Report
by the Comptroller
and Auditor General

Department for Communities and Local Government

Planning for 100% local retention of business rates

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Department for Communities and Local Government

Planning for 100% local retention of business rates

Report by the Comptroller and Auditor General

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Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

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This report provides an overview of the Department for Communities and Local Government's planning for the introduction of the 100% business rates retention system in April 2019.

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Key facts

£11.3bn

business rates retained locally under the 50% local retention scheme, 2015-16

£388m

additional business rates growth retained by local authorities under the 50% retention scheme from 2013-14 to 2015-16

£12.5bn

estimated additional business rates to be retained locally by 2019-20, offset against new responsibilities and by funding some existing responsibilities from additional retained rates instead of grant

5.4%	forecast real-terms reduction in local authorities' core spending power (government grant, locally retained business rates and council tax) from 2015-16 to 2019-20
27.7%	planned reduction in the Valuation Office Agency's workforce from 2015-16 to the end of the current Spending Review period
50.2%	proportion of local authorities in 2015-16 where the Department for Communities and Local Government does not have final details of retained rates income because they are members of business rates pools
£2.8 billion	local authorities' provisions in place by 2015-16 to meet the costs of appeals
39.6%	reduction in full-time equivalent staff from 2011 to 2017 working in the Department for Communities and Local Government's directorate with responsibility for delivering the scheme

Summary

1 Business rates are a charge on most non-domestic properties in England. In the 2015 Spending Review, the government announced that 100% of business rates income would be retained by the local authority sector by the end of the current Parliament. The objectives of this change are to:

- incentivise local authorities to develop their local economies; and
- enable local authorities to become more financially self-sufficient.

The move to 100% local retention builds on the process begun in 2013-14 whereby 50% of business rates income was retained by the sector.

2 The Department for Communities and Local Government (the Department), as the department with responsibility for overseeing the local government finance system, is responsible for delivering the scheme. There is also engagement from HM Treasury. This study focuses on the Department's work on planning for the 100% scheme. It examines the challenges faced by the Department, the extent to which it has learned from the 50% retention scheme, and the progress it has made to date with the 100% scheme.

3 Designing and implementing the 100% scheme will require a 'radical overhaul' of the local government finance system. The Department faces complex design issues, which need to be addressed in the context of often competing views within the sector. At the same time, the Department is undertaking a fair funding review of the sector. This will identify relative levels of needs and resources across the sector and set the baseline distribution for funding under the 100% scheme. The Department is undertaking this work having faced some reduction in staff resource.

4 There are risks in designing and implementing the 100% scheme. These include short-term risks whereby failing to deliver the scheme on time or to provide the sector with enough information in advance could undermine local financial planning. There are also more significant long-term risks whereby poor planning and design could deliver a scheme that puts local authorities' financial sustainability at risk or fails to create a mechanism that delivers local economic growth.

5 The Department has confirmed that it will introduce the scheme in 2019-20. We are engaging relatively early in the reform process and a significant amount of work remains to be done by the Department. However, engaging at this stage allows the Department time to address any issues or shortcomings before the introduction of the scheme. Early engagement will also support Parliamentary scrutiny of the Local Government Finance Bill, which entered the House of Commons in January 2017 and contains framework legislation.

Our report

6 Given the stage of the Department's work, our focus is on the arrangements to design and deliver the scheme rather than on assessing any decisions on design either taken or not taken. Our objective is to examine whether the Department has realistic plans in place to support the delivery of 100% local business rates retention by the end of this Parliament. The report addresses this question through three separate parts:

- Part One examines the challenges and issues that the Department will need to address in designing the 100% local retention scheme.
- Part Two explores the planning for and operation of the 50% local retention scheme and focuses on the extent to which the Department has learned from this experience.
- Part Three examines the progress made by the Department to date in delivering the 100% scheme.

A separate *Methodology* document is available on the National Audit Office website: www.nao.org.uk/report/planning-for-100-local-retention-of-business-rates/

Key findings

Challenges in moving to 100% retention

7 The Department's core objectives for the scheme are to promote financial self-sufficiency in the sector, and to promote local economic growth (paragraphs 1.36 and 3.2). There are significant issues to be addressed in creating a system that meets these objectives.

- **The Department is pursuing self-sufficiency through 100% local rates retention in the context of a long-term reduction in local authority funding.** Local authorities' spending power (government grant, locally retained business rates and council tax) fell in real terms by 25.2% from 2010-11 to 2015-16 and will fall by a further 5.4% by 2019-20. Service demand, not least due to an ageing population, is likely to grow. The challenge facing the Department is to assure itself that the absolute level of funding in the system at the start of the 100% scheme is enough to address both current service pressures and the additional demand to come (paragraphs 1.49 to 1.50).

- **The link between business rates and economic growth is not direct.** By allowing local authorities to retain tax base growth, the government expects that this will incentivise them to adopt pro-development planning and investment policies. This is expected to deliver economic growth in the long term. However, the scheme incentivises local authorities to increase their tax base, and tax base growth does not necessarily generate economic growth: new developments might lead to the relocation of existing economic activities rather than the creation of new ones. Equally, not all areas have the same capacity to grow their tax base. The challenge for the Department is to design the 100% system to maximise the scheme's potential to deliver economic growth rather than just tax base growth, and to ensure that the benefits of the scheme are widely spread. The Department will also need to understand the propensity and capacity for different types of authorities to use other elements of the scheme designed to support economic growth including multiplier reductions and the infrastructure supplement (paragraphs 1.37 to 1.48).

8 **Funding local services through the local retention of business rates requires fundamental design issues to be addressed, which will result in a complex system.** A key problem for locally retained business rates is that an area's capacity to generate business rates does not necessarily match demand for services. The 50% scheme addressed this through a redistribution mechanism based on 'tariffs' and 'top-ups'. Secondly, some areas have the capacity to grow their tax bases while others may see theirs shrink. The 50% scheme managed this divergence through periodic resets in which all areas' incomes were returned to a baseline. Other mechanisms such as safety nets and pools further helped to limit risk and smooth volatility. These core mechanisms from the 50% scheme are likely to continue into the 100% scheme (paragraphs 1.4 and 1.7 to 1.14).

9 **The Department will have to review and redesign the elements of the 50% scheme which will continue, and there are important new tasks to complete as well.** The Department will have to redesign existing elements of the 50% scheme such as agreeing the length and nature of resets and reviewing the mechanism to cover appeals costs. A substantial new task is to ensure that the new scheme is 'fiscally neutral' by balancing any additional funding received by local authorities against new responsibilities or by replacing existing grants. The Department is also undertaking a fair funding review to assess relative levels of needs and resources, which in turn will form the distributional baseline for the 100% scheme (paragraphs 1.15 to 1.28).

Learning from the 50% scheme

10 **The 50% scheme was introduced on time but there was significant pressure on the Department in achieving this.** The Department delivered the 50% scheme against a 30-month delivery timetable. The tight timetable meant that there were no pilots, significant decisions were taken late in the process and work on accounting arrangements was still ongoing after the scheme had started. The Department's resources were also put under pressure by the workload (paragraphs 2.4 to 2.9).

11 **The 50% scheme has allowed the sector to retain some additional funding, but there have been significant issues with aspects of the scheme.** The sector has retained an additional £388 million in the three years of the scheme. However, this has been overshadowed by the operation of the appeals system, whereby rate payers can challenge their rating valuation. Local authorities now have greater liability for meeting the costs of successful appeals. This injected volatility into the system because authorities can suffer substantial losses on appeal. Authorities have been cautious in setting the level of provisions they must make to cover appeals; by 2015-16, provisions had reached £2.8 billion. This is funding that cannot be used to support service delivery (paragraphs 2.11 and 2.20 to 2.28).

12 **The Department has learned lessons from the 50% scheme and is applying them to the 100% scheme.** As a consequence of learning from the 50% scheme, the Department has adopted a more open approach to designing the new system and has involved the local government sector more fully. The Department has also recognised the need to address accounting and accountability at the outset. It also understands that the appeals process needs addressing and is now taking steps to reform the system under the 100% retention scheme. In general, the Department has developed a body of expertise and experience that will be of value in designing the 100% scheme (paragraphs 2.32 and 2.33).

13 **The Department does not know precisely how much funding individual local authorities have retained from the 50% scheme.** The Department collects data on all local authorities' business rates income under the current 50% scheme, and how that has changed since the implementation of the scheme in 2013-14. While this includes authorities that are part of business rates pools, the Department does not have precise data on how funding has been distributed to individual authorities in pools. Consequently, potential lessons for different authorities' future finances under the 100% scheme are not easy to draw out (paragraph 2.13).

14 The Department has not made any formal assessment of whether the 50% scheme has promoted economic growth. The Department has not examined systematically whether the incentive in the scheme has driven different types of local authority behaviour that might promote economic growth. In the Department's view, it is too early in the life of the 50% scheme to assess its impact on economic growth and it is methodologically difficult to isolate the impact on the 50% scheme from other factors that impact local economic growth. Ultimately, however, it is not yet clear whether the 50% scheme has incentivised authorities to adopt pro-economic growth policies, and whether any behaviour change has actually supported economic growth (paragraphs 2.16 to 2.18).

Progress in delivering 100% local retention

Purpose and objectives

15 The Department's work to date has a clear focus on the goal of promoting financial self-sufficiency across the sector, but there has been less attention on how the scheme will deliver economic growth. The Department has a clear understanding of how the scheme will promote self-sufficiency across the sector, with devolved funding replacing grants or leading to new responsibilities for the sector. The Department's objectives for promoting economic growth are less well developed. The extent to which the scheme can best be configured to boost economic growth has not been fully explored. Equally, the local economic implications for local authorities which cannot grow their tax bases have not been examined in detail. The Department has no measurable target for additional economic growth expected from the scheme (paragraphs 3.3, 3.7 to 3.10 and 3.29).

Set-up

16 The Department has established logical governance and delivery arrangements and has good structures to collaborate with the sector, but has fewer resources and a tight timetable. Good governance and delivery structures are in place, and the Department deserves particular credit for its sector collaboration arrangements. The Department has also recently published a more detailed forward plan. However, at this stage of a significant and complex project we would expect to see a more thorough analysis of the interdependencies between work streams, essential requirements and contingencies. Furthermore, the delivery timetable is tight, not least because of the challenge of delivering the fair funding review. The departmental directorate with responsibility for delivering the scheme has 39.6% fewer staff than when the 50% scheme was delivered (paragraphs 3.11 to 3.22).

Delivery

17 **The Department has delivered two major milestones and made progress across a range of issues, but there has been observable slippage with some initial expectations being revised in scope or timing.** The Department has made progress, but many significant issues remain outstanding. The Department told us that this is planned and reflects its use of a flexible approach to delivery in which final decisions are taken close to implementation. This creates the potential for pressure in the late stages of the project. The Department's timescale, resources and ambitions for sector engagement leave little room for further slippage. The Department's internal assessments indicate that significant delivery risks remain, but these have reduced as the project has progressed (paragraphs 3.23 to 3.36).

Risks

18 **The Department has made good progress with a complex task, but significant short-term delivery risks and long-term outcome risks remain.** There is a risk that the pressure to deliver by 2019-20 might result in a narrowly defined scheme, or one that has not been tested enough. The Department's flexible approach, in which multiple work streams are brought together late in the process, potentially increases these risks as there will be less opportunity to deal with issues that emerge. More fundamentally, the Department needs to assure itself that the scheme will deliver its core policy objectives and that these are not overlooked among the technical challenges of designing the scheme (paragraphs 3.37 to 3.42).

Conclusion

19 The Department faces a significant challenge in implementing 100% local retention of business rates by 2019-20, a process complicated by the simultaneous delivery of a fair funding review. The Department has benefited from the experience of delivering the 50% local retention scheme and is using this experience effectively. Its highly collaborative approach to the 100% retention scheme has been welcomed by the sector. The Department has also adopted a clear and logical approach to its governance arrangements and work planning. This should now be taken forward as more detailed planning and preparatory work is required.

20 The Department has made progress in delivering the 100% scheme but, given the scale of the challenges ahead and the limited resources available, there are clear risks to delivery. Government projects such as this are prone to over-optimism, and the Department needs to avoid this. The Department needs to ensure that the design is not compromised by the pressure to deliver to a tight timetable. The Department must also assure itself that, in meeting the scheme's objective of promoting self-sufficiency, the sector's financial sustainability is not put at risk. It must ensure that the level of funding in the system at the start is sufficient to meet the sector's needs. Greater focus is also needed on ensuring that the scheme is configured to maximise economic growth rather than simply tax base growth.

Recommendations

21 We recommend that the Department should:

a Inform its planning for 100% retention by developing a comprehensive understanding of which local authorities, and why, have benefited financially from the 50% scheme.

b Routinely collect and publish data in an accessible format on the amounts retained by individual local authorities, including those in pools.

c Ensure that it is well placed to deliver the scheme by:

- reviewing its resourcing and project plans in the light of progress to date, ensuring that they are realistic given the remaining challenges;
- publishing a revised timetable setting out the critical path of inter-linkages and sequencing between the different design elements;
- reviewing its plans for modelling to support decision-making, and sharing modelling outputs with the sector; and
- examining contingency options and discussing these with the sector.

d Deepen its understanding of the relationship between business rates and economic growth to ensure that:

- the scheme design maximises the potential to deliver economic growth, not just an expansion in local authorities' tax bases; and
- consideration is given to ways of supporting economic growth in areas where the potential for tax base growth is more limited.

e Review unfunded service pressures within the sector to seek assurance that sufficient absolute funding to meet statutory responsibilities will be available at the start of the 100% system. Depending on the timing of the next Spending Review, this may require action outside of the formal Spending Review cycle.

Part One

Issues and challenges in moving to 100%

1.1 This section examines the challenges the Department for Communities and Local Government (the Department) has to address in designing the 100% system.

Government's proposals

1.2 Business rates are a charge on most non-domestic properties. They are collected primarily by local 'billing' authorities.[1] Some £22.7 billion was collected by authorities in 2015-16. A further £1.5 billion was collected by central government via the 'central list', which includes networked properties such as major transport, utility and telecommunications facilities.

1.3 In the 2015 Spending Review, the government announced that the local authority sector would retain 100% of business rates income by the end of the current Parliament. In January 2017, ministers confirmed that the scheme would start on 1 April 2019. The change has been described as a 'radical overhaul' of the local government finance system.[2]

1.4 The initial announcement said many of the core elements of the existing system in which local authorities retain 50% of business rates would remain. Some significant changes, including allowing authorities to reduce their rates, and the abolition of the levy on disproportionate growth, were also announced.

The current system

Funding local authorities

1.5 Since 2013-14, local authorities have retained 50% of locally collected rates, and any associated growth, with the balance returned to central government. This **central share** is then largely returned to local authorities through grants (**Figure 1**). The move to 100% retention will abolish the central share by allowing for its local retention. Some existing responsibilities will be funded from additional retained rates instead of grant.

1 Billing authorities include metropolitan district councils, London borough councils, unitary authorities and district councils. Billing authorities pass fixed proportions of retained business rates to major precepting authorities – county councils, fire and rescue authorities and the Greater London Authority.

2 Joint Departmental and Local Government Association Business rates retention steering group, *Terms of reference*, 12 April 2016. Available at: www.local.gov.uk

Figure 1

Sources of local authority spending power, 2015-16

Business rates are already an important source of income for local authorities

Funding source	£ billion	Share of core spending power (%)
Locally retained business rates	11.3	25.4
Revenue support grant and other government grants	11.1	25.0
Council tax	22.0	49.5
Total core spending power	**44.5**	**100.0**

Notes

1 Rows may not sum to totals due to rounding. Based on 384 authorities.

2 Education funding and income from sales, fees and charges are excluded.

Source: National Audit Office analysis of Department for Communities and Local Government data

Balancing trade-offs through complexity

1.6 There is a range of challenges in using local retained business rates to fund local authorities. These have been addressed in the 50% system in various ways. However, the resulting system is complex.

Balancing resources and need

1.7 The capacity of an area to generate business rates does not necessarily match local demand for services. For instance, there is no correlation between an area's business rates payable per person and its level of deprivation (**Figure 2** overleaf).[3]

1.8 The 50% scheme addresses this through a redistribution system of **tariffs** and **top-ups**. Local authorities have a **baseline funding level** set by the Department, which reflects local need. Authorities in which the collected business rates exceed their baseline funding pay a tariff. This in turn is received as a top-up by authorities where collected business rates are below their baseline funding.

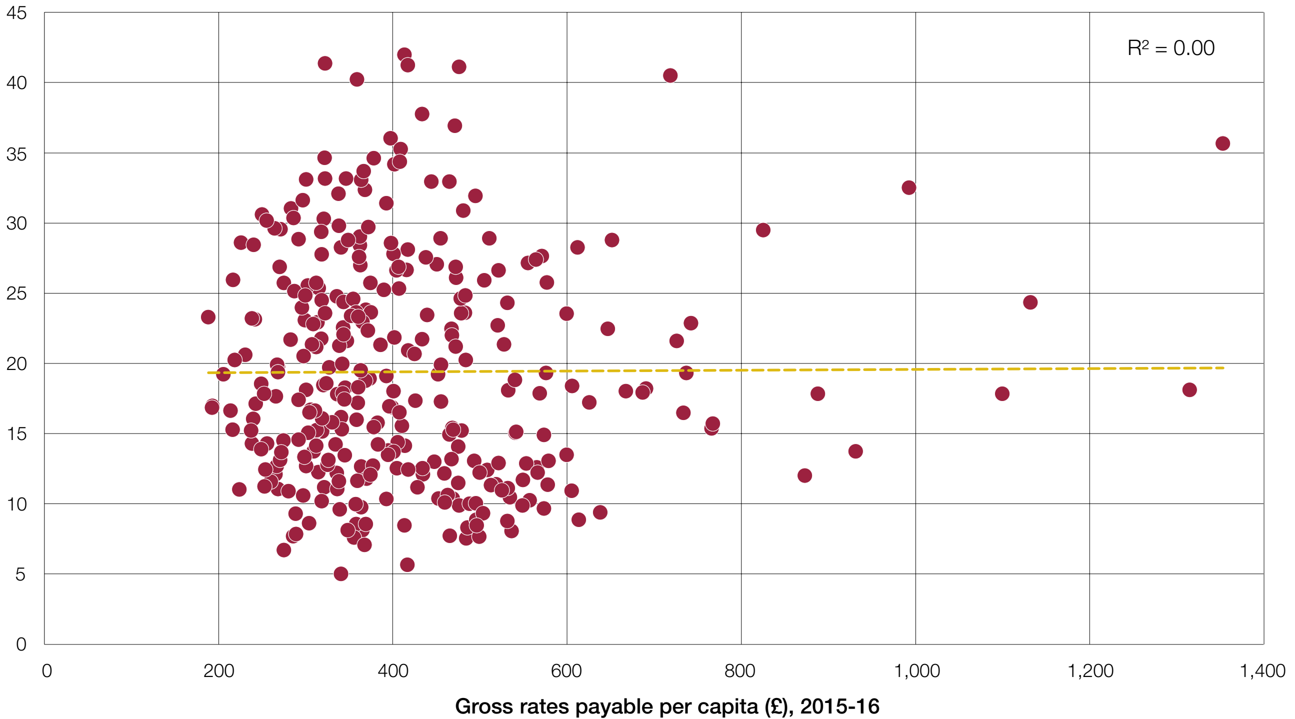
1.9 Need and business rates generation in an area can diverge over time. The 50% scheme is designed to address this through the use of periodic **resets**, although none have yet taken place. In principle, the reset system is designed to allow for the recalculation of the amounts to be redistributed via tariffs and top-ups following consideration of changes in relative need.

3 Although important, deprivation represents only one element of local relative need. However, other drivers of relative need such as share of the population aged over 65 or 85 show a similar lack of correlation to business rates payable per capita.

Figure 2

Level of deprivation and gross rates payable per capita by billing authority

The scale of an area's business rates tax base (per capita) does not necessarily match its level of need for local services



Notes

1 See separate *Methodology* document for details of data sources and methodological approach.

2 The dotted line is a regression line which shows no correlation between the two variables.

Source: National Audit Office analysis of Department for Communities and Local Government and Office for National Statistics data

Balancing growth and risk

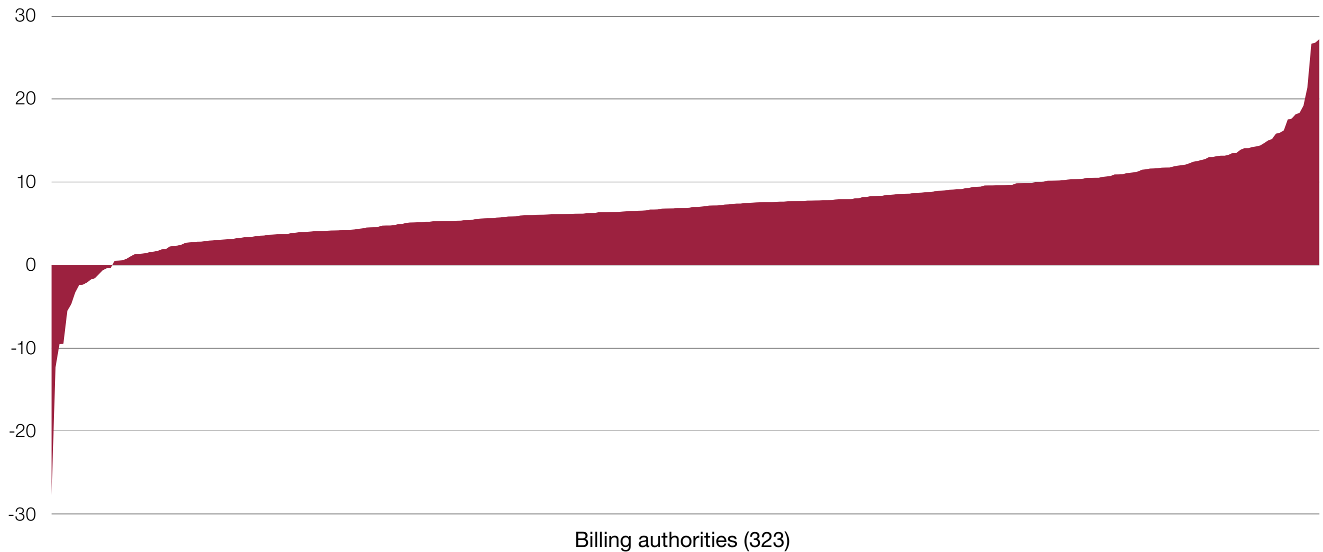
1.10 Some areas are able to grow their tax bases while others are at risk of reductions. Over time, this leads to divergence between areas (**Figure 3**). The reset mechanism in the 50% scheme, although not used to date, is designed to remove this divergence from the system periodically. The aim is to allow local authorities with growing tax bases to benefit from growth between resets, while ensuring that those with declining business rates receive periodic protection.

1.11 There can also be sharp short-term movements in a local tax base. The range of change in gross rates payable in billing authorities from 2014-15 to 2015-16 ran from an increase of 40.0% to a fall of 67.3%.

Figure 3

Change in business rates generation, 2010-11 to 2015-16

Some authorities' business rates bases grow far more than others, leading to divergence



Note

1 Three billing authorities excluded due to missing or negative data. See standalone *Methodology*.

Source: National Audit Office analysis of Department for Communities and Local Government data

1.12 The 50% scheme addressed this through **safety net** payments. These ensured that no local authority saw retained business rates income drop below 92.5% of their baseline funding in any year. The safety net was funded by a **levy** on authorities that had disproportionate business rates income growth.

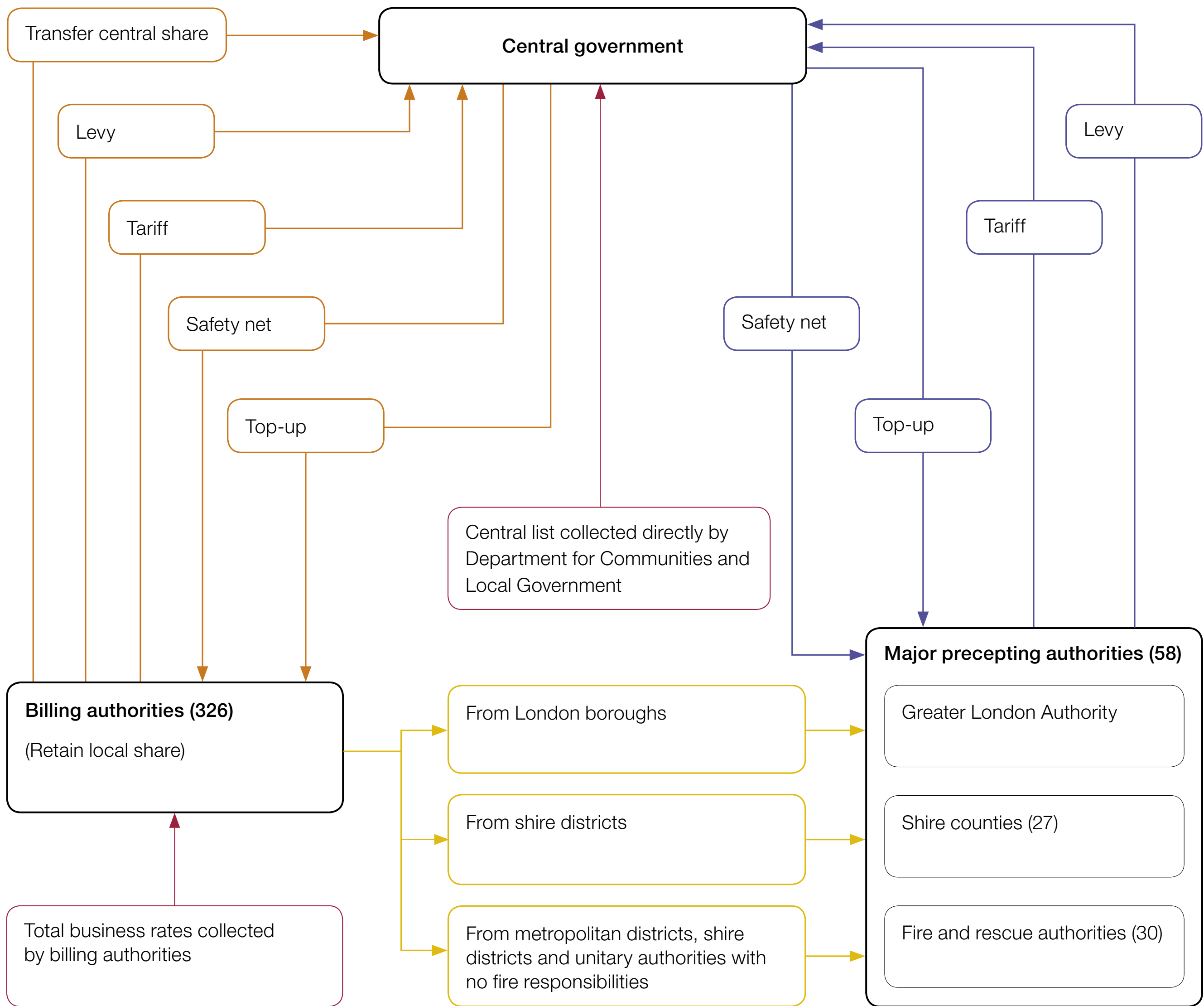
1.13 The 50% scheme also included a system of **pools**, whereby groups of authorities combine their business rates income to protect against volatility.

Complexity in the system

1.14 The need to balance the competing pressures that arise from funding local authorities from locally retained business rates means that the resulting mechanism is complicated (**Figure 4** overleaf).

Figure 4
Financial flows within the 50% business rates retention scheme

The 50% business rates system is complex



Source: National Audit Office analysis of Department for Communities and Local Government data up to 2015-16

Challenges in building on the 50% system

Reviewing the 50% system

1.15 In designing the 100% system, the Department has an opportunity to review the elements continuing from the 50% scheme such as tariffs and top-ups, safety nets and resets. Key issues for review include:

- reviewing tier splits between different types of billing authorities and major precepting authorities;
- examining the frequency and scope of resets;
- redesigning the current mechanism for meeting the costs of successful appeals, which currently requires authorities to make provisions to cover appeals, following significant criticism from the sector;
- reviewing the operation of pools; and
- ensuring that accounting and accountability arrangements are appropriate.

1.16 In addition to these core design issues, a decision also has to be taken on whether fire and rescue should be removed from the scheme.

1.17 Overall, building on the framework in place for the 50% scheme presents a significant set of review and redesign tasks for the Department.

New challenges for 100%

1.18 The most significant issues the Department faces come from new tasks that were not part of the 50% process.

New responsibilities

1.19 The government has stated that the move to the 100% scheme must be fiscally neutral. If local authorities receive additional funding via the scheme then this must be balanced by new responsibilities or a switch to funding some existing responsibilities from additional retained rates.

1.20 In 2015-16, the majority of the central share was accounted for by revenue support grant (**Figure 5** overleaf). The Department announced that this grant will be used to partially balance income devolved from the central share. However, it will have fallen in cash terms from £9.9 billion in 2015-16 to £2.3 billion by 2019-20. The Department has identified three further grants that it intends to replace with additional retained rates. These will be worth £4.2 billion by 2019-20. This leaves a large balance which will need to be matched by the devolution of new responsibilities or the ending of existing grants.

Figure 5

Estimate of value of new responsibilities to be devolved or grants to be replaced

Decisions are yet to be taken over how the outstanding business rates balance will be devolved to the sector

	2019-20 (£bn)
Revenue to be retained locally	
Central share	12.5
Central list	1.8
Grants to be replaced	
Revenue support grant	-2.3
Other grants	-4.2
Balance outstanding (excluding central list)	**6.0**
Balance outstanding (including central list)	**7.8**

Notes

1 Decision regarding use of the central list yet to be confirmed.

2 Data is in cash terms.

Source: National Audit Office analysis of Department for Communities and Local Government data

1.21 The consultation published by the Department in July 2016 on the 100% scheme set out a range of grants that could be phased out as well as possible new responsibilities to be devolved. Agreeing which of these to use in the 100% scheme will involve negotiation with the sector and other departments responsible for the activities and grants.

Setting the amount to be retained

1.22 The Department is using forecasts from the Office for Budget Responsibility (OBR) to estimate the amount to be devolved. To finalise this figure, the Department also needs to decide whether central list income is to be rolled in.

1.23 The Department will have to develop an approach that allows it to design a fiscally neutral system in the context of uncertainty over the quantum. The Department's analysis, drawing on the OBR's March 2016 forecast, suggested an upper margin of error of £14.7 billion and a lower margin of error of £10.3 billion for the central share in 2019-20.

Fair funding review

1.24 In February 2016, the government announced a fair funding review of local authorities' relative needs and resources. The outcome of the review will be used to set the distributional baseline at the start of the 100% scheme.

1.25 Delivering this work is a significant technical challenge for the Department. Arriving at a defensible distribution and agreeing transition arrangements with the sector where there will be winners and losers will also be difficult.

Multiplier flexibility – reducing or raising rates

1.26 Under the 100% scheme, local authorities will be able to reduce their business rates multiplier to boost local economic growth. The Department has decided where decision-making responsibility lies in two-tier areas and in combined authority areas.

1.27 Combined authority mayors, following consultation with the business community, will also have the power to implement a supplement to support additional investment in infrastructure. The Department will need to establish precisely how the consultation process will work and which elements of the business community are potentially exempt from any rate increases.

Pilots

1.28 The 2016 Budget announced a series of pilots to take place in 2017-18. This list was expanded in the 2017-18 local government finance settlement. The government has confirmed that it will undertake further pilots in 2018-19 in areas not covered by devolution deals, including two-tier areas. Designing and evaluating all these pilots will place demands on the Department's resources.

Business rates as a tax

1.29 Although business rates are used to support local authorities, they are a tax on business in which HM Treasury has a significant interest. Consequently, business rates are used to support government's broader objectives for businesses. As a central government tax, they also rely on the elements of the national tax infrastructure, particularly the Valuation Office Agency (VOA).

Delivering business policy through business rates

1.30 HM Treasury reviewed business rates in 2015 and concluded that the tax should remain unchanged rather than be replaced with an alternative based on, for example, local sales or gross value added.

1.31 However, the review did lead to a range of changes to support businesses such as the permanent doubling of small business rates relief. HM Treasury also committed to review the frequency of revaluations and to modernise the administration of business rates. These measures continue the regular changes to business rates to deliver the government's business objectives in recent years.

1.32 HM Treasury told us that the government will retain the right to continue to adjust taxes even under 100% local retention. In the current business rates retention scheme, decisions to change business rates that have direct financial impacts on local authorities have been compensated through grant. The government will consider how the impact of any tax changes made after the 100% scheme's introduction will be dealt with.

The role of the Valuation Office Agency

1.33 The VOA has responsibility for setting rateable values at revaluations. It also manages instances where rate payers wish to appeal against their valuation or where local authorities want to amend their local ratings list.[4] Local authority sector stakeholders we spoke to raised concerns about the VOA's ability to manage the volume of work under the 50% scheme.

1.34 The VOA's work tends to peak around revaluations (2005 and 2010) or significant regulation changes (2015) (**Figure 6**), which in turn produce periodic backlogs. Outstanding appeals and reports increased from 170,920 in 2013-14 to 334,870 in 2014-15 following changes in the regulations, which limited the extent to which new appeals could be backdated.[5]

1.35 Furthermore, the VOA has had to operate with reduced resources. From 2010-11 to 2015-16 its workforce fell by 5.5%. It expects a further reduction of 27.7% by the end of the current spending review period. The challenge for the Department is to assure itself that the VOA will be able to manage the workload generated by the 100% scheme.

Delivering policy objectives

1.36 The scheme is intended to provide incentives for local authorities to pursue business rates growth, which is expected to support economic growth. It is also designed to increase authorities' financial self-sufficiency. There are a number of challenges in meeting these objectives.

Delivering economic growth

Links with economic growth

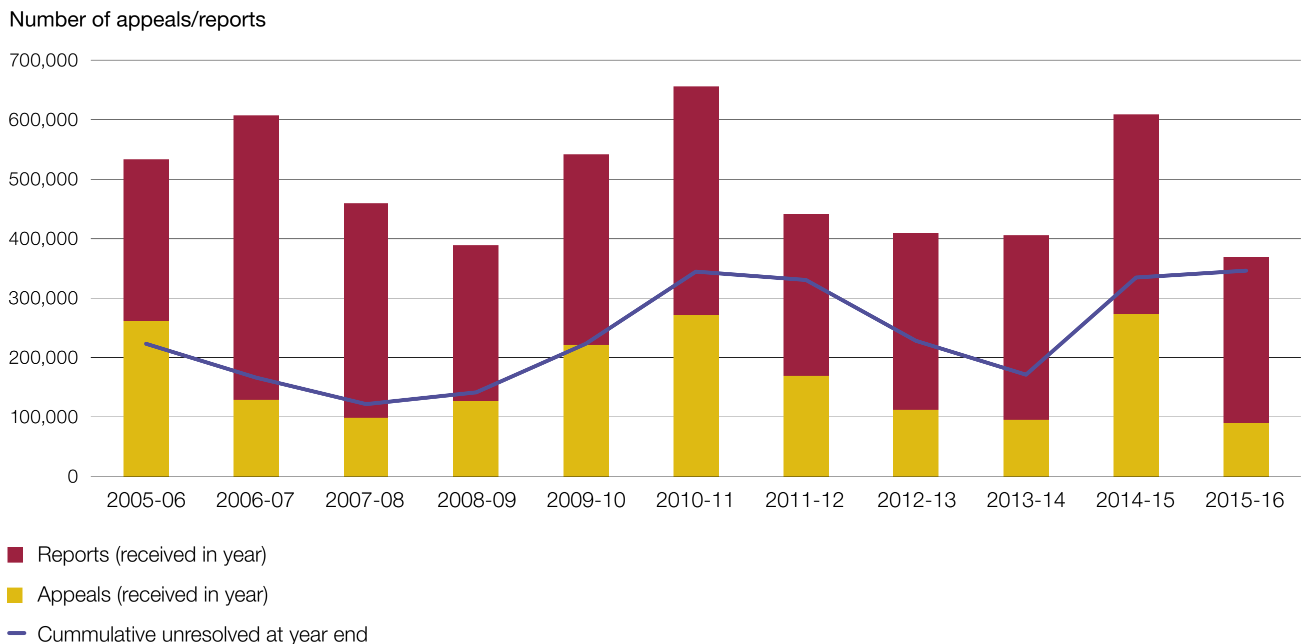
1.37 By allowing local authorities to benefit from growth in their tax base, the government's expectation is that this will incentivise authorities to adopt planning and economic development practices that promote development and construction. This is expected to deliver economic growth in the form of jobs and increased economic output.[6]

4 We use the term appeal to refer to instances where a rate payer challenges the rating list. This includes interested person proposals and actual appeals.
5 This includes appeals and reports from the 2005 and 2010 revaluations only.
6 Department for Communities and Local Government, *Business rates retention scheme: the economic benefits of local business rates retention*, May 2012.

Figure 6

The Valuation Office Agency's workload – appeals and reports from 2005-06

The workload of the Valuation Office Agency varies significantly over time and can lead to backlogs building up



Note

1 Only appeals and reports relating to the 2005 and 2010 revaluations are shown. Any appeals and reports relating to the 2000 revaluation that were received or outstanding from 2005-06 onwards are not shown.

Source: National Audit Office analysis of Valuation Office Agency data

1.38 One complication is that business rates retention incentivises authorities to increase their tax bases, through increasing floorspace, better management of their ratings lists or refurbishment of existing properties rather than necessarily pursuing economic growth. Changes in the commercial value of properties due to wider economic growth are captured in periodic revaluations. However, these must be revenue-neutral nationally, which is achieved by adjusting the multiplier. Revaluations do lead to changes in the level of rates generated in each locality, but authorities' tariffs or top-ups are adjusted to ensure their retained income is the same after revaluation. As a result, authorities do not benefit from general economic changes in the value of existing property.

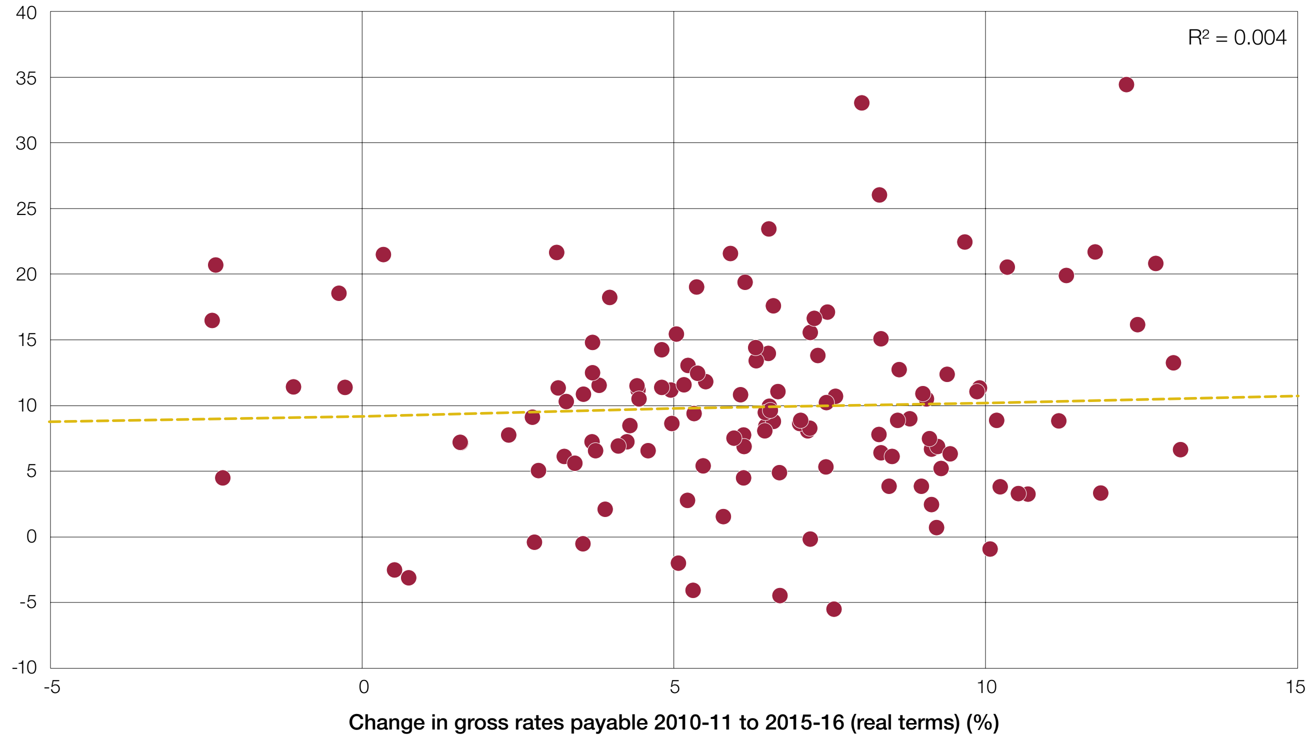
1.39 The link between tax base growth and economic outcomes is also not direct. For instance, different types of development create different levels of economic outcomes and might lead to relocation of existing activities rather than the creation of new ones. Consequently, there is no correlation between change in an area's tax base and change in its economic output within the most recent revaluation period (**Figure 7** overleaf).[7]

7 M Sandford and F Mor, *Property taxation and revenue incentives*, House of Commons Library briefing paper, 10 February 2017.

Figure 7

Growth in the business rates tax base against growth in economic output by local area

High levels of business rates growth do not necessarily reflect economic growth



Notes

1 See separate *Methodology* document for details of data sources and methodological approach.

2 The dotted line is a regression line which shows no correlation between the two variables.

Source: National Audit Office analysis of Department for Communities and Local Government and Office for National Statistics data

1.40 The challenge for the Department is to design the 100% system to maximise the scheme's potential to deliver economic growth, including considering possible perverse outcomes such as:

- 'overbuilding', whereby a local authority's desire to increase its tax base through new construction is not matched by an increase in demand;[8]
- local authorities pursuing new developments of certain types or in particular places that maximise tax base growth but do not necessarily support the needs of other existing elements of their economies;[9] and
- developers seeking more favourable terms in recognition of the financial benefit that their developments will now bring to authorities.

8 K Muldoon-Smith and P Greenhalgh, 'Passing the buck without the bucks: some reflections on fiscal decentralisation and the Business Rate Retention Scheme in England', *Local Economy*, vol. 30 issue 6, September 2015, pp. 609–626.

9 L McGough and H Bessis, *Beyond business rates: incentivising cities to grow*, Centre for Cities, December 2015.

Multiplier reductions and infrastructure supplements

1.41 The capacity for authorities to reduce their multipliers under the 100% scheme and to levy an infrastructure supplement provide potential mechanisms for authorities to support economic growth in ways other than through the planning process. The challenge for the Department in relation to multiplier reductions is to understand the propensity and capacity for different types of authority to use this mechanism, and to understand the implications for authorities and their economies where its use is less likely. A further challenge for the Department is to assure itself that the use of multiplier reductions will not lead to unacceptable levels of tax competition between localities.

1.42 In relation to the infrastructure supplement, the challenge for the Department is to ensure that it is designed in such a way that it is seen as attractive by both local authorities and their business communities.

Ability to shape their area

1.43 Different areas have different capacities to grow their tax bases. Growth in business rates tax bases since 2010-11 varies significantly and does not conform to any simple geographical pattern (**Figure 8** overleaf).

1.44 Rather, growth in the tax base is driven by a combination of factors, including local commercial property market conditions, the availability of development sites and demand in the local economy.[10] Our analysis, based on grouping local authorities around these three characteristics, suggests that:

- local authorities with a combination of low commercial rents, low population densities and vibrant economies (measured in terms of job growth) are the most likely to have seen above average growth in their tax base; and
- no local authority with high rents, high population densities, and a relatively weak economy saw above average growth in their tax base (see Appendix Two).

1.45 The challenge for the Department here is to continue to develop an understanding of factors underlying tax base growth, and particularly how these affect the potential for growth in different local authorities. This then raises questions as to how the scheme can be designed to support economic growth in those areas that do not have favourable conditions.

Delivering self-sufficiency

1.46 There are risks and challenges that need to be considered in the move to self-sufficiency via 100% local retention.

10 See footnote 8.

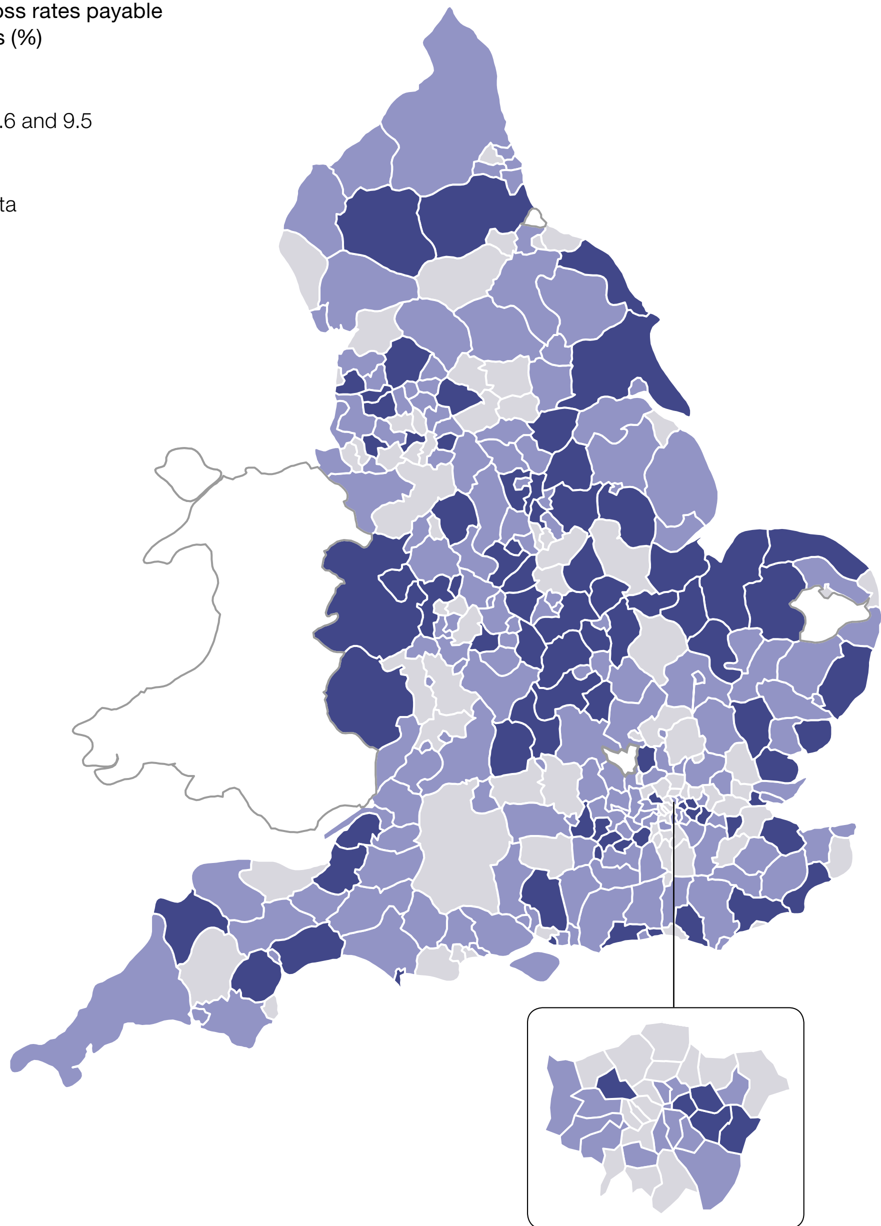
Figure 8

Change in business rates tax base in England, 2010-11 to 2015-16

There appears to be no clear geographical pattern to growth in business rates

Change in gross rates payable by rate payers (%)

- Above 9.6
- Between 4.6 and 9.5
- Below 4.5
- Missing data



Note

1 Data include billing authorities only.

Source: National Audit Office analysis of Department for Communities and Local Government data

Differences in capacity to deliver tax base growth

1.47 Different areas will be more or less able to grow their tax bases. This influences their capacity to deliver economic growth and also has implications for their ability to generate resources to deliver local services.

1.48 The challenge for the Department is to deepen its knowledge of the factors underlying tax base growth in order to understand the implications for the financial sustainability of different local authorities. For instance, do authorities with limited potential to grow their tax bases also have weaker financial positions or significant projected increases in demand? Likewise, to what extent has pooling in the 50% scheme allowed authorities to share risk and reward?

Funding sufficiency

1.49 The move to greater self-sufficiency in local authorities is taking place in the context of a reduction in their funding. Authorities' spending power (government grant, locally retained business rates and council tax) fell in real terms by 25.2% from 2010-11 to 2015-16. From 2015-16 to 2019-20, spending power will fall in real terms by £2.4 billion (5.4%) (**Figure 9** overleaf). This is a slowing in the rate of reduction but these future reductions come on top of previous reductions. Furthermore, demand is likely to continue to grow. From 2015-16 to 2019-20, the over-65 and over-85 populations are projected to grow by 7.1% and 10.7% respectively.

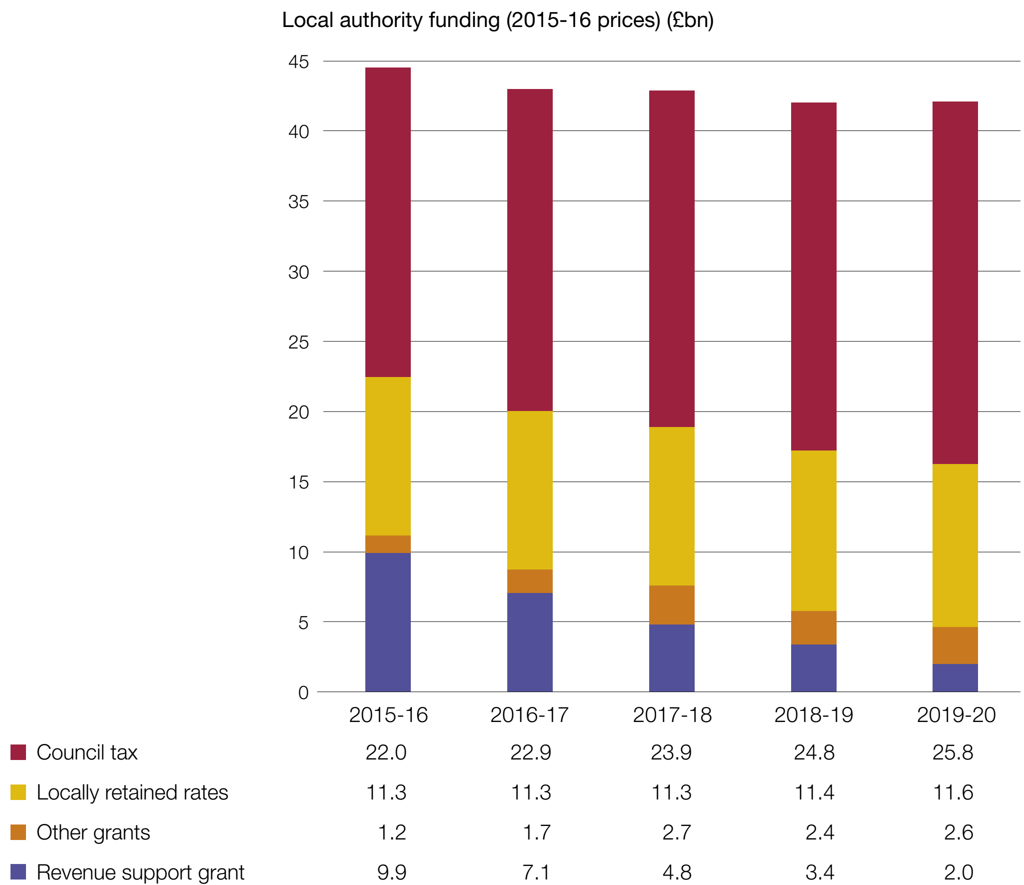
1.50 The Department expects to continue to assess the absolute level of funding for local government through future Spending Reviews. However, the current Spending Review period runs up to and including 2019-20, whereas the 100% scheme is scheduled to begin at the start of that financial year.[11]

11 For departments with protected budgets, which does not include the Department for Communities and Local Government, the Spending Review period runs up to 2020-21 inclusive. Capital budgets for all departments run up to 2020-21 inclusive.

Figure 9

Change in components of core spending power, 2015-16 to 2019-20

Core spending power will fall until 2018-19, then rise slightly



Source: National Audit Office analysis of Department for Communities and Local Government data

Part Two

Learning from 50% local retention

2.1 This section examines the Department for Communities and Local Government's (the Department's) planning for the 50% scheme, and reviews the scheme's operation. It also examines the extent to which the Department has learned lessons from the 50% scheme.

Planning for 50% retention

The Department's approach

2.2 The 2010 Local Growth white paper announced the government's intention to allow local authorities to retain business rates. The scheme was introduced on 1 April 2013. The Department's design work was built around a series of overlapping stages:

- **The period up to completion of the consultation in July 2011.** In this period, the Department did the bulk of the design work and agreed the broad principles with other departments and stakeholders.
- **The passage of the bill through Parliament.** The Local Government Finance Bill entered the House of Commons in December 2011 and received Royal Assent in October 2012. The Department framed the legislation in enabling terms rather than being highly specified to ensure that it retained flexibility in designing the regulations.
- **The design of the regulations and the publication of the 2013-14 local government finance settlement.** There was significant debate while developing the regulations and working through their distributional implications throughout 2012.

2.3 The Department engaged with stakeholder bodies such as the Local Government Association (LGA). Engagement with the wider sector outside the consultation was more limited.

Challenges and issues in planning for 50%

Delivering on time

2.4 The Department had 30 months to design the 50% scheme. There had been no preliminary work ahead of the white paper. However, the Department considered that an early decision not to make any significant changes to the needs formula reduced its potential workload.

2.5 The tightness of the timetable had implications, however. The Department could not pilot any elements of the scheme. The Department also did not finalise some of the accounting and accountability arrangements for the scheme and these were still being worked on after the scheme's introduction.

2.6 Sector stakeholders told us that significant decisions were made late in the process, including the decision to base predicted business rates income on a two-year rather than a five-year average. Late changes to the design of the levy also meant that some local authorities reviewed their plans to enter into pools late in the process.

Resources

2.7 The Department was happy that it had sufficient skills in the team, which it supplemented with secondees. However, the Department also recognised that the tight timetable meant that the work was pressurised and there were times when it had to draft in people from other directorates.

Parliamentary scrutiny

2.8 The Department's use of enabling legislation was designed to provide it with flexibility in the design of the scheme. Some MPs and members of the House of Lords criticised this approach. They argued that it was difficult to subject the legislation to scrutiny when much of the detail had yet to be announced.

Operation of the 50% scheme

2.9 The Department views the scheme as a success: it was implemented on time, no local authority has failed financially and there have been no significant legal challenges. The Department has not formally reviewed the scheme, however.

2.10 Nevertheless, there are a number of issues that have emerged in the operation of the 50% scheme that may have implications for the design of the 100% arrangements.

The scale and distribution of funding

Aggregate impact

2.11 Across the sector as a whole, the 50% scheme has allowed local authorities to retain an additional £388 million over the three-year period. The amounts retained varied from year to year, and include a loss in the first year (**Figure 10**).

2.12 The additional sums generated for the sector are relatively small: the additional £332 million retained in 2015-16 is equivalent to 0.7% of spending power for the sector as a whole (£44.5 billion).

Different impacts across local authorities

2.13 The use of pools, whereby income is distributed based on locally agreed principles, makes it difficult to understand which local authorities have benefited from the scheme. The Department's primary data set on business rates, the national non-domestic rates return, does not allow for the distribution of retained rates within pools to be calculated.[12] The Department told us that although it does not systematically collect data on the distribution of retained rates within pools in this data set, it believes it has a good understanding of the distribution of the vast majority of local business rates income.

Figure 10

Additional business rates retained under 50% scheme

An additional £388 million has been retained by the sector during the 50% scheme's first three years

	2013-14	2014-15	2015-16
Local share of business rates	10,697	11,134	11,608
Baseline funding	10,899	11,111	11,323
Balance before levies and safety nets[1]	**-201**	**23**	**285**
Levy payments	25	53	68
Safety net payments	197	115	114
Retained business rates growth[2]	**-29**	**86**	**332**

Notes

1 Local share of business rates minus baseline funding.

2 Balance before levies and safety nets minus levy payments plus safety net payments.

3 Numbers may not sum due to rounding.

Source: National Audit Office analysis of Department for Communities and Local Government data

12 The Department does have an alternative data set, the revenue outturn return, which collects data that could potentially provide insights on distribution within pools. However, a significant share of authorities (37.7%) appear to re-submit the indicative figure provided by the Department in the form based on budget data rather than its actual outturn data. The indicative figure does not include an estimate for safety net or levy payments for authorities in pools. There are also marked differences in retained rates for individual authorities not in pools in the revenue outturn data compared with the Department's own analysis based on the national non-domestic rates data returns.

2.14 Our analysis focuses on local authorities not in pools in 2015-16 (**Figure 11**). District councils have seen higher rates of growth in retained income relative to their baseline funding levels (7.9%). Their strong performance is driven by the fact that their baseline funding levels are small relative to their business rates base. This high 'gearing' means that only a small movement is needed in their business rates base to generate a relatively large movement in their retained income.

2.15 In two-tier areas, the system was designed to give protection to county councils through a low gearing. The Department has recognised that there is a case for strengthening the growth incentive in upper-tier areas. However, options to address gearing rates in single-tier areas are limited.

Delivery against growth objectives

Promoting economic growth

2.16 The Department has not systematically examined whether the 50% scheme has incentivised pro-economic growth behaviours. The Department's view is that it is relatively early in the life of the scheme to reach a conclusion. It also feels that assessing the growth impact will be complex because it is difficult to control for the impact of the growth incentive in the context of other factors acting on local economies. In addition, the Department also told us that the impact on local authority budgets of provisions for successful appeals adds to the challenge of assessing the picture at local authority level.

Figure 11

Business rates growth retained by authority type (excluding members of pools), 2015-16

Benefits from the 50% scheme appear to vary across different authority types[1]

	Median business rates growth retained as a percentage of baseline funding (%)	Median business rates growth retained as a percentage of core spending power (%)	Median gearing
Fire and rescue authorities	0.7	0.2	0.4
County councils	0.9	0.1	0.4
Metropolitan district councils	2.5	0.7	0.6
London borough councils	2.6	0.6	0.6
Unitary authorities	3.1	0.8	1.0
Shire district councils	7.9	1.8	7.1

Note

1 Authorities not in pools may well have different business rates characteristics to those in pools. However, the significance of differences in gearing between different authority types is likely to be present in both groups.

Source: National Audit Office analysis of Department for Communities and Local Government data

2.17 Many of the stakeholder organisations we spoke to were sceptical about the extent to which the 50% scheme had incentivised pro-economic growth behaviours.[13] Some, with experience of local authorities with strong economies argued that they had little role in driving growth, suggesting that this was a function of other factors such as location, and had not seen much evidence of authorities promoting growth in response to the 50% scheme. Those representing local authorities with weaker economies felt that they were already taking action to deliver growth.

2.18 Ultimately, it is not yet clear whether the scheme has incentivised authorities to adopt pro-economic growth policies, and whether any behaviour change has actually supported economic growth.

Focus on ratings lists

2.19 Local authorities can grow their rates income by managing their local ratings lists more effectively and reducing avoidance and fraud. The Department believes that authorities are more interested in this activity and have begun investing in their business rates collection teams. The Institute of Revenues Rating and Valuation (IRRV) and Valuation Office Agency (VOA) agreed.

Appeals

The issue

2.20 Rate payers can appeal against their valuation. If successful, rate payers will receive a backdated payment and a reduction in their future rate payable. The way in which this process has operated in the 50% scheme has been heavily criticised by many of the stakeholder bodies we spoke to.

2.21 Before the 50% scheme, appeal costs were pooled nationally. Under the 50% scheme, local authorities became liable for half of the cost of backdated appeals. The Department estimated the cost of appeals and built it into the system design with a standard adjustment made to each authority's estimated business rates income.

2.22 However, in practice, the distribution of appeals is uneven and does not conform to a national average. Consequently, local authorities with high levels of appeals were potentially exposed to significant income reductions.

2.23 Further complications reported by stakeholders relate to the large number of appeals and the time taken to process them by the VOA. The availability, timeliness and quality of appeals information available from the VOA in order to inform financial planning was also questioned by some stakeholder bodies we spoke to.

13 However, one stakeholder body provided an example of one pool of authorities using their additional retained rates specifically to support their Local Enterprise Partnership's local growth strategy.

2.24 The VOA told us that its ability to process appeals is hampered by the large number of what it regards as speculative appeals. A new appeals system (Check, Challenge, Appeal) will be introduced in April 2017. The VOA told us that the new system is designed to reduce the number of appeals and the time taken to process them. The VOA also told us that following the 2016 Enterprise Act it is now able to share a broader range of information. It feels that this will increase the timeliness and quality of information available to authorities.

2.25 Overall, stakeholders told us that in the current system appeals risk adds considerably to the instability of business rates as a source of income. The Department has recognised that the impact of appeals had taken the edge off the growth incentive and made it difficult for local authorities to forecast their annual business rates income.

Financial implications

2.26 Local authorities are required to make a provision to cover the potential cost of appeals. However, authorities lacked experience on how to value these costs. This, combined with limited information about the scale and nature of appeals, means that authorities have been cautious in calculating provisions. By 2015-16, the level of provisions had grown steadily to £2.8 billion. This is funding that cannot be used to support service delivery in that year.

2.27 The Department told us that although it had worked with local authorities in modelling the potential impact of appeals it had not anticipated that authorities would continue adding to their provisions after creating them in the first year.

Appeals and the safety net

2.28 An additional issue that emerged from the appeals process was that in several cases the scale of an individual local authority's provisions pushed it below the safety net level. The LGA estimates that authorities' provisions for backdated appeals in 2013-14 generated an extra £171 million in safety net payments, 83% of total payments.[14] A number of stakeholder bodies indicated that meeting the cost of provisions was not the purpose of the safety net.

Protecting against risk through pools

2.29 By participating in a pool, local authorities can reduce their risk of reductions in rates income. They can also limit their exposure to levy payments. The proportion of authorities in pools increased from 23.2% in 2013-14 to 50.2% by 2015-16 (**Figure 12**). Forecast data for 2016-17 show that this has increased to 54%.

2.30 This meant that total safety net payments to the sector were £14.2 million lower than if pools not been used. Also, over the same period the use of pools meant that local authorities reduced their levy payments by £101.5 million.

14 Local Government Association, *Business rates: the story continues*, March 2015.

Figure 12

Pool membership, and safety net and levy payments

Pools have been an effective way for local authorities to avoid levy payments

	2013-14	2014-15	2015-16	Total
Percentage of authorities in pools (%)	23.4	28.9	50.3	–
Reduction in safety net payments due to pools (£m)	2.4	9.1	2.7	**14.2**
Reduction in levy payments due to pools (£m)	12.8	25.6	63.1	**101.5**
Percentage of safety net payments by value avoided through the use of pools (%)	1.2	7.3	2.3	**3.2**
Percentage of levy payments by value avoided through the use of pools (%)	33.8	32.8	48.3	**41.1**

Source: National Audit Office analysis of Department for Communities and Local Government data

2.31 Several stakeholder bodies told us that pools were often used primarily to reduce levy payments rather than to spread risk. The Department recognised that it did not fully anticipate the extent to which pools would be used to maximise gains rather than reduce risk.

Learning from 50% local retention

Lessons learned

2.32 The Department has learned lessons from the 50% scheme and intends to apply that learning in the 100% scheme. Key aspects include:

- **adopting a more open approach to the design process.** The Department has adopted an inclusive approach to the design of the 100% scheme in terms of its engagement with the sector;
- **an understanding that the full range of potential impacts needs to be addressed in the design process from the outset.** From its experience of designing the 50% scheme the Department has recognised the importance of including elements of accounting from the outset of the design of the 100% scheme. An accountant has been in the 100% team from the start;
- **a greater understanding of timetabling risks.** The Department had to make a number of late decisions when designing the regulations for the 50% scheme. It has allowed itself more time to finalise the regulations for the 100% scheme;

- **understanding that the appeals process needs to be addressed.** The Department told us that it is aware of the sector's concerns and is looking to address them in the 100% scheme. A measure paving the way for the Department to address this is included in the Local Government Finance Bill, which was introduced to Parliament in 2017;
- **a need for a baseline starting position with broader support from the sector.** The decision not to review the baseline for the 50% scheme saved time but has proved contentious in the sector. The fair funding review is designed to address this; and
- **an awareness of the need to revisit pooling arrangements.** The Department told us that it was thinking about ways to use pools to aggregate risk and promote joint working over wider areas. A series of measures are set out to address this in the current Local Government Finance Bill.

2.33 In addition to these specific issues, the Department has also developed a body of expertise and experience that will be of value in designing the 100% scheme.

Outstanding issues

2.34 Although the Department has learned and benefited from the 50% scheme, the lack of a systematic review means that there might be gaps in its knowledge as it moves to the 100% scheme.

2.35 The extent to which areas have benefited financially from the scheme, and why, has also not been fully explored, not least because the Department does not have data on how funding has been distributed in pools. Consequently, it does not have a detailed understanding of which local authorities are likely to benefit and why, and what this in turn means for financial sustainability under the 100% scheme.

2.36 The Department has also not examined systematically how the incentive has driven different types of behaviour change and consequently how the 100% scheme ought to be configured to deliver economic growth in different places.

Part Three

Planning for 100% local retention

3.1 This section examines the Department for Communities and Local Government's (the Department's) work to date on the 100% scheme, focusing on three themes:

- Purpose: Are there clear, realistic objectives and an understanding of what success looks like?
- Set-up: Has the programme of work been set up in a clear and logical way give the nature of the tasks?
- Delivery: Does progress so far indicate that the project is being well managed?

Purpose of the scheme

3.2 The Department's main goals for the scheme are to support the sector's financial self-sufficiency and to promote economic growth.

Financial self-sufficiency

3.3 A key aim is to reduce the dependence of local authorities on government grants. The Department has a clear understanding of what this means and how it will be delivered. Additional retained business rates will replace some central government grants that fund existing activities. New responsibilities may also be devolved.

3.4 The Department has a flexible definition of success in relation to financial self-sufficiency. While it is confident that the introduction of 100% retention will increase the level of financial self-sufficiency, it does not have a specific target for how far it will do so or what level will be reached.

3.5 While they welcomed greater self-sufficiency, several stakeholder bodies told us that the first call on additional funding should be to fund existing unfunded pressures. This view was shared by the business representatives we spoke to, who were concerned about the impact of funding pressures so far, such as cuts in business support spending.

3.6 The July 2016 consultation document states that "under 100% business rates retention all authorities will be funded for their existing responsibilities and for any new responsibilities devolved". When we discussed this with the Department, it told us that it wanted to ensure that the new system was sustainable over time, and that this would be considered at the point of implementation.

Growth incentives

3.7 The 2015 Spending Review said that the changes to local government finance "will strengthen incentives to boost growth, help attract business and create jobs".

3.8 When we spoke to the Department it was clear that by growth it means local economic growth such as jobs and output. However, the Department will not set a measurable target for the level of additional growth that the reforms should achieve, such as a specific increase in the level of gross value added.

3.9 The Department's understanding of the relationship between economic growth and growth in the local business rates base rests on analysis carried out for the Department in 2012. The Department has not carried out any further analysis in light of the 50% retention scheme.

3.10 Sector stakeholders told us that there had been little discussion in the working groups on the actual connection between business rates and economic growth. Consequently, how the scheme can best be configured to boost economic growth has not been fully explored. Equally, the local economic implications for local authorities which are not able to grow their tax bases have not been examined in detail.

Programme set-up

Internal organisation

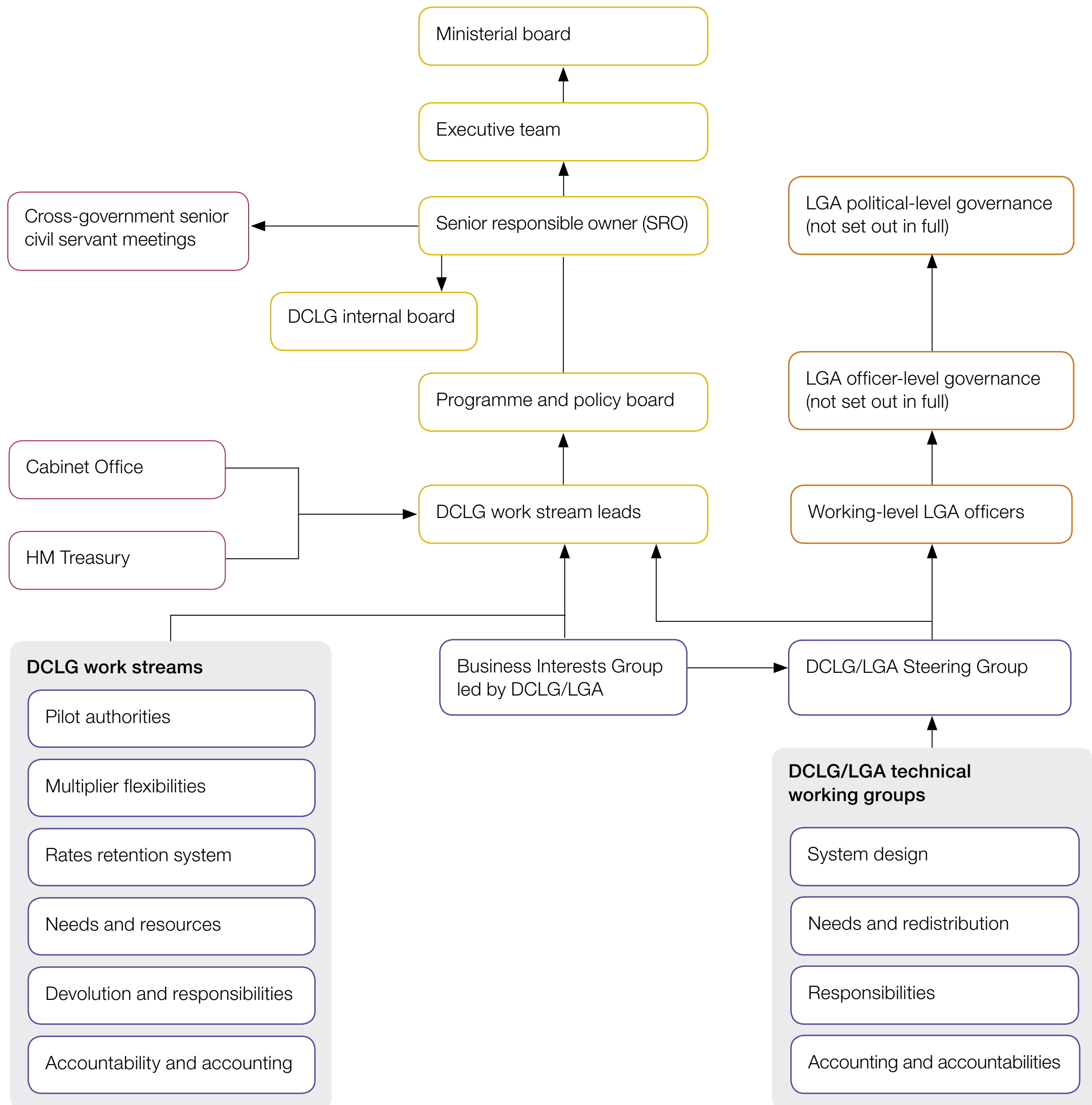
3.11 The Department has organised itself in a clear and logical fashion. It has broken down the overall business rates reform project into a number of work streams (**Figure 13**). The work streams are the basis for progress-tracking and oversight. In addition to a lead official, each work stream has a senior civil servant assigned to oversee it.

Structures for collaboration

3.12 The Department's collaborative approach has been implemented through working groups, jointly chaired by the Department and the Local Government Association (LGA) (Figure 13). The groups are overseen by a jointly chaired steering group. There are four technical groups made up of local government and other stakeholders. There is a separate jointly chaired group that represents business interests. The groups are transparent: agendas, papers and minutes are published on the LGA's website.

Figure 13

Governance and delivery arrangements for the 100% scheme



Note

1 More information on LGA governance arrangements available at: www.local.gov.uk.

Source: National Audit Office review of Department for Communities and Local Government and Local Government Association documents

Governance and leadership

3.13 Within the Department there is a clear line of accountability through a senior responsible owner (SRO) to the executive team and ministers. There are suitable arrangements for engaging with civil servants beyond the boundaries of the project team. An internal board, chaired by the SRO, considers policy links across the Department. Work stream leads meet fortnightly with officials from HM Treasury and the Cabinet Office. The SRO also chairs cross-government senior civil service meetings covering the reforms.

Plan and timetable

3.14 Ministers confirmed in January 2017 that the scheme and a new funding formula would be delivered by 1 April 2019. Prior to that, the Department had been planning for delivery on that date, but provisionally.

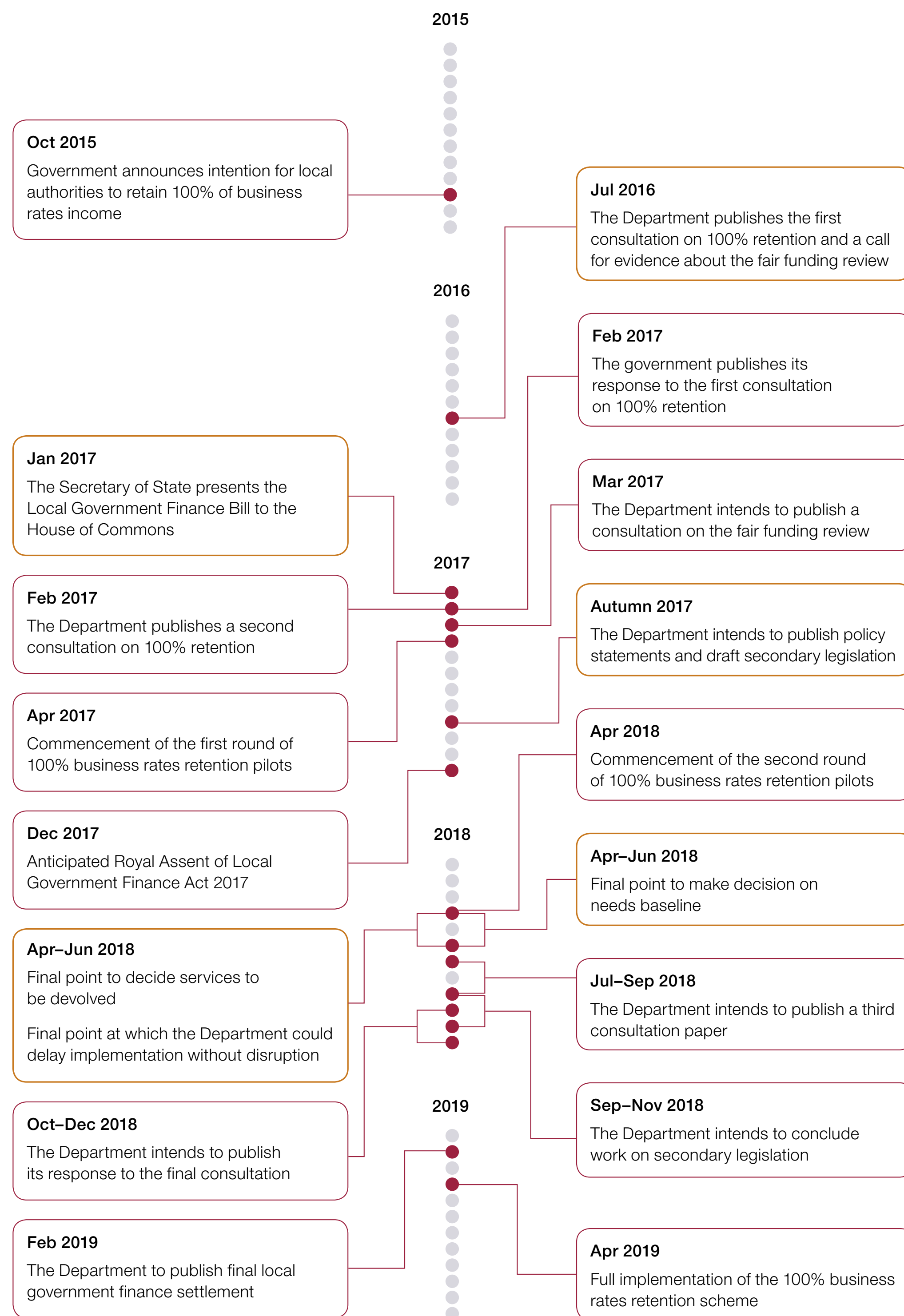
3.15 The Department's formal plans focus on the procedural elements that need to be carried out in order to meet an April 2019 delivery: primary legislation, secondary legislation, ministerial and cross-government decision-making, and public consultations (**Figure 14**).

3.16 The Department has identified six critical milestones from mid-2016 onwards, three of which relate to the current Local Government Finance Bill (the bill). The other three are decisions that need to have been taken by the second quarter of 2018, one being the new needs baselines.

3.17 Although the Department has set out its key milestones, at this stage of a significant and complex project we would expect to see evidence of a more thorough analysis of essential requirements, interdependencies between work streams, and contingencies. Several stakeholder representatives told us that a more detailed plan and timetable would be advantageous. The Department has recently set out a more detailed set of milestones, although with a low level of precision about expected timings. We have not seen material that enables us to assess the Department's analysis of essential requirements, interdependencies between work streams, and contingencies.

3.18 Stakeholder bodies frequently told us that the timetable appears challenging. Their main cause for concern is the difficulty of delivering a genuinely fundamental fair funding review alongside designing the 100% scheme. The Department is clear that its needs and resources work stream will take longest to deliver.

Figure 14
Timeline for the delivery of the 100% scheme



Source: National Audit Office review of Department for Communities and Local Government documents

Resources

3.19 Early in the project, the Department carried out detailed resource planning. The May 2016 Delivery Plan recorded vacancies against team profiles, and informed the initial assessment of delivery risk. The most severe risks identified at this stage related to staffing: the number of vacancies across the project as a whole, and the analytical resource for certain work streams. The Department has not revisited its resource planning comprehensively since then but has recruited to fill the majority of identified vacancies and has strengthened its analytical resource. In the Department's view, the risks on staff resource have now reduced.

3.20 A number of stakeholders expressed concern about overall resources or about the analytical resource available. Some expressed the view that the Department was reliant on a relatively small number of staff with business rates expertise, creating fragility. However, stakeholders also commented positively about the Department's knowledge and expertise on the operation of business rates compared with the situation during the development of the 50% scheme.

3.21 The Department told us that relevant experience is largely within the Local Government Finance Directorate. The staffing in this directorate has fallen by 39.6% from March 2011, when the 50% scheme was being developed, to January 2017. The Department told us that its staffing resources had been under pressure in designing the 50% scheme and it had drawn in people from other directorates at certain times.

3.22 The Department intends to revisit its resourcing estimates shortly, as part of its business planning cycle.

Delivery

The Department's approach to delivery

A flexible approach

3.23 The Department has adopted a deliberately flexible approach to the delivery of the scheme. Key elements include:

- seeking early passage of enabling legislation;
- designing initial consultations to be open, containing a wide range of ideas and inviting others, with firm proposals to be consulted on later;
- making continuing progress on developing scheme building blocks within separate work streams without integrated modelling, and only modelling different options for the system as a whole at a late stage; and
- taking final decisions affecting funding and the precise balance between different objectives as close to the implementation as they feel is reasonable.

3.24 While this approach maintains maximum flexibility, it may generate pressure towards the end of the timetable.

Approach to Parliamentary scrutiny of the bill

3.25 For the 50% retention legislation, the Department published detailed policy statements when the bill moved to the House of Lords in order to inform Parliamentary scrutiny. The Department intends to publish detailed policy statements or draft regulations where possible during the passage of the current legislation. However, the Department's approach, including ongoing engagement and consultation with the sector, may have an impact on what it is possible for it to publish.

3.26 Given the Department's approach, in which final decisions on the fair funding review and system design are brought together in 2018, the starting baselines for individual authorities will not be available until after the bill has passed through Parliament. In this respect, any impact assessment published to accompany the bill's passage through Parliament will not cover the implications of the scheme for specific authorities.

Delivery to date

3.27 The Department has delivered against important milestones and made progress in all its main work streams.

Major milestones

3.28 The first two critical milestones are the publication of a first consultation to inform policy development, and the introduction of primary legislation to Parliament. The consultation was published in July 2016. The Local Government Finance Bill was introduced to Parliament on 13 January 2017 and contains enabling provisions for 100% local retention. The Department's response to the consultation was published on 15 February 2017, alongside a further consultation on some elements of system design.

Progress with work streams

3.29 The Department has delivered progress across all its work streams (**Figure 15** on pages 43 and 44). A range of decisions have not yet been taken:

- **Devolution and responsibilities.** Decisions covering around half of additional business rates have been announced with the remainder still to be confirmed. No decision has yet been reached to devolve any wholly new responsibilities and there are no provisions in the bill. The government is continuing to work with the sector on options for the remainder of the devolution package and has indicated that it will reach a final decision in spring 2018.

- **System design.** The Department has not explored the relationship between growth in the business rates base and local economic growth to inform its system design work. Nor has it carried out further work on the local authority behaviours that might be incentivised by different arrangements. A range of significant decisions remain outstanding such as the division of business rates within two-tier areas, the level of the safety net, the proportion of growth that may be retained at a partial reset and how this growth might be defined, and precisely how a central approach to appeals would work.

- **Multiplier flexibilities.** The issue of whether multiplier reductions may boost local growth in one area at the expense of others has been raised by the Department and the sector but no analysis has been presented to the working groups on this. The same is true about the implications of areas having more or less capacity or propensity to use the multiplier flexibility or levy infrastructure supplements.[15] Various detailed decisions about secondary legislation are still outstanding, such as the level of a threshold determining which businesses are subject to the infrastructure levy.

- **Needs and resources.** This work stream supports the fair funding review. The focus of work has been on assessing need. Other aspects such as relative resources have received less attention. At the end of February 2017, a planned further consultation had not yet been published.

- **Accounting and accountability.** The bill proposes a major change to central government accountability to Parliament for the distribution of funding to local government. Local government will be consulted on general principles of allocation with no Parliamentary vote. No decision has yet been made on any ringfencing or other conditions to be attached to new responsibilities or where grants will be replaced.

- **Pilots.** There has been slower than expected progress on agreeing responsibilities to be funded by the additional business rates. The Department has announced its intention for some pilots in two-tier areas, to start in 2018-19, but has not yet published any more information to inform potential candidates.

15 The Department is putting in place requirements in relation to the two flexibilities which it believes will be important safeguards. These include the requirement for an authority to consult with its neighbours where it intends to reduce its multiplier, and to produce a prospectus and consult the business community where it plans to levy a supplement.

Figure 15
Progress within work streams and working groups

Multiplier flexibilities

- Work has been informed by the system design working group, the business interests group and the accounting and accountabilities working group.
- The Department has made decisions feeding into primary legislation, such as setting the requirements for the use of the multiplier discount (including consultation with neighbouring authorities) and the conditions required before an infrastructure levy may be imposed (such as publication of a prospectus and consultation with affected businesses).
- The Department has considered and discussed externally a range of accounting implications, such as whether the infrastructure levy should be classified as revenue or capital.

Needs and resources

- Work has been informed by needs and redistribution working group which has discussed variation in local government expenditure, reviewing the indicators used in previous needs formulae, and looking at cost drivers for services. These are expected to be the subject of the fair funding review's first technical consultation.
- A sector led sub-group is developing a proposal as a contribution to this work.
- There is sector interest in finer-grained data to capture pockets of deprivation within local authorities; the Department is aware that time pressure makes data collection at small levels difficult.
- Some consideration of different statistical methodologies but not yet clear if these will feature in first technical consultation.
- Working group has not discussed distributing funding at geographies other than at the local authority level.

Accountability and accounting

- Covers central government accounting, central government accountability, local government accounting and local government accountability.
- Also deals with practical issues such as the collection of supporting information. Takes a lesson from the 50% experience: think about implementation issues like this well in advance.
- Work has concentrated on central and local government accounting issues, to inform primary legislation.
- Has informed the legislative proposals to reduce the three rating accounts kept by the Department to a single account.
- Has discussed with the accounting and accountabilities working group the accounting implications of various system design proposals including resets, funding the safety net, changing the multiplier in two-tier areas, and appeals.

Figure 15 *continued*

Progress within work streams and working groups

Rates retention system

- Assisted by the system design working group and steering group on most issues, the Department has developed its thinking on a range of issues, with decisions expressed in the bill or proposals included in the second consultation.
- Confirmation that several existing mechanisms (safety net, tariffs and top-ups) will continue.
- Confirmation of a central approach to appeal risk, funded by a top slice.
- Proposal for partial resets, on a five-year cycle.
- Proposal for a less voluntary approach to pooling, and for additional mechanisms that exempt some growth from resets ('growth zones').
- Decision not to proceed with sub-national 'area' lists.

Devolution and responsibilities

- Significant Departmental engagement with other government departments or public bodies with policy responsibility for existing grants.
- Decision not to devolve responsibility for Attendance Allowance.
- Decision to replace four grants for existing responsibilities (Revenue Support Grant, Rural Services Delivery Grant, Public Health Grant, and GLA Transport Grant).
- Responsibilities working group has examined the practicalities involved with replacing the funding for various grants, including some still under consideration.
- Following discussion within the technical working group, the LGA is leading work on employment and skills.

Business interests

- Group has focused on elements of the reforms that will have implications for business including the infrastructure levy and the power to reduce the multiplier.
- Has also discussed wider aspects of the reform.

Pilot authorities

- Work on agreeing responsibilities to be covered, scheme design elements to be tested in reality or by 'shadow' modelling.
- Informed by 100% growth pilots, announced at Budget 2015, to start in April 2015. Greater Manchester Combined Authority told us that it has not yet reached full agreement on the baseline for measuring growth in 2016-17 for the 2015 pilot.

Source: National Audit Office review of technical working group minutes and interviews with stakeholders and officers from the Department for Communities and Local Government

3.30 At present the Department is modelling the impact of different system design choices in isolation, and has not yet modelled the system as a whole. It has not yet shared all its modelling with the sector.

3.31 The government recognises concerns over the appeals system. It told us that a number of changes in the operation of business rates as a tax should improve the process; provisions in the Enterprise Act 2016 will allow for more information-sharing by the Valuation Office Agency (VOA), and a new appeals system based on clearly structured stages for appeals (Check, Challenge, Appeal) will be operational from April 2017. The Department is also taking steps to improve coordination between itself, the VOA, HM Revenue & Customs and HM Treasury.

Challenges going forward

3.32 The Department risks being over-optimistic about the speed and ease of delivery of its remaining tasks.[16]

Main delivery issues

3.33 The main issues where the Department is vulnerable include:

- **delivering and agreeing the fair funding review.** The work stream still has much progress to make on measuring needs and resources, and the outcome will need to be defensible in the sector. Our past work on formula funding illustrates how difficult these issues can be.[17] We have also previously said that government "tends to be over-optimistic about its ability to align the different views [of stakeholder groups] and the amount of time it will take to have sufficient engagement, particularly where the project is complex or involves new ways of working";[18]
- **agreeing replacement of grants or devolution of new responsibilities with other departments.** This took longer to agree in relation to 50% retention than the Department expected. The same issue has arisen in relation to the 100% pilots; and
- **the complex and technical nature of the work.** Public bodies frequently underestimate the delivery challenges of complex projects.[19] The West Midlands pilot illustrates the complexity of arrangements that the system design will need to cope with: seven authorities; members of one pool, another pool or no pool; three local enterprise partnerships; non-constituent members of the combined authority; and membership cutting across tiers. The proposals for partial resets and for 'growth zones' within pools, for example, have strong potential for complexity.

16 National Audit Office, *Over-optimism in government projects*, December 2013.
17 Comptroller and Auditor General, *Cross-government landscape review, Formula funding of local public services*, Session 2010–2012, HC 1090, National Audit Office, July 2011.
18 See footnote 16.
19 See footnote 16.

3.34 The Department has allowed itself more time between the passage of the legislation and introduction of the new system than it had in relation to 50% retention. However, given the additional tasks relative to the 50% scheme, this time will be needed and is not a contingency.

Evidence of pressure in the system

Slippage

3.35 Some milestones or tasks have had their delivery time revised or the scope of the task narrowed (**Figure 16**). Further slippage would risk squeezing the timetable further.

3.36 The Department regularly monitors progress of the project. The latest internal assessment concludes that there are substantial risks to delivery. This is an improvement on earlier assessments, reflecting progress in preparing legislation. The most significant remaining risks are external: brokering numerous complex changes with local government and other departments.

Figure 16
Slippage against departmental milestones

Milestone	Initial expected date to achieve these	Current status (at end February 2017)
Publish four government discussion papers, with defined response period, to inform summer consultation	April 2016	Achieved April 2016 in downgraded form: submitted to steering group as meeting papers, which were then published online by LGA.
Agree specific proposals for system design, for example tier splits, for July 2016 consultation	May–June 2016	Not achieved – specific proposals were not included in the consultation.
Agree full details of first round of pilots, starting 2017-18	June 2016	Not yet achieved in full; overall agreement to pilot announced in December 2016; some details settled but others still outstanding. Some elements of first round pilots being considered for 2018-19 introduction.
Publish response to July 2016 consultation	October 2016	Achieved late (February 2017).
Publish second, more technical consultation on system design	Autumn 2016	Partially achieved late (February 2017); does not include specific proposals for some areas where this was expected for first consultation, such as tier splits.
Publish first consultation relating to the fair funding review, alongside shortlist of options for devolution	Autumn 2016	Downgraded and not yet achieved; consultation expected shortly but without shortlist of options.

Source: National Audit Office review of Department for Communities and Local Government documents and Departmental and stakeholder interviews

Risks

Short-term delivery risks

3.37 The decision to implement on 1 April 2019 was announced in January 2017. Several stakeholders we spoke to indicated that delivery in 2020-21 would not necessarily have had any adverse implications for the sector.

3.38 Now the Department has committed to a delivery date, it must ensure that it can provide advance warning of the likely impacts of the scheme to local authorities to inform financial planning in good time. This should be through a consultation containing substantial details and exemplifications (information spelling out the financial impact of the proposed options) in summer 2018. The inter-linked delivery of the fair funding review, which could have potentially significant distributional consequences for the sector, reinforces the need for advance provision of information to the sector.

3.39 The Department also needs to ensure that there is sufficient time within its delivery timetable to perform stress-testing and to examine the implications for different types of authority. The Department's adoption of a flexible approach in which the outputs of multiple work streams are brought together in system-level modelling relatively late in the process means that it might not have fully considered interactions. It also means that significant implications for specific types of authority might not become apparent until later, when there is less scope to deal with them.

3.40 Several stakeholder bodies expressed concern that, to deliver by 2019-20, the Department might not deliver objectives they value. Variously, they suggested that the Department could reduce its ambitions in relation to growth; might not deliver the necessary level of stability and thus have a significant impact on the financial position of some councils; might not deliver on the promise of the fair funding review; or might deliver an overall outcome that largely replicates existing arrangements through new mechanisms.

Long-term outcome risks

3.41 The Department needs to ensure that it is able to deliver against its policy objectives and that it implements a mechanism to incentivise local authorities to promote local economic growth rather than just increase tax bases. It also needs to ensure that the move to financial self-sufficiency does not risk the sector's financial sustainability.

3.42 As the Department continues its work it must avoid focusing on the technical delivery of 100% local retention of business rates at the expense of the broader policy objectives this initiative is designed to deliver. This would risk the creation of a scheme which allows local authorities to retain business rates but which lacks the ability to deliver economic growth, and contains insufficient funding to maintain local service delivery.

Glossary

Business rates

Term	Meaning
50% scheme	From 2013-14 the local authority sector annually retains 50% of business rates income as the *local share*, with the balance transferred to government as the *central share.*
100% scheme	The government's intention is that from 2019-20 the local authority sector will retain 100% of business rates income. The *central share* will cease to exist.
Appeals	Ratepayers are able to challenge the *rating list* entry for their property. This can be done, for instance, to challenge the assessed *rateable value* of a property. A successful appeal can lead to a backdated payment and a reduced rate going forward. We use the term 'appeals' to include both interested person proposals (the first stage of the appeals process) and actual appeals which go to tribunal.
Baseline funding level	Within the funding calculated for an individual authority by central government for 2013-14 (see *start-up funding assessment*), this was the element that was funded by business rates retained within the sector. Under the *50% scheme*, the remainder of the funding was provided by revenue support grant. Since 2013-14, baseline funding levels have been uprated by the annual change in the small business rate *multiplier*.
Business rates baseline	This was the government's estimate of the business rates income that would be retained by each local authority in 2013-14. Since 2013-14, authorities have seen business rates growth if, in real terms, they collect more than this level.
Billing authorities	Local authorities which bill and collect business rates. This includes London borough councils, metropolitan district councils, district councils and unitary authorities. They pass some business rates income to *major precepting* authorities (see *tier splits*).
Central list	Contains the *rateable values* of the network property of major transport, utility and telecommunications undertakings and cross-country pipelines. Business rates for these properties are collected directly by government rather than *billing authorities*. In accordance with statute, the income from the central list is used by government for the benefit of local government.
Central share	In the current scheme, 50% of locally collected business rates is paid to central government by *billing authorities*. The central share will not exist in the *100% scheme*.
Gearing	The relationship between an authority's *baseline funding* and its *business rates baseline*. Authorities with 'high gearing' have relatively low baseline funding levels (effectively their relative level of need and ability to raise other resources) compared with their business rates baseline (effectively the area's business rates tax base).
Infrastructure supplement	Proposed power under the *100% scheme* for mayors of combined authorities and London to be able to levy a 2p supplement on the rates to fund infrastructure projects.

Term	Meaning
Levy payments	A mechanism to limit disproportionate benefit from growth in business rates in individual local authorities in the *50% scheme*. Levy payments will not exist in the *100% scheme*.
Local share	In the current scheme, 50% of locally collected business rates is retained by the local authority sector.
Major precepting authorities	Local authorities that do not collect business rates but are part of the business rates retention scheme. They receive business rates income from the *billing authorities* in whose areas they exercise responsibilities.
Multiplier	The business rates multiplier when multiplied by the *rateable value* of a property determines a ratepayer's business rates bill. There are separate multipliers for small and larger businesses, and some *rate reliefs* that can be applied.
Multiplier flexibility	Under the *100% scheme*, under certain circumstances, local authorities will be able to reduce their multiplier. They will also be able to raise a *local infrastructure supplement*.
Pools	Local arrangements between groups of local authorities in which business rates income is pooled and redistributed in line with locally agreed principles. Pools of authorities are treated as single entities in relation to *safety net and levy payments*.
Provisions	In the *50% scheme* local authorities are required to set aside financial provisions to cover the costs of changes to *rating lists*, including successful appeals.
Rateable value	The legal term for the notional annual rent of a rateable property. Rateable values are based broadly on the annual rent that the property could have been let for on the open market at a particular date set in law.
Rating lists	Registers created and maintained by the Valuation Office Agency containing the *rateable value* of all rateable properties, excluding those in the *central list*. Ratepayers are able to challenge (*appeal*) their rating list entry, and *billing authorities* are able to file *reports* in order to have a rating list entry reviewed following alterations to a property or to bring in new properties. There are separate local rating lists for each billing authority area.
Rate reliefs	Mandatory reliefs of different types are available for certain categories of ratepayer. Local authorities are also able to grant discretionary reliefs.
Reports	These are often sent from *billing authorities* to the Valuation Office Agency, for an entry in their *rating list* to be reviewed following alterations to a property or advising of new or demolished properties.
Resets	Periodically new *baseline funding levels* and *business rates baselines* (and therefore new *tariffs and top-ups*) are set for each authority to take account of changes over time in their relative needs and resources. There have not been any resets to date under the *50% scheme*.

Term	Meaning
Revaluations	There are periodic revaluations of all *rateable values*. Revaluations are designed to be revenue neutral at the national level, which is achieved by adjusting the *multiplier*. Revaluations do lead to relative changes in local rateable values. This reflects changes over time to local rental markets. The local effects of revaluations are currently not passed onto local authorities as they are removed by adjusting *top-up and tariff* payments.
Safety net	A mechanism to protect any authority which sees its business rates income drop significantly. In the *50% scheme* safety net payments are available to authorities where business rates income has fallen 7.5% below their *baseline funding level* in any year.
Start-up funding assessment	For the *50% scheme*, this was the starting government decision about the distribution of resources within the local government control total, made up of revenue support grant and the local share of business rates. The description of the equivalent arrangement within the *100% scheme* is not yet known.
Tariff payments	Authorities make tariff payments to government if their *business rates baseline*, after taking account of *tier splits*, is expected to exceed their *baseline funding level*. Tariff payments fund *top-up payments* to other local authorities.
Tier splits	Where *billing authorities* are required to pass business rates to *major precepting authorities*, the tier split describes the ratio of the amount retained by billing authorities and the amount passed on. In the *50% scheme*, for instance, district councils (billing authorities) pass 20% of their local retained business rates to county councils with fire responsibilities (major precepting authorities) and retain the balance. Where the county council is not a fire and rescue authority, 18% is passed on, and 2% then passed to the relevant fire and rescue authority.
Top-up payments	Authorities receive a top-up payment from government if their *business rates baseline* is expected to be less than their *baseline funding level* after taking account of *tier splits.* Top-up payments are funded by *tariff payments* made by other local authorities.

Appendix One

Our audit approach

1 This study provides an overview of the Department for Communities and Local Government's (the Department's) planning for the introduction of the 100% business rates retention system in April 2019.

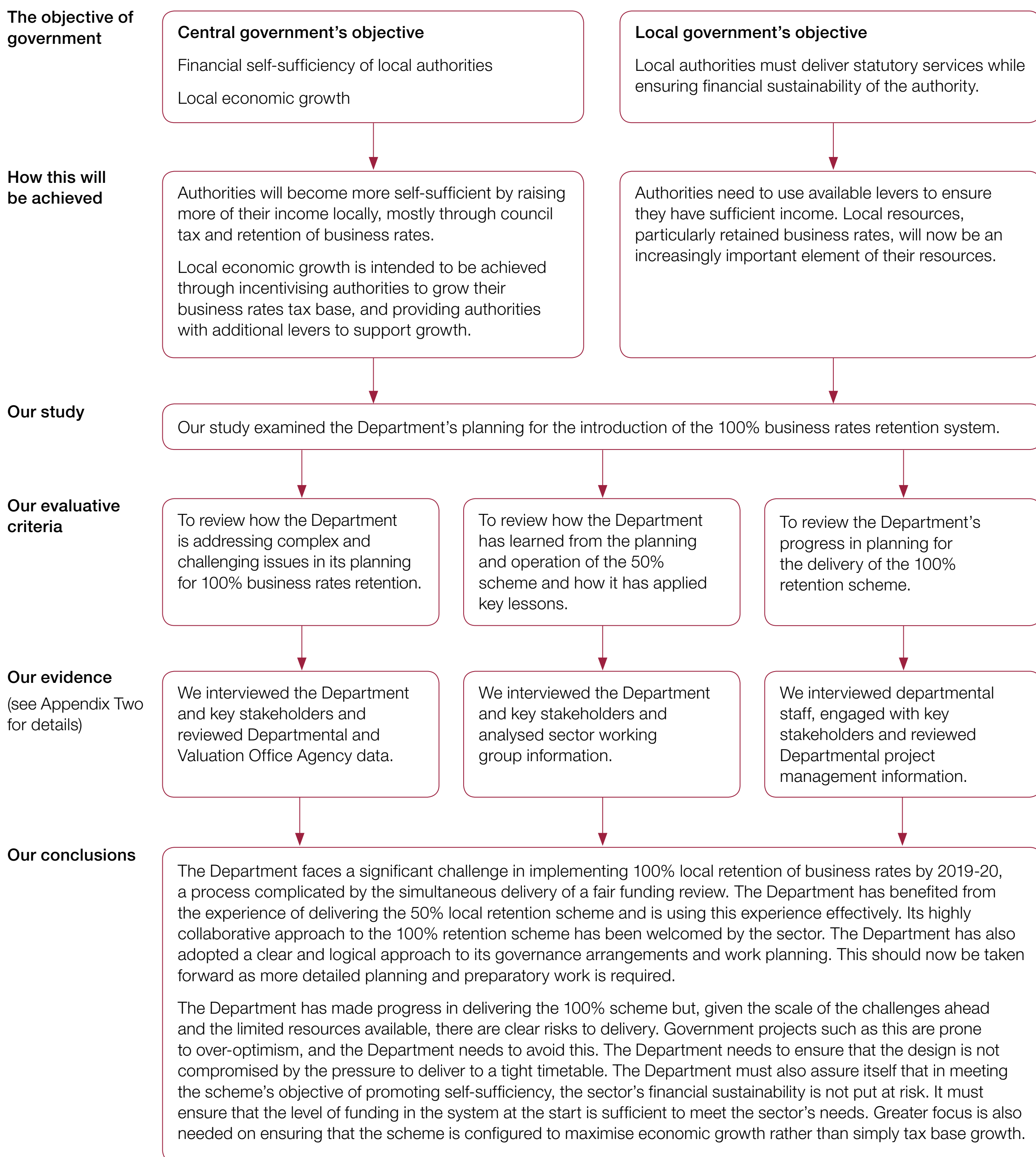
2 The report sets out the main issues and challenges within the business rates retention system that need to be considered by the Department if 100% retention is to be successful. It considers the planning and operation of the 50% business rates retention scheme and the lessons learned by the Department following this process. Finally, the report considers the Department's progress in planning ahead of the introduction of 100% retention in terms of the purpose, set-up and delivery of the scheme.

3 There were three main elements to our work:

- we gathered information from the Department and key stakeholders;
- we analysed how the 50% scheme had operated to date and the scale of the issues facing local authorities; and
- we reviewed whether the Department had learned key lessons from the planning and operation of the 50% scheme and whether it was likely to deliver against its objectives for the 100% scheme.

4 Our audit approach is summarised in **Figure 17** overleaf. Our evidence base is summarised in Appendix Two.

Figure 17
Our audit approach



Source: National Audit Office

Appendix Two

Our evidence base

1 We reached our independent conclusions on the value-for-money risks of the Department for Communities and Local Government's (the Department's) planning for 100% business rates retention after analysing evidence between November 2016 and January 2017. Our audit approach is outlined in Appendix One.

2 **We interviewed officials from government departments.** We designed these interviews to focus on how the Department:

- understands the key issues and challenges within the business rates system;
- has learned from the planning and operation of the 50% business rates retention scheme; and
- is progressing against its objective to deliver 100% business rates retention by April 2019.

We also spoke to officials from HM Treasury and the Valuation Office Agency.

3 **We conducted interviews with key stakeholder organisations**. We spoke with key stakeholders that have engaged with the Department in its planning for the 100% scheme through the sector working groups. This includes the Local Government Association, which jointly chairs the sector working groups. We also met with:

- the Chartered Institute of Public Finance and Accountancy;
- the Institute for Revenues Rating and Valuation;
- the Society of County Treasurers;
- the Society of Municipal Treasurers;
- the Society of Unitary Treasurers;
- the Society of London Treasurers;
- the Society of District Council Treasurers;
- the Association of Local Authority Treasurers' Societies;
- the Special Interest Group of Municipal Authorities;
- London Councils;
- the District Councils' Network;
- the Confederation of British Industry; and
- the Federation of Small Businesses.

4 We also spoke to representatives from Coventry City Council, Manchester City Council and Greater Manchester Combined Authority about their participation in the 2017-18 pilots.

5 We analysed a range of quantitative data from the operation of the 50% rates retention scheme. This included changes in local authority income overall, changes in the level of business rates income, variation in business rates income by geography and the links to local economic growth. We also examined the level of appeals, and safety net and levy payments.

6 We analysed the relationship between property market, economic and geographical indicators to understand what drives business rates growth. Specifically, we used rateable value per square metre as an indicator of local authorities' commercial rent levels; population density as a measure of the potential availability of development sites; and job growth as an indicator of local economic performance. For each indicator, we grouped authorities as 'low' or 'high' based on whether they fell below or above the average for the respective indicator.

7 Our findings indicate that areas with low commercial rents that have low population densities but are thriving economically (Group 1) were most likely to have achieved above average business rates growth from 2010-11 to 2015-16 (**Figure 18**). In contrast, billing authority areas with high commercial rents, high population densities and low job growth were substantially less likely to see above average growth in business rates income (Group 8). This analysis is illustrative and sets out potential areas for further exploration rather than seeking to provide a definitive analysis of the factors underlying business rates growth.

8 We reviewed Departmental and sector documents. We reviewed internal working documents that set out the Department's project milestones and objectives, and reviewed external consultation papers. We also reviewed agenda papers and meeting minutes from the working groups chaired by the Local Government Association and the Department.

Figure 18

Business rates growth in different billing authority groups, 2010-11 to 2015-16

Group	Rateable value per m^2 2010	Population density 2011	Job growth 2010 to 2015	Number of authorities	Percentage of authorities with above average growth in total rates payable (%)
1	Low	Low	High	67	65.7
2	Low	Low	Low	99	57.6
3	High	Low	High	28	57.1
4	Low	High	Low	25	48.0
5	Low	High	High	10	40.0
6	High	Low	Low	29	34.5
7	High	High	High	43	32.6
8	High	High	Low	22	0.0

Note

1 See separate *Methodology* document for details of data sources and methodological approach.

Source: National Audit Office analysis of Department for Communities and Local Government, Valuation Office Agency, Office for National Statistics, and Business Register and Employment Survey data

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