Manchester City Council
Report for Resolution

Report to: Economy Scrutiny Committee – 7 September 2016

Subject: New Business Rates Regime – Implications for the Economic Growth Agenda

Report of: The Chief Executive and City Treasurer

Summary

To provide an overview of the new business rates regime and to highlight the implications of this for the city's economic growth agenda.

Recommendations

That the Scrutiny Committee members note and comment on the content of this report.

Wards Affected:

All

Manchester Strategy outcomes	Summary of the contribution to the strategy
A thriving and sustainable city: supporting a diverse and distinctive economy that creates jobs and opportunities	The health of the city's economy is fundamental to the future prosperity of the city's residents and to ensuring there are jobs and opportunities for all.
A highly skilled city: world class and home grown talent sustaining the city's economic success	Business rates will provide an increasingly important contribution to the city council's income over coming years. There are therefore implications arising from the new regime for the level of resources available to invest in key priorities such as skills.
A progressive and equitable city: making a positive contribution by unlocking the potential of our communities	The report describes the new business rates regime and identifies the impact that this could have on the economies of different parts of the city.
A liveable and low carbon city: a destination of choice to live, visit, work	The report describes the new business rates regime and identifies the impact that this could have on the economies of different parts of the city.
A connected city: world class infrastructure and connectivity to drive growth	None directly

Full details are in the body of the report, along with any implications for:

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

Financial Consequences – Revenue

None directly

Financial Consequences – Capital

None

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Background documents (available for public inspection):

None

1. Introduction

1.1 Business rates are a form of tax charged to occupiers of most types of non-domestic property. Rates are payable on shops, offices, pubs, warehouses, factories, holiday rental homes and guest houses. The amount charged to occupiers of non-domestic premises is calculated by multiplying the Rateable Value (RV) of the property (determined by the Valuation Office Agency) by the multiplier (set by the department for Communities and Local Government).

1.2 Broadly speaking, the RV of most non-domestic property is the same as the market rent at each premises in April 2008 (two years before the last revaluation). However, for pubs and other licensed premises their expected ‘Fair maintainable trade’ is used to determine their rental value and in turn their RV. Fair maintainable trade is the annual level of trade (excluding VAT) that a pub can be expected to achieve assuming a reasonably efficient operator.

1.3 The multiplier is reset at each revaluation and typically changes each year in line with inflation (currently linked to RPI). At a revaluation the multiplier is reset to ensure that the overall national revenue from business rates only rises in line with inflation. In addition to the standard multiplier, in 2005/06 the small business multiplier was introduced, this is a slightly lower multiplier than the standard and is currently used to calculate the bill of some premises with an RV of less than £18k.

2. Recent changes to the business rates regime and their likely economic impact

2.1 In the 2014 Autumn Statement the Government announced a radical review of the national business rates regime with the aim of modernising the tax to make it “fit for purpose in a 21st century economy”[1].

2.2 A series of announcements by Chancellor George Osborne followed that announcement which will have a direct impact on Manchester. The first of these was that the GM Mayor has been given devolved powers to introduce a rates supplement to support investment and more recently, it was announced in the 2016 Budget that Greater Manchester (GM) would become one of three areas to trial 100% retention in 2017 with a view to roll out to the rest of England in 2020/21. The implications of other key announcements made in the 2016 budget are discussed in section 3 below.

<u>Pilots and devolution of business rates in GM</u>

2.3 The devolution timetable as currently set out is summarised below:

Pre-2013	All rates revenue sent to Whitehall
April 2013	50% rates revenue retained locally
April 2015	Pilot areas (inc GM) retain 100% rates growth
April 2017	Pilot areas (inc GM) retain 100% rates revenue

[1] Business rates review: terms of reference and discussion paper

April 2020 National roll out of 100% retention

2.4 From 2013/14 the Local Government Resource Review (LGRR) introduced the partial re-localisation of business rates which brought a lot more volatility to the local government funding system. The risk of any reduction in local business rate yield due to the closure of businesses or appeals against rateable values previously lay with Central Government, and similarly they benefitted from any increase in local yield. From 1 April 2013 those risks and benefits were shared between Councils and Central Government. Councils retain an element of the business rates collected, for districts like Manchester this is 49%.

2.5 The central share is redistributed to councils in the form of revenue support grant and other grants. The local share is kept by local government, but is partly redistributed between local authorities through a system of tariffs and top-ups. This redistribution is to ensure that areas do not lose out just because their local business rates are low compared to their assessed needs. Local authorities are either tariff authorities, who collect more than their assessed level of need, or top up authorities who collect less and receive a government top up grant to make up the difference. Tariff authorities pay their excess business rates back via a levy of to fund the top ups that other authorities receive.

2.6 Therefore Manchester City Council retains 49% of growth in business rate receipts arising from new or expanding businesses. Local authorities that pay tariffs are also liable to pay a levy of up to half of this type of growth. The money raised from this levy is then used to fund a safety net system. This system protects those councils which see their annual business rate income fall by more than 7.5% below their ‘baseline funding level’. The baseline funding level is that assessed by government based on levels of need and estimated business rates and council tax collectable.

<u>Greater Manchester and Cheshire East Business Rates pool</u>

2.7 Under the business rates pool regulations authorities can voluntarily come together to pool their business rates, providing them with the potential to generate additional growth and more importantly retain any levy payments rather than returning them to central government. This is possible because the Pool treats Authorities as a single entity for the purpose of calculating top-up, tariffs, levies and safety net requirements. From April 2015 Councils from Greater Manchester and Cheshire East joined together as a Pool, seeking to maximise the amount of Business Rates retained within the area. Cheshire West and Chester joined the pool in April 2016.

2.8 The Governance Agreement for the pool set out the arrangements for those authorities generating a levy payment to be retained by the pool. There will be an initial call on this levy in the following proportions: Cheshire East and Cheshire West and Chester retain 50%, Trafford and Stockport retain one-third with the remainder being pooled at GM level. The 2015/16 total saving is £2.3m of which £1.5m will be retained by the Combined Authority and utilised to the benefit of the region.

Greater Manchester and Cheshire East 100% Growth Retention Pilot

2.9 In the 2015 Budget the Chancellor of the Exchequer announced a pilot to retain 100% of additional business rate growth in Greater Manchester and Cheshire East. The scheme set a growth baseline above which named authorities would retain 100% of growth.

2.10 The scheme started on 1 April 2015, as a pilot and allows local authorities to retain 100% of "additional growth" in business rates. The formula remains under discussion with the Department of Communities and Local Government (DCLG) to identify the level of growth which removes the volatility of appeals. It has not been decided yet how any additional growth will be applied.

2.11 Importantly, under the 100% retention pilot there has been assurance from the Government that pilot areas will not be financially worse off than if they hadn't participated[2]. For GM this will include covering the loss of any extra revenue generated from the current pilot (100% retention of additional business rates growth) and the business rates pool.

2.12 It is estimated that the current pilot (100% retention of additional growth) will generate £5m of extra revenue in 2015/16. This has the potential to grow year on year as English Local authorities move towards full retention. Less clear however, is how the impact of the 2017 revaluation (the first since 2010) and the resulting appeals will be managed. The rateable value of premises in 2017 could vary dramatically from those assigned at the last revaluation.

2.13 As part of the pilot it is intended be to press for functions that help to support future productivity and future growth , such as funding for vocational skills for 16 - 18 year olds, to be transferred to GM. In this way there would be a closer alignment between the future business rates system and the City's and GM's wider growth and reform priorities.

100% Business Rates Retention

2.14 The government has committed to delivering 100% Business Rates retention for local authorities in England by the end of this Parliament. They will pilot the approach from 1 April 2017 in a number of areas including Greater Manchester and Liverpool City Region.

2.15 By moving to 100% business rate retention local councils in England will have control of around an additional £12.5 billion of revenue from business rates. In order to ensure that the reforms are fiscally neutral, councils will gain new responsibilities, and some specific grants which are currently funded through the business rates central share will be funded through the local share instead.

2.16 The business rates baseline ('tariffs and top-ups') will be reworked to ensure that authorities that are more deprived or with less capacity to raise business

[2] Any loss of income in the 4 year trial period will be compensated by government through a section 31 grant

rates do not suffer at the start of the new arrangements. The move to 100% retention does not represent additional funding for local government.

2.17 Under 100% business rates retention all authorities will have a new power to reduce the business rates multiplier. Authorities with elected mayors will have the power to levy a 2p in the pound supplement on business rate bills to fund new infrastructure projects. The Levy will be removed but an element of safety net retained. The design of the new system will take account of the changing shape of local government, including the role of Combined Authorities.

2.18 The Government's intention is that policy should be developed with the sector, but decisions will lie with Ministers. The DCLG and Local Government Association (LGA) established a technical steering group and three sub-groups to provide information and expert advice.

2.19 The following principles provide the basis for pilots to be developed:

- Give authorities an incentive to grow local tax bases by ensuring they see long-term rewards from growth;
- Maintain a predictable income stream against which authorities can take long term investment decisions; and
- Ensure that local authorities can continue to provide a full range of local services, whilst recognising that decisions about spending priorities should be made locally by locally-elected representatives accountable to local taxpayers.

2.20 There has been assurance that Authorities will be no worse off as a result of taking part in the pilot. For GM this will include covering the loss of any extra revenue generated from the current pilot (100% retention of additional business rates growth) and the business rates pool. The pilots will help to develop the mechanisms that will be needed to manage risk and reward. The approach will include financing new responsibilities and/or existing funding streams from additional business rates, including those that support economic growth at district or regional level.

2.21 There are four main areas of focus for the GM pilot:

I. Incentivising economic growth – in particular how growth can be incentivised and headroom for investment created

II. Creating a stable funding stream – addressing issues such as how risk, particularly that associated with appeals is dealt with and how a new safety net arrangement to protect local authorities from the increased levels of volatility in their funding, should operate

III. Transfer of Functions – which functions will transfer to being funded from business rates income. It is given that Revenue Support Grant will cease and be funded via business rates income

IV. System design - in particular how revaluations, resets and tariffs and top ups will operate

2.22 A complementary report on business rates retention is on the agenda for the forthcoming Resources and Governance Scrutiny Committee on the 8th of September 2016. This will focus on issues covered across points II,III and IV above. The purpose of this report however is to examine the implications of the new business rates regime for the economic growth agenda within the city (bullet I).

2017 revaluation

2.23 At revaluation, the government adjusts the value of business rates to reflect changes in the property market. It usually happens every 5 years.

2.24 The most recent revaluation came into effect in England and Wales on 1 April 2010, based on rateable values from 1 April 2008. The next revaluations will be in 2017.

2.25 At revaluation all properties are given a new rateable value and multipliers are revised. As with previous revaluations, the 2017 revaluation is expected to trigger a sharp increase in the number of appeals lodged by businesses against their assessed RV. In Q2 2015 Manchester had the fourth highest number of outstanding appeals outside London (6,570)[3], this represents 26% of all non-domestic premises in Manchester.

2.26 The longer the period between revaluations, the stronger the incentive for businesses to appeal their valuation. Government is currently consulting on the possibility of more frequent revaluations (at least every 3 years as opposed to every 5) which will make the tax more responsive to changes in property values, but is unlikely to dissuade all businesses from appealing their valuation.

2.27 Crucially, the number of appeals and the associated adjustments to rates payable has the potential to nullify financial benefits arising from the pilot schemes. These impacts could be felt more acutely post-2020 when outside of the fiscal protection of the pilot scheme.

2.28 The principle of devolved business rates was established in various devolution deals agreed in the period up to 2016. However, as the system continues to evolve, a very different national regime sits behind the responsibilities bequeathed to GM compared to the system in place when discussions about rates devolution began.

3. Budget 2016

3.1 In the spring budget (2016) the Government announced a series of additional changes to the national business rates system. The most notable changes come into effect in April 2017 (Table 1).

[3] Adam Burke – Colliers International

3.2 Under these changes;

- 600,000 small businesses across England will no longer pay any rates
- A further 50,000 will benefit from the expansion of tapered relief
- 250,000 smaller properties will pay 1.3p in the pound less, as they switch from the standard multiplier (49.3p in the pound) to the small business multiplier (48p in the pound)

Table 1

Proposed policy changes	**Current rules**	**April 2017 (2020)**
Small Business Rate Relief (SBRR) thresholds	• RV<£6k = 100% relief • £6k<RV>£12k = 100%-0% tapered relief	• RV<£12k = 100% relief • £12k<RV>£15k = 100%-0% tapered relief
Small Business multiplier threshold	• RV<£18k = bill is calculated using the lower small business multiplier	• RV<£51k = bill is calculated using the lower small business multiplier
Annual indexation	• Linked to RPI	• (Linked to CPI)

4. Current overview of business rates in the city

4.1 There are more than 25,000 business premises in Manchester including over 10,000 offices paying over £110m and over 8,000 shops paying over £80m in business rates annually in the city.

4.2 These two sectors combined account for over 50% of total rates revenue (despite significant levels of relief). Other significant rate paying businesses in the city include warehouses & stores, hotels and car parks.

4.3 Almost half of the total amount of revenue raised from business rates is generated in the city centre (reflecting the preponderance of the Grade A office market including developments such as Spinningfields and the retail core including the Arndale shopping centre).

4.4 Other significant concentrations of large scale rate paying business premises include Manchester Airport, Corridor Manchester, various out of town convenience and comparison retail hubs including Manchester Fort and Central Retail Park.

<u>The current system of relief</u>

4.5 It is estimated that relief for empty properties in the city amounts to £18m annually. Circa 70% of this £18m (£12.6m) is currently claimed in the city centre, with around £8m of city centre claims (more than 60%) attributable to empty city centre office space.

4.6 Empty Listed buildings currently receive 100% relief. In contrast to other empty buildings listed relief has no time limit, so whereas non-listed buildings get 3 months relief, listed buildings receive relief until they are re-occupied.

4.7 The current system of relief is not always well targeted on growth or regeneration objectives. In the case of listed buildings the current system of relief provides little incentive to owners to either sell, regenerate or somehow return to sustainable, employment generating economic use.

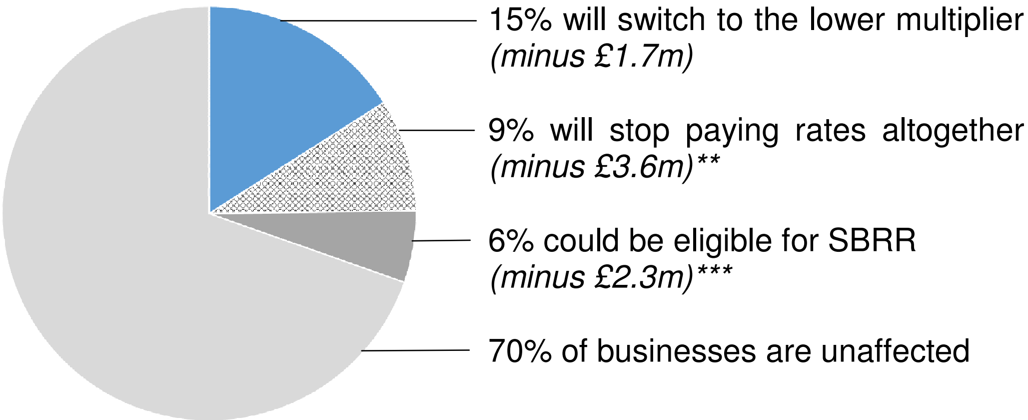
4.8 Other significant sectors in receipt of mandatory relief include education (including the universities) and charitable organisations which receive 80% mandatory relief.

4.9 It is important to note that currently there is no local control over mandatory reliefs and there are strict policies in place governing the areas where it is possible to grant discretionary reliefs. This is set to continue under the 100% retention system leaving little current room for local authorities to operate the regime in a more flexible or targeted way. As part of the current consultation the Council is seeking some additional local flexibility relating to mandatory relief to deal with issues of contrivance, particularly with charitable relief.

5. Implications of 2016 budget for rate paying businesses in the city

5.1 It is estimated that following the enactment of the reforms announced in the 2016 budget, in the region of 2,200 small businesses will stop paying business rates completely in the city. In addition circa 3,800 business will begin using the lower multiplier and 1,400 more could be eligible for SBRR.

5.2 The total reduction in revenue could amount to some £7.6m* per annum broken down as follows:



* Based on 2016/17 multipliers and does not account for interest rate changes
** Figure includes current tapering arrangements
*** Proportion of SBRR awarded to businesses within the £6-12k RV bracket applied to £12-15k RV bracket

6. How can the city council use the new regime to support its economic growth agenda?

6.1 Looking forward, two key policy challenges exist for the city:

I. The first relates to ensuring that the business rates regime contributes to the city's economic growth agenda, helping residents to benefit from that success;
II. The second relates to developing a new business rates charging framework (in the city/GM) which meets the internal financial business revenue objectives of the city council and its partners in a devolved environment.

6.2 These objectives are not mutually exclusive. In a future devolved environment there will be an increasing need to consider whether changes to the regime could deliver wider benefits for the city.

6.3 It is important that the future regime recognises that attracting growth and investment to GM includes some additional costs for the local authorities, including city council services such as the Strategic Development and City Centre regeneration teams and GM functions such as MIDAS, Marketing Manchester and the Growth Hub. There are also costs that arise from a growing economy such as additional demands for refuse collection and street cleaning all of which add to costs and should be recognised in a business rates system that incentives growth.

Growing the revenue base in already high performing sectors

6.4 Table 2 shows the current distribution of revenue raised according to rateable value bands. The reforms in the 2016 budget will further reduce the rates paid by smaller businesses and mean that in future there will be an increasing reliance for income on larger businesses occupiers.

Table 2: Rateable Values and Business Rates Levied Based on the Position in June 2016

Rateable value bands	Number of properties	% of total number of properties	Total rateable value	Total bill amount	% of total bill amount
£0 - £4,999	9923	39.7%	£22,693,495	£4,673,523	1%
£5,000 - £14,999	7451	29.8%	£65,307,075	£21,273,139	6%
£15,000 - £24,999	2326	9.3%	£44,732,127	£19,039,940	5%
£25,000 - £49,999	2340	9.4%	£82,404,700	£34,819,598	10%
£50,000 - £74,999	901	3.6%	£55,208,000	£23,769,855	7%
£75,000 - £99,999	536	2.1%	£46,146,000	£19,721,100	5%
£100,000 -	328	1.3%	£36,562,900	£16,128,015	4%

£124,999					
£125,000 - £149,999	249	1.0%	£33,777,000	£14,793,816	4%
£150,000 and above	960	3.8%	£461,826,050	£204,436,245	57%

6.5 The above table shows that 57% of business rates income is raised from just 3.7% of properties. Within these properties large scale office and retail premises contribute a significant proportion of the total. Recent city centre developments such as the Grade A office space at Spinningfields, Piccadilly Place and St Peter's Square are examples of recent schemes that have added to business rate income.

6.6 In contrast to the office market there are currently no new large scale expansions of retail floorspace planned (conversions and refurbishments aside) within the traditional city centre retail core. In contrast to the office core therefore there are currently no major schemes in the pipeline that are likely to increase business rates revenue from the main retail area in the city centre in the period from 2016.

6.7 Elsewhere, planned investment by Beijing Construction & Engineering Group (BCEG) coupled with other investment at the Airport and in the Airport City Enterprise Zone will deliver increased revenues into the future. This established investment plan provides the necessary framework for business growth and therefore business rate revenue expansion in and around the North's main international Gateway in the period to 2050.

6.8 A second enterprise zone has since been established in the form of the GM Life Sciences Enterprise Zone. Enterprise Zones offer incentives to attract new businesses, generate jobs and drive growth. They also act as catalysts for new businesses, allowing the local LEP to reinvest business rate growth into the zones to attract additional investment.

<u>Enterprise Zones</u>

6.9 Within Enterprise Zones the uplift in business rates receipts as a result of the Zone's introduction can be used by the local enterprise partnership for key economic priorities, related to the zone itself or elsewhere within the local enterprise partnership's boundaries. This is a long term arrangement that is planned to last for a period of 25 years. Within an Enterprise Zone a local authority has the power to discount business rates for specific businesses.

<u>Addressing inefficient land uses in high demand locations</u>

6.10 Over time Manchester has witnessed the redevelopment of a large number of unused and under used sites. This process of regeneration is continuing and as uses such as small temporary surface car parks are replaced with other uses so the revenue raised through business rates or council tax will increase. Under the new business rates regime there will be a greater direct benefit to the city resulting from active commercial uses on such sites and the business rates regime could therefore be a means of incentivising growth in certain key sectors.

Business Rates Supplement, the Mayoral Levy and Major Infrastructure Schemes

6.11 Under the current business rates scheme a Business Improvement District (BID) can be designated enabling a 2% increment to be applied to rateable values in a pre – determined area where the additional funds are used for the benefit of the contributing businesses. For example Manchester has the 'Heart of Manchester' BID set up around the Arndale Shopping Mall. These additional funds are used to promote the area and attract and create retail opportunities[4]. At present the Government is consulting on a range of different future business rate retention measures including a proposed infrastructure levy and its possible relationship to the existing Business Rates Supplement (BRS) powers.

6.12 The Mayoral Levy (or Infrastructure Levy) allows a 2p in the pound supplement to be levied on business rates bills in Combined Authority Areas, with all additional revenue being used for cross boundary infrastructure projects. The approval of the majority of the business members of the Local Enterprise Partnership (LEP) board will be required for a levy to be raised. For simplicity it is suggested the Mayoral Levy supersedes all existing BRS schemes in Combined Authorities and City Regions[5]. An alternative option would be to continue successful BID schemes and to remove the relevant businesses from the requirement to pay the infrastructure levy.

6.13 Different infrastructure schemes are treated differently by the current business rates system with some being listed locally with all revenues being part of the local list, while others are part of a national list with all revenues going to Government. Metrolink, for example, is on the local list and we therefore see the benefit of the investment being reflected in local business rate revenues. As part of the current consultation and as part of the business rate pilot work the Council is arguing that other major local infrastructure such as Victoria Station which has been the subject of local investment decisions, should be transferred from the national to the local list.

6.14 Historically, business rates relief could have been seen as a potential tool to support small businesses based in district centres. However, the most recent changes (Table 1) to SBRR are likely to reduce the overall costs of business rates to many businesses in many of the city's district centres, particularly those without large scale retailing and office provision.

6.15 The Committee will be aware that a District Centres sub group has been established to consider a range of issues associated with the future role and vitality of district centres. Against this backdrop, it is suggested that the District Centres sub group consider this (and associated issues) in greater detail, in

[4] A BID can only be implemented following a successful referendum.
[5] Another option is to continue successful BID schemes and remove them from the infrastructure levy.

particular considering the stimulus that taking small businesses out of the business rates net may give to centres in the future.

7. Conclusion & issues for further consideration

7.1 In light of the recent reforms and the devolution of business rates (100% retention pilot commences in 2017) in the city/GM in particular, the opportunity exists to consider a new framework for considering how the business rates regime can best contribute to the city's economic growth agenda and the long term financial sustainability of the council and its partners combined.

7.2 This paper sets out an introduction to this challenge and highlights some of the key issues and ideas for further consideration linked to the potential for a fiscally neutral regime which supports and prioritises high value sectoral growth within key growth markets and amongst high value occupiers while also providing some support for future growth sectors whose growth may need incentivising.

7.3 With this in mind it is clear that increases in business rates revenues in the future will be increasingly reliant on:

- growing large scale floorplate occupiers particularly offices and retail in the city centre; and
- ensuring higher value land uses are encouraged in high value locations

7.4 Other important future considerations include what role a reformed business rates regime may play in:

- regenerating district centres; and
- creating a system of relief that supports the regeneration and efficient economic use of empty commercial buildings

7.5 With this in mind, officers propose to undertake further work on these issues as part of making a case for further freedoms and flexibilities including investigating the opportunities for growth as part of the current business rates retention consultation designed to ensure that the future business rates regime delivers the best overall outcomes in the context of the city's economic growth agenda.