Borough Council
William Fullbrook –Test Valley District Council
Nick Tustian – Eastleigh Borough Council
Alexis Garlick – Winchester City Council
Kevin Jaquest – Basingstoke & Deane Borough Council

Mr B Jackson
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7 June 2012

Dear Bob

CHANGES TO COUNCIL TAX BENEFIT

Thank you for your joint letter dated 25 May 2012 and for providing the County Council, with the opportunity to give you some initial views as part of the consultation process.

In your letter you have asked for specific responses to a number of questions, which I have set out below:

1. Acceptance that a complete redesign will not be possible for 2013.

We appreciate the various difficulties, set out in your letter, that would be involved in undertaking a complete re-design at this stage and therefore accepts that this may not be possible for April 2013.

2. Delaying complete redesign to coincide with the implementation of the Universal Credit.

This seems like a sensible approach given the complexities within both systems and given the likely overlap and confusion that this could cause not only in benefit administration but also for recipients of benefits during the transition periods. However, the County Council is obviously concerned about the potential financial impact of any delays in scheme re-design, which are addressed under the next question.

3. The views of precepting authorities on the loss of grant and the impact on precept levels.

Clearly as a Precepting Authority, the main impact of the changes to the Council Tax Benefit system are financial, since whilst we are required to be consulted over scheme design, we have no ultimate control over what scheme billing authorities eventually implement.

There is a potential impact of £4.8M on the County Council's budgets from 2013/14 onwards, none of which was anticipated when the Medium Term Financial Strategy was approved. This is before we know how the

Government may choose to distribute the grant funding for these changes and before any potential increase in benefit take up as a result of wider public awareness of the changes to the schemes.

We are therefore keen to stress that as a precepting authority we would want to see the new schemes designed in such a way that they will close the 10% funding gap either directly through the scheme design or using other methods such as changing existing discounts.

It is however recognised that due to the limitations described in your letter, this may not be entirely achievable in the first year of the scheme through scheme design, but there does still remain the option of 'top slicing' in order to achieve the necessary savings from the outset.

4. Protection to any particular groups within the community from changes to the Council Tax Benefit Scheme during an interim period.

We believe this is a matter for each billing authority to consider at a local level, within the confines of the financial objective set out above.

5. Protection for any groups within the community once the scheme redesign has been carried out.

We believe this is a matter for each billing authority to consider at a local level, within the confines of the financial objective set out above.

6. Any principles the preceptors would like to see considered in the scheme redesign.

Other than the principle around the financial objectives, the County Council would be keen to see schemes across the County that were similar in design to avoid confusion amongst residents and also that were perceived to be fair and consistent and benefitting those groups for whom the original council tax benefit scheme was intended.

7. Any merit in discussing potential for risk sharing models in the event of unexpected changes in benefit caseload.

No regulations have been determined for dealing with in year changes to benefit caseload and therefore any arrangements for risk sharing would be for local agreement. Our preference would be that any in year differences be contained within the collection fund in line with the current approach and precepting authorities will of course meet their share of any potential in year losses through that mechanism. Regular monitoring of the situation would of course be useful throughout the year.

We are also keen to avoid any complications in respect of precept payments and would seek to continue the current arrangements for these.

8. Any other issues of concern to precepting authorities.

None at the present time, but the County Council would welcome the opportunity to continue dialogue with billing authorities prior to the formal consultation.

I hope this is sufficient for your purposes, but if you have any further issues or questions, please do not hesitate to contact me.

Yours sincerely

Carolyn Williamson
Director of Corporate Resources

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 Annex 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 Annex 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. Annex 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 Annex 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 Annex 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 Annex 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	

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.

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

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

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%

FORECAST FUNDING CHANGES - 1.9% COUNCIL TAX INCREASE

	2013/14		2014/15		2015/16	
	£'000	£'000	£'000	£'000	£'000	£'000
Loss of Formula and Other Grants						
Reduced formula grant (9%, 8%, 8.7%)	14,768		11,946		13,161	
Loss of Specific Grants	5,154		4,295			
Total Formula and Specific Grant reduction		19,922		16,241		13,161
Additional pressures / Changes						
Phase 1 Efficiency Savings and Other Base Changes	(5,837)		(143)			
Reduced Spending to Match Loss of Specific Grants	(5,154)		(4,295)			
Capital Financing Costs	2,396		1,815		375	
Drop out of 2012/13 one-off RCCO	(8,439)					
Inflation and Base Changes	14,593		14,893		18,638	
Social care demography and complexity	11,000		11,000		11,000	
Drop out of 2012/13 one-off contingencies	(25,300)					
Localisation of Council Tax Benefits	4,800		(1,800)			
Change in use of reserves	3,122		735		1,720	
Total Spending Changes		(8,819)		22,205		31,733
Council Tax / Savings						
Council Tax Income - 1.9% per annum	(8,735)		(11,656)		(10,521)	
2% Efficiency Savings (planning totals)	(10,000)		(9,800)		(9,500)	
		(18,735)		(21,456)		(20,021)
Total Net Budget (Surplus) / Deficit in Year		(7,632)		16,990		24,873
Net (Surplus) / Deficit Brought Forward				(7,632)		9,358
(Surplus) / Deficit Carried Forward				9,358		34,231

CAPITAL THEMES

Energy
Information Technology
Strategic Land Development
Strategic Transport Infrastructure
Flood and Coast Defence
Strategic Project Investments
Asset Management
Children's Services

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.)

Document

Location

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.