Operationalising Levy and Safety Net payments under the Alternative Model

Introduction

1. At the June 2019 System Design and Implementation Working Group, a paper was presented outlining how the safety net and levy could operate under the alternative model for business rates retention. The paper concluded that under the current legislative framework, the safety net and levy would continue to operate much in the same way as they currently do, i.e. as separate payments streams alongside top-up and tariffs.

2. This paper continues the conversation had at the June 2019 System Design and Implementation Working Group, illustrating how the safety net and levy would operate under alternative model by working alongside 'floating' top-ups and tariffs and in line with the legislative framework set out in paragraph 5.

3. The multiplier, levy and safety net thresholds featured in these illustrations have been set for illustrative purposes at their current rates. Decisions on actual levy and safety net thresholds for a reformed business rates retention system are yet to be made.

4. Members of the Working Group are invited to discuss the detail of the mechanics as presented in this paper, including if they notice any issues with the outline of the technical proposal.

Safety net and levy operation under the conventional arrangements:

5. Safety net payments are made in circumstances whereby an authority's income from business rates drops below a pre-determined safety net threshold. Safety net payments are primarily funded by a levy on growth, which is paid into a central levy account. Safety net payments are then in turn taken from this account.

6. The legislative basis for the Levy and Safety Net is set in primary legislation by Part 6 and 7 of Schedule 7B of the Local Government Finance Act 1988. In addition to this, the basis on which levy and safety net payments are to be made is set out in the *Non-Domestic Rating (Levy and Safety Net) Regulations 2013 (SI 2013/737)* and the conditions around payment of a levy account surplus is set out in the *Non-Domestic Rating (Rates Retention and Levy and Safety Net) (Amendment)* and *(Levy Account: Basis of Distribution) Regulations 2019 (SI 2019/709).* This legislation dictates that:

   - Levy and safety net payments must be credited and debited into/from a separate levy account.
   - The end-year balance on the account must be carried forward to the following year.
   - The calculation of any payments due under those regulations can only be made "as soon as practicable after the end of the year"; but that 'on-account' safety net payments can be made (but not 'on account' levy payments).

7. The Secretary of State can determine that all, or part of a surplus on the levy account at the end of a year can be distributed to authorities in accordance with regulations; and any amount so distributed must be paid to authorities before the end of that year.

8. Currently, 'on account' safety net payments are paid out on return of NNDR1 forms to authorities whose expected income is less than 92.5% of their Baseline Funding Level (BFL).

These payments are reconciled upon the return of NNDR3 forms which confirm an authority's actual non-domestic rating income for the year.

9. Unlike safety net payments, current legislation does not allow for levy payments to be made 'on account'. Instead, authorities only pay levy upon the return of NNDR3 forms which confirm in year growth.

Safety net and levy operation under alternative model:

10. Under the alternative model, the safety net and levy would continue to operate as separate payment streams alongside top-ups and tariffs. Safety net payments would also continue be calculated as a percentage of an authority's Baseline Funding Level and levy would be calculated as a percentage of growth achieved.

11. However, unlike in the conventional system, top-ups and tariffs would be calculated in two stages, with a first stage top-up/tariff calculation calculating whether rates revenues match Baseline Funding Level and a second stage 'growth' calculation separately measuring growth. As the alternative model retain the principles of the current system in relation to risk and reward, the growth that authorities experience could be negative, and thereby lead to a safety net payment.

Tariff, top-up, levy and safety net calculations under the alternative model:

12. This section illustrates the detail of top up, tariff, levy and safety net calculations under the alternative model. The example illustration assumes that growth would be measured using a mixture of Rateable Value and NNDR data. The system would be operated a 'non-lagged' basis, so that authorities experience any effects of growth or decline in-year on the basis of their NNDR1 forecasts, with reconciliations made on the basis of NNDR3 reporting at a later stage.

Figure 1: System Set Up

	Parameters	**Baseline figures**
Rateable Value (RV) (RV data by the VOA)		130,000,000
Multiplier	**0.5**	
GRP Growth Baseline (RV*Multiplier)		65,000,000
Reliefs	**0.06**	-3,900,000
Net Rates Paybale (NRP) (GRP-reliefs)		61,100,000
Adjustment factor (NRP/GRP)		0.94
Baseline Funding Level (BFL) (Informed by the needs funding formula)		30,568,234
Local share	**0.5**	
Safety net threshold	**0.925**	28,275,616
Levy on growth	**0.5**	

13. Figure 1 (above) shows system set-up parameters for a fictional authority under alternative arrangements, including **growth baseline** (derived from gross rates payable), **net rates payable** (income post reliefs), **adjustment factor** (calculated as the ratio of net rates payable to gross rates payable), **Baseline Funding Level** (assessment' on the authority's relative needs), and both the **safety** net threshold and **levy rate**.

14. Figure 2 (below) shows NNDR reporting for the same fictitious authority between Years 1 and 3. The bottom row shows local retained income prior to the calculation of tariff and top ups. In Years 1 and 2, the authority predicts growth in their Rateable Value at the NNDR1 stage but as per NNDR3s the actual growth is even higher than predicted (top row). This is reflected in the retained local share (bottom row). In Year 3, the authority predicts decline in its Rateable Value, resulting from a business closure. As per Year 3 NNDR3, actual decline ends up being even greater than estimated.

Figure 2: NNDR reporting in years 1 – 3

	Year 1: NNDR1	Year 1: NNDR3	Year 2: NNDR1	Year 2: NNDR3	Year 3: NNDR1	Year 3: NNDR3
RV	130,000,000	132,000,000	133,000,000	134,000,000	120,000,000	118,000,000
Multiplier	0.5	0.5	0.5	0.5	0.5	0.5
GRP	65,000,000	66,000,000	66,500,000	67,000,000	60,000,000	59,000,000
(less) Reliefs @ 6% of GRP	-3,900,000	-3,960,000	-3,990,000	-4,020,000	-3,600,000	-3,540,000
NRP	61,100,000	62,040,000	62,510,000	62,980,000	56,400,000	55,460,000
(less) Accounting adjustments, disregarded amounts, etc.	-5,517,493	-5,517,493	-5,517,493	-5,517,493	-5,517,493	-5,517,493
Non-domestic rating income	55,582,507	56,522,507	56,992,507	57,462,507	50,882,507	49,942,507
Local Share 50%	27,791,254	28,261,254	28,496,254	28,731,254	25,441,254	24,971,254

15. Figure 3 (below) shows how top-ups, tariffs, safety net payments and levy would be calculated in Years 1-3 in relation to NNDR1 and NNDR3 reporting stages. Because levy and safety net payment amounts relate to growth and decline that an authority might have experienced, it is necessary to first calculate the authority's top-ups and tariffs to understand its total retained income for the year and then determine how much that is in relation to the authority's Baseline Funding Level.

16. The top row of Figure 3 illustrates the stage 1 top up and tariff calculation made on the return of NNDR1 forms each year. In this calculation, the Baseline Funding Level of £30,568,234 (as seen in Figure 1) is subtracted from the forecast of retained local share (as seen in Figure 2), giving us the first stage top-up or tariff that is required to take the authority to its Baseline Funding Level.

Figure 3: Top-ups tariffs, levy and safety net payments at NNDR1 and NNDR3

Top-ups/tariffs, levy and safety net payments as per NNDR1			
	Year 1	**Year 2**	**Year 3**
Stage 1 top-up/tariff (BFL - Year 1 NNDR1 local share)	2,776,981	2,071,981	5,126,981
Forecast Stage 2 'growth' (NNDR1 GRP - System set-up GRP) * Adjustment Factor * 50% Local Share	0	705,000	-2,350,000
Forecast total top-up or tariff* Stage 1 'need' + Stage 2 'growth' + Stage 2 'growth reconciliation'	2,776,981	2,776,981	2,776,981
Local Share 50% (NNDR1)	27,791,254	28,496,254	25,441,254
Forecast total retained income	**30,568,234**	**31,273,234**	**28,218,234**
Levy payment forecast	**0**	**352,500**	**0**
Safety net 'on account' estimate	**0**	**0**	**57,382**
Top-ups/tariffs, levy and safety net payments as per NNDR3			
Stage 2 growth actual	470,000	940,000	-2,820,000
Top-up/tariff adjustment (as per growth actual)	470,000	235,000	-470,000
Actual total top-up or tariff	3,246,981	3,011,981	2,306,981
Actual total retained income	**31,038,234**	**31,508,234**	**27,748,234**
Actual levy payment	**235,000**	**470,000**	**0**
Actual safety net payment	0	0	527,382
Safety net payment reconciliation	**0**	**0**	**470,000**

17. The second row of Figure 3 shows the stage 2 ‘growth’ calculation made on the basis of NNDR1 returns. This compares NNDR reporting on gross rates payable with the growth baseline (as determined at system set-up – Figure 1) and multiplies the difference by the adjustment factor and local share (also in Figure 1). Next, the stage 1 and 2 top-ups and tariffs are summed up to produce ‘forecast total top-up or tariff’, which when combined with the forecast local share gives us the ‘forecast total retained income’.

18. Stage 1 and 2 top-up and tariff calculations, as described in paragraphs 15 and 16, are re-run following the return of NNDR3s. Top-ups and tariffs paid as a result of the NNDR1s are then reconciled to match the actual outcomes.

Safety net and levy payments under the alternative model in each year:

19. For Year 1, because there is no growth forecast at the NNDR1 stage, retained income after top up matches the Baseline Funding Level. However, upon the return of NNDR3 forms, some growth has been recorded and is thus reflected in the top-up/tariff adjustment. The authority will pay a levy on the growth achieved following the return of NNDR3.

20. In Year 2, some growth is predicted at the NNDR1 stage and is thus reflected in the top-up issued in year. NNDR3 returns find actual growth to be greater than estimated. As in year 1, a top-up adjustment is therefore required and this is paid at the same time, and as part of,

the following years top-up/tariff (as outlined in previous working group papers). At the NNDR1 stage, the levy payment due based on estimated growth has only been forecasted, but local authorities will need to have taken it into account in their budgets and will need to recognise the outturn amounts in their account. They will only physically pay the levy amounts to Government following the return of NNDR3s, in line with existing legislation.

21. Finally, in Year 3, a predicted drop in the authority's Rateable Value reduces its top-up in-year, leaving the authority's income below its Baseline Funding Level (due to the negative growth). This leads to a small 'on account' safety net payment. Following the return of NNDR3, it becomes evident that the drop in Rateable Value has been higher than predicted. It means that there will be a top-up reconciliation payment, paid at the same time, and as part of the following year's tariff and top-up (and which, in this case, will result in a repayment of money by the authority) and a safety net reconciliation payment, which will ensure that, overall, the authority's income for the year is not below its Safety Net. The top up reconciliation payment will be paid to the authority immediately following the return of NNDR3s, as happens in the current arrangements under existing legislation.

Timings:

22. The time at which safety net payments are made, and levy payments taken, is set by primary legislation. The regulations permit the 'on account' (based on NNDR1 estimates) issuing of safety net payments, which ensure that under current arrangements, local authorities will always operate, as a minimum at 92.5% of their Baseline Funding Level. Levy payments cannot be made 'on account' so will only be made following the return of NNDR3 forms. Also at this time, any safety net reconciliation will take place.

23. Given the timings of the NNDR reporting cycle, in practical terms this means that top-up/tariff payments and safety net payments for Year 1 would be adjusted and reconciled in Year 3 of the new system, reconciliations for Year 2 would be made in Year 4 and so forth.

Discussion:

24. Members of the Working Group are invited to discuss the detail of the safety net and levy payments under alternative arrangements, including if they notice any issues with the outline of the technical proposal.