Spreading the Risk of Valuation Losses across the Local Government Sector to Reduce Volatility

June 2018

The Local Government Association (LGA) welcomes the opportunity to comment on [Technical paper 3: Spreading the Risk of Valuation Losses across the Local Government Sector to Reduce Volatility.]()

The LGA is here to support, promote and improve local government. We will fight local government's corner and support councils through challenging times by making the case for greater devolution, helping councils tackle their challenges and assisting them to deliver better value for money services.

This response has been approved by the *LGA's Resources Board and Task and Finish Group on further Business Rates Retention and the Fair Funding Review.*

The LGA is continuing to work with Government officials on the implementation, from 1 April 2020, of 75 per cent business rates retention. The issue of appeals, which is covered by this submission, is a major risk issue for local government in the current 50 per cent business rates retention system and has the potential to be a greater risk when 75 per cent retention is implemented.

In our response to the 2017 consultation on further business rates retention we said that it is clear that losses from appeals as a result of 'valuation errors' could have a significant impact on the operation of the new scheme.

We reiterate our support for a centrally managed appeals risk system, on the lines of that outlined in the MHCLG paper. We think that it would be a way of mitigating risk as it would reduce the need of authorities to hold provisions to cover appeals and would only have to cover actual changes to the list. Given the impact of appeals on local authorities and local authority services, compensating authorities for losses due to appeals outweighs the risk of further complexity.

We look forward to working further with officials on the development of the system. We note that MHCLG is proposing to use as a proxy changes from the compiled list, in other words those changes which are backdated to the start of a list. We would like to see more work on this and note that no operational alternative has been suggested. Going forward, it should be explored whether information on the reason for a valuation can be provided under Check, Challenge and Appeal.

A system must be put in place to adjust for those events which cause a significant shock to the system, such as a legal decision on mandatory reliefs for NHS Trusts, decisions on rating methods, for example doctors' surgeries, and the knock on effect of Government policy decisions, such as

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the expansion of academy schools. These can be seen as shuffling income round the public sector.

The government should ensure that the valuation system is properly funded, to enable the backlog of appeals to be dealt with as quickly as possible and to ensure that the 2021 and future revaluations are as accurate as possible.

Detailed comments

Before the introduction of the current rates retention system, all business rates raised by local government were paid to central government for redistribution to local government through formula and other grants. Losses on appeal, therefore, were borne centrally. When the 50 per cent business rates retention system was introduced in April 2013, authorities were expected to refund 50 per cent of the cost of appeals including backdated losses. In line with normal accounting practice, authorities were required to make provisions for expected appeals losses.

In 2013 the LGA called for the Government to fund all appeal loss before April 2013. We still consider that this would have been the correct treatment. We believe that when 75 per cent rates retention is introduced the share of the cost of appeals which would have fallen on the central share in the 50 per cent scheme should be funded by central government and not from a top-slice.

Although, as the MHCLG recognise, the Government did reduce the business rates baseline in 2013/14 by £1.9 billion to take account of outstanding and expected appeals, this figure was effectively apportioned between authorities proportionately to their individual business rates baselines and not in accordance with the risk of appeals. Some authorities experience losses larger than their portion of the top-slice and some experience losses smaller than the portion allocated to them.

It is estimated that there was a total of £2.6 billion in appeals provision as at 31 March 2017. Over 70 per cent of appeals to the 2010 list which have been resolved have resulted in no changes to the list. There are still over 130,000 appeals outstanding from the 2010 list and there is no information on whether the appeals that are still to be resolved are more or less likely to result in a change to a valuation. However, it is unlikely that all the provisions will be needed and this is money that could be spent on local authority services which are already under severe pressure.

It is still too early to say whether Check, Challenge and Appeal has been effective in reducing the number of appeals to the 2017 list. The time needed to go through the stages of the process and the fact that all the systems needed are not in place has contributed to this. The government must ensure that the valuation system is properly resourced, in order to clear the backlog of appeals on the 2010 list as quickly as possible and to deal with more frequent revaluations.

We agree with the conclusion in the MHCLG paper that the risk from appeals has been the principal risk which has emerged in the 50 per cent system. In 2020 local government potentially faces having to take on 75 per cent of provisions for appeals loss, including backdating and this needs to be resolved before 75 per cent business rates retention is introduced.

MHCLG proposals

The LGA is in favour of a centrally managed system to cover losses from appeals and is pleased that the Government has been considering how to reform the business rates retention system to deal with appeals.

As the MHCLG paper acknowledges, there is still a lot of work to do on determining precisely how loss due to 'valuation error' is defined and measured, and exactly how and when these payments should be made, including how the revaluation cycles fit in with this.

We note the MHCLG preference not to compensate local authorities for all losses as a result of development and only compensate for appeal losses. Authorities may raise concerns about this and therefore it is important to consult on this more widely and consider the role and level of the safety net for this.

We note that MHCLG is proposing to use those changes which are backdated to the start of a list as a proxy for revaluation changes. We would like to see more work on this and note that no operational alternative has been suggested. Going forward, it should be explored whether information on the reason for a valuation can be provided under Check, Challenge and Appeal.

The interaction between the system for manging appeals risk and the safety net will also need to be considered carefully.

Funding

We have previously argued that the cost of appeals should be funded from central list income. We note that MHCLG consider that this would not be fiscally neutral, as the paper states that central list income is already used indirectly to fund various grants to local government. We therefore recommend that this is considered as part of our work on the Spending Review 2019.

We agree that in the absence of any other source of finance, a top-slice is the best alternative. We consider that the quantum needs to be kept under review so that there is no danger of overprovision and the top-slice is kept to the minimum.

There is also the issue of when 75 per cent rates retention is introduced the 25 per cent share of the cost of appeals which would have fallen on the central share under the 50 per cent scheme. This should be funded by central government and not from a top-slice. Further work should also consider what would happen if the provision for appeals in the multiplier set at revaluation is insufficient.

Timing

We note that MHCLG considers the best time to introduce the central funding of appeals would be in 2021 at the time of the next revaluation, a year later than the introduction of 75 per cent retention. This creates a significant risk for authorities in the intervening year and the Government needs to consider how other mechanisms within the system, such as the safety net, can be used to facilitate the transition.

Complexity

We recognise that reforms to centralise valuation losses will potentially add complexity. We share the aim for the system to be as straightforward as possible. However, it is imperative that the risk to local authorities due to appeals is reduced. The current system of authorities having to make provisions which may not be needed is clearly inefficient and leads to reductions in spend and services that would not be necessary if there were a centralised provision for appeals.

We also welcome the involvement of CIPFA and others from the accountancy profession, noting that the proposals must work from an accounting point of view. We look forward to further work.

On appeals more generally, we would support a review of the VOA and Valuation Tribunal Service processes to assess where the current hold ups lie. Any increased resources and appropriate measures can then be targeted to where they are needed to deal with the backlog of appeals before greater business rates retention is introduced. This should be subject to a performance and accountability framework.