Reset 2020: Setting Business Rates Baselines – Issues

Introduction

The business rates retention system is due to be "re-set" for 2020-21.

Notwithstanding the wider reforms to the local government finance and business rates retention systems, we currently envisage that the re-set will establish new *baseline funding levels* and *business rates baselines* for each local authority that is party to the rates retention system.

Baseline funding levels will be based on the spending control totals for 2020-21 and the distribution formulas that will be put in place through the Fair Funding Review.

This paper looks at how *business rates baselines* might be set for 2020-21. Specifically, it reminds IWG how they were set for 2013-14, reflects on the outcome of that approach and considers, in the light of experience and future reforms to the system, whether there are alternative approaches to setting *business rates baselines for 2020-21*.

IWG is invited to consider whether all the issues and options have been identified; and to discuss whether there is a preferred methodology for setting business rates baselines for 2020-21.

Background

1. Business rates baselines (BRBs), along with baseline funding levels, are used to establish the tariffs and top-ups paid by, or to authorities as part of the redistribution system.

2. In order to allow tariffs and top-ups for 2020-21 to be set in the provisional settlement in late 2019, we will need to have established new BRBs for authorities by October/November 2019. Before then, we will want to have consulted on the methodology to be used for calculating new BRBs.

3. We will aim for a consultation paper later this year, or early next, before finalising the methodology in time for the 2020-21 provisional settlement.

Establishing Business Rates Baselines in 2013

4. In order to establish BRBs at the outset of the scheme in 2013, we essentially adopted a “two-stage” “top-down” approach; fist calculating the aggregate rating income of billing authorities from a starting point of the “gross rates payable” and then apportioning the aggregate rating income between authorities.

Calculating national aggregate business rates

5. In order to calculate the *estimated business rates aggregate (EBRA)*, given the absence of NNDR1 forecasts for 2013-14, we:

Step 1: estimated the national rateable value (RV) at 30 September 2013 (ie the mid-point of 2013-14).

To derive the 30 September 2013 RV, we took the known RV value for the mid-point in 2012-13 and adjusted it for 12 months-worth of RV change. To calculate the RV change, we applied the same rate of change in rateable values as had occurred between 31 March and 30 September 2012 (the most recent 6 month period for which figures were available). Hence, rateable values declined by £100m between March and September 2012, so we reduced the September 2012 value by £200m (ie 2 x £100m (for a full 12m period).

Step 2: The 30 September 2013 RV was then multiplied by the small business rating multiplier for 2013-14 to establish a notional gross rates yield of £26.297 billion – an increase of 2.2% over the forecast yield for 2012-13.

Step 3: The gross rates yield was then adjusted for:

- SBRR (including an adjustment for the additional income resulting from the “supplementary multiplier”)
- other mandatory reliefs
- the transitional arrangements in place for Revaluation 2010
- discretionary reliefs
- Enterprise Zone Relief
- Cost of Collection
- City of London Offset

- Losses in Collection
- a “calibration adjustment”
- Transitional Protection Payments
- Enterprise Zone Retention
- Appeals

6. As a result of the above calculation, EBRA for 2013-14 was set at £21.797 billion.

7. Broadly speaking, the adjustments we made to the notional gross rates yield in order to derive EBRA, were supposed to mirror the actual adjustments to gross rates, including those for appeal provisions and bad debts that authorities would need to make in order to calculate their *non-domestic rating income* under the rates retention scheme. Given perfect forecasting, therefore, EBRA should have been equivalent to the *non-domestic rating income* reported by authorities in 2013-14 NNDR3s. In practice, *non-domestic rating income* in 2013-14 NNDR3s was £20.789 billion (adjusted for the compensation paid to authorities for the temporary doubling of SBRR and for “new empty” and “flooding relief”) – £1.008 billion (4.6%) lower.

8. The following table summarises the calculation of the 2013-14 EBRA and compares the figures with those in 13-14 NNDR3s:

	LG Finance Report	NNDR3	variance	%
	2013-14			
	£m	£m		
Gross Rates Payable	**26,297**	**25,663**	**-634**	-2.4%
Reliefs:				
Mandatory relief	-2,169	-2,424	-255	11.8%
Net transitional arrangments	-125	33	158	-126.4%
SBRR	-58	-246	-188	324.1%
Discretionary reliefs	-49	-84	-35	71.4%
EZ relief	-35	-8	27	-77.1%
Net Rates Payable	**23,860**	**22,934**	**-926**	-3.9%
Losses on collection	-206	-264	-58	28.2%
Losses on appeal (provisions):				
calibration adjustment	*-1,279*			
appeal adjustment	*-593*			
	-1,872	-1,745	127	-6.8%
Collectible Rates	**21,782**	**20,925**	**-857**	-3.9%
Transitional protection payments	125	-33	-158	-126.4%
Cost of collection	-84	-84	0	0.0%
City of London offset	-11	-11	0	0.0%
Designated areas (EZ retention)	-15	-4	11	-73.3%
Renewable energy retention	0	-4	-4	
EBRA (Non-domestic rating income)	**21,797**	**20,789**	**-1,008**	-4.6%

Apportioning EBRA between billing authorities

9. Having forecast the aggregate business rates income to be collected by local government, we then apportioned this figure between authorities.

10. The apportionment involved three steps. First: EBRA (£21,797m) was multiplied by the “local share” of 50% to give a total for the local authority business rates baseline of £10,899m. This was then apportioned between billing authorities to create *billing authority business rates baselines*. Finally, the *billing authority business rates baselines* were further apportioned between billing authorities and their major precepting authorities to produce *individual authority business rates baselines*.

Billing authority business rates baselines

11. In order to create each *billing authority’s business rates baseline*, the local share of EBRA (£10,899m) was multiplied by each authority’s *proportionate share*.

12. Essentially, proportionate shares were calculated as the average of a billing authority's business rates income for 2010-11 and 2011-12, expressed as a proportion of the average business rates collected nationally in those two years. The calculation was net of the impact of the national "2009-10 deferral scheme" under which some 2009-10 rates bills were deferred and paid in each of the next two years; and which, unless excluded from the calculation would have inflated 2010-11 and 2011-12 income.

13. The detailed calculation was:

$$\frac{I^{LA} + J^{LA} - K^{LA}}{I^{Eng} + J^{Eng} - K^{Eng}}$$

Where:

I	was the relevant amount for 2010-11
J	was the relevant amount for 2011-12
K	were reductions in respect of the national 2009-10 deferral scheme
LA	was the individual local authority amount
Eng	was the England total

14. The "relevant amounts" for each of 2010-11 and 2011-12, were based on authorities' contribution to the national rating pool for the year, adjusted to:

    i. strip out the impact of the transitional arrangements

    ii. strip out the impact of amounts deferred following local "schedule of payments" agreements;

    iii. strip out the impact of interest payments (on the basis that such payments were unique to a year, could vary widely, and should not therefore permanently reduce an authority's proportionate share)

    iv. strip out the impact of sums written off, or recognised for bad debts (on the basis that amounts recognised from year to year would vary widely and should not therefore permanently reduce an authority's proportionate share)

    v. strip out the impact of the City of London offset (because this would be dealt with separately once the City's business rates baseline (and tariff) had been fixed).

15. This meant that the actual level of mandatory and discretionary reliefs given by an authority were taken into account in determining proportionate shares; but its losses in collection were not. Instead, because a national figure for losses in collection was built into EBRA, each authority got a "share" of the national figure, in line with its proportionate share. Similarly, each authority got a share of the £1.87 billion "allowance" for "appeal losses" (comprising the "calibration" and "appeal" adjustment).

Individual authority business rates baselines

16. Having established billing authority business rates baselines for each authority, these were apportioned between a billing and its major precepting authorities according to the "tier-split" shares established by Government.

Observations on 2013-14 Methodology

17. In August 2011, when it first set out the methodology for calculating business rates baselines, the Government suggested that it would adopt a similar methodology at subsequent re-sets.

18. We should revisit this assumption, both because the data available through NNDRs has changed, but also, to ascertain whether alternative approaches might eliminate, or reduce, some of the less desirable impacts of the 2013 methodology on subsequent outcomes for local authorities. In assessing any possible changes to methodologies we will need to balance the requirement for "accuracy" against the possible benefits of having a transparent and stable baseline against which growth can be measured.

19. Arguably, the top-down approach (ie taking "gross rates payable" as a starting point) to fixing aggregate business rates (EBRA) stood-up pretty well. Non-domestic rating income in 2013-14 was just 4.6% lower than anticipated by EBRA – albeit that 4.6% still represents a c.£0.5 billion reduction in local authority income, under a 50% rates retention scheme. But the significant variations in some elements of the calculation (mandatory reliefs, or SBRR, for example) indicates how inherently difficult it is to make future forecasts of business rates income and suggests that, if we are trying to forecast 2020-21 business rates income as part of the calculation of *business rates baselines*, we might need to revisit our underlying forecasting methodologies.

20. As well as setting EBRA too high, the way in which it was then apportioned between authorities contributed to differences between baselines and income at local authority level. In calculating proportionate shares, the latest data used were those for 2011-12. Having no outturn figures for 2012-13 meant that significant changes in local rate bases in that year – whether losses due

to appeals, or gains because of “buoyancy” – were not factored into *business rates baselines*. We know that this made a significant difference to some authorities.

21. The decision to set proportionate shares on the basis of a two-year average also had an impact. The decision to use an average, was taken because the only data available was from NNDRs, which before 2013-14, essentially captured the “cash amount” of business rates collected in any year (notwithstanding the ability of authorities to make an allowance for bad debt).

22. NNDR3 figures, year-on year, varied significantly at the local authority level, primarily because of the impact of appeal losses. For this reason, we rejected the idea of calculating proportionate shares on the strength of a single year’s figures, which for any authority might have been exceptionally low.

23. But whilst basing proportionate shares on a multi-year average may have been justified given data limitations, there was a choice to be made at the time between using a two-year average or another period of time. There were arguments in favour of taking a five-year average, on the basis that this represented a full revaluation cycle. But against this was the argument that by using a five-year average, we were setting *business rates baselines* on the strength of rate bases which, in respect of the early years at least, were by then quite outdated. There were quite significant differences between these two approaches.

A Methodology for 2019-20

24. There are a number of options for setting business rates baselines for 2019-20.

A One- or two-stage process?

25. We need to decide whether to establish an aggregate business rates figure that is then apportioned between authorities, or whether to calculate each billing authority’s business rates directly from its NNDR data. Under the latter option, the aggregate will simply be the sum of each individual authority’s figures.

26. The choice probably depends solely on whether we seek to establish business rates baselines on the basis of a single year’s figures, or as an average of several year’s figures – ie a “spot” or “average” approach (see below).

27. If we plan to use a single year’s figures it is difficult to see that there would be much difference between a one-stage or two-stage process, since we would

be relying on the same data to set the aggregate and individual billing authorities share of that aggregate.

Top-down vs bottom-up

28. We need to decide whether to take a top-down approach and calculate business rates income by first establishing the “gross rates payable” and then making deductions for reliefs etc, or whether to calculate the business rates income directly from the “non-domestic rating income” figure.

29. Again, there may not be very much difference in practice, especially as the data for reliefs, provisions etc may, in any case, need to be adjusted before being used. However, which NNDR datasets we actually use will depend critically on how we approach this question.

30. The issues around “measuring income” are explored in greater detail in Paper IWG (18-5)1-02.

Which base year?

31. The business rates baseline established for each authority represents a “starting point” against which the authority can grow its business rates income. For the moment, we will assume that the objective of the 2020-21 re-set is to establish *business rates baselines* that represent the authority’s total business rates income. In future papers we will explore the complications of making the 2020-21 re-set on the basis of a “partial” or “rolling” re-set.

32. When the scheme was originally set-up, the base-year used was effectively 2013-14, because the starting RV figure was uprated to 2013-14 values (albeit, in this case, representing a decline in value). In other words, given perfect forecasting, an authority’s share of business rates in 2013-14 would have been equal to its business rates baseline and only from 2014-15 would authorities have had the opportunity to benefit from growth.

33. It would be possible to re-set the scheme on the same basis; making 2020-21 the base year, and leaving authorities, conceptually at least, operating at baseline funding levels in that year. To so this will require using data to make future forecasts of income.

34. Alternatively, it would be possible to set business rates baselines on the basis of a 2019-20 base year, simply uprating them by the change in the small business rating multiplier and leaving authorities free to benefit from any growth in 2020-21

35. In practical terms, the difference is between setting EBRA for 2020-21 (assuming a top-down approach) to include an estimate of growth in that year (either via an uprated aggregate RV, or by an explicit “growth adjustment” to the final income figure) or by setting it without reference to growth – ie simply uprating earlier years’ figures by the change in the business rates multiplier.

Spot or average

36. Regardless of whether we set business rates top-down, or bottom-up, we will need to rely on data from local authorities.

37. In 2013-14, we used an average of two year’s income data to derive *business rates baselines*. As explained above, this was because NNDR data was essentially providing “cash” figures, which could and did vary significantly from year-to-year.

38. Since 2013-14, NNDR data is on an accrued basis and, notwithstanding the difficulties of estimating appeals provisions, should be less volatile. The issues are explored in IWG (18-5)1-02. But, in theory at least, the fact that NNDR income figures are now net of the impact of future appeals might suggest that we can take a single year’s figures to calculate *business rates baselines* (a so-called “spot” approach) At the very least, we might be able to adopt a hybrid approach which relies more heavily on a single year’s figures.

Which dataset?

39. Because of the timing of data returns and the Settlement, we will face the same timing difficulties as in 2013-14 – namely that outturn data (NNDR3s) for the year before the reset, ie 2019-20 will not be available until July 2020 (even on a provisional basis), which is 5 months after tariffs and top-ups need to be set in the 2020-21 Local Government Report.

40. We could, in theory, rely on NNDR1 data for 2019-20, but historically, there have been significant differences between NNDR1 estimates and NNDR3 outturns.

41. On balance, therefore we are inclined not to rely on NNDR1 data, even if it could be reliably adjusted for forecasting error.

Year 2 revision to business rates baselines

42. Given the undesirability of setting baselines without reference to 2019-20 outturn data, another possibility would be to treat the exercise in the same way as we dealt with changes to tariffs and top-ups following the Revaluation.

43. In other words, we might set business rate baselines for 2020-21 on the basis of 2018-19 outturn data, but then revise the 2020-21 baselines 2021-22, once 2019-20 outturn data was available.

44. Given that revising business rates baselines would necessitate revising tariffs and top-ups and setting “reconciliation payments”, this could create quite an unstable picture, depending on how often the new rates retention system is reset and how frequently Revaluations take place. In theory, and assuming that there is a Revaluation in 2021-22 , authorities could find their tariffs and top-ups revised in 2020-21, 2021-22 and 2022-23, with reconciliation payments required in the latter two years.