Systems Design Working Group – 14 October 2016

Calculating compensation for valuation changes

Paper prepared by Department for Communities and Local Government

1. The systems working group has been considering a system of how we might compensate local authorities for appeal lost by way of a proxy based on the compiled rating list. This paper explores how that might work.

Valuation changes

2. In the past we have explored whether we can identify and distinguish changes to the list which are due to valuation changes and those due to development. That has proven to be difficult.

3. Instead we have been considering if changes in the compiled list can be taken as a suitable proxy for valuation changes. Further work will be needed to understand the rough edges of this proxy but they could include:

    a. new development completed in the months leading up to the compiled list may not make it in the list on day one. Therefore, that development would appear for the first time as a change to the compiled list, and
    b. there will be compiled list amendments which are date limited and, therefore, not shown with effect from the start of the list.

4. There may to vary degrees be solutions for these. But indications are that, at the very least, the idea will provide a fairly strong proxy for valuation changes.

Calculating the impact of compiled list changes

5. Calculating the financial impact of compiled list changes is not simple.

6. The attached spreadsheet shows a property with a compiled list value of £100,000 which is then subject to a series of 7 alterations with different effective dates. Only one of those alterations (no.3) is to the compiled list. Furthermore, alterations 3.4.5 are all as a result of appeals and actioned at the same time resulting in one refund. Finally, each of the alterations occurs at different times (shown as “Date of Schedule”) with different degrees of backdating.

7. This illustrates that there are various ways the cost of the reduction to the compiled list only can be calculated. Clearly this is a complex case but with so many alterations each year, any scheme will have to cope with this degree of complexity. Especially as large amounts of grant payments will hang upon the operation of the scheme.

8. The following section explores how we might capture the cost of the compiled list reduction in this case and identifies 3 options.

What is the cost of the compiled list reduction only?

9. In the example the compiled list (1/4/17) is reduced from £100,000 to £90,000 on 20 April 2018 (alteration 3). However, the original compiled list entry of £100,000 is only “live” for 6 months because the property is partly demolished in September 2017 (alteration 1) and then reinstated with a new extension at a higher RV the following February (alteration 2). What in these circumstances is the cost of the compiled list reduction?

10. The lines 14 to 32 look at the refunds payable to the ratepayer for each of the alterations in the list. This calculates:

    a. the bill paid between 1 April 2017 and the date of schedule before the alteration has been made,
    b. the revised bill between 1 April 2017 and the date of schedule after the alteration, and
    c. the difference to find the refund/additional amount payable.

Option 1

11. In this example there is no refund attributable to the compiled list reduction. As discussed above, alterations 3,4 and 5 were actioned at the same time with the same date of schedule and result in one refund. But only alteration 3 is to the compiled list. So in the box in lines 34 to 50 we have calculated what each of the alterations would have generated in refunds had they been done separately. Assuming it would be possible in practice to isolate the cost of alterations in this way, this provides option 1 for calculating the cost of compiled list reductions. It shows that the cost of alteration 4 in isolation (the compiled list change) is £2,493. .

12. Immediately we can see that the option 1 methodology is too low and wrong in this case. This is because option 1 only captures the cost of the compiled list alteration between 1 April 2017 and 30 September 2017 - the point at which it is overtaken by the next alteration. So if, for example, a small change had led to an alteration with a effective date of 2 April 2017 then the cost of the compiled list alteration on option 1 would be negligible.

Option 2

13. Option 2 (lines 52 to 58) calculates the cost of the refund based on the rateable value reduction. The methodology looks at the RV reduction in the compiled list and calculates a rates refund based on that reduction. The problem here is that, as in this case, the rateable value against which the error has arisen may vary over the year. In this case it is only £55,000 for part of the year so the method overstates the cost of the refund. We would also face difficulties if the ratepayer was eligible for reliefs and especially if that relief varied over the period (e.g. EPR).

Option 3

14. Option 3 (lines 60 to 66) uses the % reduction in the compiled list RV to estimate the cost of the refund. So the reduction in the compiled list is 10%, the rates paid over the period before the refund was £49,232 so the cost of the refund in respect of the compiled list change using option 3 is £4,923. This looks more accurate. For context, the total refund from alterations 3,4&5 is £9,825 but this includes some much larger reductions to the later VONs.

Option 4

15. Option 3 only captures the cost of the reduction at the point it is made (i.e. the date of schedule of the refund) so option 4 (lines 68 to 75) also calculates the cost over the rest of the year (£7,037). Therefore, on this methodology, in respect of the financial year 2018/19 there was:

    a. a refund attributable to a compiled list change of £4,923, and
    b. an ongoing reduction in rates income for the rest of the year attributable to a compiled list reduction of £7,037,
    c. making a total reduction in income in 2018/19 attributable to a compiled list reduction of £11,960.

What are the views on these options?

Are other available?

Which should we adopt?

<u>How should we compensate authorities for this?</u>

16. We have been considering whether we can directly compensate authorities for the refunded amount and then adjust the top-ups and tariffs for the on-going amount.

17. Once we have calculated the cost of the compiled list reduction, compensating is simple – we could do this via a section 31 grant based on the NNDR3.

Potentially we could allow authorities to forecast losses and also pay provisional grant based on NNDR1s.

18. Adjusting top-ups and tariffs is more difficult as we can only do this once a year in advance. We are not certain this would be manageable. So in this example:

    a. by LGFS 2018/19 we would not know about the forthcoming compiled list reduction so no adjustment for 18/19,
    b. by LGFS 2019/20 we would be able to calculate the forecast impact for 2018/19 and 19/20 from the compiled list change and reflect this in top-ups and tariffs for 19/20. But we then have adjustments for 2 years in one year's tariffs and top-ups,
    c. by LGFS 2020/21 we would know
        i. the outturn impact for 2018/19 so would need to adjust the amount we provided for in the LGFS 2019/20 for that amount,
        ii. a mid-year forecast for 2019/20 so could adjust the amount we provided for that year in LGFS 2019/20 for that amount, and
        iii. a forecast for 2020/21 so could reflect that.
    d. and so on.

19. We would need to keep track of these amounts ensuring they fell off the adjustment once completed and also ensure we did not overlap with the amounts we were paying directly for refunds.

20. Or we could just do it all under section 31. We would still face these sorts of issues but could separately identify the section 31s in respect of each year and just run forecasts and reconciliations. So in this example:

    a. at NNDR1 for 2018/19 the authority would forecast the cost of the compiled list change. This would be nil,
    b. at NNDR1 for 2019/20 (after the appeal had been settled) they would forecast the cost for 2019/20 at £5,500 (see lines 77 to 81). We would pay s31 based on that amount,
    c. at NNDR3 for 2018/19 the authority would report a compiled list cost at £11,960 (refund plus rest of the year). We would pay that amount as reconciliation (against nil forecast),
    d. and so on.

How should we compensate authorities for the compiled list changes?

Next steps

21. If we can agree a methodology in principle from this paper then we need to:

a. check it in more detail. In particular we need to consider reliefs,
b. fully explore the practical aspects of this and understand the hard edges in the methodology adopted, and
c. consider how it could be rolled out over an entire rating list. Could we, for example, calculate these numbers at the BA level (rather than at property level) with reasonable accuracy?