Introduction

This article examines the functioning of the Business Rate Retention Scheme (BRRS) introduced in England in April 2013.

The Government has stated that business rate retention is intended as an incentive-based system, to prompt local authorities to grow their local economies and obtain additional rate revenue. In view of this intention, the Government will extend the BRRS to cover 100% of business rate revenue from 1 April 2019 – currently it covers only 50%.

The operation of the BRRS is based on a number of assumptions. These are: that it does indeed provide an incentive to grow revenue; that the incentives within the system link to local economic growth; and that the system translates incentive-driven behaviour impartially into increased revenue.

We suggest that the available data makes these assumptions questionable. The incentives vary between local authorities; the relationship between business rate revenue to local economic growth is tenuous; and structural effects of business rates cut across the financial incentives provided by the system.

How business rates work

Business rates are levied on non-domestic properties across the UK. In England and Wales, the Valuation Office Agency (VOA) allocates each property a ‘rateable value’ (RV), multiplied by an England (or Wales)-wide ‘multiplier’ to produce the rate bill. In England, rate revenue is collected by ‘billing authorities’ (district and unitary councils).

The BRRS was introduced to England only from the 2013-14 financial year. From 2013 through to 2020, each individual local authority keeps up to 50% of any real-terms increase in business rate revenue (with the other 50% going to central government). A redistribution system is used to equalise in the light of variations between authorities in collected revenue. Each authority is allocated either a ‘tariff’, which is subtracted from its 50% share each year; or a ‘top-up’, which is added to its 50% share each year. The tariff and top-up amounts are fixed from year to year (and uprated annually for inflation). A regular pattern of ‘resets’ will take place, based on needs and resource assessments, which would take the form of altering tariffs and top-ups at regular intervals.

Approach
This paper uses analysis of data from the first four years of the BRRS to address the following questions:

- Does the BRRS provide an incentive to grow the local economy?
- What effects does the structure of the system have on local authorities’ revenue levels?
- How reliably can local authorities control and influence their rates income?¹

Rate retention is not linked to economic growth

The BRRS is predicated on the expectation that local economic growth will lead to growth in rate revenue in individual local areas.

If rate revenue is indeed linked to economic growth, it might be expected that areas with strong economies and/or strong rates of growth would benefit more than areas with weaker economies.

To test this, we compared local Gross Value Added (GVA) – which measures local economic growth – against the quantity of rateable value in individual local authorities between 2008 and 2015. Whilst there was a high correlation between the two ($R^2=0.84$), there is almost no correlation between growth in GVA and growth in rateable value between 2008 and 2015 – $R^2$ of 0.04 on average.²

This tells us that some authorities have experienced high GVA growth at the same time as a decline in rateable value. For instance, the borough of Wandsworth saw rateable value drop by 7% between 2010 and 2015, whilst its GVA grew by 32%. South Oxfordshire District Council experienced a fall of 2.9% in rateable value, alongside a growth in GVA of 31%.

This suggests that growth in rateable value does not always track economic growth in localities. There has been strong growth in many authorities, but it has often not been growth in forms of economic activity that require new-build property. Thus business rates revenue does not rise to reflect the growth.

The 2017 revaluation of business rates will see rateable values adjusted in line with recent rental values. The draft revaluation lists show changes to rateable values that approximate better to local economic growth in many areas: In other words, local economic growth translates into higher rateable values at the revaluation (the $R^2$ between GVA growth (2008-2014) and the growth in RV that is due to the revaluation only is 0.78).³

However, the tariffs and top-ups are to be adjusted to balance the effect of the revaluation. This means individual councils’ revenue will continue to reflect 2010-17

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¹ The analyses presented are based on DCLG’s NNDR1 form, which billing authorities use to supply DCLG annually with figures for forecast revenue (final outturn revenue is published annually via the ‘NNDR3 form’). Socio-economic indicator data from the Office for National Statistics (ONS) and local authority finance data from the DCLG was also used. Some parts of the analysis use the complete VOA database of properties on the 2010 valuation list, as at May 2016.

² $R^2$ values can range between 0 (no correlation between the two data sets compared) and 1 (total correlation). A high $R^2$ value, such as 0.84, indicates that the two data sets are closely related.

³ Rateable values are assigned to all commercial properties. The standard method of assessment bases rateable value on the annual rent that the property could have been let for on the open market at a particular date (this is 1 April 2008 for the 2010 lists and 1 April 2015 for the 2017 lists).
rateable values, and will not take account more broadly of local economic growth. The rationale for this is that the revaluation should not itself affect outcomes for councils.

**Rural councils have seen the highest growth in rateable value**

If a link can be established between rateable value growth and other social indicators, it might be possible to identify what causes rateable value growth. We compared rateable value growth with GVA per resident, jobs per resident, jobs per hectare, rateable value per resident, and the Index of Multiple Deprivation in the same time period. None of these measures were associated with higher levels of percentage growth in rateable value.

However, we did find a relationship between rateable value growth and the rurality of an area. Chart 1 shows that growth in rateable value throughout the 2010 rating list (first year of data is for 2009) has been greatest in the more rural authorities; and rateable value has grown most slowly in the most urban authorities. Chart 2 looks solely at changes since the introduction of the BRRS in 2013 (base year 2012). The same pattern is visible: indeed, rateable value has actually fallen in the most urban authorities since 2012.

If, in practice, BRRS incentivises the building of new property, it is less surprising that this has been easier in more rural authorities that have more free land on which to build. By contrast, urban authorities might attract high-value businesses which do not have large property requirements. This will bring wider benefits to the local economy, but it will not necessarily lead to rises in business rates revenue.

This finding provides further support for the idea that strong city economies are not necessarily the best placed to benefit from business rates retention, in spite of the fact that they tend to experience stronger employment and GVA growth.

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4 This correlation investigated whether there was a relationship between a low position in the index and high growth.

5 Rurality is measured by the Government’s 2011 Rural-Urban Classification of local authority districts.
Property taxation and revenue incentives

These trends in rateable value are echoed in revenue outcomes for rural authorities. Table 1 below shows forecast business rate revenues for 2016-17, broken down by the 2011 Rural-Urban classification. It shows that revenue growth has been highest in the more rural authorities and lowest in the most urban authorities.

Table 1: Projected retained income in 2016-17, broken down by rurality index

<table>
<thead>
<tr>
<th>Rurality</th>
<th>% growth of income above the BRRS baseline (set in 2013-14)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mainly Rural (rural including hub towns &gt; 80%)</td>
<td>9.6%</td>
</tr>
<tr>
<td>Largely Rural (rural including hub towns 50-79%)</td>
<td>11.4%</td>
</tr>
<tr>
<td>Urban with Significant Rural (rural including hub towns 26-49%)</td>
<td>7.5%</td>
</tr>
<tr>
<td>Urban with City and Town</td>
<td>6.9%</td>
</tr>
<tr>
<td>Urban with Minor Conurbation</td>
<td>7.9%</td>
</tr>
<tr>
<td>Urban with Major Conurbation</td>
<td>5.3%</td>
</tr>
<tr>
<td>Total</td>
<td>6.9%</td>
</tr>
</tbody>
</table>

The BRRS’s technical structure influences outcomes for councils

Chart 3 shows each local authority’s gain in rate revenue as a percentage of Net Revenue Expenditure (NRE). For an authority at 10% on this chart, the projected gain or loss from business rates between 2013-14 and 2016-17 amounts to 10% of its net revenue expenditure (NRE) in that financial year. The chart measures the difference that rate

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6 The percentages here are derived from data provided by local authorities in the annual ‘NNDR1’ form, which records collected business rate revenue.

7 NRE is in essence the council’s budget. Funding sources include council tax, business rates, Revenue Support Grant, and ancillary grants. NRE excludes expenditure funded by dedicated grants, such as school spending.
retention makes to individual authorities’ budgets: in short, how much they benefit from rate retention.\(^8\)

The chart shows differing outcomes for different classes of authority. Some district councils have retained a large proportion of revenue, whilst other district councils have lost revenue. The range of outcomes is much wider than for the other types of authority. Conversely, though some county councils may have gained substantial amounts in cash terms from rate retention, this has not been reflected in the percentage rise in their budgets. This is mainly explained by their budgets being much larger than those of districts. The three classes of single-tier authority (metropolitan district, London borough and unitary authority) show a limited range of outcomes similar to those of county councils, with a small number of outliers.

The Government’s decision to allocate 80% of rate revenue to district councils and 20% to county councils has a critical effect here. To demonstrate the impact of that revenue distribution on outcomes, we modelled the effects of reversing it for the period since 2013-14. That is, we model 80% of revenue passing to county councils and 20% to district councils. The outcome is shown in Chart 4.

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8 The BRRS rewards growth in actual rates income above the baseline, which was set by the Government as the amount it expected local authorities to collect in 2013-14. The Government adjusted the baseline by: a) lowering it to continue the trend line of a small decline in RV during the 2011-13 b) an allowance for appeals. The charts include income from section 31 grants that compensates for policy reductions in rates income.
The three classes of single-tier authority are omitted from Chart 4 as they are unaffected by the change. The effect on county council budgets is small. However, far fewer district councils experience either large gains or losses. The extra revenue that made up those large gains is still present, but it is located in county council budgets, and it has a smaller effect on their much larger overall expenditure levels.

This highlights that ostensibly technical decisions on the workings of the BRRS can have a critical influence on outcomes.

**Authorities struggle to influence their income due to external factors**

The BRRS is also based on the assumption that it is possible for local authorities to influence rateable value and thus grow their rate revenue.

Chart 3 demonstrates that rate revenue can grow. However, there are factors outside local authority control that mean authorities will often struggle to influence their overall income. It is influenced by economic trends and changes to property valuation over which local authorities have no control.

**Large movements beyond local authority control**

Total rateable value across the whole of England has only grown by 1.7% between 2010 and 2016. Excluding growth in the education and health sectors (both of which are driven by public money rather than economic growth) and ATMs (where a policy change has led to a large rise in valuations), the total taxbase has barely grown at all: 0.9% over 6 years. The unequal distribution of gains noted in the previous section has masked low overall levels of growth in rateable value.

However, this small overall growth figure hides very large movements between different sectors within the taxbase. These are summarised in Table 2. For instance, rateable value
in the ‘storage and distribution’ sector grew by 11.3% and that in the ‘hotel, guest &
boarding sector’ by 10.9%, while the ‘other - industrial’ sector declined by -8.6%.

This scale of movement is likely to have significant impacts on authorities which collect a
lot of their revenue from these sectors. That could outweigh any gains they have made by
growing their local economies. For instance, whilst ‘other-industrial’ property declined by
8.6% across England, a local authority in a traditional industrial area might have seen its
industrial property rate revenue fall by a much greater proportion.

Table 2: change in rateable value by VOA sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>£000s</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>RETAIL – SHOPS</td>
<td>388,414</td>
<td>2.7%</td>
</tr>
<tr>
<td>EDUCATION</td>
<td>387,463</td>
<td>15.1%</td>
</tr>
<tr>
<td>STORAGE &amp; DISTRIBUTION</td>
<td>240,519</td>
<td>11.3%</td>
</tr>
<tr>
<td>HOTELS, GUEST &amp; BOARING, SELF CATERING etc</td>
<td>160,409</td>
<td>10.9%</td>
</tr>
<tr>
<td>HEALTH</td>
<td>61,352</td>
<td>5.1%</td>
</tr>
<tr>
<td>ASSEMBLY AND LEISURE</td>
<td>57,696</td>
<td>1.3%</td>
</tr>
<tr>
<td>TRANSPORT</td>
<td>46,583</td>
<td>8.9%</td>
</tr>
<tr>
<td>UTILITIES</td>
<td>41,869</td>
<td>3.0%</td>
</tr>
<tr>
<td>OTHER – RETAIL</td>
<td>40,488</td>
<td>3.6%</td>
</tr>
<tr>
<td>OFFICES</td>
<td>5,044</td>
<td>0.0%</td>
</tr>
<tr>
<td>NON RESIDENTIAL INSTITUTIONS</td>
<td>293</td>
<td>0.1%</td>
</tr>
<tr>
<td>RESIDENTIAL INSTITUTIONS</td>
<td>-1,968</td>
<td>-1.5%</td>
</tr>
<tr>
<td>OTHER – OFFICES</td>
<td>-16,063</td>
<td>-5.1%</td>
</tr>
<tr>
<td>RETAIL – FINANCIAL &amp; PROFESSIONAL SERVICES</td>
<td>-21,866</td>
<td>-4.9%</td>
</tr>
<tr>
<td>OTHER</td>
<td>-29,720</td>
<td>-2.0%</td>
</tr>
<tr>
<td>OTHER – INDUSTRIAL</td>
<td>-132,630</td>
<td>-8.6%</td>
</tr>
<tr>
<td>GENERAL – INDUSTRIAL</td>
<td>-263,217</td>
<td>-2.8%</td>
</tr>
<tr>
<td>Total</td>
<td>964,666</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

Besides swings between sectors, analysis of the data shows tentative signs that rateable
value changes may be reflecting current macroeconomic trends. There is no room for a
full-scale analysis of these here, but the following may be worthy of further research:

- A large decline in the rateable value of ‘Financial and professional services’, which
could indicate that the sector needs less floorspace. This could reflect bank branch
closures and a rise in online banking;

- No rateable value growth in ‘offices’, at a time of high labour force growth, which
could indicate that office space is being used more efficiently (working from home,
hotdesking, etc). It may also reflect the large increase in the number of self-
employed, who require little or no commercial office space;
A decline in the rateable value of high street stores, alongside a large rise in the rateable value for hypermarkets and superstores (these are sub-categories within the retail sector). There is no reason to suppose that these superstores will be located in the same authority as the high street shops. So the business rates income from many high-street shops in many different authorities is replaced by one large superstore paying high rates to one authority. The decline in smaller stores is also accompanied by a rise in ‘warehouses’ – perhaps related to the rise of electronic retailing. The total rateable value of ‘large distribution warehouses’ rose by 16.1% between 2010 and 2016, or £182m in absolute terms. This was the third largest increase (in absolute terms) in rateable value of all sub-categories during the 2010-16 period.

A common thread between these data trends is that of a further decoupling of economic growth and property use – which influences the quantity of rateable value.

Dominance of high value properties

The degree to which local authorities can influence their rate income is also skewed by the highly unequal distribution of rateable value. Table 3 indicates that most rateable value is concentrated in a small number of very high value properties. Properties with rateable value of £51,001 and over represent 10.1% of all properties, but account for 71.4% of total rateable value. This figure will increase further on the 2017 rating list, to 72.3%.

Table 3: Distribution of Rateable Properties and Rateable Value by Rateable Value Interval as at 25 September 2016

<table>
<thead>
<tr>
<th>Rateable Value Interval</th>
<th>2010</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rateable Properties</td>
<td>Rateable Value</td>
<td>Total Rateable Value</td>
</tr>
<tr>
<td>ENGLAND</td>
<td></td>
<td></td>
</tr>
<tr>
<td>£0 - £6,000</td>
<td>836,500</td>
<td>57,685,500</td>
</tr>
<tr>
<td>£6,001 - £9,000</td>
<td>231,440</td>
<td>1,724,796</td>
</tr>
<tr>
<td>£9,001 - £12,000</td>
<td>154,800</td>
<td>1,306,046</td>
</tr>
<tr>
<td>£12,001 - £15,000</td>
<td>96,320</td>
<td>947,088</td>
</tr>
<tr>
<td>£15,001 - £51,000</td>
<td>350,330</td>
<td>41,170,372</td>
</tr>
<tr>
<td>£51,001 and Over</td>
<td>187,070</td>
<td>41,170,372</td>
</tr>
</tbody>
</table>

The top 1% alone of premises (the highest percentile) accounts for 35.6% of total RV, and the top 3% accounts for 51.5%. In 26 billing authorities, the highest ratepayer accounted for over 10% of rateable value; and the highest ratepayer accounted for over 10% of NRE in 109 authorities. In three authorities, the highest ratepayer accounted for an average of 176% of NRE.

At the other end of the scale, Table 3 shows that 54.1% of properties on the 2017 list account for just 6.5% of rateable value. This is compounded by the planned extension of Small Business Rate Relief from April 2017, and by the smaller tax rate that applies to properties with RV below £51,000 (the ‘small multiplier’). From April 2017 63.0% of
properties by number will pay no business rates at all, as 100% small business rate relief will be available to properties with a rateable value of £12,000 or under.

This narrow distribution of the taxbase concentrates both risk and incentive (within the BRRS, these are two sides of the same coin). The BRRS's financial incentive only applies when a property actually pays business rates: local authorities will not benefit financially from growth in rateable value that takes the form of new small properties.

By the same token, changes to the rateable value of one high-value property, that dominates its local taxbase, can have a significant effect on local authority revenue. Changes in rateable value outside of a revaluation arise from a decision either by the VOA or a court to adjust a property's rateable value: this may also trigger backdated repayment of funds to the ratepayer. Such decisions are outside the control of local authorities. Alternatively, a high ratepayer may simply relocate or shut down. The Government has recognised this issue by including a provision for 'loss payments' following appeals in the Local Government Finance Bill 2016-17.

The above analysis illustrates two points. First, the deck is likely always to be stacked against some authorities, as macroeconomic trends have a more universal influence than authorities' own actions. Second, the same macroeconomic trends can produce large rises in revenue for individual authorities, again irrespective of local policy.

**Conclusion**

The financial incentive introduced by business rate reform may be desirable for some local authorities, and may help to generate additional revenue as a by-product of local growth. However, indications over recent years are that the business rates taxbase does not currently grow alongside GVA. The link is tenuous at best. Many local authorities have been barely able to grow their taxbase, and hence their revenue has increased only marginally since 2013; in the same period, the taxbase has exhibited large-scale movements between sectors that are likely to relate to broader economic trends and VOA policy decisions.

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11 The broad data analysis is reflected in the experience of some individual authorities. For example, since 2012 Selby District Council has lost £1.2 million of rate revenue per year (equivalent to 12% of NRE) due to the revaluation of Eggborough Power Station; but it has also gained £5.37 million per year from the decision to use biomass at Drax Power Station (this was defined as renewable energy, thus 100% of business rates were retained locally). Redcar and Cleveland Council lost £10.4 million per year from the closure of SSI Steelworks in October 2015. It has been partly compensated by the BRRS safety net: but this in turn removes the incentive structure entirely, as it tops up any local authority where business rates income falls below 92.5% of its funding baseline.
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