Finance and Policy Committee

Date: **31 May 2012**

Item 6: **Local Government Resource Review: Implications for TfL**

This paper will be considered in public

1 Summary

1.1 This paper briefs members on the expected impact of the Local Government Resource Review (LGRR) on TfL, following the publication by the Department for Communities and Local Government (CLG) on 17 May 2012 of a ‘Statement of Intent’ that makes explicit reference to TfL’s funding arrangements (Appendix 1).

1.2 On 18 May 2012, the Secretary of State for Transport followed up publication of the Statement of Intent with a letter to the Mayor (Appendix 2), clarifying that the new arrangements should not be construed as a weakening of Government’s support for TfL, and should not reduce the amount of money available to TfL over the Spending Review period. TfL has started briefing the credit rating agencies regarding the proposed changes, and has shared the letter with them.

1.3 Department for Transport (DfT) officials have also written (Appendix 3) to clarify that the reference in the Statement of Intent to the Bus Service Operators Grant (BSOG) was an “administrative error”, and should not have been included in the list of grants to be devolved under the new system.

2 Recommendation

2.1 **That the Committee note the proposed reforms, their likely impact on TfL’s future funding arrangements, and the key outstanding issues to resolve.**

3 Background

Business Rates Reform

3.1 National Non Domestic Rates (NNDR or ‘business rates’) in effect became a centralised tax in 1990. A nationally set ‘multiplier’ is used to determine liabilities for individual properties based on their ‘Rateable Value’ (closely related to their market rent). The multiplier increases annually in line with RPI. In addition, non-domestic properties are revalued every five years, and any relative increases or falls in value are redistributed, in such a way as to keep the overall tax take constant in real terms. Business rates represents about four per cent of the total UK tax income.

3.2 Collecting authorities (district councils and boroughs) pass business rates to central Government; the money is then redistributed back to local authorities on the basis of a complex formula and supporting data (including population and deprivation).

3.3 The Local Government Resource Review was launched by the Secretary of State for Communities and Local Government in late 2010, after the Coalition government indicated its intention to replace the current 'needs based' system with one that incentivises authorities to grow their business rates base. This reflected a wide consensus that the current system did not incentivise local decisions that supported growth.

GLA group funding

3.4 In London, the boroughs are the collecting authority for business rates and council tax, with the GLA the major precepting authority (ie able to set a council tax charge that the boroughs are then required to pass to the GLA).

3.5 The key grants (excluding specific grants) received by the GLA and its Functional Bodies under the current system are shown in the table below.

Table 1: GLA and Functional Body – Grants

Grant / Source	**2013/14 amount (SR10 figures, estimated where appropriate)**
Core GLA grant	£47m
London Fire and Emergency Planning Authority (LFEPA) – formula and fire revenue grant	£242m
Mayor's Office for Policing and Crime (formula grant and police grant)	ca £1.9bn
Transport Grant (paid by DfT to the GLA "for the purposes of TfL")	£2.7bn (comprising 'General Grant' of £1.8bn and 'Investment Grant' of £900m)

Expected Timetable

3.6 The Government first consulted on proposals for the introduction of the local retention of business rates in summer 2011, and published final proposals in December 2011. The Local Government Finance Bill, which provides the necessary powers for the reforms, is currently going through Parliament.

3.7 To support the Bill's Third Reading in the Commons on 21 May, CLG published a Statement of Intent on 17 May (Appendix 1), which sets out some key principles regarding how the scheme will operate, and the funding streams to be devolved into it (including the Transport Grant).

3.8 The Bill is due to undergo its House of Lords stages in June, with Royal Assent expected before the summer recess. CLG will then consult on the scheme detail over the summer, with detailed financial information being finalised over the autumn, in advance of the Local Government Finance Settlement in January 2013. The scheme is expected to start in April 2013.

Central and Local shares

3.9 Under the new system, any local growth (or decline) in business rates compared with the base year will be shared between local and central government, until such time as the whole system is 'reset' (see para 3.12 below). Billing authorities (in London, the boroughs) will pay a percentage of the rates they collect to central Government – known as the 'central share' – which will be used in its entirety to fund the local government sector[1], including the 'New Homes Bonus'[2]. It will be supplemented by a 'Revenue Support Grant', in order to meet the spending control totals for local government in 2013/14 and 2014/15 that were announced in the 2010 Spending Review.

3.10 The Statement of Intent published by CLG confirms that the central share will be set at 50 per cent until any 'reset'. This has been set at a level such as to provide a real financial incentive to local authorities (growth on their 'local share' of 50 per cent, while still enabling the Treasury to maintain overall expenditure control in future years. By setting a central share of 50 per cent, which is higher than had previously been expected, the Government will share the risks (of negative growth) and rewards (of positive growth) in business rates with local authorities (collecting authorities and preceptors).

3.11 In addition to central and local shares, for two-tier authorities (including London), regulations will specify the percentage of the local share that collecting authorities are required to pass to precepting authorities. The proportionate share in two-tier shire areas will be 20 per cent for the county and 80 per cent for the district. It is again expected that these percentages will be fixed until a full system reset.

Full System Resets

3.12 The Statement of Intent makes clear that the first 'system reset' (a full needs based review of the system and funding requirement for individual authorities) is expected in 2020 at the earliest (to align with the five-yearly revaluation cycle), giving at least a seven year period over which authorities would benefit

---

[1] Policing bodies will be entirely funded from the central share during the SR10 period. Government will review the way in which the police are funded beyond the SR10 period. This could lead to policing being entirely funded from general taxation, which would allow the Government to devolve more local authority funding streams (e.g. social care, benefits support) into the business rates system.

[2] The Government provides additional funding for new homes by match funding the additional council tax raised for new homes and empty properties brought back into use, with an additional amount for affordable homes, for the following six years.

from growth in their local share. Thereafter, the Government intends the periods between “resets” to last 10 years.

Top up vs Tariff authorities

3.13 To provide a fair starting point for each authority under the rates retention system, there needs to be an initial re-balancing of resources, such that resource-poor authorities (including most London boroughs) receive ‘top up’ funding, which will be financed from the ‘tariffs’ paid by resource rich authorities (e.g. City of London, Westminster). If an authority collects more in business rates[3] than its baseline funding requirement[4], it will be required to pay a ‘tariff’ to central Government; if an authority has a baseline funding requirement that is more than it collects in business rates, it will receive a ‘top up’. Tariffs and top-ups will be fixed in 2013/14 and increase annually by RPI until any reset.

3.14 It should be noted that the exposure to risk and reward is smaller for top up authorities (who will receive a share of their ‘local’ funding in the form of an RPI-linked top-up, and for whom increases in business rates translate into proportionately smaller increases in total available funding) than it is for tariff authorities (for whom the reverse applies). In two tier shire authorities, the 80/20 district / county split is designed to ensure that all counties will be top-up authorities and all districts will be tariff authorities, reflecting the latter’s primary role in planning and economic development (and thus more suitable to the greater incentive through being a tariff authority).

3.15 Certain authorities who pay a very significant tariff – for example, perhaps their business rates take is more than double their baseline funding requirement – may experience ‘disproportionate’ growth, since a small percentage growth in business rates would translate into a much larger percentage change in funding available. It is expected that this will be subject to a ‘disproportionate growth levy’, the proceeds of which may be used to assist authorities who experience a sudden drop in business rates income – for example, through closure of a major plant. The details of the levy / fund have not been announced, but it is currently thought unlikely to affect the GLA.

4 Proposed Involvement of TfL

4.1 As can be seen from Table 1, the ‘core’ GLA and LFEPA grants amount to less than £300m per annum, of which half could be centrally funded. This would leave only approximately £150m to be funded through locally retained rates. The growth incentive – perhaps annual growth of one per cent, on a local share of £150m – would thus be minimal for ‘core’ GLA and LFEPA alone.

[3] calculated using a five year average over the last five years to iron out volatility
[4] This will be derived from authorities’ formula grant entitlement in 2014/15, with a separate payment outside the system in 13/14, to ensure that the SR10 settlement is maintained

4.2 The Government has stated that Policing bodies will be entirely funded from the central share during the SR10 period, and Government will review the way in which the police are funded beyond the SR10 period. Consequently, the Government's policy position is that a proportion of TfL's funding should be through locally retained business rates. This was confirmed in the 2012 Budget, which stated:

> *"The Government intends, in principle, that Transport for London (TfL) should receive funding from a locally-retained share of London's business rates that will allow the Mayor of London to continue sustainable investment in transport, and is considering options for how this might be achieved."*

4.3 CLG's Statement of Intent (Appendix 1) now confirms that a proportion of the GLA Transport Grant will be included in the business rates retention scheme from 2013/14. A footnote clarifies:

> *"Funding for TfL will (i) continue to include a Transport Grant payable directly to the GLA for the purposes of TfL, as provided for under Section 101 of the GLA Act; and (ii) include a share of the locally retained business rates passed through the GLA."*

Financial impact on TfL

4.4 The Secretary of State's letter makes clear her intention that the proposed changes should not reduce the overall amount of money available to TfL over the Spending Review period. The 2010 Spending Review ('SR10'), which covered the years to 2014/15, splits TfL's Transport Grant into an 'Investment Grant', which was held constant in real terms, and a 'General Grant', which was subject to a 28 per cent cut, in line with local authority transport funding[5]. The new arrangements are expected to apply to the General Grant component.

4.5 The new system will start in 2013/14, and is expected to be applied broadly as follows:

(a) In 2013/14, the amount of funding TfL receives from the GLA through business rates (the baseline amount) will equal to 50 per cent of the General Grant in 2014/15, deflated to 2013/14. The remaining funding required to 'top up' TfL's General Grant to the 2013/14 amount agreed under SR10 is expected be paid as grant from DfT.

(b) In 2014/15, TfL's business rates funding received from the GLA will equal the baseline (2013/14) amount, increased by RPI. Thus in 14/15, there will be a 50/50 split in TfL's general funding between the General Grant (from DfT) and business rates (from the GLA), reflecting the split between central and local shares at a national level, as described in paragraph 3.9.

[5] These are paid as a single grant under s101 of the GLA Act

(c) From 2015/16 (ie beyond the current spending review period) until a ‘system reset’, TfL’s grant would be determined by Ministers in future spending review(s). This determination would be based on TfL continuing to receive business rates funding from the GLA, increasing annually at RPI, as well as an assessment of the need and case for continued investment in London’s transport, and overall fiscal affordability. As under the current regime, the Secretary of State may then review future TfL funding levels if there is significant deviation from mutually agreed commitments (which would include funding from business rates).

The next Spending Review must take place by Autumn 2014 (and could take place sooner, although it is assumed that TfL’s settlement for 2014/15 would be maintained).

4.6 The Mayor, rather than TfL, would thus benefit directly from any real terms growth in business rates, and DfT would not take account of it in future spending review (which would have removed the incentive for the Mayor). The Mayor could, of course, choose to spend the proceeds of that growth through TfL, on projects that support his growth agenda.

4.7 The table below shows the estimated funding streams available to TfL and the Mayor under the old and new systems. Where applicable, grant amounts in the post Spending Review period have been held constant in real terms.

Funding comparison under current system and post LGRR.

	Total £m	SR10		Post SR10 (assumed funding rolled forward in real terms)				
		2013-14	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
Current system								
Funding received from DfT								
Investment Grant	6,907	904	928	956	985	1,014	1,044	1,076
General Grant	11,808	1,840	1,541	1,587	1,635	1,684	1,734	1,786
Overground Grant	209	28	28	29	30	31	32	32
Funding received from GLA								
Council Tax precept	42	6	6	6	6	6	6	6
Total Recurring Grants	**18,966**	**2,778**	**2,503**	**2,578**	**2,655**	**2,735**	**2,816**	**2,901**
Post LGRR								
Funding received from DfT								
Investment Grant (no change)	6,907	904	928	956	985	1,014	1,044	1,076
Overground Grant (no change)	209	28	28	29	30	31	32	32
General Grant (50% of General Grant in 14/15 under SR10)	5,732	1092	771	794	817	842	867	893
Funding received from GLA								
Council Tax precept	42	6	6	6	6	6	6	6
Locally retained business rates passed to TfL (RPI linked from 13/14 until reset)	5,732	748	771	794	817	842	867	893
Recurring Grants and Business Rates Funding	**18,966**	**2,778**	**2,503**	**2,578**	**2,655**	**2,735**	**2,816**	**2,901**
Potential real growth in Business Rates available to the Mayor[6]	119	-	5	10	16	22	29	36
Total Potential Funding	**19,084**	**2,778**	**2,508**	**2,588**	**2,671**	**2,757**	**2,845**	**2,936**

Credit Rating Agencies

4.8 The credit rating agencies have placed importance on the close relationship between TfL and the DfT, evidenced through the continued payment of the Transport Grant, and its basis in law (section 101 of the GLA Act 1999).

4.9 It is therefore helpful to have the Secretary of State's confirmation in writing that no change will be made to the legal basis of the Transport Grant, which will continue to be paid to the GLA 'for the purposes of Transport for London' and passed straight to TfL. The Secretary of State's letter also reaffirms the strategic importance of London transport to the national economy, and that the changes should not be construed as any weakening of the Government's

[6] Assumes a 35 per cent GLA share of the London local share (which would make the GLA subject to a fairly small tariff), and 0.5 per cent real annual growth. Should growth be higher (1%) and the GLA take more risk / reward by taking a 50 per cent share and paying a higher tariff, the upside to the Mayor could be around £350m over the seven years before a possible reset in 2020.

support - indeed, they represent an opportunity to benefit financially from London's continued growth, and potentially to reinvest that benefit in transport.

4.10 TfL has begun the process of briefing the credit rating agencies of the proposed changes, and has shared the Secretary of State's letter to the Mayor with them.

Bus Service Operators Grant (BSOG)

4.11 In addition to mentioning the Transport Grant, Annex A of the Statement of Intent also makes reference to BSOG in London, stating that it would form part of the business rates retention scheme. DfT has confirmed that the inclusion of BSOG in the list was an "administrative error" and does not represent current policy (Ministers remain committed in principle to devolving the London element of BSOG, but have not yet decided how or when this should happen, and intend to consult on a package of BSOG measures over the summer).

5 Key outstanding issues

5.1 Although the principles have now been established, a number of more detailed issues still need to be resolved. TfL will be working closely with GLA colleagues over the coming months to address these, which include:

(a) The proportionate shares of the business rates baseline in London. This could be set at such a level as to make the GLA a tariff authority, giving a greater exposure to risk and reward, which may be appropriate given the GLA's role as London's strategic planning authority with responsibility for economic development, and the ability to 'pool' risk across London. As a tax on property (including unoccupied property), business rates have historically been relatively stable, even in economic downturns, and projections for growth in London's population and economy give grounds to believe that they are likely to remain stable or grow. However, taking greater risk would require agreement within the GLA on how any downside risk would be managed.

(b) The detailed arrangements within the GLA Group, including funding flows between the GLA and TfL and profiling, and how decisions on allocating the proceeds of growth will be taken.

List of appendices to this report:

Appendix 1 – Statement of Intent
Appendix 2 – Secretary of State letter
Appendix 3 – BSOG letter

List of Background Papers:

These are attached as Appendices 1, 2 and 3.

Contact Officer: Steve Allen
Telephone: 020 7126 4918
E-mail: steveallen@tfl.gov.uk