1 BACKGROUND – THE LOCAL GOVERNMENT RESOURCE REVIEW

1.1 The Secretary of State announced the latest local government resource review on 17 March 2011 with an associated press release which included the review's terms of reference. A summary of the main changes to local government finance systems post 1945 is set out in Annex I and the terms of reference are set out in Annex II.

1.2 In summary the review is intended to:

- Consider the way local government is funded "with a view to giving local authorities greater financial autonomy whilst insuring that all authorities will have adequate resources to meet the needs of their communities";
- "Look at ways to reduce the reliance of local government on central government funding" and so will;
- "Include consideration of changes to the business rates system" including;
  - "Focus in particular on the optimum model for incentivising local government to promote growth by retention business rates"
  - "Examining the scope for further financial freedoms for local authorities, while standing up for and protecting the interest of local taxpayers…"

1.3 In essence the review may, as a minimum, seek to allow Councils to retain locally some fraction of the growth in business rates for their areas for a period of years as an incentive to assist the growth of their business base. More far reaching reform may also be under consideration such as enabling regions, such as London, or individual authorities to opt out of the Formula Grant system in return for retaining the vast majority of business rates income.

1.4 The review will also consider a range of other issues including Tax Increment Financing. These are new borrowing powers against future business rate revenues to fund key infrastructure and other capital projects to support local driven economic development and growth. It may also cover how Council Tax Benefit will be localised.

1.5 To date there is nothing in the public domain on the outcome of discussions with local government representatives and interested parties. It is understood that there has been one meeting between the responsible Department for Communities and Local Government official and local government representative bodies.

1.6 The review is due to report in July 2011 and it is assumed that any reforms, if proposed and agreed, will potentially be implemented in 2013/14 after the December 2010 two year local government finance settlement has ended.

1.7 The Council Leader is very involved in this subject and has been asked to lead on this subject by the Conservative group at London councils and is being involved in discussions and the commissioning of reports by London councils to explore several options. A key aim of the Hammersmith and Fulham approach is to enable

Boroughs to retain as much as their own buisness rates growth as possible – redistribution of resources should be kept to a bare minimum.

2 OVERVIEW AND IMPACT ON LBHF

2.1 £20 billion of national non-domestic rates is collected locally and then redistributed to local authorities through the local government formula grant distribution system (currently the 'four block' model) in an attempt to balance spending need with available resources. This represents 20 per cent of local government funding.

2.2 Hammersmith and Fulham have long argued that the current formula grant distribution system is incomprehensible and not fit for purpose. This Council is a grant 'floor' authority which means that it receives a below average grant settlement (for example in 2011/12 grant to Hammersmith and Fulham will reduce by 11.3% compared to the national average of 9.9%). Were the 'floor' arrangements not in place this authority would be £30m worse-off (as our notional formula grant allocation is significantly below our actual allocation). Unless radical changes are made to the formula grant system this authority will be at the 'floor' for the foreseeable future.

2.3 There is a huge variation in net contributors to and net benefactors from the system. For 2011/12, businesses in Hammersmith and Fulham are due to pay £173 million in business rates, of which the Council will receive £124.5 million back as Formula Grant (of which £95.1m is redistributed business rates and £29.4m revenue support grant). Nationally total business rates are expected to exceed total formula grant by approx £2.5bn in 2013/14 and £5.0bn in 2014/15.

2.4 For London overall the total amount of business rates forecast to be collected will exceed the total amount of grant distributed within the current two year grant settlement. This raises the prospect that London could seek to become self-funding from 2013/14 onwards. London could sit outside the formula grant system and develop its own regional system for deciding how business rate income should be distributed (pooled) between the boroughs. London Councils are currently working up a model on how this might operate which seeks to incentivise individual boroughs to promote business rates growth whilst taking account of need. As an overriding principle, London, as a region would seek to be more self-sufficient in respect of local government finance and less reliant on funding decisions made by central government.

2.5 The initial modelling produced by London Councils requires a significant redistribution of business rates growth between boroughs. Whilst boroughs would keep a proportion of their own growth the rest would be shared across London. It is argued that this would enable boroughs that have a low business rates base to share in the benefits of the scheme but also mean that risk would be shared. Hammersmith and Fulham has concerns that this redistribution acts as a brake on incentivisation. Boroughs should retain as much growth as possible. This authority is developing a model with London Councils under which:

- No Borough would be worse under any new system than the old system from day 1.
- There would be 5 (possibly 6) super boroughs (Westminster, Tower Hamlets, City of London, Camden and Hillingdon) that would retain 10% of their

business rates growth with the balance going toward funding the Greater London Authority and subsidising other regions.
- All other boroughs would retain 100% of their growth for a 5 year period.

2.6 Alternatives to a regional approach could be adopted. For example, the think-tank Localis have suggested that councils should be able to buy their way out of the Formula Grant system on a negotiated basis for an initial period of between three and five years and should then benefit from the net difference from the business rates they are able to collect over the same period (a downside of the Localis approach could be that central government would thus still determine what the appropriate base position would be for each authority). The localis approach has been largely rejected due to the complexity of its implementation.

2.7 A more minimalist approach could also be adopted. For example the Government have already outlined a possible Business Increase bonus (BIB) which would allow councils to keep a proportion, rather than all, of any growth in a tax base over a fixed timeframe.

2.8 It should be noted that the resource review does not provide for local authorities to increase the business rates multiplier. Any increase in funding would come from growing the business rates base. Powers being considered as part of the Localism Bill mean that local authorities would be able to reduce the effective multiplier but not increase it.

2.9 There are risks as well as rewards associated with a greater share of and more control over funding raised locally. In the present system all the risks associated with future yield (at least for the settlement period) rests with central government. Individual local authority funding allocations are effectively guaranteed. Business rate yields can go down as well as up.

2.10 In addition, there is not always a directly causal relationship between local government actions and changes in business rate yields.

3. CONCLUSION

3.1 The key points are that:

- The case for radical reform of the existing Formula Grant system is compelling. It is immensely complex and subject to central government interference. Moreover the current system will condemn this authority to receiving poor grant settlements for the foreseeable future.

- This review does represent a potentially radical change for local government resourcing. There will be many views contributed, but it does provide an opportunity for councils to control and raise a much larger proportion of the money they spend directly from their locality. This is to be welcomed, particularly, for an authority such as Hammersmith and Fulham that is actively seeking to regenerate large parts of the borough.

- Any final proposals are unlikely to be simple and transparent due to inherent tensions between

    - Simplicity and fairness;
    - Sharing resources on the basis of needs, set against rewarding ‘good’ behaviour by Councils; and
    - Local and national control of a major share of public expenditure, all within a challenging economic environment. But the alternative would be to continue with the current top-down dependency culture whilst not incentivising councils to promote economic growth.

3.2 It is recommended that Hammersmith and Fulham welcomes in principle the potential retention of a much greater proportion of business rates locally. There does need to be a fair trade-off between potential gain and risk but this is an opportunity to move away from the current centralist system. This authority continues to press for any system to keep redistribution of resources to a minimum.

3.3 There are a number of models for taking forward the resource review which have different pros and cons. Government thinking is not yet known. Officers will keep a close watching brief on developments and contribute, in consultation with Members, if and when possible and appropriate either as an individual borough or through its regional representative – London Councils.

Annex I

History of Local Government Funding

Local government accounts for 25 per cent of total public spending. Around 25 per cent of local government spending is funded locally through the Council Tax and charges.

Before 1900, most of the spending of local bodies was financed locally. There were few grants from central government. Various rates were levied for specific services e.g. highway rates, poor rates and school rates.

Following the abolition of the separate poor rate in 1929, rates became a single unified tax. By then, sizeable central government grants were being paid to encourage different areas to provide services of a consistent standard. These were usually made for specific purposes rather than as general (unhypothecated) financial support for local spending.

1945	Nearly 80 per cent of central government grants were in the form of specific grants. The remaining 20 per cent was an unhypothecated "Block Grant". Approximately equal amounts of funding were obtained from government grants and local rates.
1948	Transfer of responsibility for the setting of rateable values of all properties to the Inland Revenue Valuation Office (now the Valuation Office Agency). Previously, each local authority set its own rateable values, resulting in substantial differences between average rateable values for similar properties in different parts of the country.
1948	Block Grant paid only to authorities whose means or rate resources were below the national average and renamed Exchequer Equalisation Grant.
1958	Many specific grants replaced by "General Grant", a new form of unhypothecated block grant, therefore specific grants accounted for less than 30 per cent of government grants. Exchequer Equalisation Grant is renamed Rate Efficiency Grant.
1966	General Grant, Rate Deficiency Grant and specific grants for school meals and milk incorporated into Rate Support Grant (RSG) with three elements: domestic, needs and resources.
1974	Following structural reorganisation, the proportions of resources and domestic elements of RSG increased. Needs element paid to upper tier; resources and domestic elements payable to lower tiers. More specific grants incorporated into RSG. About 20 per cent of government grants were specific grants. Around 37 per cent of funding is from local rates.
1981	Needs and resources elements of RSG became "Block Grant" – payable to both upper and lower tiers – and calculated to penalise high spending authorities for the first time. Its distribution was based on each authority's Grant-Related Expenditure (GRE) as calculated by the Department of the Environment.
1984	Rate limitation (capping) introduced (cash spending limit). During the 1980s, the method of grant allocation was adjusted to provide a disincentive to over-spending.

1986	The government published a Green Paper, Paying for Local Government, which considered ways of improving the system.
1989	Non-domestic rating revaluation. New national rating system came into effect from April 1990.
1990	Domestic rates were abolished and the Community Charge (or "Poll Tax") and nationally determined uniform non-domestic rates introduced. Revenue Support Grant replaced Rate Support Grant. Aggregate External Finance (AEF) replaced Aggregate Exchequer Grant (AEG). Standard Spending Assessments (SSAs) replaced GREAs. Ring-fenced housing revenue account introduced. Districts collected RSG for the area and passed a portion of this and of community charge to county councils.
1991	An additional £140 per charge payer was provided in central government support, thereby increasing the proportion of local government spending funded by central government.
1993	Council Tax replaced the Community Charge as the local domestic tax.
1998	The white paper Modern Local Government – In Touch with the People announced a three year review programme for Revenue Grant Distribution aimed at improving its fairness and equity.
1999	Pre-announced universal capping limits were discontinued to be replaced with reserve powers, which allowed local authorities' budgets to be looked at over more than one year. Non-domestic rating revaluation. New rateable values came into effect from April 2000. Central support protection grant introduced to ensure minimum levels of grant support for billing and precepting authorities.
2000	Modernising Local Government Finance: A Green Paper consulted on options for reform of the revenue grant distribution system. For authorities with education and social services responsibilities damping of changes in grant support now based on the floor and ceiling mechanism.
2002	A new Formula Grant distribution system introduced based on Formula Spending Shares (FSS) instead of SSAs from 2003/04.
2003	The Local Government Bill 2003 received Royal Assent on 18 September, which included new borrowing freedoms, powers to charge for discretionary services, new trading powers and the introduction of a fixed 10-yearly cycle for Council Tax revaluation.
2006	A new four block grant distribution system was introduced for 2006/07 (consisting of a needs assessment, a resources element, a central allocation and a floor damping block). Schools funding was transferred to the Dedicated Schools Grant. For the first time, two years of grant allocations were announced at the same time (2006/07 and 2007/08).
2007	The Lyons Inquiry considered the future of local government finance as part of a broader remit of reports. Radical change is ruled out in the short to medium term. More details on this can be found in a the local report to Cabinet in June 2007: http://cmis/CMISWebPublic/Binary.ashx?Document=21978 http://cmis/CMISWebPublic/Binary.ashx?Document=21979 The first three year settlement (2008/09 – 2010/11) was issued in late 2007.

2008	Area Based Grant (ABG) a new non-ringfenced grant was introduced from 2008/09 replacing a number of grants previously reported as specific grants.
2010	The coalition government announced a Coalition Agreement setting out that it would, amongst other proposals, review local government finance, phase out the ring fencing of grants, review the Housing Revenue Account and freeze Council Tax for at least one year. Following the government's 2010 'emergency' Budget and Spending Review, a two year settlement for local government (for the 2011/12 and 2012/13 financial years) was announced on the 16 December 2010. A large number of grants end (including Area Based Grant) or are simplified and all local authority funding allocations are reduced based on a government defined measure of spending power.
2011	The government formally announces the Review of Local Government Finance and proposals for a new housing finance system (due to be in place from 1 April 2012). Council tax is confirmed as frozen for English local authorities for 2011/12.

Based on the Department for Communities and Local Government Local Government Finance Statistics No 20, June 2010 (Annex C5, pages 208-210).

Annex II

Terms of Reference

Phase 1

The first phase of the Review will consider the way in which local authorities are funded, with a view to giving local authorities greater financial autonomy and strengthening the incentives to support growth in the private sector and regeneration of local economies.

It will look at ways to reduce the reliance of local government on central government funding, increase local accountability and ensure that the benefits of economic growth are reflected in the resources authorities have.

The review will include consideration of changes to the business rates system, and focus in particular on:

a) the optimum model for incentivising local authorities to promote growth by retaining business rates, whilst ensuring that all authorities have adequate resources to meet the needs of their communities and to deliver the commitments set out in the Spending Review;

b) the extent to which these proposals can set local authorities free from dependency on central funding;

c) considering how to fund authorities where locally raised funding would be insufficient to meet budget requirements and control council tax levels, as well as councils who do not collect business rates, such as upper tier authorities, recognising that some parts of the country are currently more dependent on government funding;

d) reviewing the scope for greater transparency and localisation of the equalisation process;

e) the position of councils whose business rate yield would be significantly higher than their current spending;

f) how to ensure appropriate protections are in place for business, within a framework of devolving power to the lowest level possible;

g) how to deliver Tax Increment Financing proposals against a context of greater retention of business rate revenues;

h) how various aspects of the business rate system, including business rate revaluation and reliefs, should be treated;

i) examining the scope for further financial freedoms for local authorities, while standing up for and protecting the interests of local taxpayers, and

j) The wider implications of rates retention for related policies, including the work of the Commission on the Funding of Care and Support and the Government's other incentive schemes (the New Homes Bonus and the commitment to allow communities to keep the business rates for renewable energy projects).

The Review will take account of the responses made to the questions in "Local growth: realising every place's potential". It will also conduct extensive engagement with interested parties, including businesses of all sizes, to ensure that all views and perspectives are taken into account.

Following the announcements at the Spending Review and through introduction of the Welfare Reform Bill that Government will localise Council Tax Benefit, the Review will also consider the design of the new scheme (to be launched in 2013-14) and what flexibilities local authorities should have to help keep overall council tax levels down.

The first phase of the Review will conclude by July 2011, followed by the necessary steps to implement the concluded reforms.

Phase 2

The second phase of the Local Government Resource Review will commence in April 2011 and will focus on Community Budgets. It will be taken forward in parallel with the continued roll out of these Budgets. Detailed Terms of Reference will be published shortly.