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PASSING THE BUCK WITHOUT THE BUCKS – SOME REFLECTIONS ON FISCAL DECENTRALISATION AND THE BUSINESS RATE RETENTION STRATEGY IN ENGLAND

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Kevin and Paul reflect on the intricacies and potential impacts of the government's drive toward fiscal decentralisation and independence. They focus on the government's Business Rate Retention Strategy (BRRS) and its consequences for local authorities in contrasting locations.

Introduction

The current hyperbole associated with devolution in England intimates that enhanced territorial governance and localism is bound up with, and dependent on, fiscal decentralisation. The current emphasis on the 'Northern Powerhouse' and the entrepreneurial Devo-Manc would have us believe that a degree of locational independence will be the catalyst for economic resilience and the impetus for spatial rebalancing throughout England. Indeed, it is hardly possible to pick up a government policy document or city future think-piece without finding some reference to more localised power and control of local finance. Timely research by Northumbria University offers a perspective in relation to this situation, in particular the potential impact of the government's Business Rate Retention Strategy (BRRS) which was introduced in 2013. The central policy drivers for the strategy are localism and economic growth, totems that will receive even more emphasis as local authorities are increasingly expected to stand on their own 2 feet amidst more swingeing public sector cuts and fiscal prudence. Yet, due to its arcane workings, the new system has received relatively little attention (next to the slightly better known Tax Increment Financing, New Development Deals and Enterprise Zones) which has let it fly under the radar with little scrutiny. [Ed – see Roger Messenger's article in 2014/15 Terrier].

The economics of Business Rate Retention

Without question the belated English interest in devolution presents a rare opportunity for new ways of working. Yet, our findings suggest that the current arguments in favour of fiscal decentralisation and spatial rebalancing are hollow words when distilled against the variegated economic geography in England. Rather than ameliorating spatial inequality, the BRRS potentially exacerbates uneven development. Our findings suggest that the centralised national economy could be replaced by an equally divisive city based one where a minority of locations are dealt all of the aces while the rest get a raw deal. Indeed, the former leader of Newcastle City Council, Lord Jeremy Beecham, argues that the BRRS could result in a case of '*Passing the buck, without the bucks*.' (Newcastle Evening Chronicle, 28th March 2015). The BRRS replaced the centrally determined formula grant funding mechanism for local authorities. The new strategy allows local areas to retain 50% of business rate income and an additional 50% of any new business rate income (Manchester has recently been awarded 100% retention privileges by George Osborne, the Chancellor of the Exchequer and First Secretary of State). The model is clearly complex (perhaps its main weakness). However for the purpose of this article, attention is paid to the incentive effect and the adjustments for national rating revaluation. The incentive effect means that local

authorities in England are encouraged to increase the size of their business rate base in order to create revenue to pay for local service provision, economic development and urban regeneration. However, the adjustment for revaluation that takes place every 5 years strips out any increase in urban growth (through the adjustments in the top up and tariff mechanism); the only growth that remains is that associated with net new floor space, either derived from new build construction or repurposed floor space. The critical point, therefore, is that the relative increase in rental values of existing properties cannot be capitalised. This means that the success or failure of the BRRS incentive mechanism is bound up with the economics of commercial real estate development, which is spatially selective. However, in the absence of central government grant, all local authorities are expected to create investment in new commercial real estate in order to underwrite the funding of public services and urban regeneration.

Dealing with an uneven hand

Our central finding is that the BRRS is not driven by a desire to tackle inequality or to narrow the gap between rich and poor. Rather, the strategy is founded upon the ability to create new floor space through new build construction or conversion of existing floor space. To reaffirm our position, there are traditionally 2 methods of extracting value from the built environment in order to generate ‘growth’ (new money) in urban finance. The first involves building new properties in order to create ‘new’ business rate yield. The second involves investment in current property stock and its surrounding area in order to increase its inherent value. In England, in the majority of circumstances, the latter method is unrewarded, quite literally devaluing the exiting built environment. This means that the minority of locations where market conditions are conducive to new development, those with buoyant rental market structures have a distinct advantage over the rest. We have developed a broad typology of locations in England to illustrate this situation, namely ‘premium locations’, ‘stranded locations’, and ‘redundant locations.’ The formulation of the simple typology is based upon the potential ability of local authorities to capitalise their urban assets into the BRRS model of urban finance.

Premium locations

Premium locations are most adept at exploiting and actualising the twin BRRS policy objectives of ‘localism’ and ‘growth.’ Capitalising on buoyant property market characteristics, such locations are relatively autonomous because they are able to leverage the more or less guaranteed ability to promote new floor space creation. Investment yields in these locations create attractive propositions for global property investors who view property as a long term investment medium. This gives premium locations an automatic advantage over other areas because it is these institutional investors and global investment capital that determine, when, where and how commercial floor space is developed. These locations have the inherent ability to exploit and strategise their real estate development, creating and securitising growth, and in turn, linking into international circuits of capital and financialisation. This is because commercial real estate in such locations is more liquid and fungible and can be repackaged into alternative financialised products and traded on the capital markets. In England, these locations are typically few, a consequence of their relative size, and include the central London boroughs, the ‘core cities’ of Birmingham, Bristol, Nottingham, Sheffield, Manchester, Liverpool and Newcastle (and their cousins over the border Edinburgh and Glasgow) and increasingly the ‘Metros’ (which include Reading, Oxford and Cambridge).

Stranded locations

Stranded locations have relatively buoyant business rate portfolios in terms of quantity but find it difficult to utilise the BRRS growth incentive. The current formulation of the BRRS, particularly the ‘stripping out procedure,’ hinders these locations from achieving their full economic potential. This can be because of the historical nature of the built environment (think Liverpool, Bath and Durham), restrictions in the availability of space to build new properties, or more simply, a general satisfaction with the current composition of commercial real estate in such locations. Local authorities like Westminster Council, the holder of one of the most valuable business rate portfolios in England, argues that its hands are tied because it cannot maximise the income from all of its property assets for growth (a consequence of restrained expansion space and the lack of appetite for redevelopment or conversion). Westminster LBC should not see any decline in tax relative to its baseline funding level (dependent on the accuracy of the baseline assessment) however the authority will not be able to manage its existing assets in order to generate any new growth because of the primacy given to new floor space construction.

Redundant locations

Redundant locations are disadvantaged because of their inferior property market characteristics. Such locations have either marginal or negative development values and cannot generate high enough rental levels to justify the costs of new development. Concurrently, these locations may also be shrinking due to economic change and demographic adjustment. Redundant locations are typically associated with older, secondary property markets which exhibit depressed rental levels and low levels of occupier demand. Institutional investors will not provide finance for development in these locations because they are unprofitable and do not conform to the conventions of commercial real estate development. It is problematic for these locations to exploit the BRRS as they do not have the underlying growth potential or critical business rate mass to pay for public services. These locations are typically situated in the north, such as Teesside, Humberside, Grimsby, Scunthorpe, Bury, Oldham, Crewe and

the Black Country, indicating that it is often the small towns and cities that suffer urban decline rather than the big cities. Simply put, it is a little churlish to devolve power (and blame) to locations that cannot wield it.

Concluding remarks

How will those local authorities that cannot demonstrate economically viable commercial real estate development fund their future public welfare needs? Which type of local authority do you work for? Are you lucky enough to be in a premium location? Are you frustrated in a stranded location? Or are you struggling to deal with inferior economic conditions in a redundant location? We predict that a key challenge in the future for local government officers (on top of the complexity involved in administering the system) will be retaining the correct balance and mix of employment sites and premises amid pressure to expand local business rate portfolios. Hence, in the future, an underlying question for local government asset managers could be: are you faced with a situation where you are promoting new commercial development to fund public sector services rather than the needs of economic demand? How can local government officers make sure that the pack of cards is stacked evenly? There is no easy answer! However, we propose a number of considerations: First, it is not appropriate to introduce new urban finance processes without them being subject to some kind of practitioner and intellectual oversight. The speed with which fiscal decentralisation (and its associated tools of urban finance) is taking place makes it imperative to understand its implications for the funding of welfare provision, economic development and urban regeneration. It is therefore important empirically to monitor, evaluate and review new tools of urban finance in order to expose the uneven geographical distribution, impact and consequences of fiscal decentralisation and contemporary methods of urban finance. Second, there is considerable tension between the notion of fiscal devolution and equal redistribution and how both concepts might be reconciled. This is because business rate retention, in certain locations, is about the amount of money coming into a location, rather than what could be generated in that location, a consequence of the variability in geographical tax base in terms of quantity and the concomitant ability for that tax base to expand. Third, amidst the clamour for more local power there must also be an engagement with the textures of locally specific commercial real estate markets and the professionals who understand them best. This is because our analysis of the BRRS in England proves that fiscal decentralisation is bound up with the relative structures of locally specific commercial real estate markets (and therefore the professional expertise of ACES members) and the interlinked ability to both attract and justify investment in commercial real estate development. This work forms part of an ongoing research project and consultation service (R3intelligence, Department of Architecture and Built Environment at Northumbria University). In order to monitor the Business Rate Retention Strategy we have recently developed a multi criteria commercial real estate model for every local authority location in England and Wales. The intelligent model can be programmed to appraise any geographical scale from the local street, to the economic strategy zone, to the local authority boundary, pooled area or functional economic territory.