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additionality and ballots

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1 Introduction to Business Rate Supplements

1.1 Sir Michael Lyons' Inquiry into Local Government[1] recommended introducing a new local power to set a supplement on the current National Non-Domestic Rate (NNDR), or business rate.

1.2 The Government responded to Sir Michael Lyons' recommendation in both the 2007 Budget and the *Review of sub-national economic development and regeneration.*[2] It supported Sir Michael's proposal and stated that there would need to be adequate protection for business and that any BRS would need to command the support of those affected by it.

1.3 In October 2007, alongside the 2007 Pre-Budget Report and Comprehensive Spending Review, the Government published *Business rate supplements: A White Paper.*[3]

1.4 The Government is now taking forward these proposals through the Business Rate Supplement Bill.[4] In England, the Bill will provide county councils, unitary district councils (in areas where there is no county council), and the Greater London Authority (GLA) with a new power to levy a supplement on the national business rate for additional expenditure to promote economic development. BRS will ensure that local areas have further choices over investing in their own economic success, with local authorities working in partnership with their business communities to drive local economic progress.

1.5 The Bill requires authorities wishing to levy a BRS to consult on proposals set out in a prospectus and to hold a ballot of business where revenue from the BRS is expected to amount to more than a third of the total cost of the project to be funded. It sets an upper limit for BRS of 2p per pound of rateable value, and enables the Secretary of State to prescribe a rateable value threshold for triggering liability for BRS.

1.6 The Bill sets out the requirements for the prospectus on which the levying authority must consult. Amongst other things, the prospectus will include details on:

- the amount to be levied;
- the duration of the supplement;
- any exemptions or reliefs that will apply on top of those provided for by the Bill;
- how the expenditure is additional to the authority's existing plans;
- how the authority will deal with differences between the planned and outturn expenditure for the project being supported via the BRS; and
- the assessment of the impact of the supplement on local businesses and how this relates to the economic benefits that will be delivered from the project supported by the BRS.

[1] The Lyons Inquiry into Local Government, Place Shaping: a shared ambition for the future of local government, Sir Michael Lyons, March 2007

[2] Review of Sub-National Economic Development and Regeneration, HM Treasury, Department for Business Enterprise and Regulatory Reform and Communities and Local Government, July 2007

[3] Business rate supplements: a White Paper, HM Treasury and Communities and Local Government, October 2007

[4] More information on the Bill can be found at: http://services.parliament.uk/bills/2008-09/businessratesupplements.html

Purpose of this Guidance

1.7 This guidance is provided to those local authorities in England that are considering the use of BRS to fund projects. In accordance with clause 26(2) of the Bill, the guidance provides supplementary information on two key financial issues that potential BRS levying authorities will need to consider in working up BRS proposals to ensure compliance with the provisions of the Bill:

- compliance with the condition in clause 3(1) of the Bill, i.e. that the money raised through the BRS is only used for expenditure that the authority would not otherwise have incurred (the 'additionality' requirement); and
- assessing project costs for the purpose of establishing whether a ballot needs to be held on the imposition of a BRS or on a proposal to vary a BRS.

1.8 The Government intends to issue further guidance looking at the scrutiny arrangements for BRS and in particular dealing with the kinds of projects and expenditure which may and may not be regarded as appropriate uses for BRS revenues; and the carrying out by a levying authority of the economic assessment of its proposals required by Schedule 1 to the Bill.

1.9 Clause 27 of the Bill makes provision ('Special Introductory Provision') for a BRS to be raised for expenditure on projects begun before the power to levy a BRS in clause 1 of the Bill comes into force, providing that the BRS is levied on or before 1 April 2012.

1.10 Clause 27 of the Bill also anticipates that guidance may be issued prior to its coming into force ('pre-commencement guidance'), and provides that where this is the case, guidance will later be treated as issued under what would then be section 26 of the Business Rate Supplements Act. In recognition of the fact that it is intended that levying authorities should be able to levy a BRS with effect from 1 April 2010, this document sets out pre-commencement guidance on the additionality and ballot requirements included in the Bill.

1.11 Clause 27(6) sets out that the Secretary of State may make provision, by regulations, about the exercise of the Greater London Authority's power in these circumstances, including provision disapplying a provision of the Bill or applying it with modifications. To the extent that any regulations made under clause 27 disapplied any parts of the BRS Bill, it should be noted that the guidance relating to those aspects of the Bill would also be disapplied.

2 Additionality

BRS in the context of other funding mechanisms

2.1 There are a number of funding mechanisms available that enable local authorities and their communities to raise revenue locally to invest in the local area, for example Business Improvement Districts and the Community Infrastructure Levy (from April 2010). BRS can be used alongside other funding mechanisms as part of a wider funding package, or on separate projects. The key point in establishing if a BRS can be used will be whether or not the levying authority can meet the requirements set out in the legislation. In particular, the levying authority will need to satisfy itself that the BRS is being used on a project, or part of a project, that will promote economic development and that the BRS is being used to fund expenditure it would not otherwise have incurred.

BRS and existing services

2.2 A BRS is not a new means to fund existing expenditure or a resource to support general service expenditure. Clause 3(3) lists key services that a local authority has an obligation to provide which the Government does not consider appropriate to be funded through a BRS. However, there may be other projects – such as the provision of major physical infrastructure – connected to the provision of those services which might be suitable to be funded through a BRS, provided, of course, that the link to economic development can be demonstrated and that the expenditure would be additional. Levying authorities may wish to work with businesses and stakeholders in their area to consider whether the flexible use of BRS in this way would be appropriate.

Additional expenditure

2.3 Clause 3(1) requires that the levying authority uses BRS revenues only for expenditure that would not otherwise have been incurred. Schedule 1 to the Bill requires local authorities to provide an explanation in the prospectus of how the requirement will be discharged.

2.4 In practice, the additionality requirement means that local authorities cannot use revenues from supplements to deliver on existing spending plans and commitments. The revenue should therefore either be spent on new projects or to add something extra to a project already underway, i.e. to spend money which otherwise would not have been spent.

2.5 In relation to a project that the authority proposes to fund entirely through a BRS, the local authority should be able to demonstrate that no expenditure would be incurred in the absence of the BRS. In relation to a project that the authority proposes to part-fund through a BRS, i.e. as part of a wider funding package, the authority should be able to demonstrate how the BRS would add to existing available funding to make the project viable or to extend its scope.

2.6 Clause 27 of the Bill makes provision for a BRS to be raised for expenditure on projects begun before the power to levy a BRS in clause 1 of the Bill comes into force, providing the BRS is levied on or before 1 April 2012. In those circumstances, it will be necessary to demonstrate how the levying of a BRS would add to the existing project plans. For example, it could be used to deliver something extra that could not be achieved in the absence of the BRS.

2.7 Authorities will want to consider whether the project might be more appropriately funded through other mechanisms. These might include, for example, developer contributions through the planning regime such as the Community Infrastructure Levy, Business Improvement Districts, voluntary business contributions, grants from central government and its agencies and, potentially, fare revenues in the case of a transport project. If the project is to be funded entirely through BRS, the levying authority will want to be able to demonstrate that the other possible funding streams are not appropriate or available to cover the expenditure for the project. If the supplement is being used as part of a wider funding package, the authority will want to show that the BRS will pay for an additional element of the project that cannot be funded through the other means.

2.8 If a BRS is used as part of a wider funding package, it will be necessary for local authorities to understand what proportion of the maximum levy would need to be applied to raise required levels of project funding, given the other funding streams available.

Demonstrating compliance

2.9 In practice, demonstrating additionality may be complex. The development of regional strategies and the proposed local economic development assessment duty should support the evidence base, particularly since business will have had strong input into all such work.

2.10 A number of checks are likely to be necessary in order to provide an effective test. In particular:

- existing spending and service levels could be benchmarked in areas affected by spending from the supplement. The authority could then assess how new service provision will be additional. This is more difficult in the case of capital investment, where by definition expenditure is one-off rather than recurrent and there is no meaningful baseline;
- local authorities should consider setting out the funding routes that have been explored, and the reasons that they are not sufficient or appropriate;
- where a local authority has set full three-year budgets, these provide a useful benchmark. If an authority is prepared to commit to given levels of service expenditure across the range of its responsibilities, whether or not a supplement is levied, this implies that supplement revenue is not being used to finance those services; and/or
- in cases where an authority intends to use a supplement to support borrowing, they could set out their borrowing plans, distinguishing between those that will only be undertaken if they levy a supplement and the remainder.

2.11 Ultimately, stakeholders at the consultation and possible ballot stages (see next section) will take a view on whether the prospectus makes a convincing case for the additionality of the project being proposed.

3 Assessing when a ballot needs to be held

3.1 Where the revenue raised by a levying authority towards a given project supported by a BRS exceeds one third of the estimated total cost of the project, the Bill requires that a ballot of those businesses that would be liable to the BRS be undertaken.[1] A ballot may also need to be held where the BRS is varied under clause 10 of the Bill. A ballot will need to be held if one was held on the imposition of the original BRS, or if the revenue raised by a levying authority towards the project by the BRS as varied exceeds one third of the estimated total costs of the project. Authorities can also voluntarily decide to hold a ballot where project costs funded by the BRS do not exceed one third of the total.

3.2 Assessing the future costs and funding requirements of major projects can be complex given the variable internal and external factors that can impact upon project delivery. The time at which the local authority is in a position to properly assess whether a ballot should be held would normally be at a stage of project development which is sufficient to give an appropriate level of cost certainty, for example at the point of option selection.

3.3 HM Treasury's Green Book contains guidance on valuing the direct costs of project options including, for example, how to take account of costs (and benefits) that are incurred over an extended period of time. Local authorities that are assessing the need to undertake a business ballot should consider the following.

Cost overruns or underspends

3.4 The project prospectus should be based on a full assessment of direct project costs. This should be done in accordance with existing best practice as identified in this guidance and include within estimates of project costs an assessment of 'optimism bias'[2] and/or a margin for contingency[3] risks and overruns.

3.5 For the purposes of assessing project costs and the one third requirement, optimism bias adjustments and contingency costs, as they can be most accurately defined at the point of assessment, should be included within the total project cost figure.

Project costs

3.6 The definition of what should be included in project costs will vary depending upon the nature of the project. For example, some projects may include a construction phase or the procurement of assets that will be used for the delivery of a public service over a subsequent operating phase. Where a project includes both construction and operating phase(s), project costs may include both the upfront capital costs, the cost of assets essential to the delivery of

[1] See clause 7 (holding of ballot)

[2] Optimism bias is the demonstrated systematic tendency for appraisers to be over-optimistic about key project parameters, arising particularly in relation to: capital costs; works duration; operating costs; and under-delivery of benefits. Further information about optimism bias and its mitigation is provided in the Green Book (HM Treasury – Appraisal and Evaluation in Central Government, April 2003) and in its supplementary guidance available at http://www.hm-treasury.gov.uk/greenbook

[3] Contingency being defined as an allowance of cash or resources to cover unforeseen circumstances

the scheme, and ongoing running costs over the project life. For projects which do not have a construction phase or require infrastructure or assets for the provision of ongoing operations or services, project costs would be likely to relate only to running costs over the project life.

3.7 Some projects, in particular those with significant upfront capital costs, are likely to raise external borrowing to fund upfront costs. This borrowing may be raised against the BRS and/or other future revenue streams. In this case, the assessment of ongoing running costs should include the financing costs associated with externally raised debt.

3.8 Financing costs are a component of the whole life costs of delivering a project where debt is to be raised to fund the project. In all cases, the 'one third' test should be calculated on a present value basis, applying the Green Book methodology to calculate the present value of both the project costs and the BRS to be raised (i.e. both numerator and denominator). In this context, external financing costs should be included in assessment of total project costs.

Defining acceptable project costs

3.9 Developing and delivering successful economic development projects using BRS will require effective partnership working between the public sector (in particular the levying authority), local businesses and other stakeholders. In making an assessment of the project costs, levying authorities should be mindful of this relationship and pay regard to the fact that the assessment undertaken by the authority as part of early stage scoping and feasibility work may not accord with the perspective of local businesses.

3.10 Ultimately, business will have the scope to challenge prospectus assumptions at the consultation stage and for that reason it is in the levying authority's best interests to ensure the robustness of its business case and to ensure work on the preparation of the prospectus involves detailed discussions with local business and other interested parties. Under clause 6(6) of the Bill, a levying authority must publish a revised prospectus where the results of consultation lead the authority to think it is necessary or appropriate to do so, including where consultation leads to a re-assessment of project costs. In such cases, it is the re-assessed project costs that are relevant to the determination of whether a ballot is required. Local authorities must take responsibility for managing the relationship with their business stakeholders, to develop a funding and delivery solution that meets overall economic development objectives.

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