REPORT TO:	**FINANCE AND MANAGEMENT COMMITTEE**	**AGENDA ITEM: 9**
DATE OF MEETING:	**16th OCTOBER 2014**	**CATEGORY: DELEGATED**
REPORT FROM:	**DIRECTOR OF FINANCE AND CORPORATE SERVICES**	**OPEN**
MEMBERS' CONTACT POINT:	**KEVIN STACKHOUSE (01283 595811)** **Kevin.stackhouse@south-derbys.gov.uk**	**DOC:** u/ks/business rates/Derbyshire poo/pooling committee proposal
SUBJECT:	**BUSINESS RATES POOLING**	**REF**
WARD (S) AFFECTED:	**ALL**	**TERMS OF REFERENCE: FM 08**

1.0 Recommendation

1.1 That subject to 1.2 below, the Council enters into a County wide Business Rates Pool from 2015/16.

1.2 That this is subject to final governance proposals being agreed with fellow authorities.

1.3 That subject to 1.2 above, authority is delegated to the Director of Finance, in liaison with the Chief Executive and Leader of the Council, to sign a joint submission to the Department for Communities and Local Government on 31st October 2014.

2.0 Purpose of Report

2.1 To consider a proposal for the Council to pool its Business Rates with other Derbyshire authorities

3.0 Detail

Background

3.1 A predominant source of funding for local authorities is derived from redistributing business rates. This is based on what is known as a Business Rates Retention System, with incentives for authorities who generate growth in business rate receipts in their area.

3.2 At the basic level, business rates income generated in each authority is shared as follows:

- 50% to central government
- 40% to district councils *(this is the rates target or baseline amount*)
- 9% county council
- 1% fire authority

3.3 Within the retention system, authorities are either a "tariff" or a "top up" authority. Tariff authorities (of which South Derbyshire is one) are assessed, in the national funding system, as having a rates income target (i.e. the 40%) above their spending need and consequently pay over the difference to the Government.

3.4 Any additional income, due to growth, above their baseline is retained by the authority, subject to a maximum of 50% being transfererd to the Government as a "levy." The greater the difference between spending need and rates target, the greater the levy (up to 50%).

3.5 Top up authorities are those where their rates income target is lower than their spending need and they receive a top up payment through the system. This payment is financed from the tariffs and is effectively the redistribution system for financing local government.

3.6 Therefore, top up authorities do not pay a tariff and are not subject to a levy. County councils and fire authorities are top up authorities as they do not directly receive rates income; many districts and boroughs are tariff authorities.
(***Police authorities are subject to a separate funding framework and are not part of the business rates system***)

3.7 A safety net exists which protects individual authorities from large losses compared to their baseline, with the maximum loss incurred being limited to 7.5% of their spending need.

3.8 The remaining loss is met by the Government and is funded by their share of growth receipts. Any additional receipts above any safety net payments are retained by the Government.

Business Rates Pooling

3.9 As part of the system, authorities are able to join up, on a voluntary basis, to pool their business rates. A minimum of two authorities can form a pool but there is no maximum limit. In addition, a pool is not limited by county or any other geographical boundaries.

3.10 In issuing its annual prospectus on pooling ahead of 2015/16, the Government believes that pooling offers the following benefits:

- Furthers the process of joint working
- Authorities can benefit from economic growth across a wider area
- Furthers collaboration on infrastructure investment
- Authorities can retain more business rates receipts locally
- Volatility in income is spread and shared

How Pooling Works

3.11 Pools are established under provisions contained in the Local Government Finance Act 1988. Applications to form a pool are subject to approval by the Government (DCLG) and new applications have to be made by 31st October each year. If approved, authorities then have until 31st December to confirm their membership of a pool.

3.12 This allows authorities time to consider any impact following the annual local government financial settlement. If at this stage, one authority withdraws from a designated pool, the pool would not proceed and would be revoked by the Secretary of State.

3.13 Once in operation, a pool can be dissolved by the member authorities, or individual authorities can opt to withdraw at any time. However, once a pool is designated it will have to operate for the full financial year. If notice is received before 31st October, then the pool can be dissolved or members can opt out from the following financial year.

3.14 Each year, pools have to signify that they will continue, although there is no requirement to formally reapply unless the membership changes.

3.15 Although each authority continues to administer and collect rates locally and maintains its own Collection Fund, the pool is treated as a single entity for the purposes of calculating tariffs, top ups, levies and safety net payments.

Governance

3.16 An application for pooling has to be accompanied by proposed governance arrangements. A model or standard agreement is available from the DCLG.

3.17 The agreement must specify how growth is shared amongst the pool members. In addition, a lead (or administering) authority needs to be appointed through which inter pool transactions are made and the pooled account is maintained.

3.18 Normally, this will tend to be the largest authority in a pool, as this authority will also become responsible for funding receipts and payments, including those to the DCLG on behalf of pool members. Other pool members do not transact directly with the DCLG, so managing and financing cash flow falls to the lead authority.

3.19 Currently, there are 18 pools in operation across the country covering 111 authorities, approximately 25% of all local councils in the country. The pools are listed in **Appendix 1** and are estimated to generate growth receipts of approximately £159m in 2014/15.

3.20 The principle of pooling is that authorities have greater scope for generating and sharing additional growth through collaboration, together with smoothing the impact of volatility in rates income across a wider area, i.e. gains and losses can be balanced across the pooled area.

The Levy Rate

3.21 The fundamental benefit of pooling arises from the levy rate, i.e. the amount of growth that is paid over to central government. This is because the levy rate for a pool as a whole will usually be lower than that for individual authorities (outside of a pool).

3.22 Depending on baselines, growth and levy payments for individual authorities, the levy rate may in fact reduce to zero in a pool. This then retains more growth in the pool which can be shared amongst member authorities. This is illustrated later in the report.

The Risks of Pooling

3.23 Each authority must decide whether pooling is appropriate. The consequences of forming a pool will be different in each case and will also depend on other members willing to pool.

3.24 For an authority to join a pool, the levy rate will need to be much lower compared to the rate if they remained outside a pool. Not only will this generate much more income to be retained locally, it will also need to provide a buffer for any losses (compared to the baseline) incurred over the life of the pool.

Losses

3.25 Losses can occur due to businesses leaving an area, being terminated, together with reductions due to appeals and revaluations – income can be volatile. Not all authorities within the pool may generate growth and some may incur losses. This then reduces the amount to be shared.

3.26 Although levies can be reduced by pooling, conversely there is <u>no safety net – losses are entirely met by the pool.</u>

A Derbyshire Pool

3.27 Senior financial officers in all Derbyshire authorities (*excluding the Police and Crime Commissioner*) have been analysing the effects of a county wide pool. This has involved all 8 district and borough councils in Derbyshire, along with the County Council, Fire Authority and Derby City Unitary Authority.

3.28 Pooling has shown to be the most beneficial where there are a number of lower tier (district and borough councils) with high levy rates growth, combined with an upper tier or unitary authority that is a top up authority.

3.29 This is the situation in Derbyshire and makes a strong case for pooling. The following table shows the levy rates payable by authorities in Derbyshire, together with the total for all authorities – effectively the pool if all authorities joined.

	Rates Target £m	Spending Need £m	Diff £m	Raw levy	Actual Levy
Derbyshire County Council	16.3	100.5	84.2	-517%	0%
Derby City Council	37.8	50.4	12.6	-33%	0%
Derbyshire Fire	2.6	8.0	5.4	-208%	0%
Amber Valley	11.8	2.9	-8.9	75%	50%
Bolsover	8.1	2.6	-5.5	68%	50%
Chesterfield	13.8	3.0	-10.8	78%	50%
Derbyshire Dales	6.9	1.5	-5.4	78%	50%
Erewash	9.4	3.0	-6.4	68%	50%
High Peak	9.2	2.1	-7.1	77%	50%
North East	5.4	2.5	-2.9	54%	50%
South Derbyshire	8.3	2.2	-6.1	73%	50%
TOTAL	**129.6**	**178.7**	**49.1**	**-38%**	

3.30 The table shows that all district and borough councils in Derbyshire are subject to the maximum 50% levy on any growth. This is because their spending need is well below their rates target, or available income. Conversely, the County, City and Fire Authorities have a spending need greater than rates and receive top ups and pay no levy.

The Raw Levy

3.31 However, the key indicator for a Derbyshire Pool is the total figure and in particular the “**raw levy**.” This is a measure of the difference in spending need compared to the rates target across pool members.

3.32 Where it is positive, this indicates that spending need is lower than income and under the retention system, means a levy is paid on growth at that percentage. If the raw levy is greater than 50%, the levy is capped at 50%.

3.33 Where the raw levy is negative, this means that spending need is greater than income and a top up payment is made. No levy is then payable on growth.

3.34 The overall raw levy for the County as a whole is negative. This means that overall in Derbyshire spending need is higher than target rates or available income. This is due to the magnitude of the County's figures.

3.35 As the raw levy is negative overall, this means that should a pool arrangement exist, there would be no levy to pay, i.e. every £1 of growth over the initial 50% generated at each authority, would stay within the pool for distribution.

3.36 Under a pooling arrangement, all members are grouped and treated as a single entity.

Scenarios

3.37 Derby City Council has indicated that they not do not wish to be included in a pooling arrangement. All other authorities are currently seeking appropriate approval to join.

3.38 The exclusion of the City Council makes no difference financially to the viability of a pool. If they are excluded, the raw levy is still negative overall. The fundamental issue to a county-wide pool is the inclusion of the County Council.

3.39 Because their difference between spending need and rates income is significant, they have a raw levy which is substantially negative. If the County Council is excluded, the rate levy would be positive at 31% as the remaining districts all have positive levies.

3.40 Although this is lower than 50%, it is considered that this is not adequate enough to cover any potential losses; effectively, 1/3 of any growth would still flow out of the pool.

3.41 If Derby City is also excluded, the levy rises to over 60%. Clearly this would then make a pooling arrangement for Derbyshire authorities unviable.

The Size of the Pool

3.42 Besides the importance of the County Council being pool members, any number of authorities could join. Clearly, the more that join, the greater the viability of a pool. In principle, a pool could work with only one District together with the County Council as the raw levy would remain negative.

3.43 However, it is considered that it would be more beneficial for the greatest number of authorities to join. This would help to maximise growth across the area and although this is shared amongst more members, there is greater protection against any losses.

The Magnitude of the Figures

3.44 If a pool was operating in 2014/15, the latest estimates across all authorities (excluding Derby City) show that a levy of approximately **£2.9m** would be avoided in a pooled arrangement and be retained within the pool. Effectively, this is the total of the individual levies (at 50%) being paid by each authority. This shown in the following table.

	Rates Target £m	Estimate 2014/15 £m	Gain £m	Levy £m
Derbyshire County Council	16.391	17.686	1.295	0.000
Derbyshire Fire	2.607	2.607	0.000	0.000
Amber Valley	11.752	12.540	0.788	0.394
Bolsover	8.079	8.794	0.715	0.357
Chesterfield	13.847	14.634	0.787	0.394
Derbyshire Dales	6.850	7.320	0.470	0.235
Erewash	9.407	10.157	0.750	0.375
High Peak	9.163	9.822	0.659	0.330
North East	5.422	6.760	1.338	0.669
South Derbyshire	8.332	8.576	0.244	0.122
TOTAL	**91.848**	**98.896**	**7.048**	**2.876**

3.45 The amount of levies paid in 2013/14 (the first year of the retention system) across Derbyshire authorities, was approximately £600,000. This was lower as many authorities set up initial provisions for bad debts and appeals to cover future liabilities and losses, which were one-off transactions.

Sharing the Retained Amount

3.46 Within a pooled arrangement, the basis of the retention system remains, i.e. the initial 50/50 split between the Government and local authorities. In addition, the initial 50% of growth in each authority is retained locally.

3.47 Within the governance arrangements and in the application to the DCLG, the agreement for sharing the retained amount needs to be set out. There is no limit to how the sharing works and different pools have different arrangements. However, there is some consistency in principle and in the range of shared proportions.

3.48 The biggest contention has been the share to county councils and to a lesser extent, fire authorities. County councils take the biggest risk in that they pay no levy, so there is no saving, but potentially take on a greater share of any losses. In addition, as is shown earlier for Derbyshire, the county council generally need to be within the pool for it to be viable.

3.49 In existing pools, the county share averages between 25% to 30%, but is as low as 5% and as high as 60% elsewhere.

3.50 Besides the share to the county and fire authorities, the distribution should ideally recognise where growth has been generated, together with spending need. All these factors need to be balanced.

3.51 For a Derbyshire pool, it has been proposed that the share is distributed as follows:

- 1/3 to the county and fire authorities
- 1/3 based on growth – the greater the contribution, the greater the share
- 1/3 based on spending need

3.52 The effect of this distribution on a pooled arrangement for 2014/15 is shown in the following table.

	£m
Derbyshire County Council	0.863
Derbyshire Fire	0.096
Amber Valley	0.270
Bolsover	0.245
Chesterfield	0.277
Derbyshire Dales	0.151
Erewash	0.268
High Peak	0.212
North East	0.344
South Derbyshire	0.150
TOTAL	**2.876**

3.53 For South Derbyshire, instead of foregoing £122,000 in a levy, the Council would benefit in cash terms by £150,000.

Risks

3.54 The report earlier highlighted the risk of losses and that a safety net does not exist under a pooling arrangement. Although individual authorities will continue to carry provisions for appeals, bad debts and losses though revaluations, etc. the impact of a business failure or a major business leaving the area, could have an altogether bigger impact.

Derbyshire's Business Rates Base

3.55 It is likely that over a county area, the business rates base will change over time. Assuming that this evens out, the prognosis for future growth across the county area is promising, with current growth as highlighted earlier, positive in all authorities.

3.56 Most authorities have a low starting base. This means that even small to moderate growth will be beneficial. All authorities have large supermarkets and other retail outlets and even in areas such as High Peak, there are large industrial businesses.

3.57 No major concerns have been highlighted with these businesses, but clearly this can change.

3.58 There are only 6 or 7 businesses across the county area with a rates liability in excess of £1m. The biggest business rates payer in the county area is in South Derbyshire, where rates for that business are twice as much as the next highest in the county.

3.59 Other authorities see this as the biggest risk and some analysis has been undertaken on the effects of that rates income being excluded in a pooled scenario.

3.60 With no safety net protection, the pool would need to cover approximately £1.6m. However, if growth elsewhere remained, this would be met within the overall gain.

3.61 The greatest risks are continuing growth and a substantial loss. The position would be regularly monitored as part of the governance arrangements. If at any stage the projection for the overall position looks negative, the pool can be dissolved by giving the appropriate notice, or individual authorities could choose to leave. This would be reviewed each year.

Governance

3.62 The lead authority is still to be determined. If implemented, it is proposed that a fee of £40,000 is paid to that authority in recognition of the additional work and responsibility to administer a pool. The fee would be paid out of the growth receipts retained.

4.0 Financial Implications

4.1 As detailed in the report.

5.0 Corporate Implications

5.1 None directly

6.0 Community Implications

6.1 None directly

7.0 Background Papers

7.1 DCLG Business Rates Retention: Pooling Prospectus 2015-16

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332962/Prospectus_2015-16.pdf