REWARD GRANTS UNDER THE ALTERNATIVE SYSTEM

Introduction

1. At the joint meeting of the Systems Design and Implementation Working Groups (SDWG and IWG) in July, local government officers presented a paper outlining an alternative way to configure the rates retention system. The paper argued that by separating ”redistribution” and “reward for growth”, the rates retention system would:

   i. be radically simplified’

   ii. more fully guarantee “baseline funding levels” and give authorities earlier notice about the income they would receive in any year;

   iii. remove the impact of appeal losses and provisions on rating income; whilst

   iv. still allowing authorities to see the benefit of any growth in local business rates.

2. The paper and subsequent discussions at the meeting highlighted the need for the working groups to discuss further the design of the “growth” element and to think about the practicalities of measuring growth and decline under such an alternative model.

3. This paper is a contribution to that discussion. It does not represent Government policy. Instead, it sets out a number of options as a stimulus to debate.

Background

4. When the Business Rates Retention Scheme (BRRS) was introduced in 2013, the then Government expressly described its purpose as being to create a direct financial incentive for local authorities to support local economic growth. By being responsive to business concerns and supporting physical development of business property – new-build, redevelopment, refurbishment etc – every local authority would be able to keep a proportion of the growth in its own local tax (business rates) base, instead of surrendering it to central government for redistribution amongst all authorities (as happened prior to 2013). Hence, the BRRS contributed to the greater self-sufficiency of local government by making a greater proportion of an authority’s income dependent on the growth in it tax base, instead of “funding formulas”.

5. Nevertheless, the BRRS still provided for a substantial proportion of national business rates income to be redistributed between authorities, reflecting their resources and relative “needs”. Redistribution was effected via “tariffs” and “top-

ups”. These were established at the outset of the scheme. They were then to remain unchanged, in real terms, until a reset (which was to be every ten years, after a first reset in 2020).

6. *Baseline funding levels* and *business rates baselines* were used to both determine tariffs and top-ups (i.e. the “redistribution” amount) and the “growth” that authorities were to keep if their local tax bases grew, or the reduction in income they would bear if local tax bases declined (subject to a safety net) – “growth” is simply the difference between retained business rates income (+/- top-up/tariff) and the authority’s *baseline funding level*.

7. In practice, the growth or decline that individual authorities have seen does not reflect only increases/decreases in underlying rate bases – i.e. new-build, redevelopment, refurbishment etc - but also inaccuracies in baselines at set-up; the difference between the “allowance” for appeal provisions built-in to the scheme at set-up and authorities’ judgement of the required level of provisions; and, ultimately, of the level of appeal loss experienced by individual authorities. The working groups have discussed these issues with the current system and possible improvements to be made at the reset planned for 2020.

Options

8. In order to establish the desirability of moving to the alternative model proposed by some members of the working group, it is necessary to consider how it would operate and how growth might be similarly rewarded.

9. Under the alternative arrangements, for the purposes of redistribution, there would still be the equivalent of a fixed *baseline funding level* for each authority. But there would no longer be a fixed *business rates baseline*. Instead, an authority’s *baseline funding level* would be compared to a floating *business rates baseline* (comprising the authority’s share of business rates income as determined each year on the basis of its completed NNDR1). This would give an annual tariff or top-up, which would automatically wash-out the impact of growth or compensate decline in business rates income.

10. Because the reward for growth would need to be separately calculated, it would be possible either to measure reward (and decline) in broadly the same way as growth is currently measured under the BRRS, or to adopt a different approach.

11. Regardless of how the “reward” were measured, Government would likely expect local government’s share not to exceed the headline level of retention – i.e. if the local share is set as 75%, authorities would keep 75% of any growth. The Government would also be likely to prefer a system which recognises not only growth in BR but also decline as the current system does. It can therefore be expected that individual local authorities would be expected to bear some of the

risk that local area business rates income might decline, albeit mitigated by a "safety net".

12. At the design level there are two broad choices. Between "reward" models:

    i. based on measuring the increase/decrease in business rates against a "baseline"; or

    ii. based, as the previous paper suggested, on behaviours/choices of authorities – e.g. the correction of omissions from the rating list – that are not directly related to changes in business rates income.

13. Within these two broad design options there are a raft of different choices about the extent to which "growth" in a particular authority is left with that authority (and for how long), or is pooled at the local or national levels. But these are no different from the questions/options that arise in relation to a redesigned BRRS and are inextricable from questions about re-set periods, full/partial resets, etc, and tier splits.

14. It would also be possible to combine "baseline" and "behavioural" models, apportioning the available growth on the basis of a number of different measures.

Baseline Models

15. Under any baseline model it is necessary to determine the way in which "income" is to be measured and the baseline against which it is to be compared.

Standard Baseline Model

16. As the previous paper suggested, at its simplest, it would be possible to rely on the difference between tariffs and top-ups from year-to-year to measure the difference in "income". Because tariffs and top-ups would be adjusted each year to reflect authorities' estimate of income (+/- previous year's Collection Fund surplus/deficit), any growth in income would manifest itself as a surplus of tariffs over top-ups. E.g.

	Year 1	Year 2
Baseline Funding Level	100	100
Share of BR income (NNDR1) *(+/- previous year's surplus/deficit)*	`100	110 (ie +10 "growth")
Tariff	**0**	**-10**

17. By allowing an authority to keep the difference between one year's tariff/top up and a previous year's tariff/top-up, we would effectively replicate the reward available to authorities under the current BRRS.

18. But in the same way as "growth" under the current system is affected by appeals/provisions, using differences in tariffs/top-ups as the basis for calculating reward would be similarly dependent on the impact of provisions and appeals.

Alternative Baseline Model

19. Because under the alternative arrangements, it is no longer necessary to rely on the same calculations for "redistribution" and "reward", other bases of measurement become possible, including the possibility of excluding provisions/appeals from the calculation.

20. In the context of setting business rates baselines, IWG has previously discussed that conceptually, the baselines/reward should be set to reflect "net rates payable", <u>after all appeals have been determined</u>. In the real world, it is not possible, before the event, to know what impact appeals will have on any year's net rates payable. But, once the appeal is heard, its impact on each year's net rates liability is known, and is already captured in NNDR3s in the form of "prior-year adjustments".

21. At present, NNDRs do not separately identify "prior-year adjustments" for "gross rates payable" – although it is a component of the "gross rates payable" figure that is provided by authorities in NNDR3s – and whilst NNDR3s <u>do</u> give figures for prior-year adjustments for reliefs, they are provided as a single figure for all years (ie they are not "posted" to individual years).

22. In theory, if prior-year adjustments were posted to individual years, it would be possible to calculate a "baseline" based on an authority's net rates payable for a year and then later to re-calculate that baseline to reflect adjustments made to that year's net rates payable as a result of an appeal. By comparing an authority's net rates payable for a year with that year's re-calculated baseline, it should be possible to measure "growth" consistently across years, without there being any impact from "appeals". Decline in business rates could be similarly measured and apportioned to local authorities, subject to a safety net.

<u>Behavioural Models</u>

23. As the previous paper suggested, it would be possible, as an alternative, or a complement, to a "baseline model" to reward authorities for specific behaviours/choices they make – and the paper suggested a number of possible measures.

24. Adopting behavioural models would be a departure from the objectives for the scheme set out when BRRS was introduced in 2013. The scheme would become less a broad incentive for authorities to support local economies and to benefit from the growth in local tax bases and more dependent on measuring outcomes that are largely independent of changes in local tax base.

25. Apart from questions about the what measures should be used – which might depend on the degree of influence that authorities are perceived to have on the outcome – it would probably still be necessary to measure growth in local tax bases in some way, in order to determine how much reward, in total, was available to distribute between authorities.

Questions for the working group:

- **Do you agree that this paper covers the broad options available for measuring growth/decline in business rates under the alternative model proposal?**

- **Do you have a preference for a baseline model vs a behavioural model? Or a combination?**

- **Can a baseline model be delivered operationally in the way described in this paper?**

- **Considering the options for reward/risk set out in this paper, do you have a view as to the continued desirability of exploring the 'alternative model' for delivering business rates retention from 2020?**