

URGENT KEY DECISION: REPORT TO CABINET PORTFOLIO MEMBER

DECISION TO BE TAKEN BY: (Cllr Mike Taylor)
(Strategic Resources - Well Run Council)

REPORT AUTHOR: Daren Turner (Strategic Director – Corporate Focus)

REPORT NO. LDS109

DATE: 8th October 2013

SUBJECT OF KEY DECISION:	The decision relates to the joining of a Lincolnshire wide Business Rates Polling mechanism for the financial year 2014/15.
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CORPORATE PRIORITY:	Well Run Council (the decision will underpin all other priorities)
CRIME AND DISORDER IMPLICATIONS:	Not applicable
FREEDOM OF INFORMATION ACT IMPLICATIONS:	(This report is publicly available via the Your Council and Democracy link on the Council’s website: www.southkesteven.gov.uk
BACKGROUND PAPERS:	DCLG Business rates pool prospectus https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/6085/Pooling_Prospectus.pdf LG Futures report – BR Retention Pooling – Lincolnshire (1 and 2)

(1) PURPOSE OF REPORT

1.1 The following report provides the Portfolio Holder with an overview of the Business Rates pooling mechanism and analysis of the financial implications of using such a mechanism in partnership with the other Local Authorities within Lincolnshire. The report should enable the portfolio holder to make an informed decision about joining a Lincolnshire pool in 2014/15.

- 1.2 The 2013/14 local government finance settlement saw the launch of the business rates retention scheme as a central part of local government funding.
- 1.3 Under the proposed system, a start-up funding assessment (SUFA) is determined for each local authority. This is determined in the same way as Formula Grant was determined previously i.e. using the four block model to determine a level of need and taking into account changes in responsibility (e.g. with specific grants moving in and out of general grant).
- 1.4 The start-up funding assessment is then split between Revenue Support Grant (RSG) and Business Rates Retention (expressed as Baseline Need). The level of RSG is guaranteed throughout the year, whilst the Baseline Need element is not.
- 1.5 To fund the Baseline Need element, local authorities each has an expected level of business rates that is to be collected (NDR Baseline). Due to differences between Baseline Need and the level of business rates collected by individual authorities, there is a further adjustment required. As follows:-
 - For authorities with a Baseline Need that is higher than their NDR Baseline, a Top Up grant is required (this is also guaranteed). Whereas for authorities with a baseline need that is lower than their NKDR Baseline, a fixed Tariff is paid to central government.
 - Those authorities that collect a higher level of NDR income compared to their NDR Baseline should be rewarded through the scheme, as they will be able to retain an element of the associated increased NDR revenues. However, authorities that collect a lower level of NDR income will see decline in their business rates revenue and a relative reduction in their overall resources.
- 1.6 The new scheme has a damping mechanism in place to limit individual gains/losses. The system uses a Safety Net (to limit losses) which will be funded through a levy (on disproportionate gains). The Safety Net and Levy are explained below.
- 1.7 If authorities were to collect business rates at their NDR Baseline amount, the level of resources that they would receive (through NDR income and RSG) will be at their start-up funding assessment (i.e. they have neither lost nor gained from the business rates retention scheme).

The Levy

- 1.8 The government has chosen to apply a proportional levy within the system. Under the proportional levy, each local authority will be assigned an individual levy rate.

1.9 There are three key variables in determining the amount to be paid through the levy by an individual local authority. These are:-

- The ratio of the proportional levy
- The ratio of the NDR Baseline to Baseline Funding Level
- The level of NDR Income

1.10 The final element of the levy calculation is determined by the level of NDR income for an authority. Only local authorities that have growth in their NDR income are required to pay the levy (i.e. NDR income is higher than NDR Baseline). It is important to note that growth in NDR income is based on CLG's determination of authorities' NDR baselines i.e. a levy will only be due if NDR income is higher than the amount that CLG has determined it should be. This gives rise to a number of different scenarios where actual growth may/may not result in levy payments i.e.

- NDR baseline (set by CLG) is higher than actual NDR income, no levy is due
- NDR baseline (set by CLG) is lower than actual NDR income – a levy will be due on NDR income above the baseline
- NDR baseline (set by CLG) matches the actual level of NDR income – a levy will be due only if the authority achieves actual growth in NDR income

It is also important to note that no levy is due on income increases due to annual changes to the multiplier or as a result of revaluation (scheduled for 2017).

Safety Net

1.11 The Safety Net within the business rates retention system will ensure no authority's income will fall by more than a set percentage of their original baseline funding level (and this level will be increased by RPI every year). The Safety Net percentage has been set at -7.5% for 2013/14. The safety net is theoretically funded by the Levy.

How Business Rates Income is split

1.12 The business rates income collected by billing authorities is split between central government (central share), the billing authority and its major preceptors. The government has set the central share at 50%.

1.13 Each billing authority's business rates will be further split between the billing authority and any relevant major precepting authorities in its area, in order to produce, for every authority, an individual authority NDR Baseline. The split will be undertaken on the basis of the proposed major precepting authority shares:

- Two-tier areas – shire counties with fire – The split of 80% district and 20% county is applied.

Pooling

1.14 Under the business rates retention scheme, local authorities are able to voluntarily form a business rates retention pool. Local authorities within a pool are treated as a single authority, with all Tariffs i.e. where the NDR Baseline is higher than the Baseline Need, and all Top-Ups i.e. where the NDR Baseline is lower than the Baseline Need, being combined, and a single levy rate being applied. Similarly, safety net eligibility is also calculated at aggregate pool level.

1.15 There is, therefore, the potential for pooled authorities to receive a lower aggregate amount (than if they had acted individually), if authorities that would previously have been eligible for the Safety Net (if treated as individual authorities) were no longer eligible, due to being part of a pool.

1.16 Local autonomy to distribute resources amongst pool members applies; for example, authorities could decide that each member will receive at least the same amount as they would have if a pool had not been in place ("no worse off"), and additional resources could be distributed through local discretion or weighted (potentially according to the level of benefit received).

1.17 The main points therefore in relation to pooling are that:

- Pooling is entirely voluntary.
- Local authorities will themselves determine a pool's geographic coverage, including wider than within a county-region, although government has the ability to refuse pooling proposals where they perceive that there is no clear rationale for the proposed pool. Government also has the right to consider whether the operation of pools could impact upon the level of funding available for the safety net and (in exceptional circumstances) consider such affordability, when making decisions on pools.
- One pool member will need to act as the lead authority, in terms of payment/administrative arrangements.

- Pools can be any size, although authorities can only be a member of one pool.
- Pools will need to determine their own governance arrangements and transparently publish their pooling arrangements and financial information on how the pool will operate.

1.18 In 2013/14, pooling groups were required to notify CLG of their intention to pool in July 2012, with the final composition of the pool confirmed by 5 December 2012. In 2013/14 a pool was created in Lincolnshire by Lincolnshire County Council, North Kesteven DC and South Holland DC. North Kesteven acts as the lead authority.

1.19 For 2014/15, pooling groups will need to notify DCLG by **31 October 2013** of their intention to pool, including the composition of the pool and its governance arrangements.

1.20 An external assessment has been undertaken on the viability of a wider pool, to include all of the **Lincolnshire authorities**, for the 2014/15 financial year. Table 1 below shows the individual Top Up / Tariff status and resulting levy rate of the perspective pooling authorities.

Table 1 – Top up/Tariff status of the pooling authorities, and the resulting levy rate, using a 1:1 proportional levy

Local Authority	Top up/ Tariff	Baseline Need (£m)	NDR Baseline (£m)	Top up/ (Tariff) £m	Levy
Boston	Tariff	2.4	7.3	(4.9)	50%
East Lindsey	Tariff	5.4	12.3	(6.9)	50%
Lincoln	Tariff	3.3	15.7	(12.3)	50%
North Kesteven	Tariff	2.7	8.7	(5.9)	50%
South Holland	Tariff	2.9	9.4	(6.4)	50%
South Kesteven	Tariff	3.2	15.5	(12.3)	50%
West Lindsey	Tariff	2.6	6.0	(3.3)	50%
Lincolnshire	Top up	97.4	18.7	78.7	0%
Overall	Top up	119.9	93.5	26.5	0%

1.21 The table above shows that, if all the authorities were acting as a single pool, there would be an overall Top up of £26.5m i.e. the NDR Baseline is £26.5m lower than Baseline Need. This results in a 0% levy rate under a 1:1 proportional levy. The individual levy rates of the authorities are also shown in the table.

NDR Baseline vs. NDR income projections

- 1.22 The NDR Baseline for local authorities was set based upon authorities' historic amount of business rates collected as a proportion of the forecast national business rates income for 2013/14. Using the 2013/14 NNDR1 forms (local authorities own estimates of business rates income for 2013/14) it is possible to compare NDR Baselines and business rates income at a national and local level.
- 1.23 At a national level, the NDR baseline equals the forecast business rates income for 2013/14 (based on local authority NNDR1 returns). However, at a local level, there are variances between the NDR Baseline and the amount that individual authorities are forecast to collect. This effectively creates either a potential windfall gain for authorities (when forecast NDR income is greater than the NDR baseline) or a potential loss for authorities (when forecast NDR income is lower than the NDR Baseline).
- 1.24 Table 2 below compares the NDR Baselines of the prospective pooling authorities against their forecast business rates income. The decision on whether to pool will be based upon the financial benefits for 2014/15, and it is therefore necessary to adjust the 2013/14 figures to take into account the removal of additional Small business Rate Relief.

Table 2 – Comparison of NDR baselines and adjusted NDR income projections

Local Authority	NDR Baseline £m	Forecast NDR income £m	Variance £m	Variance %
Boston	7.3	7.7	0.4	5.3%
East Lindsey	12.3	13.5	1.2	10.0%
Lincoln	15.7	16.8	1.1	7.2%
North Kesteven	8.7	9.3	0.6	6.9%
South Holland	9.4	10.1	0.7	7.7%
South Kesteven	15.5	16.0	0.5	3.4%
West Lindsey	6.0	6.7	0.7	12.2%
Lincolnshire	18.7	19.9	6.5	7.0%
Overall	93.5	99.3	5.9	6.3%

- 1.25 The table shows that based on the adjusted 2013/14 NNDR1 forms, the overall forecast NDR income is higher by £5.9m. The projected position for **SKDC** is extremely prudent as in order to maintain cash flow and to manage the risks associated with the new system a low initial forecast was used for NNDR1.

Appeals

1.26 The 2013/14 NNDR1 forms include an allowance for successful backdated appeals. This adjustment should represent a one-off cost that authorities will be required to pay in 2013/14, or beyond. Local authorities prepared these forecasts on limited information for 2013/14, due to the lack of established processes / data, both internally and from the Valuation Office Agency (that is responsible for dealing with business rates appeals). Here again **SKDC** chose to budget for appeals at a very high level to manage the risk of a large number of backdated appeals coming through during the year.

1.27 Table 3 below compares the NDR Baselines of the prospective pooling authorities against their forecast business rates income after removing the one-off adjustment for appeals.

Table 3. – Comparison of NDR baselines and adjusted NDR income projections (adjusted for the one-off appeals allowance)

Local Authority	NDR Baseline £m	Forecast NDR income £m	Variance £m	Variance %
Boston	7.3	8.0	0.7	9.4%
East Lindsey	12.3	14.1	1.7	14.2%
Lincoln	15.7	17.2	1.5	9.5%
North Kesteven	8.7	9.5	0.8	9.2%
South Holland	9.4	10.5	1.1	12.0%
South Kesteven	15.5	16.0	0.5	3.4%
West Lindsey	6.0	6.8	0.8	13.4%
Lincolnshire	18.7	20.5	1.8	9.6%
Overall	93.5	102.4	9.0	9.6%

1.28 The table shows that based on adjusted 13/14 NNDR1 forms, the overall forecast NDR is higher by £6.5m.

1.29 The forecasts for NDR for 2014/15 from the business rates retention scheme for the **South Kesteven**, whilst remaining outside the pool, are shown below. The Levy is 50% of the assumed growth and resultant extra revenue. (Please note the forecast has been based on 0% growth)

Table 3.1

South Kesteven

	2014/15	2015/16	2016/17	2017/18
	£m	£m	£m	£m
Business Rates retained locally	16.505	16.951	17.476	18.070
Top up / (Tariff)	(12.663)	(13.005)	(13.408)	(13.864)
Equals pre-levy income	3.842	3.946	4.068	4.206
Less Levy on growth above RPI	(0.269)	(0.276)	(0.285)	(0.295)
Equals post levy income	3.573	3.669	3.783	3.912
Plus Safety Net payment	-	-	-	-
Total	3.573	3.669	3.783	3.912

2. Benefits of Pooling

2.1 The potential benefit, for the whole of Lincolnshire, from pooling has been estimated for a pool containing all of the authorities see table 4 below. It is important to note that:

- A pool can be comprised of two or more authorities.
- Local authorities cannot be members of more than one pool.
- The amount shown in the table below is in addition to the amount that each authority would have received outside of a pooling arrangement
- How the additional amount is split between the members of the respective pool would be determined by the pool, through its governance arrangements.

Table 4. Forecast change in resources, due to pooling

	2014/15	2015/16	2016/17	2017/18	TOTAL
	£m	£m	£m	£m	£m
1 Acting individually	127.7	131.2	134.5	140.2	534.4
2 Acting as a pool	130.5	134.2	138.6	1.31	547.0

2.2 The table shows, for the period 2014/15 to 2017/18, there is a forecast gain of potentially from pooling for both of £2.8m in 14/15 and 12.6m over the next four years.

3. The Safety Net

3.1 Whilst over the medium to longer term, NDR income should reflect business growth or decline, in the short term, income levels can vary significantly between years, due to factors such as collection rates and large one-off successful appeals.

3.2 In order to assess the potential impact of income volatility, the following analysis examines the loss in business rates required for an individual authority to reach the safety net level. It would be beyond this point that the gains of pooling would begin to be offset by a “cost”.

3.3 Table 5. below shows the required percentage drop in NDR income in 2014/15 for each authority for it to reach the -7.5% Safety Net level. This assessment is shown against each authority's NDR Baseline and the Forecast NDR income (i.e. based upon the NNDR1 returns).

Table 5. – The percentage reduction in NDR income required, in 2014/15, for an individual authority to reach the -7.5% safety net boundaries using the NDR Baseline and forecast income levels

Local Authority in decline	NDR Baseline	Forecast NDR income
Boston	-2.4%	-10.8%
East Lindsey	-3.3%	-15.3%
Lincoln	-1.6%	-10.2%
North Kesteven	-2.4%	-10.6%
South Holland	-2.3%	-12.8%
South Kesteven	-1.6%	-4.8%
West Lindsey	-3.3%	-14.7%
Lincolnshire	-39.1%	-44.4%

3.4 The table shows that as all of the authorities are forecasting higher NDR income than their respective NDR Baselines (after taking into account the appeals adjustment), the required reduction in NDR income to reach the safety net is higher than if the NDR Baseline was the assumed NDR income amount. Lincolnshire County would require the largest fall in forecast NDR income to reach the safety net (at 44.4%), whilst South Kesteven would require a 4.8% drop in forecast income to reach the safety net.

3.5 It should be remembered that reaching the safety net level does not trigger an additional payment to an authority. It would only be reductions beyond the safety net level that are protected against i.e. at the -7.5%

level; an authority would be guaranteed an income level equivalent to -7.5% of its Baseline Need.

- 3.6 The table below shows the cost of supporting each authority, if it were to have a fall in income equivalent to -8.5% of baseline need, i.e. 1% below the safety net level. This would be a cost paid for by the pool, which would reduce any pooling gains made or potentially cause the pool to make a loss.
- 3.7 The likelihood of individual authorities requiring this support is also considered in the table, with a column showing the percentage reduction in business rates (based on forecast NDR income) that would be required in order for an authority to be at -8.5%.

Table 5.1 – The potential cost to the pool of an authority’s business rates retention income falling to 1% below the -7.5% safety net and the required reduction in NDR income (using forecast NDR income) for this to occur

Local Authority in decline	Percentage reduction in NDR to require support	Cost to the pool £m
Boston	11.1%	0.024
East Lindsey	15.7%	0.054
Lincoln	10.3%	0.033
North Kesteven	10.9%	0.027
South Holland	13.1%	0.029
South Kesteven	5.0%	0.032
West Lindsey	15.1%	0.026
Lincolnshire	49.1%	0.974

- 3.8 The table shows that the cost of supporting an authority that falls 1% below the safety net ranges from £0.024m (Boston) to £0.974m (Lincolnshire CC) per annum. **South Kesteven** has the lowest reduction in NDR income (5.0%) to require support, however, this only equates to £0.032m per annum.

Collection Rates

- 3.9 The collection rates across each authority will impact on the amount level of NDR generated locally of which the table below shows the current collection rates performance compared to the previous year as at August 2013.

Table 6.

Local Authority	Collection rate year on year comparison
Boston	(1.07%)
East Lindsey	(0.93%)
Lincoln	(0.16%)
North Kesteven	0.14%
South Holland	(0.51%)
South Kesteven	0.18%
West Lindsey	0.60%

4. Potential Allocation Methodologies for the pool.

- 4.1 CLG has stated that “it would be for pools themselves to decide how to distribute aggregate revenues within the pool”.
- 4.2 The pool firstly needs to determine if it wants to (i) split all the proceeds of business rates retention using a local methodology (e.g. population) or (ii) only split the net cost / benefit of pooling using a local methodology, with funding initially being allocated based on a “no worse off approach”.

“No Worse Off”

- 4.3 The most common approach to splitting the proceeds from pooling is to firstly allocate resources to authorities at the same amount if they had been acting individually (providing the pool has not made a loss). Under this approach, funding would be allocated on a “no worse off” basis. The non-pooled distribution will be possible to calculate based on CLG’s information requirements, so would not impose an additional reporting burden. In summary **South Kesteven** would receive the initially 50% of any gain as it would if it acted alone.
- 4.4 Where pooling generated a net benefit, the additional resources could be earmarked for distribution based on any other of the methods described below. Where there was a net loss to pooling (for example, through the loss of entitlement to safety net funding), the loss could also be allocated based on the same distribution methodology.

“Local Methodology”

- 4.5 It is possible for a pool to allocate all the proceeds of business rates retention using a local methodology. However, this approach requires authorities to devise a methodology that would create local winners and losers (compared to acting individually) for splitting the “net benefit” or “net cost” of pooling could be used to split the whole amount.

Splitting the net benefit/cost of pooling

4.6 In order to calculate the net cost/benefit of pooling, it is first necessary to determine the amounts that the pooling authorities would have received, had they acted individually. These amount can be deducted from the aggregate resources of the pool determine its net cost / benefit. The individually authority amounts will be based upon NNDR 3 returns, in the same way, had they acted individually

Draft Allocation Methodology

4.7 The allocation of resources will be based on the following principles:

- No authority will receive a lower level of funding than they would have received without the Pool.
- Any additional resource that is generated will be shared by pool members using the basis of allocation below.

4.8 The underlying basis of allocation is as follows:

A: The running costs of the pool, if any, will be paid to the lead authority North Kesteven DC.

B: Each individual authority, where resources allow, will receive the same level of funding they would have received without the Pool (excluding running costs).

The remaining amount will be the net retained levy.

- If after commitment A, commitment B cannot be met, each authority will receive an allocation of resources proportional to the amount that would have been received without the pool. For example, if £10m was required to meet commitment B and only £9.8m in resources was available, each authority would receive 98% of the amount that would have been received without the pool.

4.9 The allocation of the Net Retained Levy will be calculated as follows:

- 40% of the Net Retained Levy to be allocated to Lincolnshire County Council and with 60% allocated to the District Council that has generated the business rates growth.

4.10 Table 7 below shows how the forecast net gain from pooling for 2014/15 would be split using this methodology. It is important to remember that the amounts below would be in addition to the amounts authorities would have received had they acted individually.

Table 7. Potential split of pooling income

Local Authority	2014/15 Net Gain £m
Boston	0.120
East Lindsey	0.379
Lincoln	0.377
North Kesteven	0.200
South Holland	0.240
South Kesteven	0.161
West Lindsey	0.223
Lincolnshire	1.133
Overall	2.833

- 4.11 The gain from pooling for South Kesteven would therefore be £161k. This gain should not be confused with the gain from what will be retained locally which would be in addition to the illustrated £161k.
- 4.12 Acting independently the Council would receive the additional NDR laid out in **Table 3.1**, that is after the Government has taken its 50% levy. Acting jointly, in a pool, the Council WILL NOT PAY A LEVY and therefore keep the additional £161k.

5. Conclusions

5.1 The business rates retention scheme provides local authorities with an opportunity to retain a proportion of increases to local business rates income. For authorities with large business rates bases (relative the level of resources government believes is needed locally), the proportion that can be retained locally is lower, due to a levy payment. However, through pooling, where groups of authorities act as a single authority in terms of business rates collected, the levy payment can be reduced, allowing pooling members to receive additional resources.

5.2 It is important to note that:

- The additional resources would allow all of the authorities to receive the amount that they would have received if they had acted individually and also receive an additional amount, due to the benefits of pooling.
- It is for each pooling group to determine how the gains from pooling are to be split.
- The projected gains are based on local projections for business rates income, which are not guaranteed.

5.3 The next opportunity for local authorities to enter into a pooling arrangement will be for the financial year 2014/15. The deadline for the submission final pooling groups is 31 October 2013.

(2) RECOMMENDATION(S)

- **That, subject to the agreement of a 60:40 (District :County) distribution formula, the South Kestevn District Council agree to entering a Lincolnshire “pool” for 2014/15 with an allocations/distribution methodology laid out in section 4 of the report.**
- **That North Kesteven be accepted as the designated “pool Lead Authority” for 2014/15**

**(3) REASONS FOR RECOMMENDATION(S)
(including any alternative options considered and rejected)**

- The Council has done the requisite due diligence in determining the viability of the Lincolnshire Pool.
- The Council believes that the Lincolnshire pool creates the opportunity for a larger proportion of locally derived Business Rates to stay within the County and the district which will be to the benefit of local residents.
- This course of action is in line with the Councils Medium Term Financial Strategy.

(4) COMMENTS OF FINANCIAL SERVICES

These are contained in the main body of the report.

(5) COMMENTS OF LEGAL AND DEMOCRATIC SERVICES

Pooling arrangements have been established under paragraph 34 of Schedule 7B of the Local Government Finance Act 1988 as inserted by Schedule 1 of the Local Government Finance Act 2012. The provision for pooling is acknowledged in the draft Medium Term Financial Strategy which has been approved by Cabinet for recommendation to Council at its meeting on the 7th

November 2013. The Cabinet has delegated the decision on pooling to the Portfolio Holder Strategic Resources – Well Run Council. Such a decision must be made before the 31st October 2013 to allow the proposal to pool to be put to the DCLG before the deadline of the 31st October 2013. In these circumstances the decision must be taken as a matter of urgency in accordance with the provisions set out in the Constitution.

(4) DATE DECISION EFFECTIVE:

If decision taken on 17th October 2013 date effective will be 17th October 2013 as this is an Urgent Key Decision and is not subject to the call-in procedure.