Transition to alternative arrangements:

Dealing with changes to provisions against 2010 and 2017 lists

Introduction

1. In the alternative model, top-ups and tariffs would be re-calculated annually to take account of changes to local authority income from business rates, including changes to provisions set aside. This would help reduce volatility in the business rates retention system by preventing provisions from impacting the amount of retained rates in the way that they do under current arrangements.

2. However, the system of 'floating' top-ups and tariffs presents a transitional question relating to provisions against previous lists. If provisions against 2010 and 2017 lists were carried over to the alternative model, then these provisions – if released – would be treated as income for the purposes of top-up and tariff calculations. Effectively, this would mean that provisions released in respect of previous lists would show as income and either reduce the top-up or increase the tariff that an authority would have otherwise received. The reverse would also be true, so that if provisions against previous lists were increased, central Government would assume liability for these through increased top-ups and reduced tariffs.

3. This paper invites members of the Working Group to consider the objective of the alternative model (i.e. – should it look to address volatility that still exists in relation to previous lists or only moving forward) and how this objective should be reflected in our treatment of changes to provisions in moving to the proposed model. Members are also asked to consider the pros and cons of the outlined options, as well as to consider if there are any other options available.

Volatility in the current system

4. When the current business rates retention system was set up, it was anticipated that local authorities would have to set provisions aside to cover losses on appeal. Therefore, the Government made an allowance of £1.9bn for future provisions, based on an estimate of the aggregate cost of appeals outstanding against the 2005 and 2010 lists. A further allowance of £1.3bn was made at the 2017 revaluation. On both occasions, the allowances were apportioned between local authorities in line with their Business Rates Baselines.

5. At local authority level, s151 officers set provisions according to their professional judgement and agreement with auditors. In many cases, local level estimates have differed from the way in which the central estimate was apportioned. Given that the current BRR system is operated through 'fixed' top-ups and tariffs, differences between local and central estimates have added to volatility in the current system and have impacted authorities in two ways:

   - Where **local authority provision is higher than the central estimate**, authorities will see their ability to spend decrease initially, as they defer revenue and expenditure to later years. Later, if the provision is no longer needed and is released, this will come through the system as 'growth'.

   - Where **local authority provision is lower than the central estimate**, authorities will have greater resources to spend on services. However, if successful appeals turn out to be of greater value than the provisions set aside, authorities will see a reduction in income.

6. In either of the above cases, actual appeal losses could still be higher than the provisions set aside. If the loss has been significant, it could reduce NNDR income so that a safety net payment is required.

Addressing volatility through alternative arrangements

7. The alternative model aims to address volatility that relates to provisioning (as described in paragraph 5) partly through the mechanism of 'floating' top-ups and tariffs. The floating top-ups and tariffs would adjust to annual changes in level of provisions so that regardless of the amount set aside the starting point is for local authorities' income to match with their Baseline Funding Need. This would reduce volatility in comparison to current arrangements.

8. However, the mechanism of 'floating' top-ups and tariffs presents a transitional question relating to changes to provisions against previous lists. If we decided to carry provisions against 2010 and 2017 lists into the alternative model, and authorities subsequently decided that these provisions are no longer needed and can be released, then the first stage top-up and tariff calculations would take account of these provisions as income. This would lead to either a lesser top-up or a higher tariff than the authority would have been due had those provisions not been released. If the same provisions were released under current administrative arrangements, then authorities could retain the released funds as 'growth' without any impact on their top-up or tariff amounts.

9. In the alternative model, the effects of provisions released against 2010 and 2017 lists would vary between local authorities, depending on how the provisions previously set aside fared against central estimates:

   - Authorities that had **'overestimated'** their provision in relation to the central estimate could see themselves as being disadvantaged because they would have deferred their ability to spend to later years, but in the alternative model their released provisions would either lead to a lesser top-up or increase in tariff.

   - Authorities that had **'underestimated'** their provision in relation to the central estimate could be seen as being advantaged by the situation because they would have benefitted from higher income under current arrangements with no effect on their income under the alternative arrangements. That is, if after transitioning to alternative arrangements such authorities decided that the provisions previously set aside were too low, and made a decision to increase them, then liability for the resulting increases in top-ups and decreases in tariffs would be assumed by central Government.

10. As per 2018-19 NNDR3, the total amount of provisions held against 2010 and 2017 lists amounts to £2.9bn. These provisions have been informed by best available forecasts by local authority financial officers and are subject to annual changes. Therefore, the question on how changes to provisions should be treated is speculative and may not arise in practice.

Options for dealing with changes to provisions against previous lists at transition

11. The way in which we approach the question of moving provisions to a reformed system is one of objectives and principles. The Working Group is thereby invited to discuss the following:

   - *Should the alternative model seek to address volatility relating to previous lists or only in relation to future lists?*

12. If there was a principled view that future reforms should seek to address all volatility, including in relation to past lists, then the implication is that **provisions already made against 2010 and 2017 lists should be carried over to the reformed.** Under this option, central Government would assume any benefits and/or liabilities arising from such arrangement. At the same time, this option could be seen to either advantage or disadvantage an authority depending on how the provisions previously set aside fared against central estimates (see paragraph 9).

- *Could this option create perverse incentives in relation to forecasting of provisions prior to implementation of the alternative model?*
- *Would this proposal work for all types of local authorities, including those who may not have made provisions against the 2017 list?*

13. If there was a principled view that the alternative model should seek to address volatility only in relation to future lists, then one option would be to **ask authorities to split their provisions against different lists in their NNDR form returns,** as is currently done**.** This could help isolate changes to provisions against 2010 and 2017 lists from the new model so that any increase or decrease to those provisions cannot affect an authority's top-up/tariff payment under the alternative arrangements. Local government would continue carrying any benefits and/or liabilities of such arrangements in relation to previous lists, as they currently do.

14. To determine the effectiveness of such solution, we would need to consider the administrative implications of splitting provisions and how accurate we could expect those splits to be. The Working Group is therefore invited to discuss:

- *What are the administrative implications of splitting provisions?*
- *Is it controversial not to treat released provisions as income for the purpose of setting first stage top-up and tariffs?*
- *Should provisions released against 2010 and 2017 lists still have to count for the purpose of safety net payments under the proposed option?*

15. Overall, members of the Working Group are invited to discuss:

    16. Any other options and views on the question of moving provisions to a reformed system.