THE RELATIONSHIP BETWEEN GROWTH AND THE COLLECTION FUND

Following a discussion at the last meeting of the Working Group, this paper explores the relationship between retained growth and Collection Fund balances under the Alternative Model.

The Working Group is invited to consider the paper's conclusions that:

A) *The Alternative Model <u>will</u> reward authorities for the underlying growth in their rates bases; including*

B) *Any change in underlying growth between NNDR1 and NNDR3;*

C) *Notwithstanding the fact that a change in underlying growth between NNDR1 and NNDR3 is part of that year's surplus, or deficit on the Collection Fund, the proposals for dealing with Collection Fund surplus/deficits under the Alternative Model, discussed in previous papers, will not result in "mis-counting" ie authorities will receive the benefit of the underlying growth in their rates bases, regardless of the treatment of Collection Fund surpluses and deficits;*

D) *To the extent that:*

Total retained growth under the Alternative Model ≠ estimated non-domestic rating income (NNDR1) + Collection Fund surplus/deficit

the discrepancy will be the result of changes to "appeals"[1] and/or provisions and bad debt allowances;

E) *The alternative model, therefore, indemnifies individual local authorities against the impact of changes to appeals, provisions and bad debt. Instead, the impact of those changes has an impact on Collection Fund surpluses and deficits and, therefore, materially changes the sums owed to, or by central government. <u>This paper does not consider the implications of this in detail, nor does it consider how the cost of indemnifying authorities against the impact of appeals and provisions should be financed at the outset of the scheme.</u>*

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[1] "appeals" and "appeals losses" are used throughout the paper as a shorthand for any change to rateable values resulting from a valuation change backdated to the first day of a rating list.

Background

1. Previous papers considered by the Working Group have outlined an Alternative Model under which the calculation of an authority's tariff or top-up for a year would be based on the sum of two separate calculations:

    a. A "stage 1" calculation dealing with "need": this is calculated as the difference between an authority's
        i. estimated *non-domestic rating income* for the year as set out in its NNDR1; and
        ii. its *baseline funding level* (BFL) as set out in the fair funding review;

                              and

    b. A "stage 2" growth calculation: this is calculated in one of two ways. Either, as:

        i. the difference between an authority's:
            1. "in-year" net rates payable (from NNDR data); and
            2. a "growth baseline", calculated as the in-year net rates payable for a base year (also from NNDR data); or

                              or

        ii. the difference between:
            1. "in-year" gross rates payable (from NNDR data); and
            2. A "growth baseline" calculated as the in-year gross rates payable for a base year (derived from Rateable Value (RV) data provided by the Valuation Office Agency (VOA));

        the "difference" between (1) and (2)would be multiplied by an "adjustment factor" worked out as the ratio of net rates payable to gross rates payable in order to determine the final figure to be used in the stage 2 "growth calculation"

2. Under either version of the "growth calculation" the baseline against which growth would be measured, would be adjusted each year to strip out the impact of "appeals".

3. Previous papers also set out proposals for how Collection Fund balances might be dealt with. It was proposed that either:

    a. An authority's share of the estimated Collection Fund (CF) balance would be taken into account when making the Stage 1 calculation – ie it would be calculated as:

        BFL – (share of NNDR income for year + share of previous year's estimated CF balance)

                              or

    b. The LA's share would be ignored entirely for the purpose of the Stage 1 calculation and, instead, the entire surplus/deficit on the Collection Fund would be credited, or charged to central Government.

4. Previous papers demonstrated that the way in which the alternative model dealt with Collection Fund balances did not matter; the financial impact of either option was exactly the same for both central and local government. But even though the financial impact of both options might be the <u>same</u>, some concerns were expressed at the last working group that it might not be "right" and that the interaction between the Stage 2 "growth" calculation and the treatment of "Collection Fund balances" might double-count, or mis-count the reward due to local government.

5. The rest of this paper explores those concerns.

Modelling assumptions used in this paper risk

6. In order to explore the relationship between the Stage 2 "growth" calculation and Collection Fund balances, we have modelled how the Alternative Model behaves under different scenarios. In doing so, we have assumed that the Alternative Model operates as follows:

   a. The "growth calculation" is made on the basis of RV data provided by the VOA – ie the variant spelt out at paragraph 1b(ii) above.

   b. Collection Fund surpluses/deficits are ignored for the purpose of calculating the distributable amount, but instead are paid to/from the department in their entirety (see paragraph 3b above).

   c. Local authorities make an *estimated* "growth calculation" for a year on the basis of the NNDR1s they submit. The estimated calculation is used to work out that year's tariff/top-up (in other words, authorities are "rewarded" for their estimated growth in the year to which that estimate relates).

   d. The *actual* "growth calculation" for the year is made following the submission of NNDR3s. The difference between the *actual* and *estimated* calculations produces a reconciling adjustment to tariffs and top-ups in "year 3" – ie two years after the year for which the estimate was made.

   e. The adjustment factor, used in the "growth calculation", is calculated as the ratio of net rates payable: gross rates payable. More importantly, it "floats" – ie it is recalculated based on the latest NNDR data. Hence, for the estimated growth calculation, it is calculated on the basis of the gross and net rates payable figures in the NNDR1; and for the actual growth calculation is recalculated using the gross and net rates payable figures in the NNDR3. The paper on the Adjustment Factor, considers in more detail different ways in which the adjustment factor might be set and looks at the implications for local authorities' funding under the Alternative Model.

7. We have also made a number of simplifying assumptions – mainly to strip-out the elements of the business rates retention scheme that sit "outside" the tariff/top-up calculation. These simplifying assumptions will have no effect on the outcomes and conclusions in this paper; they simply remove some of the "noise" that would otherwise make the modelling more difficult to follow.

8. Unless otherwise stated, therefore, the modelling is based on:

    a. A single authority which retains 100% of non-domestic rating income

    b. The cost of collection, designated areas (ie EZs etc) and renewable energy are ignored for the purpose of the modelling

    c. Deductions from central share and s.31 grants are similarly ignored

    d. Business rates income is <u>not indexed.</u> Where results are shown over several years, the numbers from one year to the next are directly comparable.

    e. The modelling does not explicitly show "prior-year adjustments". In practice, for the most part, prior-year adjustments reflect changes to a previous year's rates liability caused by "appeals", for which authorities will have made provisions. In the modelling for this paper, therefore, prior-year adjustments are assumed to be "charged" to provisions and will have no impact on non-domestic rating income. To the extent that the charge exceeds total provisions, it is assumed to be dealt with through a change to provisions and is picked-up in the modelling.

Rewarding underlying growth

9. The way in which the Alternative Model would reward underlying growth can be simply illustrated – see fig. 1.

10. When setting-up the system, Authority X has a baseline funding level (BFL) of £30,500,000 and a growth baseline – which was calculated as its RV (from VOA data) multiplied by the non-domestic rating multiplier.

11. At year n, the growth baseline is £74,400,000, after being adjusted for "appeals" losses up to that point in time.

12. The authority's gross rates payable – based on its NNDR returns – is £76,300,000 and its net rates payable is £64,096,102 (giving an adjustment factor for the year of 0.84). Having made further deductions for bad debt and provisions, the authority's non-domestic rating income is £58,596,102

13. The "Stage 1" amount for the purpose of the tariff/top-up calculation, is simply the authority's BFL minus its non-domestic rating income: £30,500,000 - £58,596,102 =£-28,096,102.

14. The "Stage 2" growth element of the tariff/top-up calculation is the difference between the gross rates payable from the NNDR (£76,300,000) and the growth baseline (74,400,000) – ie £1,900,000 – multiplied by the adjustment factor of 0.84 = £1, 596,102.

15. When added to the distributable amount of £-28,096,102, this gives a tariff for the year of £26,500,000.

16. The income retained by the authority in respect of year "n" under the Alternative Model, therefore, would be its non-domestic rating income of £58,596,102, less its tariff of £26,500,00 – ie £32,096,102 – which is equivalent to its BFL plus growth of £1,596,102.

Fig. 1

Set-Up	
BFL	30,500,000
Growth Baseline	74,400,000
Adjustment Factor (AF)	NRP/GRP

	Year n

Non-domestic rating income	
GRP	76,300,000
(less) Reliefs	-12,203,898
NRP	64,096,102
(less) Bad Debt Allowance	- 500,000
(less) Provision	- 5,000,000
NDR Income	58,596,102

Tariff/Top-Up Calculation		
Stage 1 "need"	=BFL - NDR Income	-28,096,102
Stage 2 "growth"	(GRP - Growth Baseline) * AF	1,596,102
Tariff		-26,500,000

Retained income		
LA Income	NDR Income	58,596,102
	Tariff	-26,500,000
	Retained Income	32,096,102

17. This analysis can be expanded to show how, in the above example, the authority would still be rewarded for underlying growth of £1,596,102, even if some (or all) of that growth was not picked-up at NNDR1, but at NNDR3 – see fig. 2

18. In fig. 2, the authority under-estimates its business rates income at NNDR1. On the same basis of calculation as outlined above, the authority's retained income in year 1 is equivalent to its baseline funding level (BFL) of £30,500,000, plus its estimated growth of £504,032.

19. Following the submission of the NNDR3 for year 1, the growth calculation is re-run and shows that underlying growth was, in fact, £1,596,102 (the same as in fig.1 above). The difference between estimated and actual growth (ie between NNDR1 and NNDR3) is £1,092,070, which is taken into account in working out the tariff and top-up in year 3.

20. For simplicity of illustration, in fig. 2 it is assumed that the authority receives no NNDR income in years 2 and 3 and that the Stage 1 calculation for the purpose of working out the tariff/top-up, is £30,500,000 (top-up) in each year (ie BFL of £30,500,000 – ndr income of £0). Over the three years, therefore, the authority retains £93,096,102. This is equivalent to 3x its BFL of (£30,500,000) = £91,500,000, plus the <u>actual</u> growth from year 1 of £1,596,102.

Fig. 2

Set-Up	
BFL	30,500,000
Growth Baseline	74,400,000
Adjustment Factor (AF)	NRP/GRP

		Year 1		Year 2		Year 3	
Non-domestic rating income							
		NNDR1	NNDR3	NNDR1	NNDR3	NNDR1	NNDR3
GRP		75,000,000	**76,300,000**				
(less) Reliefs		- 11,995,968	-12,203,898				
NRP		63,004,032	64,096,102				
(less) Bad Debt Allowance		- 500,000	- 500,000				
(less) Provision		- 5,000,000	- 5,000,000				
NDR Income		57,504,032	58,596,102				

Tariff/top-up calculation							
Stage 1 "need"	=BFL - NDR Income	- 27,004,032		30,500,000		30,500,000	
Stage 2 "growth"	(GRP - Growth Baseline) * AF	504,032	_1,596,102_				
(2A) Growth reconciliation						1,092,070	
Tariff		- **26,500,000**		**30,500,000**		**31,592,070**	

Retained income					
LA Income	NDR Income	57,504,032		0	0
	Tariff/Top-Up	- 26,500,000		30,500,000	31,592,070
	Retained Income	**31,004,032**		**30,500,000**	**31,592,070**

Cumulative Retained Income		**93,096,102**

<u>The Collection Fund</u>

21. As far as the Collection Fund is concerned, the position at the end of year 1 would be as set out in fig. 3.

22. Assuming a "0" opening balance, the amounts credited to the Collection Fund are equivalent to the actual amounts paid by ratepayers (the net rates payable at NNDR3), less the final (ie NNDR3) provisions and bad debt allowance. The amounts debited to the Collection Fund are the sums transferred to the General Fund (and in real life, paid to central government and major precepting authorities) – ie the non-domestic rating income calculated at NNDR1.

23. The surplus of £1,092,070 is equal to the growth that is still owed to the authority as a result of the recalculation of year 1 growth following the submission of NNDR3s. In the version of the Alternative Model illustrated in this paper, the entire surplus is paid over to central Government and therefore exactly offsets the "growth reconciliation" made to the authority in year 3.

Fig. 3

Collection Fund			
Opening Balance			0
Credits			
	Net rates payable from ratepayers (from NNDR3)	*64,096,102*	
	(less) Allowance for Bad Debt	- *500,000*	
	(less) "Appeals" Provision	- *5,000,000*	
			58,596,102
Debits	*Transfer to General Fund (from NNDR1)*		57,504,032
Closing Balance			1,092,070

Further thoughts on the Collection Fund

24. The Alternative Model is designed to reward authorities for the underlying growth in their rate bases – ie for changes in the rates liability of ratepayers. As currently envisaged it would disregard the impact of "appeals", provisions and bad debt allowances which, under the existing rates retention scheme, can reduce (or boost) authorities' retained rates income.

25. Figures 2 and 3 above illustrate a simple scenario in which the only change between NNDR1 and NNDR3 is caused by a change in "underlying growth". As a result, the reward, as measured by the growth calculation for the purpose of tariffs and top-ups, is exactly matched by the surplus on the Collection Fund.

26. In practice however, whilst the movement in appeals, bad debts and provisions between NNDR1 and NNDR3 will have no impact on the growth calculation and no impact on the tariffs and top-ups that are set, it <u>will</u> have an impact on Collection Fund balances.

Provisions and Bad Debts

27. The impact of changes in provisions and bad debts between NNDR1s and NNDR3s is illustrated in figs. 4 and 5.

28. Fig. 4 illustrates the same growth scenario as in figure 2, but shows the impact on a local authority's retained income of also increasing its provision and its allowance for bad debt between NNDR1 and NNDR3. Compared to fig. 2, the authority's NNDR3 non-domestic rating income is lower, but the changes to bad debt and provisions have no impact on the Stage 2 growth calculation and, therefore, no impact on the authority's retained income.

Fig. 4

Set-Up	
BFL	30,500,000
Growth Baseline	74,400,000
Adjustment Factor (AF)	NRP/GRP

		Year 1		Year 2		Year 3	

Non-domestic rating income							
		NNDR1	NNDR3	NNDR1	NNDR3	NNDR1	NNDR3
GRP		75,000,000	76,300,000				
(less) Reliefs		- 11,995,968	-12,203,898				
NRP		63,004,032	64,096,102				
(less) Bad Debt Allowance		- 500,000	- 650,000				
(less) Provision		- 5,000,000	- 6,500,000				
NDR Income		57,504,032	56,946,102				

Tariff/top-up calculation							
Stage 1 "need"	*=BFL - NDR Income*	- 27,004,032		30,500,000		30,500,000	
Stage 2 "growth"	*(GRP - Growth Baseline) * AF*	504,032	1,596,102				
(2A) Growth reconciliation						1,092,070	
Tariff		- 26,500,000		30,500,000		31,592,070	

Retained income							
LA Income	NDR Income	57,504,032		0		0	
	Tariff/Top-Up	- 26,500,000		30,500,000		31,592,070	
	Retained Income	31,004,032		30,500,000		31,592,070	

	Cumulative Retained Income					93,096,102	

29. Fig. 5 shows the position of the Collection Fund at the end of year 1, in the scenario modelled in fig. 4.

Fig. 5

Collection Fund			
Opening Balance			0
Credits			
	Net rates payable from ratepayers (from NNDR3)	64,096,102	
	(less) Allowance for Bad Debt	- 650,000	
	(less) "Appeals" Provision	- 6,500,000	
			56,946,102
Debits	*Transfer to General Fund (from NNDR1)*		57,504,032
Closing Balance			- 557,930

30. Contrasting this with figure 3, it can be seen that the surplus of £1,092,070, which was created by the underlying growth in figure 3, has been more than offset by the £1,650,000 negative change to allowances and provisions; and the Collection Fund now shows a deficit of £557,930. This is owed to the Collection Fund, in its entirety, by Central Government.

31. Comparing figs. 2 and 3, with figs. 4 and 5, shows that, under the alternative model, local authorities will be protected against increases in bad debts and provisions, unlike the current system, under which, in the above example, the authority would see a decline in its non-domestic rating income

32. But the opposite is also true. If, instead of increasing bad debt and provisions, an authority were to reduce them – see fig 6 – the resulting increase in its non-domestic rating income, would have no impact on the Stage 2 growth calculation and no impact on its retained income, despite the increase in its non-domestic rating income.

Fig. 6

Set-Up	
BFL	30,500,000
Growth Baseline	74,400,000
Adjustment Factor (AF)	NRP/GRP

		Year 1		Year 2		Year 3	
Non-domestic rating income							
		NNDR1	NNDR3	NNDR1	NNDR3	NNDR1	NNDR3
GRP		75,000,000	76,300,000				
(less) Reliefs		- 11,995,968	-12,203,898				
NRP		63,004,032	64,096,102				
(less) Bad Debt Allowance		- 500,000	- 400,000				
(less) Provision		- 5,000,000	- 4,500,000				
NDR Income		57,504,032	59,196,102				

Tariff/top-up calculation							
Stage 1 "need"	=BFL - NDR Income	27,004,032		30,500,000		30,500,000	
Stage 2 "growth"	(GRP - Growth Baseline) * AF	504,032	1,596,102				
(2A) Growth reconciliation						1,092,070	
Tariff		- 26,500,000		30,500,000		31,592,070	

Retained income							
LA Income	NDR Income	57,504,032		0		0	
	Tariff/Top-Up	- 26,500,000		30,500,000		31,592,070	
	Retained Income	31,004,032		30,500,000		31,592,070	

Cumulative Retained Income						93,096,102	

33. And instead of a deficit on the Collection Fund, (as is the case in fig. 5), the reduction in provisions and bad debt, results in a significant surplus – see fig 7. The surplus is owed entirely to central government. In contrast to figs. 2 and 3 (which illustrate the "growth-only" scenario) and which can be thought of as "revenue neutral"; or figs. 4 and 5 (which show the impact of increasing provisions and bad debt) in which the Collection Fund balance is insufficient to meet the cost of the "growth reconciliation" payment), the surplus is now considerably greater than the growth reconciliation payment that is owed to the authority.

Fig. 7

Collection Fund			
Opening Balance			0
Credits			
	Net rates payable from ratepayers (from NNDR3)	*64,096,102*	
	(less) Allowance for Bad Debt	*- 400,000*	
	(less) "Appeals" Provision	*- 4,500,000*	
			59,196,102
Debits	*Transfer to General Fund (from NNDR1)*		57,504,032
Closing Balance			1,692,070

34. In general, this serves to illustrate a more fundamental feature of the alternative arrangements. At the point that the system is first set-up, central Government would have to build-in an estimate of the total appeal loss, and hence the total provision, that authorities will need to make at the outset of the scheme. If that estimate proves to be completely accurate (and its distribution between authorities is similarly correct), the system would behave as in figs 2 and 3. In other words, the surplus on the Collection Fund (except for changes to reliefs – see below) will be sufficient to reward authorities for the underlying growth they achieve. If central Government underestimates the appeal loss, the system would behave as in figs. 4 and 5. Authorities will have to increase their provisions (or see a reduction in non-domestic rating income as a result of being required to make backdated refunds to ratepayers which they can't cover from their provisions) and the Collection Fund balance would be insufficient to reward authorities for the underlying growth they achieve. If, on the other hand, central Government overestimates the appeal loss, the system would behave as in figures 6 and 7. When the overestimate is unwound, it will generate a surplus on the Collection Fund, over and above what is needed to fund underlying growth. This would be returned to central Government. The alternative arrangements therefore do the opposite of the current arrangements, insofar as the impact of over-, or under-estimating appeal loss/provisions at the set-up of the scheme would be borne by central Government, instead of local authorities.

Reliefs

35. Figs 8 and 9, and 10 and 11 below, explore some of the implications of changes to reliefs. As set out in paragraph 6 above, for the purpose of this paper, the adjustment factor used in the growth calculation is updated following the submission of each NNDR in order to reflect up-to-date data. Hence, changes to reliefs will have an impact on the growth calculation and will, therefore, affect authorities' retained income.

36. As the paper on "Adjustment Factors and Reliefs" makes clear, the adjustment factor can be set in a number of different ways. It can be set at a national, or local level; and can be "fixed" at the outset of the scheme, or allowed to float depending on how reliefs change. The impact on the growth calculation will, of course, differ depending on the form that the adjustment factor takes and will not necessarily be the same as illustrated in this paper. As illustrated below, with a floating adjustment factor, changes in reliefs would affect the amount of "growth" under the alternative arrangements, but "growth", would always be matched by the Collection Fund balance. With a "fixed" adjustment factor, growth would not vary with changes to reliefs, but there would be a discrepancy between growth and the Collection Fund balance. Choosing a national adjustment factor (whether fixed or floating) whilst giving broadly the same result as just described, would also introduce a "local effect" depending on the relationship between reliefs at the national and local levels.

37. Figures 8 and 9 are based on the same increase in gross rates payable as figures 2 and 3 (and 4 and 5). But , additionally, reliefs increase relative to the increase in gross rates. As a result, the growth calculation in fig. 8 results in a lower number than in fig.2 and the authority sees less reward. However, as shown in fig. 9 the reward, which the authority sees in year 3 under the growth reconciliation calculation is exactly matched by the surplus on the Collection Fund at the end of year 1.

Fig. 8

Set-Up	
BFL	30,500,000
Growth Baseline	74,400,000
Adjustment Factor (AF)	NRP/GRP

		Year 1		Year 2		Year 3	
Non-domestic rating income							
		NNDR1	NNDR3	NNDR1	NNDR3	NNDR1	NNDR3
GRP		75,000,000	76,300,000				
(less) Reliefs		- 13,500,000	-13,734,000				
NRP		61,500,000	62,566,000				
(less) Bad Debt Allowance		- 500,000	- 500,000				
(less) Provision		- 5,000,000	- 5,000,000				
NDR Income		56,000,000	57,066,000				

Tariff/top-up calculation						
Stage 1 "nned"	*=BFL - NDR Income*	- 25,500,000		30,500,000		30,500,000
Stage 2 "growth"	*(GRP - Growth Baseline) * AF*	492,000	*1,558,000*			
(2A) Growth reconciliation						1,066,000
Tariff		- 25,008,000		30,500,000		31,566,000

Retained income					
LA Income	NDR Income	56,000,000		0		0
	Tariff/Top-Up	- 25,008,000		30,500,000		31,566,000
	Retained Income	30,992,000		30,500,000		31,566,000

Cumulative Retained Income		93,058,000

Fig. 9

Collection Fund			
Opening Balance			**0**
Credits			
	Net rates payable from ratepayers (from NNDR3)	*62,566,000*	
	(less) Allowance for Bad Debt	*- 500,000*	
	(less) "Appeals" Provision	*- 5,000,000*	
			57,066,000
Debits	*Transfer to General Fund (from NNDR1)*		**56,000,000**
Closing Balance			**1,066,000**

38. Figures 10 and 11 show the same scenario, except insofar as reliefs reduce relative to the change in gross rates payable between NNDR1 and NNDR3. In this situation, the growth calculation in fig. 10 results in a higher number than in fig.2 and the authority sees more reward as a result of the relative reduction in reliefs As can be seen from fig. 11 the reward, which the authority sees in year 3 under the growth reconciliation calculation is exactly matched by the increased surplus on the Collection Fund at the end of year 1.

Fig. 10

Set-Up	
BFL	30,500,000
Growth Baseline	74,400,000
Adjustment Factor (AF)	NRP/GRP

		Year 1		Year 2		Year 3	

Non-domestic rating income							
		NNDR1	NNDR3	NNDR1	NNDR3	NNDR1	NNDR3
GRP		75,000,000	76,300,000				
(less) Reliefs		- 10,500,000	-10,682,000				
NRP		64,500,000	65,618,000				
(less) Bad Debt Allowance		- 500,000	- 500,000				
(less) Provision		- 5,000,000	- 5,000,000				
NDR Income		59,000,000	60,118,000				

Tariff/top-up calculation						
Stage 1 "need"	*=BFL - NDR Income*	- 28,500,000		30,500,000		30,500,000
Stage 2 "growth"	*(GRP - Growth Baseline) * AF*	516,000	*1,634,000*			
(2A) Growth reconciliation						1,118,000
Tariff		- 27,984,000		30,500,000		31,618,000

Retained income				
LA Income	NDR Income	59,000,000	0	0
	Tariff/Top-Up	- 27,984,000	30,500,000	31,618,000
	Retained Income	**31,016,000**	**30,500,000**	**31,618,000**

Cumulative Retained Income			93,134,000

Fig. 11

Collection Fund			
Opening Balance			0
Credits			
	Net rates payable from ratepayers (from NNDR3)	*65,618,000*	
	(less) Allowance for Bad Debt	*- 500,000*	
	(less) "Appeals" Provision	*- 5,000,000*	
			60,118,000
Debits	*Transfer to General Fund (from NNDR1)*		**59,000,000**
Closing Balance			**1,118,000**

Conclusions

39. Previous papers have demonstrated that the impact of appeals on gross (and net) rates payable can be stripped out of the system by recalibrating the growth baseline from year to year.

40. The modelling in this paper demonstrates that underlying growth, as measured under the Alternative Model, is affected by the growth, or decline of reliefs, relative to gross rates payable. But that changes in provisions (and/or the allowance for bad debt) will not impact on the measurement of underlying growth.

41. To the extent to which there is underlying growth between NNDR1 and NNDR3, it will result in a surplus on the Collection Fund.

42. In the absence of changes to provisions and/or bad debts, the surplus on the Collection Fund will match the growth calculation under the Alternative Model.

43. An increase in provisions and bad debts, will result in the Collection Fund surplus being smaller than the sums awarded to authorities under the growth calculation; and, a reduction in provisions and bad debts will result in the Collection Fund surplus being larger than the sums awarded to authorities under the growth calculation. Under the alternative arrangements, therefore, the risk that the underlying growth awarded to authorities is different from Collection fund balances is borne by central Government and, is a function of the amount that central Government builds into the system at the outset for appeals/provisions.

44. Increases, or reductions, in reliefs, relative to gross rates payable, could result in reductions, or increases in the sums awarded to authorities under the growth calculation; and/or differences between "growth" and Collection Fund balances. The precise impact on growth (and retained income) will depend on quite how the adjustment factor is constructed. If the adjustment factor "floats" – ie is allowed to change as reliefs change relative to gross rates payable – changes in growth will be exactly matched by changes in the Collection Fund. But this will not be the case if the adjustment factor is fixed (at either national or local level) or is allowed to "float" at a national level. Some of the implications of setting adjustment factors in different ways are set out in the paper on "Adjustment Factors and Reliefs".