

ROYAL BOROUGH OF KENSINGTON AND CHELSEA SUBMISSION TO THE LYONS INQUIRY

1. SUMMARY

1.1 The Royal Borough of Kensington and Chelsea believes in confident local government, giving purposeful local leadership. We want to be accountable for decisions about local services that are responsive and differentiated to local needs and characteristics. It is our hope that the Lyons Inquiry can put forward proposals for a sustainable system of local government funding that will underpin this vision.

1.2 The Council has held two public meetings with local residents on possible changes to Council Tax and has debated the subject at its Council meeting in February 2005. The Council's agreed policy is to seek

- commitment that the combined effect of revaluation or system changes should produce a maximum increase for any Council Tax payer of no more than 10% in any one year:
 - a) in recognition of the disparity between disposable income and property values for lower income households, be they pensioners, low income families or young people; and
 - b) because over half of the Borough's households are tenants for whom Council Tax is a tax on income and not on property wealth
- the treatment of London as a distinct region in revaluation through regional Council Tax banding
- the need to widen access to Council Tax benefit
- retaining business rates income locally with business taking a more proportionate share of the cost of local services,
- access to wider sources of revenue.

1.3 The Borough's submission responds to the anxieties of local people about the combined impact of revaluation and other potential changes. Our key concerns are

- to establish a system that supports, rather than undermines, the local taxpayer relationship and local accountability
- to defend the credibility of Council Tax so that it is sustainable for the longer term
- to put arguments and evidence for equity for London taxpayers in relation to low income, wealth and services.
- to ensure the impact of any system change is affordable, both through limiting the degree of turbulence, and robust transitional arrangements
- to take into account different patterns of housing tenure, not just owner-occupiers. It means getting underneath glib

assumptions that high property prices mean high incomes or rich owner-occupiers

- to gain recognition that revaluation is likely to increase bills for Londoners, and other changes to banding could make this worse. We support London regional banding to reduce differentials. If this is seen as a complexity too far then the overall degree of possible Council Tax change becomes more limited
- to improve the balance of funding and gearing effect by restoring business rates to local control, at the same time improving partnership between commercial and public sectors in promoting the prosperity of the local community
- to seek improvements to Council Tax benefit to make it more accessible to low income households and mitigate the impact of high housing costs for our residents
- to create a new system that is stable and predictable, including safety net arrangements for local authorities affected by grant change.

2. THE PROBLEM

2.1 The problems of the current system are well rehearsedⁱ. High dependence on central Government grant and the consequent gearing effect undermines accountability.

- It gives a misleading impression to the public about expenditure increases. It is natural for residents to believe a 6 per cent Council Tax increase implies a 6 per cent spending increase. That this is not the case unjustifiably damages trust in the local council's management and value for money.
- It is difficult for the normal resident to understand the gearing effect. There is no easy way of engaging with the subject and public dialogue is very difficult.
- Gearing increases have been seen as bearing particularly harshly on people with low income buoyancy, such as pensioners and people on inflation limited benefits.
- Dependency on grant and gearing break the link between spending and tax decisions. Differential tax rises reflect grant changes as much as spending decisions. The general public is unclear who is responsible for the quality of local services. This clearly undermines local accountability and helps feed a climate of cynicism.
- The confusion over funding responsibility also reflects confusion over service responsibility. There is scope for broad agreement that in education and children's services central

Government will seek to be the major 'shareholder' – though not necessarily the 100 per cent claimed by the nationalisation of schools funding. However, for local services such as parks, parking or libraries, local government should be the lead and central Government intervention and input targets must be challenged. The Council would be pleased to see the Lyons Inquiry engage in this debate.

- As the Audit Commission found in its review of 2003/04 tax increasesⁱⁱ, Council Tax has been affected in recent years by increasing cost pressures and the expectations of the public, Government and inspectors for higher standards of service, including ringfencing large increases for schools. Spending has risen faster than grant. The tax effect has been exacerbated by gearing and has put Council Tax under strain. Public concern about the Tax has been prompted particularly by headline comparison with percentage increases compared with inflation rates.
- This strain, which has threatened the credibility of the tax has been exaggerated by the cap on the annual contribution increase from the business sector. Nationally, business rates met 29 per cent of Council spending in 1990/91 but 19 per cent in 2004/05.

3. OPTIONS FOR CHANGE

Council Tax Reform/Revaluation

- 3.1 We need to stress the importance of looking at revaluation alongside other changes. The Lyons Inquiry clearly needs to look beyond Revaluation in designing a system for the long term. However it is essential that modelling of the effects of change takes full account of revaluation. We have now had two public meetings on the possible future changes and it is clear that public perception will not separate the two issues. It is the combined effect that will determine the acceptability at the outset of any new system. It will also determine the overall degree of turbulence and hence the design of transitional arrangements.
- 3.2 Firm data will not be available until revaluation is complete but there are clearly anxieties that London will be particularly hard hit. For example:
- Land Registry data indicate that house prices rose between 1995 and 2004 by over 200 per cent in Kensington and Chelsea, compared with 175 per cent for London and 150 per cent for England and Wales.ⁱⁱⁱ

- The Balance of Funding Review reported “Most homes now in Band C in London would go up one band –and in a few cases two.”^{iv}

3.3 Revaluation could have very different effects on local people in different regions. For instance, if households in Bands D and above move into higher bands the Council Tax impact is an increase of $\frac{2}{9}$ rather than $\frac{1}{9}$ – before taking account of any revised weighting of Bands. There is a much smaller proportion of people in Band A to C in London than nationally.

Band	England %	London %	RBKC %
A	26	3	1
B	19	14	4
C	22	27	10
D	15	25	16
E	9	15	15
F	5	8	14
G	4	6	23
H	1	2	16
	100	100	100

Equity

3.4 Equity is often used as an argument for increasing the cost of Council Tax for people in higher property Bands, whether by adding bands at A or G/H, or by adjusting the band weighting. We wish to present some of the other relevant equity arguments, particularly for London, that have received far less attention.

- House prices in London are not a proxy for high incomes.
- House prices in London are not a proxy for wealth for the very large rented sector. For owner-occupiers they can also be linked to mortgage indebtedness.
- Council Tax helps to meet the cost of a package of local services. To maintain the integrity of the tax, it needs to remain at an amount which can be seen as proportionate to those services. It should not simply be a way of penalising the well off.

3.5 Beyond revaluation, options for change include the creation of new bands and the changes to weighting between bands. Those who argue for this often have in mind a redistribution of Council Tax from low to high value properties. This rests on implicit assumptions that high values are a good proxy for high income and wealth. These assumptions do not hold good for London and even more particularly do not hold for Kensington and Chelsea. High values in London do not mean high incomes, especially for pensioners and people in social housing. Much of the Borough’s social housing currently lies between bands C and F.

Income equity

3.6 There is a big disparity between disposable income and property values for lower income households, be they pensioners, low income families or young people.

- Londoners pay more for their housing than other people and income comparisons should take account of disposable income adjusted for housing costs. 20 per cent of household income is spent on housing costs in London compared to 17 per cent on average in England.^v
- High housing costs, combined with a shortage of affordable housing, creates recruitment and retention problems, particularly in the public and service sector.^{vi}
- The Council's Housing Needs survey has established that a high proportion of households would be unable to afford market housing if they were to move home. 'Unaffordable' is defined as the cost of housing (the cheaper of rent or buy) exceeding 25-35 per cent of net income.^{vii} For people renting this applies to over 90% of households.

Affordability and tenure			
Tenure	Affordability		
	Unable to afford market housing	Number of h'holds	% of h'holds unable to afford
Owner-occupied (no mortgage)	3,251	22,685	14.3%
Owner-occupied (with mortgage)	1,771	13,650	13.0%
Council	6,303	6,832	92.3%
RSL	11,053	11,832	93.4%
Private rented	11,363	22,017	51.6%
Total	33,741	77,016	43.8%

- There are significant numbers of people on council tax benefit in upper bands in the Royal Borough, and elsewhere in London, as evidenced by a study for the Association of London Government in 2003.^{viii} This study also suggested that the number of households on benefit in bands F and above could increase from 9,000 to 50,000 if revaluation caused households to move up a band. The table below shows council tax benefit distribution in the Royal Borough, but there are also some important caveats:
 - it is likely to significantly understate the numbers of those eligible to claim benefit, especially amongst home owners, given the national picture of take-up.
 - it is quite possible to be on a low income and not be eligible for Council Tax Benefit because of the low £16,000 savings threshold, particularly for pensioners.
 - the effect of Revaluation could pitch a large number of local residents into a higher band.

- on average Londoners pay more Council Tax because they tend to be placed in higher bands. Council Tax Benefit could alleviate this for low income households but low take-up and an ungenerous scheme mean this is not the case.

Distribution of CTB by tenure and band					
	Owners	RSL	Private Rent	Council	Totals
A	1	19	45	198	263
B	13	547	94	1008	1661
C	76	1630	252	1801	3760
D	118	2244	512	1016	3890
E	141	1375	459	469	2443
F	81	640	318	97	1135
G	102	166	294	67	629
H	24	28	60	4	116
Totals	557	6649	2033	4660	13899

Wealth

- 3.7 There is a big disparity between wealth and high property prices in London and even more so in Kensington and Chelsea. For people renting their property, Council Tax is not a tax on wealth.
- 3.8 The Royal Borough has one of the lowest levels of owner occupation in England and Wales, ranked 366 of 376^{ix}. A large number of people do not own their home in London^x.

	England	London	RBKC
	%	%	%
Owner occupied	69	57	44
Social rented	19	26	26
Private rented	12	17	30
	100	100	100

- 3.9 Properties are placed into Council Tax bands based on an assumption of open market value in good condition, often not a real world situation. People placed in social housing do not have an option to move, nor do people with registered rents. As recently as February 2005 the editor of the New Statesman wrote in the Public Finance magazine: "I know it can be hard for those living in large houses to meet the bills with only their pensions coming in. I hope it is not too shocking to suggest that, even if the old dears do not wish to move to a smaller property (thus easing housing shortages for families), they can easily find a bank or building society willing to provide them with a modest lifetime income in return for a share of the equity."^{xi}
- 3.10 It is essential to puncture this myth, which has such a strong hold on the views of those who advocate shifting the burden of Council Tax to higher bands. People in London in high property bands are not necessarily in large houses and they are not especially likely to

own them. Many of them are on low incomes or moved into their homes before property prices escalated in gentrified or regenerated areas. Whilst the average weekly cost of a one bedroom flat for private rent in this borough is £283^{xii}, nevertheless 33 per cent of the Borough's households have an income below £10,000.^{xiii}

- 3.11 There are therefore strong equity arguments for a policy restriction on the impact of change for upper bands in London, such as a regional banding arrangement.

Benefit

- 3.12 Improving access to benefit is a further way of ensuring equity for people on low incomes.
- 3.13 There is a range of options to increase benefit take-up. These include:
- Updating the savings threshold, unchanged for 17 years, from £16,000, or abolishing it. It is a disincentive to saving.
 - Reducing the rate of taper for deemed earnings on savings.
 - Making it easier to passport between benefits without further form filling, for example by unifying eligibility calculations, e.g. on contributions from other adults in the home.

Tax and service relationship

- 3.14 Council Tax paid should remain proportionate to the services received. It is not the function of Council Tax to penalise the well off.
- 3.15 There are equity arguments against skewing band weighting heavily towards the upper levels, even where affordability is not an issue. The Balance of Funding Review quoted a New Policy Institute (NPI) study illustrating a new band H weighting of 48/9.^{xiv} In the Royal Borough this would imply a Tax of over £5,000, compared with around £2,000 at the moment. The figure would be higher in other parts of the country, as the borough's taxes are the fifth lowest nationally. In our view this is an excessive level compared with the comparative levels of benefit received

Sustainability of Council Tax

- 3.16 Council Tax has many merits. It is cheap to administer and has high rates of collection. It is clearly related to the local community. It is well understood, and was generally accepted until subjected to the strain of large growth demands and a shift in the tax burden from business rates. Its weaknesses are a lack of buoyancy and the gearing impact. The Royal Borough would like to defend the sustainability of Council Tax and recapture public acceptance.
- 3.17 There are some potential obstacles to this objective from some of the options for change, which need to be avoided. These are:

- Excessive levels of redistribution that alienate those paying more.
- Continuing to alienate pensioners.
- Pushing the tax burden too high.
- Pushing the rate of increase in the tax burden too high.

3.18 Excessive levels of redistribution are a risk because

- It is likely that revaluation and the proposals for change in banding that feature in the Balance of Funding Review would reinforce each other, producing unacceptable combined levels of increase.
- Local taxpayers will be aware that the extra amount they are paying will be offset by reduced grant – i.e. their extra contribution will not be spent on local services.
- For councils spending below the Formula Funding Share, whose tax base is increased by revaluation and/or banding changes, an additional funding gap will open up. This is because equalisation means grant would be withdrawn at the notional standard tax rate, whilst the actual Council Tax being levied will yield a lesser tax income. Kensington and Chelsea is in this position.
- In some areas it is possible that the combined effect of change could put the council into negative grant. Either equalisation would be suspended for these authorities (which we would benefit from), or residents' Council Tax payments will actually be paid away to other regions as an overt subsidy. This could well be very difficult for local residents to swallow. Winners and losers are inevitable from change, but this is more acceptable if there is some relationship or sense of community between them.

We have done a crude exemplification of the effect of combining revaluation changes and banding changes to illustrate how this could happen in this borough (Appendix 1). An additional Council Tax contribution of £90m (excluding the Greater London Authority (GLA) precept) would be likely to completely cancel the borough's grant which is estimated at £87m excluding schools at today's values. This takes into account the shift of schools funding from general to specific grant, so that the level of Formula Grant is much lower than now, and therefore more readily extinguished by higher local tax contributions. This emphasises the point that it is essential to model the impact of potential tax changes in a way that reflects other likely policy changes, and to engage practitioners in this exercise.

3.19 Pensioners have been the most organised and articulate group protesting rises in Council Tax. The great majority of those attending this Council's own public meetings were pensioners, who

were very anxious about the potential agenda for change. As a group pensioners are likely to have the greatest interest in a Local Income Tax (LIT) replacing Council Tax, both because the comparison between inflation linked income and tax rises is felt most keenly, and because LIT would be most likely to distribute tax away from them. We understand these feelings but would prefer Council Tax to be retained because of its clear identification to the locality, which supports local accountability.

- 3.20 The Government has introduced several measures to make payment easier for pensioners, including better benefit rules than for others, and a lump sum winter payment (though the most recently announced payment is not guaranteed to be ongoing). However, many pensioners continue to receive bills at the gross amount, and it may be presentationally easier for pensioners to appreciate the reductions they receive if the resources devoted to reducing their costs could be more evidently linked with the bill.
- 3.21 The risks of excessive tax and rises in tax would be partly addressed by increased buoyancy and reduced gearing, which could come through additional funding sources and proper resourcing of the demands on local government. Self-discipline and good financial management on the part of local government also plays a part.
- 3.22 It is also vital that there are very **strong transitional arrangements** for any change. This Council has resolved to seek assurances that annual increases (including revaluation) should be no greater than 10 per cent above inflation. However, testing with local residents at our public meeting suggested that this was felt to be the upper end of a tolerable range.
- 3.23 This implies that the degree of acceptable turbulence from change options is limited. Revaluation by itself will produce winners and losers. We do not believe it will be acceptable for transitional arrangements to be spread over an indefinitely long period, creating a semi-permanent anxiety of above average current bill increases and threat of higher bills in the future.
- 3.24 Restriction of a major outflow of taxpayer contributions from the capital can be achieved by regional banding. We do not believe this is an over complication of the system, since it is the outcome rather than the mechanics which need to be transparent and comprehensible. However, if this option is rejected by the Inquiry then the scope for extreme redistribution is also reduced. As Appendix 1 shows, the cumulative impact of changes for this borough could be extremely large, even allowing for over simplified assumptions.

Business rates

- 3.25 The Council has long argued for the restoration of business rates to local control. As a tax, business rates can readily be identified to a local area and there are local dimensions to the relationship of councils and the business community. Recent initiatives, such as Business Improvement Districts, the Business Growth Initiative and developing procurement strategies, have shown that mutual interests are strong. However these mechanisms tend to be partial, indirect or bureaucratic.
- 3.26 The benefits of re-localising rates would be
- to make the partnership of business and councils in influencing local prosperity more central to the policy arena, through a renewed fiscal relationship
 - to encourage local authorities to strike their own balance between the advantages to the community of low business rates or public services
 - to bring business influence more strongly to bear on the performance of the council and its decisions when exercising its community leadership functions. At present, the level of disengagement is evidenced by a low level of interest in the statutory consultation exercises.
 - it would assist with the buoyancy of the tax base and would share the impact of expenditure change with council taxpayers. These arguments have been well rehearsed by the Local Government Association (LGA).
- 3.27 This Council would be willing to consider options to constrain the annual increase, e.g. to the increase in underlying national assumption of Council Tax increases, or to the level of Council Tax increases, to give business some comfort for the future operation of the power. If a selection of pre-defined local income tax bands were to be proposed, a parallel option of defined business rate bands around RPI could also be developed, to limit unpredictability for businesses.
- 3.28 We also accept that there may be some requirement within London for a degree of regional redistribution, given the concentration of rateable value in Inner London.

Local Income Tax (LIT)

- 3.29 London poses particular problems for LIT due to the very high levels of population mobility (in this borough there is around 20 per cent annual population turnover) and cross border movement between boroughs. The difficulties of tracking down London's resident population has been amply illustrated by the difficulties of the Census which only captured two thirds of the Borough's population, leaving the rest to be imputed. In practical terms, Council Tax may

be more relevant to county tiers. This too is difficult to bring into effect in London as the regional authority does not have the same substantial range of services as in other areas. It would be possible to give a restricted tax capacity to the Greater London authority, in place of the Council Tax precept. The borough would wish to see exemplifications of a broader system before deciding its position.

- 3.30 The Local Government Association (LGA) has argued for a top-up LIT contribution, which has some advantages in diversifying the tax base and introducing buoyancy. However, Local Income Tax yields will be harder to predict. Local budgets are also sensitive to the economic cycle, especially in Inner London, through their income (land charges, planning and building control, parking, income concessions on leisure) and some of their expenditure (school meals subsidy). If LIT accounted for a large contribution to Council funding, there is a risk resources could fall as net expenditure rises.
- 3.31 Any combination of taxes involving LIT should look at tax progressiveness in combination. For example, LIT should not be combined with a very progressive approach to Council Tax banding. We prefer that the balance of funding should be restored through rates rather than through LIT.

Other revenue sources

- 3.32 Alternative revenue sources, such as tourist taxes, a share of stamp duty, a local development tax or utilities road charging, are largely peripheral to the main debate on the balance of funding, but are nevertheless of interest. They could help to diversify the revenue base, and create a healthy differentiation between authorities based on their local characteristics. Any tax operated on a discretionary basis should be outside the equalisation process.
- 3.33 This Council has tested the idea of a tourist tax and recent residents' budget consultations have shown strong local support for this concept. There would need to be a relatively simple administration, possibly based on hotel capacity, and excluding bed and breakfast hostels for benefit claimants or asylum seekers. Councils adopting this approach would also need to undertake an economic assessment, as the tourism industry can be price sensitive. It is hoped that the Lyons Inquiry is examining alternative models for this as part of their investigation of international practice.
- 3.34 The Council is pleased to make this submission and would be happy to assist the Inquiry in any way that it can.

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- i* Balance of Funding Review July 2004
 - ii* Council tax increases 2003/04 –Why were they so high? Audit Commission 2003
 - iii* Latest available Land Registry Data (other datasets do not go down to local authority level over a long timescale) <http://www.landreg.gov.uk/propertyprice/>
 - iv* Balance of Funding Review para 3.20
 - v* Office for National Statistics Regional Trends 38 2004 edition table 8.11
Labour Market trends –Housing tenure and the labour market October 2002, referring to Local government Association Housing, Key workers and affordable housing. Report sent to Lord Rooker, Housing minister 19 June 2002
 - vii* RBKC Housing Needs Survey, Financial Information and Affordability, Chapter 6; pp 3 (not yet published)
 - viii* The Council Poverty Trap: measuring the impact of council tax benefit restriction. A Paper for the ALG by the New Policy Institute July 2003
<http://www.alg.gov.uk/doc.asp?doc=9519&>
 - ix* Office for National Statistics, Census 2001 Profiles, Kensington and Chelsea
<http://www.statistics.gov.uk/census2001/profiles/00aw.asp>
 - x* Office for National Statistics, Census 2001 Profiles, Kensington and Chelsea
<http://www.statistics.gov.uk/census2001/profiles/00aw.asp>
Office for National Statistics, Census 2001, Profiles, London
<http://www.statistics.gov.uk/census2001/profiles/H-A.asp>
 - xi* Public Finance February 25-March 3 2005 Opinion - Peter Wilby
 - xii* Mayor London Private Sector Rents Bulletin Winter 2002/03, Issue 1
http://www.london.gov.uk/mayor/housing/rents_bull/rents_bull_issue1.rtf
 - xiii* RBKC, Planning and Conservation, Housing Needs Survey, Financial information and affordability; Chapter 6 pp 1 (not yet published)
 - xiv* Balance of Funding Review para 3.31