SYSTEM DESIGN

We are rapidly approaching the stage whereby we need to reach consensus over the overall fundamental basics of an improved localised business rates system. The Revaluation due to be announced for the 2017 List in October will be shortly thereafter followed by the Local Government Finance Settlement in December – by which time we will need certainty over the Settlement Funding available for 2017/18 as we set our budgets.

The key areas we need to reach agreement on as to fundamental design basics include:

- **Re-Calibrating the 2017/18 Multiplier** – we argue that business should not pay less next year as a consequential result of revaluation errors in the original 2017 List. The facility to flex future year multipliers to ensure an original estimate of the appeals impact should be adjusted for based on actual experience;

- **Funding for Valuation Office Appeals Errors should fit with individual authority actuals** – simply increasing the national multiplier to reflect overall likely appeals losses will not reflect individual local authority experience. A methodology of matching funding to need needs to be established (we suggest a DCLG-pooling scheme) A pilot may be nececssary in the first instance;

- **Valuation Office Caseload** – the scale of the backlog in dealing with outstanding appeals needs to be addressed by HMT and the Valuation Office. The long delay in addressing these leads to uncertainty amongst local authorities as to their potential and ultimate impact. Any change in the period between Revaluations needs to be mindful of the Valuation Office's ability to cope with this workload alongside clearing appeals

- **Collection Fund Adjustment Account** – anomalies arise between the statutory accounting arrangements of the Collection Fund and proper accounting practice for the Levy / Safety Net payments. We suggest that this anomaly needs to be resolved by merging the Levy or Safety Net payment into the Collection Fund;

- **The Safety Net** – the protection offered by the Safety Net in 2013 has effectively been eroded by the diminishing share Revenue Support Grant contributes to SFA. Accordingly local authorities become more exposed to risk, a risk that will significantly grow as we move to full localisation;

- **Central List** – where properties on the Central List prevent that land being used to grow the local List it acts to hinder the ability to increase locally retained rates. We strongly argue that to promote growth, the Central List should be as small as possible – limited to only those assets that can't economically be separately valued. This proposal would be subject to safeguards for particularly large properties being removed from the List, as detailed in the point below.

  Additionally, the Safety Net operates as a crude instrument and a multitude of growth could be wiped out by one significant closure within an area. We suggest that any individual shocks to the system caused by the removal of an individual hereditament should equally be protected via the Safety Net;

- **Revaluation Growth** – reward for increasing the value of properties in a particular locale ought to be rewarded rather than being re-based out at every revaluation. Over time, the cost of business rates has the potential to drop as a proportion of overall business costs and profits – this should not happen and **all** of local government should benefit in some share of this growth (albeit that business would also see some of the efficiency gain);

  Additionally, those areas generating the greatest valuation growth should be rewarded by retaining a proportion of this overall gain;

- **Reliefs and Discounts** – the potential for freedoms to vary discounts at the local level raises the issue of the relationship between billing and precepting authorities – we argue that one should not be impacted by decisions by the other, but both should be separately accounted for.

Detailed Consideration of the Above

Using publically available data, we have attempted to create a model that allows the group to consider certain impacts of the current model for distributing business rates and to further explore various scenarios and their various implications on distribution.

We pose key questions around the current distribution system – especially with respect to the impending 2017 Revaluation in the belief that in order to attempt to focus the working group on agreeing the fundamental principles around which work can then continue to refine those principles for the benefit of the whole of local government.

Re-Calibrating the Multiplier for the 2017 Revaluation

The impact of the Revaluation is currently intended to have a net neutral effect on local authority finances.

Until details of the 2017 Revaluation data are released by the Valuation Office, we will be unsure as to how the gross taxbase for each individual local authority and regional area will be affected. However for the purposes of illustration we could use the scale of change between the 2005 and 2010 Lists as a proxy to facilitate our consideration and modelling.

Using the change in Gross Rateable Value between 2009/10 and 2010/11 (as per the NNDR1 Returns) and uplifting the 2016/17 Rating income in the same proportion shows that the 48.4p Multiplier would fall to 39.6p in our scenario.

Table 1

	2016/17 SBRR Multiplier *(pence)*	2016/17 Rating Income *(£m's)*	2010 Reval Increase *(%age)*	2017 Reval Region Flex *(%age)*	2017/18 SBRR Multiplier *(pence)*	2017/18 Rating Income *(£m's)*	Change *(£m's)*
East of England	48.4p	2,285	17%	0%	39.6p	2,204	(81)
East Midlands	48.4p	1,485	8%	0%	39.6p	1,309	(176)
London	48.4p	6,867	34%		39.6p	7,626	759
- Inner London	48.4p	4,789	42%	0%	39.6p	5,618	829
- Outer London	48.4p	2,078	18%	0%	39.6p	2,008	(70)
North East	48.4p	845	21%	0%	39.6p	841	(4)
North West	48.4p	2,635	18%	0%	39.6p	2,566	(69)
South East	48.4p	3,550	14%	0%	39.6p	3,310	(241)
South West	48.4p	1,899	24%	0%	39.6p	1,932	32
West Midlands	48.4p	2,006	12%	0%	39.6p	1,833	(173)
Yorks & Humbs	48.4p	1,934	19%	0%	39.6p	1,886	(48)
	48.4p	**23,507**	**21%**		**39.6p**	**23,507**	**0**
Westminster	48.4p	1,756	61%	* 0%	39.6p	2,320	564
Custom List	48.4p	2,144	35%	* 0%	39.6p	2,377	233

For Westminster, in the above case, we have included in the Custom Comparator group the following authorities: City of London, Kensington & Chelsea, Hammersmith & Fulham, Camden, Southwark and Ealing – collectively representing 16% of the nations' gross rateable value

Whilst adjusting the Multiplier in this simple way to produce the same arithmetic total across the whole of England, it should be noted that regional (and between individual local authorities) the net yield would change – thus an adjustment to the relevant Tariffs or Top-ups would need to additionally be made.

The draft 2017 Rating List will be used for determining the relevant Settlement Funding Assessment for 2017/18. That List is likely to be amended as part of the initial Check-Challenge-Appeal process which will commence as soon as the draft List is made available. Almost certainly some reductions will occur prior to the 1st of April 2017 and as such no appeal will be lodged during 2017/18. This could result in some local authorities having their Baseline effectively over - stated and thus ultimately receiving an unintentionally low SFA.

Any recalibration ought to take this into account, and/or through the resolution of the appeals issues (see below) make a corresponding adjustment. As we will not know the scale of changes to the List until the 1st of April, perhaps

the simplest solution would be add these successful challenges to the methodology for dealing with subsequent appeals as set out in the next section.

1. **Do we agree that, all other considerations being excepted (some of these are discussed later), this, in theory, is the basis that the national Multiplier should be adjusted for the 2017 Revaluation?**

2. **How might we address the problem of changes to the List between the draft and final billing versions?**

The Impact of Appeals against the Original Valuation

Experience over the last four years has shown the negative impact errors in the original 2010 Valuation List can have on business rate yield.

If we are to assume that the 2017 Revaluation will not be perfect in every instance, it is reasonable to assume that we will experience some decline to that original valuation quantum.

Everything else being equal, this would result in businesses ultimately paying less in business rates than they were doing in 2016/17 if the 2017/18 Multiplier remained unaltered at the simplistically calculated 39.6p figure set out in Table 1.

Again, we do not have a full dataset available to accurately assess the likely level of successful appeals against the 2017 List. As another proxy, we have made an initial assumption in our modelling that around £775m from the 2016/17 £23.5bn might ultimately be reduced (3.3%)[1]. We have allocated this average appeals reduction weighted in proportion to the level of appeals provisions outstanding per local authority as at March 2015.

Under this scenario, businesses would pay around £775m less than the scheme intended they should pay – and as a consequence local government would be deprived of this funding.

Clearly, this is not the intention – that errors by the Valuation Office will lead to businesses paying less overall than they had done in 2016/17. We strongly urge that the Multiplier for 2017/18 adequately take into account the likely impact of appeals and be adjusted accordingly (we recognise this was the intention in setting the 2013/14 Multiplier, but failed to be sufficient). In our modelling this would mean that an adjusted 2017/18 Multiplier of 41.0p would need to be set rather than the simplistically calculated 39.6p.

Table 2

Share to Net Yield %age 30%	2017/18 Rating Income *(£m's)*	30% Share to Net Yield *(%age)*	Appeals Flex *(%age)*	Expected Rating Income *(£m's)*	Change *(£m's)*	Appeals Adjusted Multiplier *(pence)*	Appeals Adjusted Yield *(£m's)*	Variance to 17/18 Income *(£m's)*
East of England	2,204	-5%	0%	2,136	(68)	41.0p	2,209	5
East Midlands	1,309	-4%	0%	1,281	(28)	41.0p	1,325	16
London	7,626			7,341	(285)	41.0p	7,591	(35)
- Inner London	5,618	-7%	0%	5,374	(244)	41.0p	5,558	(61)
- Outer London	2,008	-3%	0%	1,967	(41)	41.0p	2,034	26
North East	841	-4%	0%	822	(19)	41.0p	850	9
North West	2,566	-8%	0%	2,444	(122)	41.0p	2,527	(39)
South East	3,310	-5%	0%	3,206	(104)	41.0p	3,316	6
South West	1,932	-4%	0%	1,888	(44)	41.0p	1,952	21
West Midlands	1,833	-5%	0%	1,780	(53)	41.0p	1,840	7
Yorks & Humbs	1,886	-5%	0%	1,834	(52)	41.0p	1,896	10
	23,507	**-5.3%**		**22,731**	**(776)**	**41.0p**	**23,507**	**0**
Westminster	2,320	-8%	0%	2,202	(118)	41.0p	2,277	(43)
Custom List	2,377	-8%	0%	2,267	(110)	41.0p	2,345	(33)

[1] Our modelling uses 3.3% as a hypothesis for the scenario as this is broadly in line with VOA targets set at the last Revaluation, but slightly higher to reflect actual experience. This has been all allocated across all local authorities pro-rata to the value of their appeals provision as at 31/03/15.

Should the original estimate for the appeals-adjusted Multiplier prove erroneous, it could be adjusted in subsequent years – either upwards or downwards depending upon the variation experienced.

3. Do we agree that a re-calibration to the national multiplier should not result in businesses effectively paying less than they did in 2016/17 because of appeals against erroneous valuations on the original List?

4. Should the 2017/18 Multiplier be set at an estimated value sufficinet to remove this shortfall from the system? A pilot may be nececssary to achieve this – is this agreed?

5. **Should flexibility in the uplift in future year's Multipliers be introduced to ensure the estimated impact of the appeals is accurately addressed over the period of the 2017 List?**

Regional Variations in Appeals against the original 2017 List

Whilst an appeals-adjusted Multiplier has the potential to produce the overall correct gross yield, as illustrated in the end column of Table 2, it does not by itself result in each individual local authority or region being perfectly compensated – a simple increase to the Multiplier to cover appeals would produce winners and losers, with those experiencing above average appeals being the losers.

To overcome these variances, the additional amounts raised from the appeals-adjusted Multiplier would need to be pooled and distributed in accordance to actual appeals losses experienced. This would be akin to a Safety Net system being funded from a general top-slice.

In any one year, the balance on this pool could be positive or negative and for this reason would be best administered by central government. It's re-distribution would be based on actual appeals experience on an authority-by-authority basis.

Based on the modelling as illustrated in Tables 1 and 2, an illustration of how this might look in practice is given in Table 3. Note that the final Pool-Adjusted Yield exactly matches the originally calculated 2017/18 Rating Income as originally calculated in Table 1, and before the impact of appeals was factored in.

Table 3

	Appeals Adjusted Yield *(£m's)*	Contrib to Appeals Pool * *(£m's)*	From Appeal Pool *(£m's)*	Pool Adjusted Yield *(£m's)*		Change *(£m's)*
East of England	2,209	(73)	68	2,204		(5)
East Midlands	1,325	(44)	28	1,309		(16)
London	7,591	(251)	285	7,626		35
- Inner London	5,558	(183)	244	5,618		61
- Outer London	2,034	(67)	41	2,008		(26)
North East	850	(28)	19	841		(9)
North West	2,527	(83)	122	2,566		39
South East	3,316	(109)	104	3,310		(6)
South West	1,952	(64)	44	1,932		(21)
West Midlands	1,840	(61)	53	1,833		(7)
Yorks & Humbs	1,896	(63)	52	1,886		(10)
	23,507	**(776)**	**776**	**23,507**		**(0)**
Westminster	2,277	(75)	118	2,320		43
Custom List	2,345	(77)	110	2,377		33

6. Do we agree that arrangements should be put in place to ensure that the appeals-adjusted multiplier does not create winners and losers amongst authorities and that each gets a fair allocation?

7. Do we agree that a pooling arrangement would be the best methodology to achieve this?

Valuation Office Caseload

As at the end of 2014/15, local authorities were holding over £2.5bn of appeals provisions – five years after the commencement of the 2010 List. Such a large scale of provisions indicates the overall scale of the problem appeals causes and leads to significant uncertainty for local government finance.

Given the difficulties experienced by the VOA in coping with the number of appeals being lodged (999,000 challenges had been received by the end of March 2016[2]) we would ask that the revaluation period be set at an appropriate period that realistically allowed them to address the appeals workload without having to simultaneously deal with creating a brand new valuation list

Collection Fund Adjustment Account

The operation of the Collection Fund Adjustment Account operates in a different way to proper accounting practice – in so far as losses or surpluses do not impact on the bottom line of the General Fund until one (or two) years after being incurred. This was originally implemented for good reason to allow for reasonable time to plan for losses, especially where an authority is a precepting rather than billing authority and may have minimal ability to influence collection rates etc.

However the Levy or Safety Net payments are chargeable to the General Fund under normal accounting standards. This creates an anomaly, in that an in-year loss will not produce a bottom line impact to the General Fund but the corresponding Safety Net grant would be credited in year. This situation might leave a local authority reporting high levels of reserves (having been set aside for the future loss as it materialises from the Collection Fund)

The reverse situation is even more extreme. An unexpected surplus at year end would not materialise for up to two years whereas any additional Levy would be charged as a cost in the originating year.

A resolution to this anomaly is required – either by not deferring the variance from being transferred to the General Fund, or by also including the Safety Net / Levy payments within the Collection Fund.

8. **Do we agree that the current operation of the Collection Fund Adjustment Account and accounting treatment of Levy and Safety Net payments has the potential to creating mis-matches in any one year for the General Fund?**

9. **What mechanisms would best resolve any such perceived anomaly?**

The Safety Net

A safety net arrangement ought to continue to exist to protect local authorities against severe shocks to the system. Such a system would still need to exist even if appeals against the original list are separately resolved (as per the earlier discussion).

The current level at which a Safety Net payment becomes receivable is at the point where local share falls below 92.5% of Baseline Funding. Given the increasing proportion Baseline has become as a share of overall Settlement Funding Assessment, this proportion should be increased – and especially more so when full localisation is in place.

Local authorities may experience general growth, but have that completely wiped out by the loss of a single large hereditament. We would wish to explore a refinement to the Safety Net criteria that provides for the loss of a single property even if the net overall result does not push the authority below the 92.5% threshold.

[2] Source: https://www.gov.uk/government/statistics/non-domestic-rating-challenges-and-changes-england-and-wales-march-2016-experimental

Of course, Safety Net arrangements would need to be funded. Options for funding it include:

- Continue with some form of Levy on growth
- A top Slice from the national yield
- Transparent use of the Central List funds

10. Do we agree that a Safety Net system should continue to operate?

11. At what level should Safety Net become payable given the rising reliance on Baseline Funding compared to overall Settlement Funding Assessment (especially when RSG ceases)?

12. How should the Safety Net be funded?

The Central List

The Central List represents a funding resource that rightfully belongs to local government. This should be fully and transparently distributed back to local government as part of the business rate localisation scheme – unless this happens, then one hundred percent localisation cannot be said to have been achieved.

It is our belief that local authorities should retain all the business rates that are generated in their local areas where Central List heraditaments would prevent growth in the local List. As such the Central List should be kept as small as possible and limited to the following:

- Underground networks that have no material impact on the use of surface land for the local List (underground power and communications networks for instance;
- Those assets that cannot economically be valued on an authority-by-authority basis
- Those assets that yield a higher overall value on the Central List than they would individually – rail lines perhaps for instance

Calls to increase the number of assets on the Central List may largely arise due to the risk of any individual property being removed from the Local List and associated impact on retained rates. It is our argument that a modified Safety Net system that additionally takes account of extremely large individual losses would be a better solution.

By way of illustration, suppose extremely proportionately high value assets were added to the Central List. Imagine a new nuclear power station being built in a local authority area. Significant land would become unavailable for business rate growth on the local List, whilst at the same time costs of providing services and infrastructure to the thousands of workers that would come into the area would arise. Unless this hereditament was on the local List, how would the local authority be rewarded and encouraged to support such a development?

13. Do we agree that business rate yield from the Central List should be fully and transparently distributed back to local government as part of the overall business rate localisation model?

14. Do we agree that wherever possible or economically beneficial, the Central List should be kept as small as possible (subject to Safety Net arrangements to protect individual authorities from particularly significant one-off losses from their List?

15. Are we able to agree a general definition (e.g. network-type) of what should be retained on the Central List?

Revaluation Growth

The methodology around recalibrating the Multiplier following a Revaluation is designed to be fiscally neutral, and thus underlying growth in rateable value (derived perhaps as a consequence of significant infrastructure investment) is discounted out. If the general tone of an area rises, the attractiveness of an area rises to business as greater profit potential exists there – something which is likely to affect average rent levels in the area.

Because rateable values are linked to underlying rental values, it can be argued that over time business rate costs will become a smaller proportion of overall business costs and profits. In order to maintain the balance of NNDR in overall business costs, consideration of increasing the Multiplier in line with valuation growth should be considered.

16. Given the redistributive nature of the Settlement Funding Assessment, it is right that all local authorities have a share of this underlying growth which would be effected through the national Multiplier.

However, some areas have contributed a dis-proportionate share to the overall national growth. At an extreme level if the valuations across the country remained constant except for just one area that saw a phenomenal increase, the result would be that business across the rest of the country would see their rates bill fall, whilst they would rise in the one area. The fall for the majority would arise despite average rent levels (and trading conditions) not changing.

Some method of ring-fencing part of the above average growth could be developed to allow some of that additional revenue to be retained locally.

17. If Revaluation growth is to be factored into the determination of the Multiplier for the benefit of the whole of local government finances, how, or should, an element of that growth be retained by those areas that have contributed most to the gain?

Reliefs and Discounts

Our analysis of the 2016/17 NNDR1 returns provides some indication as to the size and scale of the impact of discounts and allowances on the overall net yield – for an understanding of the national picture, in this instance our comparator has been set to the whole of England:

Table 4

	Selected Authority		*Comparator*	
	(£m's)	(%age)	*(£m's)*	(%age)
Gross RV	**4,116**		**57,365**	
Gross Rates Payable	1,992	100%	27,745	100%
Mandatory Reliefs	(14)	-1%	(2,124)	-8%
Empty Property Relief	(124)	-6%	(909)	-3%
Discretionary Relief	(0)	0%	(110)	0%
s31-Funded Reliefs	(0)	0%	(27)	0%
Bad Debt Losses	(19)	-1%	(283)	-1%
Appeals Provision	(76)	-4%	(621)	-2%
Costs & Disregarded Amounts	(3)	0%	(164)	-1%
Non-Domestic Rating Income	**1,756**	**88%**	**23,507**	**85%**

Although the discretionary items in the above list are relatively small, the current arrangements mean that decisions taken by the billing authorities can impact the major preceptors. Under the future full localisation together with the possibility of further discretion being granted over the scale of reliefs that can be awarded means the impact of these decisions could be further compounded.

To avoid a decision by the billing authority impacting on major preceptors, it ought to be possible to design the Collection Fund in such a way that discretionary discounts and reliefs could be set separately between the two (although we would expect meaningful consultation to take place) and then accordingly attributed and accounted for

18. Do we agree any increased flexibilities in local discounts and reliefs should be separately funded by the billing and precepting authorities – each with the power to set its own reliefs policy?