POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

Systems Design Paper

1. The Systems Design Working Group (SDWG) has been meeting fortnightly to discuss some of the key issues in setting up the 100% rates retention scheme – especially those associated with managing risk in the system.

2. In the three meetings that have been held so far, the SDWG has taken papers on:
   - Managing the risk associated with successful business rate appeals
   - The future of the central list
   - The future of the safety net
   - Papers from central government and local government on the specific tax flexibilities announced
   - A paper from local government on localising mandatory business rate reliefs

3. A separate update note has been provided on discussions around tax flexibilities, including reliefs, so these are not covered in this paper.

Risk

4. There are elements of the current system that can lead to unexpected volatility in income for local authorities, and sensitivity to risk may be greater under 100% rates retention. Our aim therefore within the 100% rates retention system is to balance risk equitably within the system.

5. Income from business rates is at risk for broadly two reasons:
   a. As a result of changes to rateable values of hereditaments following successful appeals by ratepayers; and
   b. Because of physical changes to property, including building closures as a result of business failure.

6. Under the current 50% rates retention scheme, these risk are managed in two ways:
   a. Local authorities have to make financial provision against known liabilities – broadly, the potential impact of 'appeal losses'; and
   b. Additionally, the system provides a safety net against 'physical losses', as well as against loss on appeals in excess of provisions. The safety net is currently set to kick-in where authorities incur more than 7.5% loss as measured against baseline funding level.

7. Broadly speaking, the current system is designed so that the risk of loss is borne at individual local authority level (except when local authorities 'pool'). The exception is when the safety net is triggered, when the losses are borne by all authorities via the levy and a top-slice of Revenue Support Grant.

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8. Discussions with the SDWG have demonstrated how intertwined issues are around risk and the constitution of ratings lists. It's difficult to separate them out into separate elements and understand what the trade-offs are, and so the discussion needs to be about managing risk as a whole around the three elements of ratings lists, 'appeals risk', and the safety net.

9. We would welcome local government views on the level at which risk is best managed within the new system in order to manage risk, but also to incentivise or shape local decision making. There is an argument to be made for different geographical levels to hold different levels of risk – local, regional and national. Authorities working together to manage risk, could also benefit from greater reward.

10. We have had some interesting discussions at the SDWG about the appropriate geographical level for risk to be managed at. There was not a clear consensus within the SDWG on the right geographies for managing risk. Drawing on those discussions and further thinking, Annex A sets out some broad options, which could be joined together in different ways to create a system to manage risk. Further work is required to understand how the practicalities of these options might work.

11. Our discussions in the working group have not yet led to any decisions on the best way to manage risk in the system. Those on the working group have often held differing views – particularly between authorities who focus minimising risk so as to ensure the sustainability of funding for services, and authorities who content to manage some element of risk on the understanding they may also see greater reward by way of growth in business rates income.

12. Our expectation therefore is that the consultation document will be very broad and open on managing risk (and growth) in the system. It is unlikely to focus heavily on a specific proposal, to ensure that we can gather views on a wide range of options.

13. There may be an option to have different solutions to managing risk for different areas. Though it may be complicated to set up, we could create a system whereby some areas (for example Combined Authorities, growth deal areas, areas that choose to join together with others) could be given the option to take on a different system to individual local authorities. This may be able to give increased reward by way of growth and flexibilities, in return for sharing risk at a more regional level.

Do you agree that the consultation document should be broad and open on options to handle risk in the new system?

Is there merit in allowing different types of authority to choose different systems for managing risk and reward?

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<u>Next steps</u>

14. The SDWG next meets on 17 June, and will meet once more in July before the summer recess. We expect meetings to then restart from September.

15. In the meetings before the summer, we aim to discuss options around handling growth in the system – including possible options around resetting the system. This will also need to incorporate discussions on redistribution mechanisms (ie tariffs and top-ups). These discussions are linked to those already held on managing risk in the system.

16. From September, we expect the group to get into much more detailed discussions about elements of the system from July. This may include sharing analysis on options to demonstrate possible impact on the system.

Are there other areas of work that you would like the SDWG to take on?

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ANNEX A

The table below sets out a number of 'mix and match' options, that could be joined together in a variety of ways.

	Ratings lists (local and central)	Appeals risk	Safety net
Local level	Reduce risk held at a local level by removing 'riskier' hereditaments from local lists (and placing them on central / 'regional' lists).	Individual local authorities hold 'provisions' to manage successful appeals.	Not applicable.
Wider area / region level	Carving out 'area lists' comprising more volatile properties from local lists (eg power stations) and regionally appropriate properties from the central list (eg regional transport networks, regional utility networks). Risk and reward on 'area lists' held by groups of authorities.	A group of local authorities hold a share of a 'provision' covering a wider area, and share any growth. Managing appeals risk on an 'area list' would work in the same way.	Fund safety net payments at a regional level / across a group of authorities or CA area. Region / group of LAs could even set their own safety net rules. Funding to be provided from authorities, via top-slice of income including 'area list' income.
National level	Central list, comprising all property not on local or 'area' lists. Gains and losses on central list borne by central government, or by all authorities if income is distributed locally.	Central government could look to compensate local authorities for the losses they incur as a result of successful appeals – or a proportion of them – funded from the central list. A lot more work to do into practicalities and accounting implications – likely to have to use proxies to determine losses.	Safety net rules set nationally. Payments funded from central list income and/or a national top slice of business rates income.