Business rates retention: latest IFS research and thoughts on the way ahead

30th March 2017

MJ Future Forum, Hertfordshire

The Local Government Finance and Devolution Consortium is generously supported by the following organisations, as well as a large group of local government bodies:

IFS Programme on Local Government Finance

- Presentation draws on our recent report on revaluation and appeals
  - The impact of revaluation around the country
  - The impact of appeals between 2013-14 and 2015-16
  - Implications for 100% retention
- The IFS LG Finance Model
  - In early stages of development
  - Use it to analyse policy options and policy proposals
  - Focus on potential divergences in funding

Revaluation and Appeals: Background

- Saturday will see first revaluation since BRRS in place
- Impact will be “stripped out” of BRRS
  - Aim is no immediate gains/losses if values up/down in local area
- Lots of occupiers likely to appeal against new valuations
- Business rates multiplier will be increased to raise revenues to pay for these appeals within business rates system
  - Councils allowed to keep extra raised locally to fund appeals provisions
  - But value of appeals likely to vary a lot and may be concentrated in areas seeing biggest increase in rateable values

Impact of revaluation on average rates bills

Region	Forecast long-run impact after appeals
London	11%
South East	–1%
East Midlands	–3%
South West	–6%
East	–7%
West Midlands	–7%
Yorkshire & the Humber	–10%
North West	–10%
North East	–11%
Central List	27%
England	0%

Impact of revaluation on average rates bills

Region	Forecast long-run impact after appeals	Impact in 2017-18 before trans. relief
London	11%	16%
South East	–1%	4%
East Midlands	–3%	2%
South West	–6%	–1%
East	–7%	–3%
West Midlands	–7%	–3%
Yorkshire & the Humber	–10%	–6%
North West	–10%	–6%
North East	–11%	–7%
Central List	27%	33%
England	0%	4.6%

Impact of revaluation on average rates bills

Region	Forecast long-run impact after appeals	Impact in 2017-18 before trans. relief	Impact in 2017-18 after trans. relief
London	11%	16%	**12%**
South East	–1%	4%	**4%**
East Midlands	–3%	2%	**2%**
South West	–6%	–1%	**1%**
East	–7%	–3%	**1%**
West Midlands	–7%	–3%	**0%**
Yorkshire & the Humber	–10%	–6%	**0%**
North West	–10%	–6%	**0%**
North East	–11%	–7%	**–1%**
Central List	27%	33%	**15%**
England	0%	4.6%	**4.6%**

Big changes to BRRS tariffs (-) and top-ups (+)

Region	Pre-revaluation tariff (-) or top-up (+)	Change in tariff (-) or top-up (+)	Post-revaluation tariff (-) or top-up (+)
London		-£388m	
South East		+£22m	
East Midlands		+£25m	
South West		+£61m	
East		+£76m	
West Midlands		+£72m	
Yorkshire & the Humber		+£95m	
North West		+£134m	
North East		+£43m	
England			

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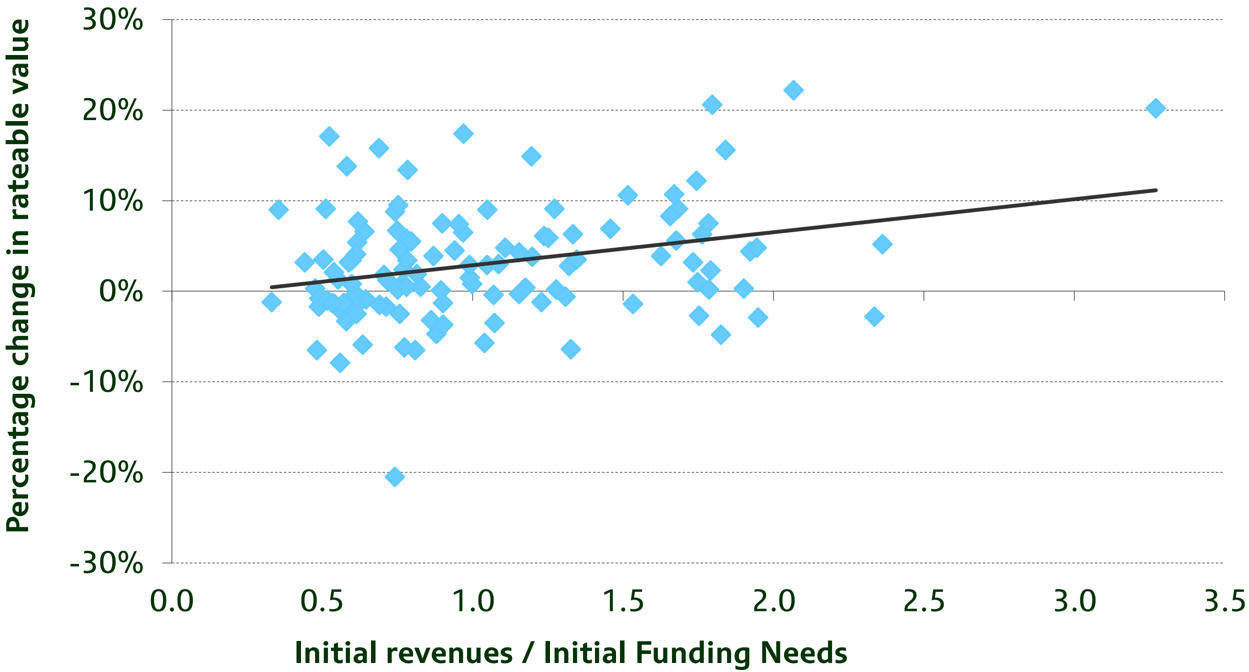
Big changes to BRRS tariffs (-) and top-ups (+)

Region	Pre-revaluation tariff (-) or top-up (+)	Change in tariff (-) or top-up (+)	Post-revaluation tariff (-) or top-up (+)
London	-£345m	-£388m	**-£733m**
South East	–£504m	+£22m	**-£482m**
East Midlands	+£111m	+£25m	**+£136m**
South West	-£91m	+£61m	**-£30m**
East	–£180m	+£76m	**-£104m**
West Midlands	+£239m	+£72m	**+£311m**
Yorkshire & the Humber	+£186m	+£95m	**+£281m**
North West	+£349m	+£134m	**+£482m**
North East	+£246m	+£43m	**+£289m**
England			

Outside London, increase in rateable values, bills and revenues larger in areas with higher revenues to start with



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Links to 100% retention and fiscal devolution

- Emphasise importance of resets and incentives/redistribution trade-off
  - New development and growth in values unevenly distributed
  - Divergence in revenues for reasons other than council performance
  - Less frequent, more partial reset mean stronger incentives, more risk
- Is even greater fiscal devolution desirable for broader incentives?
  - Weak incentive to boost demand for/use of existing properties
  - Weak incentive for small/home business and access to jobs outside area
  - Could local income tax or even sales tax be long-term options?
- Should revalue more often and move to basing tax on land value

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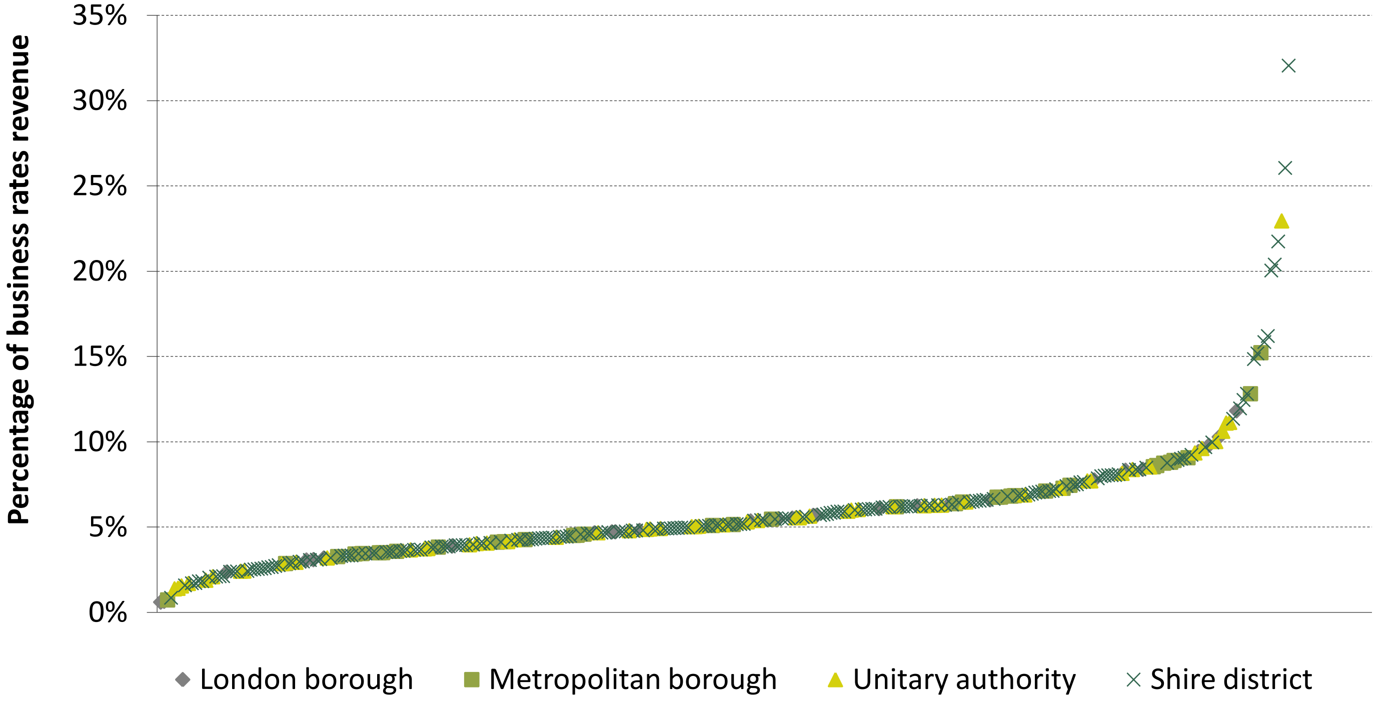
Significant variation in provisions for appeals



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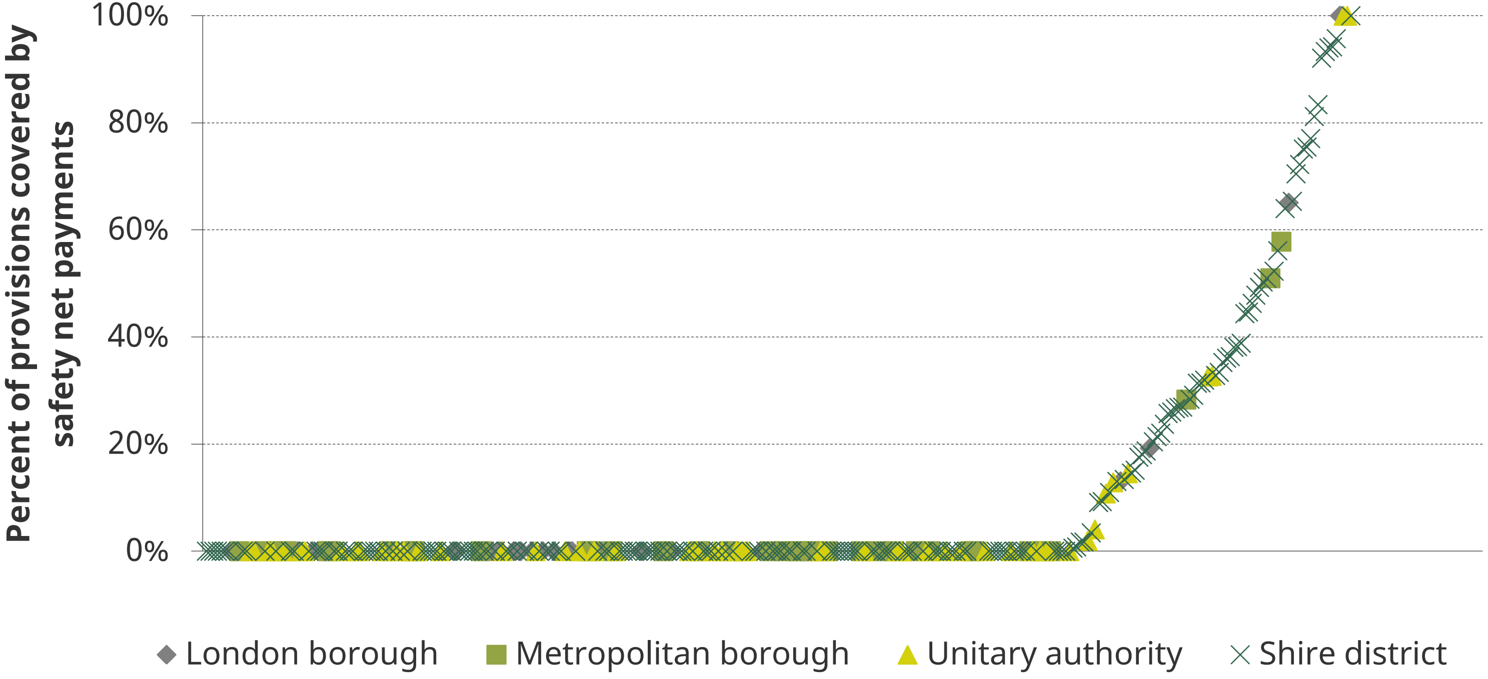
Safety net covers only a small part of these costs



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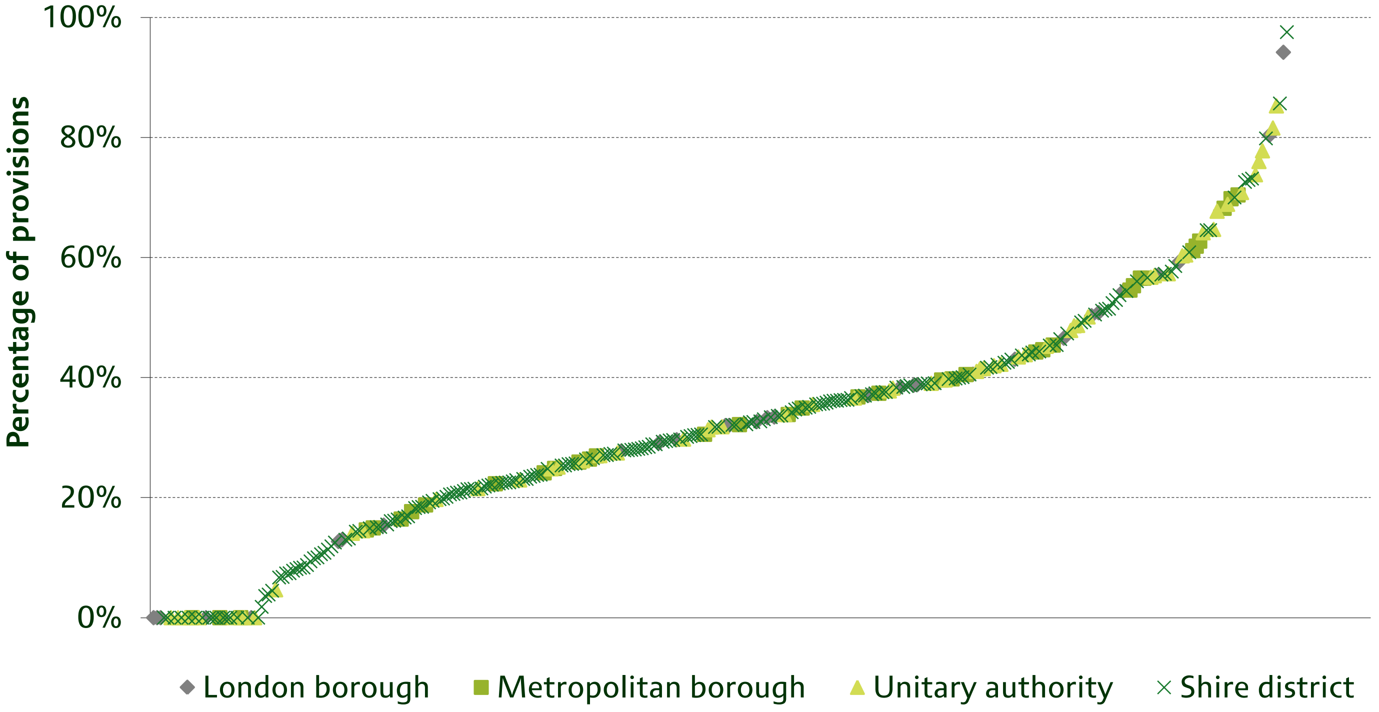
Big differences in use of provisions across LAs



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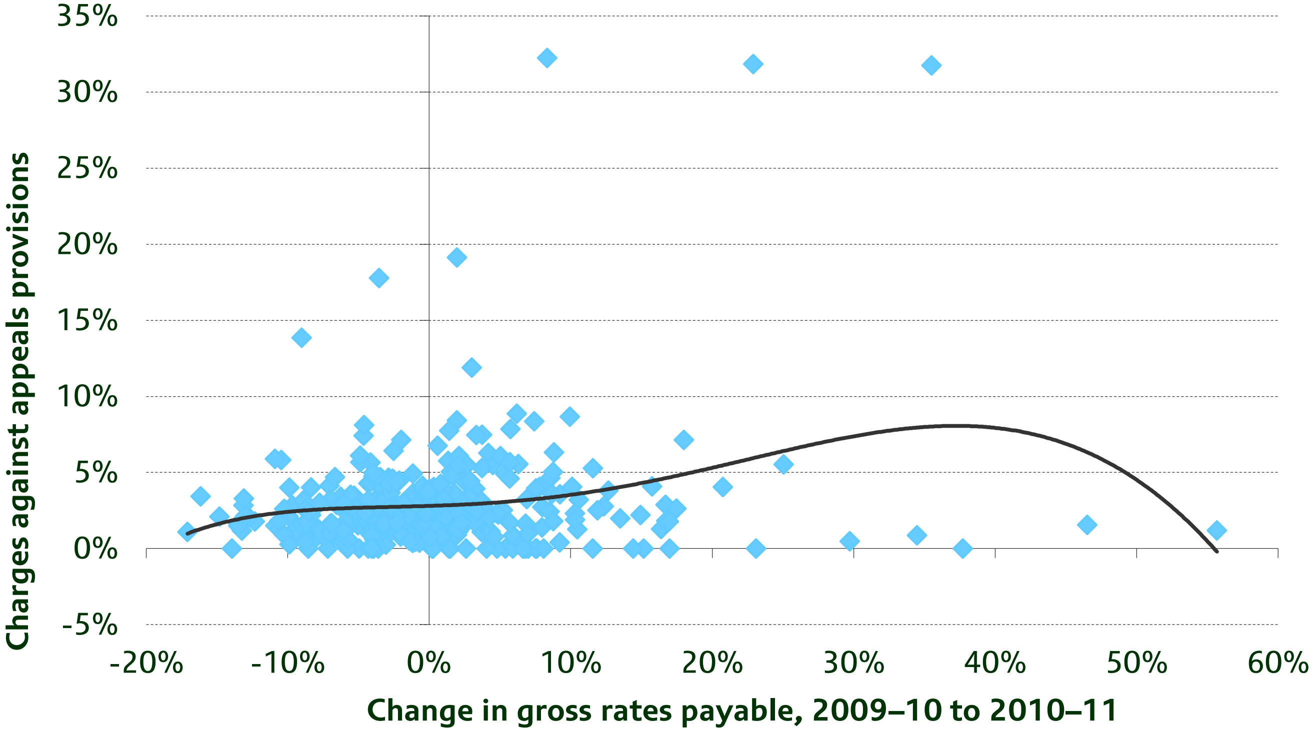
More appeals in areas with values & bills up more?



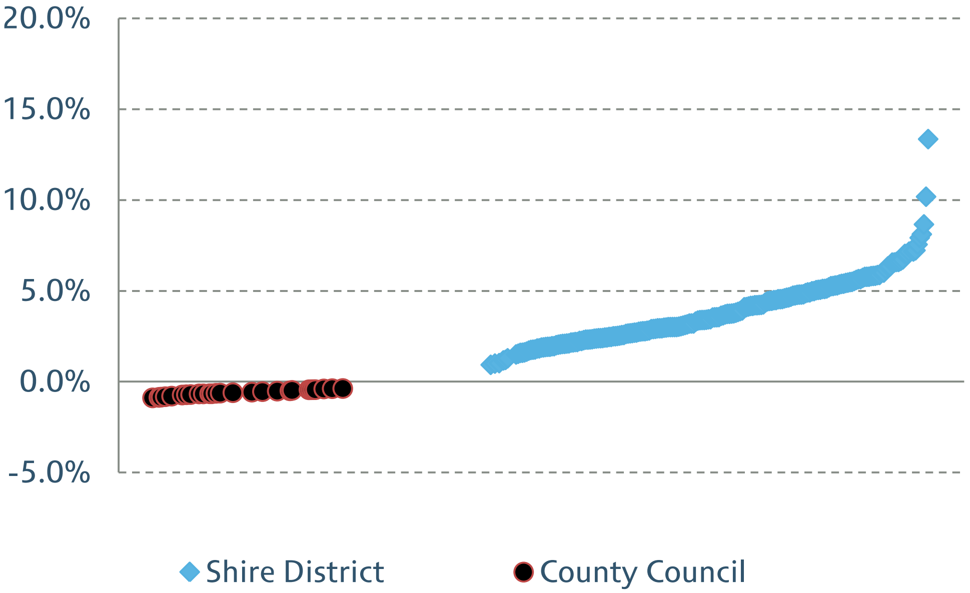
Appeals and 100% retention

- Plans to centralise risk for back-dated appeals
  - Proxy for appeals against initial valuations
  - Good idea – removing a (big) risk over which LAs have no control
- How is this likely to work?
  - Government will levy a net tariff on councils equal to expected cost of back-dated appeals
  - Use this to compensate councils as and when appeals materialise
  - Question: what happens if initial forecast of appeals too low/high?
    - ➢ Strong case that central government should bear this risk too

What should happen to tier shares in 2-tier areas?

- Current system offers stability to counties but risk of losing out on long-term revenue growth
- Looking ahead:
  - Bigger share for counties?
  - Uprate tariffs and top-ups to account for forecast national revenue growth?

Relative gain/loss after 10 years of 100% retention given existing system design and tax-base growth of 0.5% a year



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How might pooling work in future?

- Currently, councils mainly pooling to avoid ‘levies’ on revenue growth
  - Not to more broadly share risk/reward
- How can councils be incentivised to pool when levies abolished?
  - Local growth zones: areas where revenue retained outside main scheme
  - Other incentives like different reset rules for pools
  - Ministerial power to mandate pools

The IFS LG Finance Model (1)

We are building a model to:

1. Examine how changes in spending needs and revenues correlate, and extent to which changes are predictable

2. Combine this with ability to model different funding systems with different parameters for BRRS

3. Look at potential funding divergences and funding uncertainty

4. Feed into future work: economic/behavioural effects of fiscal devolution; potential effects of devolving further taxes

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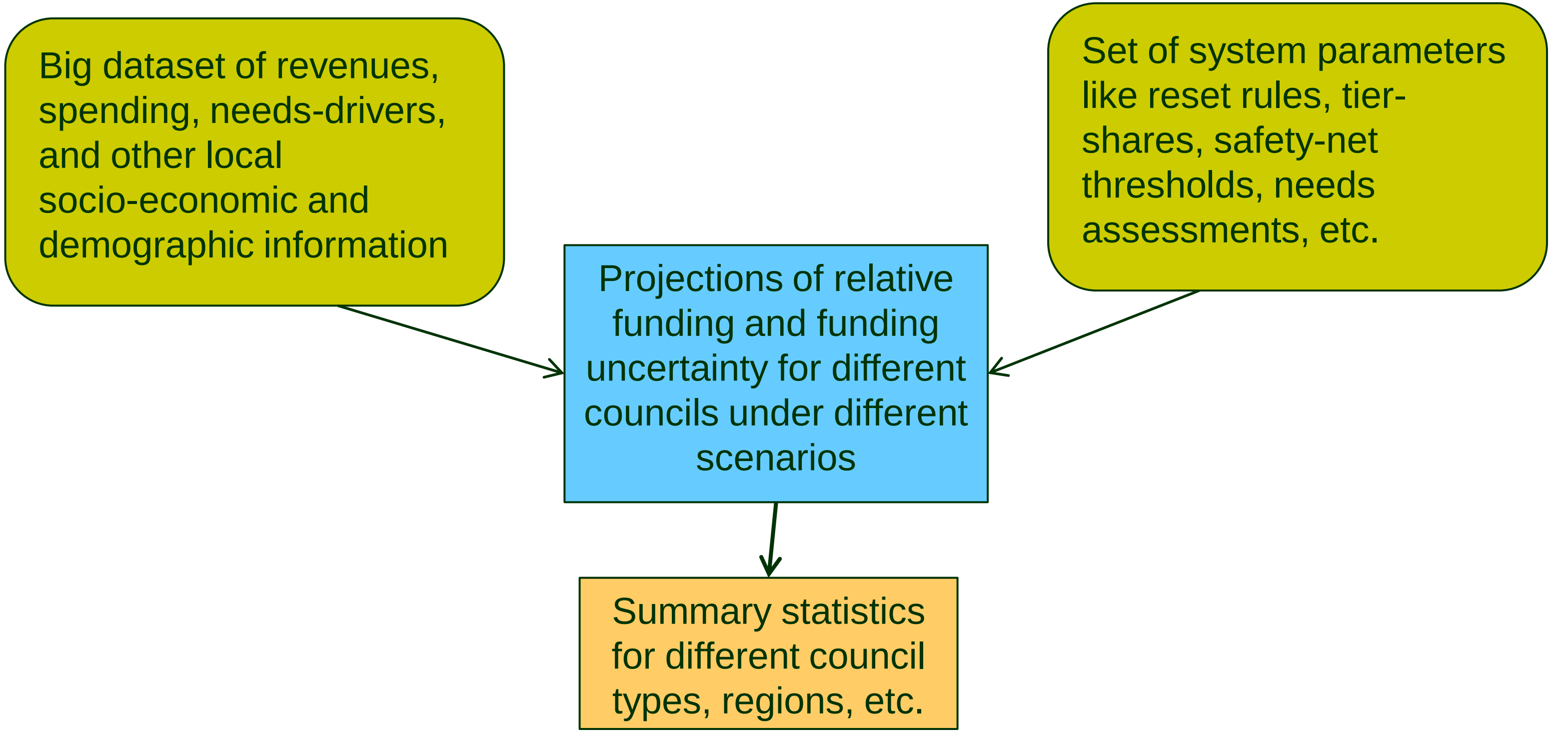
The IFS LG Finance Model (2)



The IFS LG Finance Model (3)

Aim of this model is to:

1. Help inform system design

2. Help inform councils of effects of chosen system design

3. Facilitate future research on local government finance

Concluding thoughts

- Decision to centralise risk of backdated appeals looks sensible
  - Appeals vary massively & linked to large, difficult-to-value properties
  - Risk outside LAs control – risk without (good) incentives
- Lots of other decisions still need to be taken
  - Trade off between incentives and redistribution (resets)
  - Tier-share splits and pooling incentives & mandates
  - Baseline needs assessment
  - Additional responsibilities to devolve
- Devolve other taxes to give broader incentives?

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