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Briefing Note

Business Rates Retention Reform Consultation:

Sharing risk and reward, managing volatility and setting up the reformed system

December 2018

Contents

1. Introduction

1.1. As part of the finance settlement 2019/20, the government published the consultation paper "Sharing risk and reward, managing volatility and setting up the reformed system", a technical Business Rates Retention (BRR) consultation. This is available here.

1.2. This briefing note covers the detail of the consultation paper, much of the contents of which builds on the submission of technical papers by MHCLG to the MHCLG/LGA groups that have been discussing the reform of local government funding over the last 18 months.

1.3. Therefore, to those who have been following the outputs of the Steering Group, Systems Design Working Group and Implementation Working Group, many of the proposals will not come as a total surprise. However, for many across local government, the proposals in the consultation may signal a significant change to the current system of BRR.

1.4. This note is structured as follows:

- Section 2 – Background to the working groups
- Section 3 – Balancing risk and reward
- Section 4 – Simplifying the system and reducing volatility
- Section 5 – Setting up the system
- Section 6 – Implementation and the next steps
- Section 7 – Questions

Resetting Business Rates Baselines

1.5. The main points of note within the consultation paper are as follows:

- There is a full reset planned for 2020/21, that will see the "growth" within the current business rates system up to 2019/20 transferred to Baseline Need
- Future resets could be on a quite different basis, seeing a proportion of the growth retained by local government (partial reset), with the determination of the NNDR Baseline possibly being on a phased basis (i.e. to avoid the timing of when growth occurs locally being a factor in the size of the growth retained locally)
- The safety net is to continue, at a level to be set at the end of the process
- There will be no levy, but a growth threshold (not yet determined) above which all "growth" would be lost (the paper uses illustrative figures such as 150%, 200% and 250% of Baseline Need, so this is likely to be a factor that will affect only a very small number of authorities)
- Tier splits – the government hopes that the sector can propose its own splits with the potential for a default position if no agreement can be agreed

- There would appear to be significant issues (that may not be able to be overcome) to nationalising appeals under the current system. There are also concerns regarding how authorities' NNDR Baselines would be determined under a reset (any type)
- A modified version of the BRR system is proposed that would effectively nationalise appeals and establish a more objective method of setting the starting point for each authority (and therefore capture growth more accurately).

LG Futures comment: The Reset

1.6. The consultation paper provides further clarity on what has been suspected/known for some time, that there will be a full reset in 2020, followed by partial resets (although it does then raise the possibility of periodic full resets e.g. every 15 years). However, the potential material change to resources that will arise for an individual authority is not considered.

1.7. As we have been highlighting for some time, the change in resources from a reset will be far more significant for the vast majority of authorities than the outcome of the review of relative need or the transfer to 75% BRR. As with any change to a funding system, there will be winners and losers. A full reset will see three groups emerge, these being:

Group 1 – those that gain from the reset – where the current amount gained from BRR is lower than the resources that will eventually be received, once added to Baseline Need.

Group 2 – the reset will not alter their resource levels – where the current amount gained from BRR is broadly similar to the resources that will eventually be received, once added to Baseline Need.

Group 3 – those that lose from the reset – where the current amount gained from BRR is more than the resources that will eventually be received, once added to Baseline Need.

1.8. Whilst this type of result is as would be expected from any change, it is perhaps the scale of those that could gain and, perhaps more importantly, lose, in groups 1 and 3 that is the most concerning aspect for individual authorities.

1.9. Some authorities currently receive levels of resources significantly higher than their Baseline Need figure (50%+ more) due to BRR. These "growth" amounts could be lost overnight at a full reset. Furthermore, it is also probable that, following a full reset, half of local government will have an NNDR Baseline amount higher than their forecast income). This would create a scenario where authorities significantly above Baseline Need per reset, to below Baseline Need (albeit potentially increased) immediately after the reset.

1.10. What is also concerning is that the current gains from BRR are outside of the Core Spending Power (CSP) figures. Whilst this is perhaps a reflection of the difficulties in building NNDR3 and, (perhaps even more concerning), NNDR1 figures into the CSP figures, the reality is that, for some authorities, this "growth" represents a figure that is comparable in value to their Settlement Funding Assessment or New Homes Bonus funding lines. But, due to it falling outside of the CSP figures, future years' comparisons post-SR19 will not reflect this loss in funding within the current format.

1.11. Of course, it could be argued that a significant proportion of the current "growth" in the system is not due to local growth in business rates, but the methodology for determining the national NNDR Baseline in 2013/14 and how it was split between authorities. Therefore, authorities that have gained should not be entitled to have these resources protected. However, this same argument could potentially be used for the relative needs review, where authorities have potentially gained since 2011/12 from damping arrangements that are based on the need to avoid significant funding reductions.

1.12. Whilst there is no right or wrong answer with regards to re-distribution, it does perhaps make more sense for transition to consider the actual resources that authorities are receiving from the major funding streams, rather then reflect only a single element. However, the possibility that the current gains from BRR will not be included in such transitional arrangements is perhaps something authorities should prepare for.

LG Futures comment: The alternative business rates system

1.13. The current difficulties around setting new individual authority NNDR Baselines after the reset and the problems in attempting to nationalise appeals under the current system (both highlighted in the consultation paper) should make any alternative approach look more attractive; both from a financial planning perspective and because it could establish a more transparent and fair way to reward actual growth in business rate revenues.

1.14. The table below attempts to compare the proposed alternative approach against the current system. It shows that the two systems are actually the same in most respects, with the crucial differences being around appeals risk, budget planning and, potentially, setting the baseline to measure growth against. Of course, the alternative system is still very much in its infancy and further work is needed, especially around how to measure growth, but if a robust and transparent measure can be identified, it would arguably make business rates retention a much fairer and more stable system.

Criteria	Current	Alternative
Existing Growth?	Existing growth would be added to Baseline Need	
Nationalised appeals?	Problematic/unlikely to happen	Yes
Realistic starting position?	Lottery – based on methodology and data chosen	Will be subjective, but perhaps less so than under the current system
Complexity?	The system is complex, but on issues such as S31 grants and revaluation, it has been fair	The system will require far fewer adjustments for items such as policy change and revaluaitons
Reward genuine growth?	Growth is rewarded, but this can be overshadowed by methodology/data gains and losses	A measure of growth is still needed, but it could see less distortion from appeals
Budget Planning	Appeals risk has an impact on the scale of collection fund deficits and surpluses which can cause significant income volatility between years	In -year income would be at Baseline Need levels, subject to a growth or decline adjustment, but not variances based on appeals or S31 grant (from policy changes).
Tier Splits	To be determined	To be determined
Pooling	Need to identify a reason to pool	Need to identify a reason to pool
Levy/Safety Net	To be determined	To be determined
Future Resets	To be determined	To be determined

2. Background

2.1. The government has stated its intention that there will be a reset of the BRR and a move to 75% BRR from April 2020. As part of this process, the government has been reviewing the components of the BRR system, both individually and in aggregate, and the role the system can play in continuing to provide an incentive for local authorities to grow the business rates in their area while minimising complexity.

2.2. There have been two previous consultations on greater levels of BRR for authorities and the design of the system:

- ‘Self-sufficient local government: 100% Business Rates Retention’, published in July 2016
- ‘100% Business Rates Retention, Further consultation on the design of the reformed system’, published in February 2017

2.3. The government published responses to these consultations in February 2017 and December 2017 respectively.

2.4. The system of 50% BRR was introduced in April 2013, with the intention that the new system would give local authorities more control over the money they raised locally; removing reliance on government grant and promoting and rewarding local economic growth, thus increasing overall revenue in the funding system.

2.5. In October 2015, the government announced its intention to enable local government as a sector to retain all business rates raised locally. A Local Government Finance Bill was introduced in Parliament in January 2017, to provide enabling legislation for the reforms. The Bill did not complete its legislative stages before the 2017 General Election and was subsequently not reintroduced.

2.6. In March 2016, the LGA and the then CLG, established a Steering Group and other working groups to consider initial proposals from the government. The groups met regularly throughout 2016/17. Once the Bill which had been introduced did not proceed after the General Election of May 2017, the groups experienced a hiatus; although the working group on the Fair Funding Review did meet in July 2017.

2.7. From October 2017, the Steering Group, and subsequently individual working groups, reconvened. This followed the government announcing its intention to proceed with a Fair Funding Review, a reset of the Business Rates Baseline and a move to 75% Business Rates Retention, all to be implemented by April 2020.

2.8. This consultation, the first on 75% BRR, represents a pulling together of much of the work of the groups that have been meeting. It is also the first occasion that the government has asked local government more broadly about the proposals submitted by local government representatives to the Systems Design Working Group in July 2018 in proposals titled 'Simplification of the Business Rates Retention System'.

2.9. The government has acknowledged that the existing BRR system is complex and has not always been flexible. It has also recognised that there is a level of disproportionate volatility in the current system and has stated that it is committed to reducing the impact on local authority income of factors outside of an authority's control. The proposals outlined in the consultation paper are in part intended to address some of these issues.

2.10. The various agendas, minutes and discussion papers which have been the subject of discussion at the various groups to date are published on the LGA website and are available here.

2.11. The consultation period will last for 10 weeks from 13 December 2018 until 21 February 2019.

3. Balancing risk and reward

3.1. Chapter 2 of the consultation covers how the system should be reset on a regular basis; the tier split between district and county councils; and proposals to reform the levy and the level of the safety net. Together, these elements of the system will help determine the future balance of risk and reward within the BRR system after April 2020.

3.2. The government focuses upon five main areas:

- Resetting the Business Rates Baseline
- The Safety Net
- The Levy
- Tier splits
- Pooling

Resetting Business Rates Baselines

3.3. The resetting of Business Rates Baselines (BRB) determines the growth incentive for individual authorities, by determining the amount of business rates growth they retain and for how long. At a reset, BRB will be re-calculated for the forthcoming reset period for all local authorities. The intention of the reset is to ensure that the distribution of resources remains aligned with need. There is a trade-off between resets being too frequent and the growth incentive being weakened, and too infrequent resets could mean that relative need grows faster than local tax resources.

3.4. The government states that it intends to carry out a full reset of BRB in 2020/21. It believes this will allow full implementation of reforms to the BRR system, the findings of the review of relative needs and resources, and the Spending Review. This will of course have a significant budgetary implication for many authorities, depending on the size of retained business rates gains and losses at 2019/20.

3.5. However, the government are clear that they believe that the approach to the reset in 2020/21 and the future resets after this point need not be the same. This consultation therefore seeks views on resets after 2020/21 and not what happens at the transition to the reformed system, which it indicates will be consulted on later (without specifying when this will be).

3.6. This consultation seeks views on:

- The most desirable type of reset; and
- The time period that a reset should cover.

3.7. The government's view is that the most desirable reset option is one that provides a strong incentive for growth, and that it is therefore desirable that all growth is treated equally within the system, regardless of when it occurs in a reset cycle. In addition, good planning is not supported by 'cliff edges', which arbitrarily determine if an authority will benefit from growth or not and create a perverse incentive as to when growth comes 'on stream'. The government therefore favours options that minimise these 'cliff-edges'.

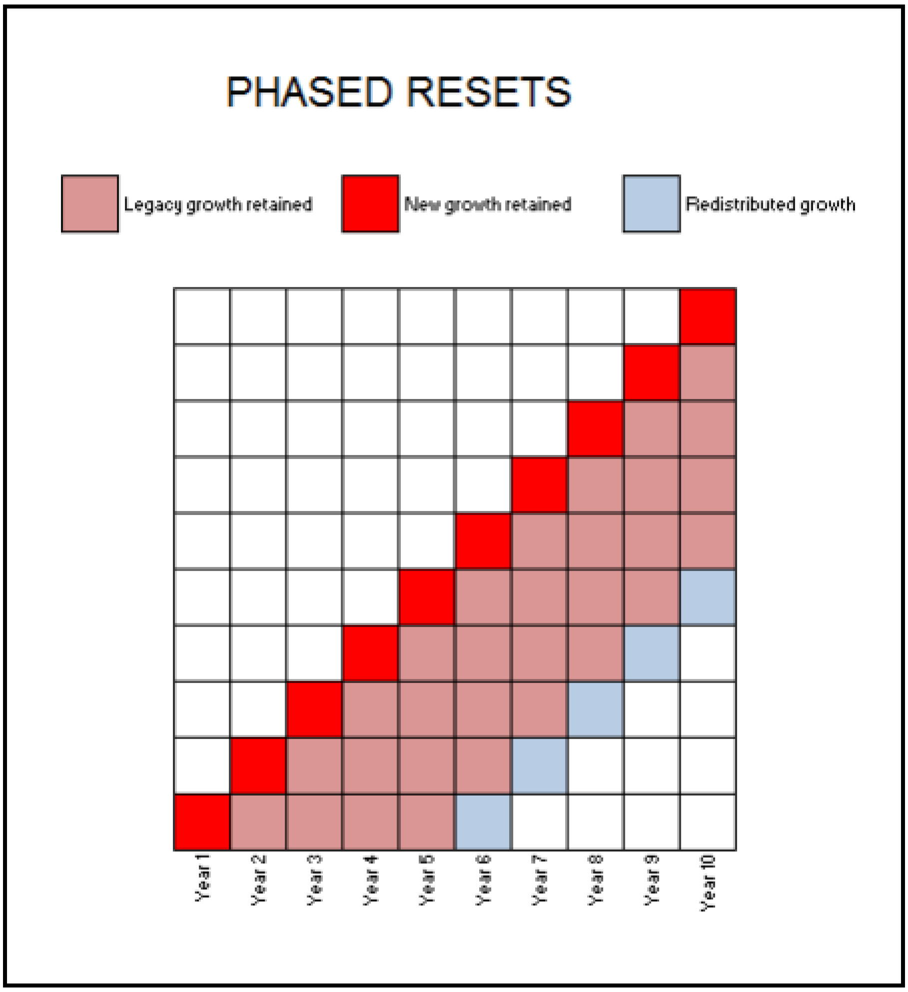
3.8. Previously, the government has consulted on partial resets and full resets. Under a partial reset (not planned for 2020/21, but for future resets) the BRB and Baseline Funding Levels are held constant for a set number of years and, at a reset, a percentage of the growth achieved over the previous period is redistributed, with the remaining growth retained by local government.

3.9. The retention of some growth into a new reset period would therefore potentially smooth 'cliff edges' and support longer term planning. The percentage to be retained is yet to be determined and the government, without specifying any preference or examples, asks for views on this. However, the government then adds that it imagines that there would still be intermittent full resets (using, for example, a period of 15 years, which could mean after two partial resets if these were spaced 5 years apart).

3.10. Under a full reset, no growth is retained into the forthcoming reset period. This creates 'cliff-edges' at the end of each reset period and creates a perverse incentive for authorities to control when growth comes 'on stream'. Because this type of reset does not meet the government's preferred criteria, and, after consideration of sector support for partial resets over full resets when responding to previous consultations, full resets at the end of every reset period are being ruled out, except, of course, for 2020/21.

3.11. However, government also believes that phased resets could be more desirable. The advantage of this type of reset is that it would help to smooth out 'cliff-edges' and could offer improved stability and certainty for authorities, whilst still allowing them to benefit from local growth.

3.12. Under a phased reset authorities retain each year's growth (or loss) in rates for a set number of years and, thereafter, that growth (or loss) is redistributed. Under this option, it would not matter when growth came 'on stream', as all growth would count equally, regardless of timing. The diagram below illustrates how a phased reset works. It uses a five-year period with a full, as opposed to partial, reset for illustrative purposes, although any time-period and any percentage of reset could be chosen.



3.13. Each year, a new year's growth is added to the amount retained by the authority up to a maximum of five years' worth of growth. In the sixth year, the first year's growth is redistributed amongst all local authorities according to Baseline Funding Levels. Thereafter, each year sees the current year's growth added to the amount retained and an historic year's growth redistributed.

3.14. The government highlights that further work will need to be carried out on reset options to scope transition from the current system, including how to reach year five if the government implements phased resets.

3.15. The time period between resets will also need to be determined. The previous consultation proposed a five-year time period between resets and this was well received by respondents. The government has since announced that business rates revaluations will happen every three years. Aligning resets and revaluations could have some benefit because it reduces, marginally, the scale of the disruption to tariffs and top-ups in between resets.

3.16. However, it is worth noting that, as the situation currently stands, MHCLG will have to adjust tariffs and top-ups in the revaluation year, the following year and (to some extent) the year after that, to ensure accuracy. Therefore, in a three-year cycle, there will be adjustment to tariffs and top-ups every year (as there would be if a phased reset is implemented). Respondents are asked to consider whether the frequency of resets aligned with the frequency of revaluations are therefore desirable (i.e. multiples of three years).

3.17. The government therefore asks:

Question 1: Do you prefer a partial reset, a phased reset or a combination of the two?

Question 2: Please comment on why you think a partial/phased reset is more desirable.

Question 3: What is the optimal time period for your preferred reset type?

Safety Net

3.18. A critical principle that the government states is its belief that the BRR system should remain one of risk and reward for local authorities. A strong growth incentive means that local authorities should also take on the risk of decline, as well as the reward for any growth in business rates.

3.19. The intention of the safety net is to ensure that this risk is proportionate and sustainable at an individual local authority level when income declines, for instance, because of the closure of a major ratepayer. It is intended to ensure that no authority falls below a minimum level of their assessed need, currently expressed as a percentage of Baseline Funding Level.

3.20. The ‘Further Consultation’ had asked respondents to consider the level at which the safety net should be set. 73% favoured raising the threshold to between 95% and 100% of Baseline Funding Level. However, given the likelihood that an authority will require a safety net payment is very much a function of other elements in the system e.g. appeals and other valuation change having a strong bearing on volatility of income at a local authority level, the government believes it is appropriate that the level at which the safety net is set be determined when decisions have been made on the wider system. So it does not propose a level of safety net percentage in the paper, although it does draw attention to the 95% level set for the 75% BRR Pilots.

3.21. The funding for the safety net within the current system comes from two sources: the levy and a top slice of Revenue Support Grant (RSG). It expects that, in future, the safety net will continue to be funded through the levy account and a top-slice, the latter on business rates income (as opposed to RSG). If the levy is reformed (as discussed in the next section), then it will provide much less income to fund safety net payments and therefore a higher proportion would need to be funded through a future top-slice.

3.22. The government believes that funding more of the safety net through a top-slice is fairer, because the cost will be shared by all authorities and not just those who have achieved growth. Therefore, the level of the safety net will affect the size of top-slice that will need to be made. However, it is anticipated that the cost of safety net payments will, in future, be lower following the reform of other elements of the system; for example, if phased resets were introduced alongside addressing appeals and other valuation change.

3.23. The government therefore asks:

Question 4: Do you have any comment on the proposed approach to the safety net?

Levy

3.24. Removing the levy entirely from the new system would require primary legislation. The government has chosen not to find Parliamentary time for primary legislation to reform BRR. However, it has stated that it is minded to reform this element of the system within the current legislative framework. This would mean raising the threshold at which the levy falls due.

3.25. In addition, MHCLG has been asked by the Business Rates Retention System Design Working Group to consider how the levy could be reformed to ensure that 'extraordinary growth' does not distort the fairness of the system. 'Extraordinary' is used here in its literal sense to describe growth outside of the ordinary; for example, as a function of provisions made and released. As this growth cannot be attributed to an authority's management of their local economy, it is reasonable and proportionate that the levy be used as an inverse of the safety net to limit gain.

3.26. The government therefore proposes that the level at which an authority becomes eligible to pay the levy should be raised so that only growth that could be considered 'extraordinary' would be subject to it. After this point, the levy should be 100% and therefore function as a cap. The government believes that this would be a simpler approach and would provide a stronger growth incentive, as authorities would be able to retain all growth that can reasonably be attributed to their management of their local economy.

3.27. The higher the threshold at which the levy fell due, the smaller the number of affected authorities. For example, using 2016/17 data, setting the levy at 150% Baseline Funding Level would have meant 18 authorities would have been subject to it, at 200%, it would have affected 7 authorities and, at 250%, it would have seen only 4 authorities subject to the levy. The consultation therefore seeks views on the level at which the levy should fall due (e.g. 150%, 200%, 250%, or another level).

3.28. The government therefore asks:

Question 5: Do you agree with this approach to the reform of the levy?

Question 6: If so, what do you consider to be an appropriate level at which to classify growth as 'extraordinary'?

Tier splits

3.29. The government is minded to retain a national tier split as an appropriate mechanism to distribute business rates income in multi-tier areas between billing and precepting authorities. However, it again states that determining an appropriate level for the tier split between counties and districts is a decision that will need to be made later in the process, following decisions on other elements of the system

3.30. When 50% BRR was introduced in 2013, the tier split between counties and districts was established with the objective of protecting counties (and adult social care and children's services, which they deliver) from risk and incentivising districts (which determine the majority of planning cases and therefore have a strong lever to affect growth). To date, no County has been in receipt of a safety net payment and Districts have experienced a high level of growth retention. However, if the levy is reformed, the distribution of growth would be changed and so the fairness of this distribution must be considered.

3.31. The government continues to highlight that there is an opportunity for this decision to be sector led, with the representative bodies for counties and districts determining what the appropriate tier split between them should be. The government will therefore continue to engage with these authorities and seek their views following decisions on the reform of other elements of the system.

3.32. However, the government recognises the need for a suitable fall-back position (i.e. a backstop) to be developed for the national tier split between counties and districts, in the event that an agreement is not reached. The government is also minded to allow pooled authorities to continue to be able to change the distribution of growth within the pool, if locally agreed, and so this consultation seeks views on:

- The appropriate principles for the reform of tier splits between county and district councils; and
- Whether respondents would welcome the opportunity to set their own tier split and what this should be

3.33. The tier split between London Boroughs and the Greater London Authority will continue to be a decision made separately, in consultation with London authorities. The government states that it also expects that Fire and Rescue Authorities will continue to retain 1% of business rates across the area they cover.

3.34. Without indicating any preferences, the government therefore asks:

Question 7: What should the fall-back position be for the national tier split between counties and districts, should these authorities be unable to reach an agreement?

Question 8: Should a two-tier area be able to set their tier splits locally?

Pooling

3.35. The government restates that pooling is desirable and offers many benefits. It believes it allows better planning across a functional economic area; in particular, facilitating joint decision making on the strategic spending of business rates growth and facilitates opportunities for collaboration and friendly scrutiny, such as in a joint approach to setting provisions for appeals and other valuation change.

3.36. However, if the levy were to be reformed, a key incentive to pool will be lessened. Therefore, this consultation seeks views on how pooling can be incentivised and improved. At the same time, the government indicates it will also consider how best to encourage pooling as part of its wider approach to devolution policy.

3.37. Without indicating any of the options, the government therefore asks:

Question 9: What fiscally neutral measures could be used to incentivise pooling within the reformed system?

4. Simplifying the system and reducing volatility

4.1. The government recognises that high levels of disproportionate volatility have arisen since 2013/14, but that these are not desirable. Following the findings of the Hudson Review, they would also like to see the system simplified, so that it is more easily understood, more responsive to change and more straightforward for local authorities and central government to administer. Chapter 3 of the consultation therefore focuses upon three main reforms:

- A review of hereditaments on the central and local lists
- The options available to deliver the commitment to address volatility caused by appeals and valuation loss
- A proposal to simplify the administration of the business rates retention system

A review of hereditaments on the central and local lists

4.2. The government has previously stated that resetting of the BRR system in 2020/21 provides an opportunity to reassess the allocation of classes of hereditaments between the central and local non-domestic rating lists.

4.3. Its view is that the reform of the central and local lists should create a rational and transparent system which is uniform throughout the country and that the central list should be used to list hereditaments, which, by their nature, are unsuitable for listing in local lists.

4.4. The Business Rates Retention System Design Working Group had considered the inclusion of a further criterion, which would have allowed high value hereditaments to be listed in the central list if they posed a risk to an authority's short-term financial stability. However, the government states it is minded to rule this out, as the safety net serves as a simpler and more consistent lever to address this type of volatility.

4.5. This consultation therefore invites authorities and rate payers to consider whether, on application of the criteria outlined at Annex A of the consultation, there are hereditaments that should be listed differently. These criteria are:

- The nature and use of the property: the central list is used for networks which are typically - cables for electricity and communication; pipelines for water, gas and other materials; railways; and certain items associated with those networks (electricity and gas meters);
- The size and geographical spread of the property: are they within the boundary of one or many local authorities and is the combined size proportionate to other entries on the central list; and

- The suitability or otherwise for assessment of the property on local non-domestic rating lists: the rules for properties which cross rating list boundaries provide for them to appear in the list which the valuation officer believes contains the largest part of the rateable value. However, there may be hereditaments which cover large areas and many local authorities, and largest part of the rateable value falling within an area may still only be a small proportion of the total rateable value of the property. Furthermore, networks most appropriately listed in the central list may be contiguous units of property, where an attempt to accurately capture the rateable value of the networks for each local rating list would create artificial assessments.

4.6. The government confirms that baselines will need to be adjusted where there is movement between lists, so that any movement will not impact on an authority's income. It therefore proposes that the most suitable time for hereditaments to move between lists is at a reset. Once a decision has been made on what type of reset will be implemented in the reformed system (i.e. beyond the 2020/21 reset), then options can be considered for how often it is appropriate to consider the listings on the Central and Local Lists.

4.7. The government therefore asks:

Question 10: On applying the criteria outlined in Annex A, are there any hereditaments which you believe should be listed in the central list? Please identify these hereditaments by name and location.

Question 11: On applying the criteria outlined in Annex A, are there any listed in the central list which you believe should be listed in a local list? Please identify these hereditaments by name and location.

Options to address volatility caused by appeals and valuation loss

4.8. The government has expressed a commitment to address the impact of appeals and other valuation change on local authority income and has previously stated its intention to centralise this risk. It has been reviewing options to do so for over a year.

4.9. However, authorities are required, under international accounting standards, to make provisions against valuation change. Both overestimating and underestimating these provisions can cause volatility in income at a local level. It is therefore necessary, within the current system, to reform how provisions are addressed alongside centralising appeals and other valuation change.

4.10. To address the volatility relating to appeals within the current system, two separate but key issues are identified:

- How to measure the compensation due to local authorities, if business rates losses due to valuation change were to be centralised

- How to mitigate the impact of provisions on authorities' ability to spend on services in-year using accounting adjustments

4.11. The government believes the first issue can be addressed using a proxy. Under this proxy, the government states it is minded to top-slice business rates income in order to compensate all changes to an authority's local list backdated to the first day of the list (i.e. the beginning of the revaluation cycle), as a 'valuation only change'. Changes not backdated to the start of the list would therefore be classified as physical changes and not compensated.

4.12. Although any proxy cannot be 100% accurate, in the absence of better information, the government believes that this proxy represents the best way to ensure that authorities are fairly compensated for valuation change outside of their control. It highlights that more detail is available in a prior technical note available here. The government therefore asks:

Question 12: Do you agree that the use of a proxy provides an appropriate mechanism to calculate the compensation due to local authorities to losses resulting from valuation change?

4.13. The government outlines four options relating to the second issue and these are:

1. Accounting through the Movement in Reserves Statement: however, it has, so far, proved impossible to design an operational model that can deal with the level of change required. In practice, it would add considerable complexity to the system and would probably require significant redesign of data requirements.
2. The alternative accounting solution: a suggestion has been made that authorities be allowed to simply show MHCLG as a debtor in their accounts for the amount of their provision. However, this is being ruled out by MHCLG, because for them it is unacceptable under proper accounting practices which local authorities have a legal duty to follow.
3. Reimbursement to authorities for provisions made: however, this is unlikely to be acceptable under proper accounting practices, which local authorities have a legal duty to follow. MHCLG would also find it difficult to justify making payments to local authorities to compensate them for probable losses that, in some cases, will not be realised for some years. In addition, this approach would mean that MHCLG would pay a cash grant to offset a non-cash expense that may never be realised, which would be very difficult to justify on value for money grounds; and
4. Using 'line 6' of NNDR3 forms. Part 2, line 6 of the NNDR3 currently asks authorities to provide the amount that has been charged to the provision for appeals. However, MHCLG believes there is a low correlation between the amount charged to the appeal provision in any year and the change made to that provision for on-going appeals. In addition, not all authorities return a value for line 6 and MHCLG has been advised by others that the value returned is an "estimate", because IT systems are not capable of generating the full reduction in liability resulting from changes to rating lists.

4.14. MHCLG, having identified options, all of which it considers are impractical to instigate as a means to mitigate the impact on authorities' ability to spend on services in-year, does not ask whether authorities agree or wish to suggest alternatives. Instead, MHCLG states that the government's view is that the alternative approach outlined in the consultation (detailed below) is the only option available to address the volatility arising from appeals and other valuation change.

4.15. In effect, MHCLG has therefore indicated that, if local government wishes to neutralise the impact that appeals, and their provisions, have been having on business rates income since 2013/14, then local government will need to agree to the new alternative system outlined. If they wish to keep with the current system, then the volatility caused by appeals will need to be accepted.

A proposal to simplify the administration of the business rates retention system

4.16. The government is using this consultation to initiate a sector-wide conversation to reform the way the BRR system is administered. Based upon a proposal originally worked-up by members of the Business Rates Retention System Design Working Group, MHCLG believes it offers a way of addressing the issue of volatility caused by appeals and other valuation change. In addition, they believe it would also simplify the system and give more certainty to authorities of the level of income they can expect to see on a year to year basis.

How the reformed system would work

4.17. Firstly, the reform proposes to use local authorities' own estimates of their income from business rates – after provisions have been made –- to set an accurate Business Rates Baseline each year. The Baseline Funding Level (the assessment of 'need') will be fixed, based on the outcome of the review of relative needs and resources and the Spending Review.

4.18. A local authority's top-up or tariff payment will continue to be set as the difference between the two figures (Business Rates Baseline and Baseline Funding Level) but will therefore be calculated each financial year using the most up-to-date information on actual business rates income. The result will be that each local authority will have certainty each year that their income net of provision will be equal to their needs assessment (before growth or decline in business rates is accounted for, as outlined below).

4.19. Accordingly, provisions will no longer adversely impact on an authority's income and any perverse incentive to underestimate provisions in order to protect income levels in the short-term will be removed. To implement this change, there is likely to be a change in the date that local authorities provide their NNDR1 forms, currently submitted by local authorities in January. The date would most likely have to be brought forward, to around September each year, for the information provided to be utilised in setting the annual provisional local government finance settlement.

4.20. MHCLG recognises that they will need to continue to work with the sector to understand the impact on authorities, were this to be implemented, and to ensure that an unreasonable administrative burden is not created.

4.21. Secondly, the reform proposes that a system of floating top-up and tariff payments would be needed to reconcile differences between the initial estimates of business rates income provided in the NNDR1 form and the outturn figures available after the end of the financial year through NNDR3 forms. NNDR1 estimates of individual local authority income from business rates will invariably differ from actual income recorded in NNDR3 forms for good reasons.

4.22. Top-up and tariff payments would be adjusted in the following year to take account of any such difference when the following year's top-up or tariff is set, i.e. the difference between the estimates at NNDR1 and the outturns at NNDR3 in year 1 will be incorporated into the setting of the top-up/tariff in year 2. Local authorities will have certainty of funding through business rates in any given year, having provided the outturn figures in annual NNDR3 forms.

4.23. Such a system of floating top-ups and tariffs would also provide more flexibility in how other elements of the system could be administered. For example, any future changes to business rates reliefs could be reflected in adjustments in top-ups and tariffs in subsequent years, rather than relying on separate Section 31 grants. In a similar way, the government could also dispense with the need for separate transitional protection payments following revaluations.

Risk and reward under the reformed system

4.24. The government reiterates that it is committed to rewarding local authorities that grow their business rates and to a BRR system that balances risk and reward for local authorities. In addition, under this reform to the administration of the business rates retention system, the government would need to introduce a new calculation to identify the level of business rates growth (or decline) to be retained by individual authorities.

4.25. MHCLG confirms that the system will be designed to ensure that:

- Under 75% BRR, local authorities would keep 75% of their business rates growth (notwithstanding decisions taken on the levy and tier splits) and 75% of any decline (notwithstanding decisions taken on the level of the safety net)
- The growth achieved and retained by local authorities would more closely represent the actual growth achieved and would not be affected by changes in provisions

4.26. Therefore, under the proposed reform, the government is minded to measure growth and decline based on outturn figures (provided in NNDR3 forms), net of provisions.

4.27. Any growth or decline in business rates income in a local area would be recognised by adjusting the following year's top-up and tariff payments, i.e. top-ups and tariffs would be used both to redistribute business rates to ensure determined need is provided for and to reflect growth. This means that a local authority would see the benefit, by way of budgeted additional income, of any growth in the year following the submission of outturn data.

4.28. This proposal would provide certainty to local authorities of the income they can expect to receive at the point of the provisional local government finance settlement. Only changes in business rates due to actual changes in the business rates base in an area, as opposed to appeals and changes in valuation, would be recognised, improving the accuracy of the system.

4.29. A more detailed guide to the proposals outlined are provided in Annex B of the consultation. This explains the key differences between how the system would operate compared to how it currently operates.

4.30. Regardless of whether this proposed reform is implemented, the government confirms that the other elements of the system being consulted on would continue to be relevant. For instance:

- It would still be necessary to determine the appropriate balance between risk and reward, through consideration of how resets will work in the future, the future tier splits in two tier areas, and how the safety net and the levy will operate
- The government would still continue to review hereditaments on the central and local lists

4.31. However, the government considers that it may not be necessary to set new Business Rates Baselines at an individual authority level, which it considers within the current system at Chapter 4 of the consultation.

4.32. The government therefore asks:

Question 13: Do you believe that the Government should implement the proposed reform to the administration of the business rates retention system?

5. Setting up the system

5.1. If the system is not reformed in the way the government has outlined in Chapter 3.4 of the consultation and explained in the paragraphs above, then it will need to set new Business Rate Baselines for 2020/21. The lead proposal by MHCLG for undertaking this is set out in the consultation at Chapter 4 and local authority views are invited.

5.2. Although the Chapter explains the government's current proposal for the operational process of setting new Business Rates Baselines for the financial year 2020/21 onwards; it should be remembered that the government has committed that there will be a full reset of the BRR system in 2020 (i.e. no growth since 2013/14 will be carried forward by individual authorities) and, therefore, all business rates growth achieved by individual authorities since 2013/14 will be redistributed at that point.

5.3. In addition, the government states that question of transition from one system in 2019/20 to new baselines in 2020/21 will be considered separately at a later date.

5.4. The consultation proposes that, if the system is not reformed as set out in Chapter 3, baselines would be based on authorities' retained business rates income as at 2019/20, the year before the reset. However, because outturn data (NNDR3s) for 2019/20 will not be available in time to set the new baselines, the government proposes to use 2018/19 NNDR3s and uprate them by the change in the small business rating multiplier.

5.5. In addition, the government proposes to use a single year's data to set baselines, rather than an average of two years' data, as was done in 2013/14. It also proposes to construct baselines "bottom-up" i.e. for each individual authority based on its 2018/19 NNDR3, rather than setting an aggregate that is then distributed between authorities, as happened in 2013/14.

5.6. In calculating billing authority baselines, the government will use data for net rates payable from 2018/19 NNDR3s, with deductions for non-collection and appeal provisions. Further deductions will also be made for "disregarded amounts" based on 2018/19 NNDR3s – i.e. Designated Areas, amounts retained in respect of renewable energy and shale gas, the cost of collection allowance and the City of London offset.

5.7. The resultant number will be the total Business Rates Baseline at the billing authority level. This will then be apportioned between billing authorities and their major precepting authorities in accordance with the relevant tier-split shares.

5.8. The government identifies what it considers to be the two most difficult deductions to calculate accurately, these being those for non-collection and appeal provisions.

5.9. In working out the deduction for non-collection, because NNDR3 figures for non-collection can change considerably from one year to another, it would not be optimal to rely on a single year's data to fix the baseline.

5.10. The government proposes therefore to use an average of more than one year's data. Respondents are asked to consider how many years' data should be used in constructing the average.

5.11. There is a similar difficulty in working out the deduction for the appeal provision. The deduction needs to be the best possible estimate of the amount of businesses rates that is currently collectible from ratepayers, but cannot be counted as "income" because, ultimately, it will be repaid to businesses following successful appeals. This amount is potentially large – nearly £900m was added to provisions in 2017-18 – and, therefore, the impact on Business Rates Baselines of over- or under-estimating the deduction is potentially significant.

5.12. There are a number of possible options for working out the deduction – three of which are set out in the paper:

- Option one would be to base the deduction on authorities' own estimate of provisions as evidenced by their 2018/19 NNDR3s.
- Option two would base the deduction on the government's own estimate of future appeal losses.
- Option three might be to ask authorities to make a one-off estimate of their provision on a centrally-determined basis.

5.13. The government therefore asks:

Question 14: What are your views on the approach to resetting Business Rates Baselines?

5.14. While the government states that it continues to work with the Business Rates Retention Implementation Working Group to determine the best way to calculate the deduction for appeal losses/provisions and would be interested in respondents' views on the three approaches outlined above, there is a feeling in this Chapter that the government would prefer not to have to reset Business rates Baselines. This view is confirmed by:

- A focus on outlining options with clear weaknesses that relate to one year's data only
- With the very limited time now available, it would be very difficult to develop a robust methodology
- There is an obvious preference demonstrated by MHCLG for a reformed system

6. Implementation and the next steps

Implementation

6.1. The consultation can be responded to as follows:

Using the (as yet unpublished) consultation response pro-forma published alongside this consultation paper. This, together with any additional information or evidence should be emailed to BRRSystemDesign@communities.gov.uk

The deadline for responses is 21 February 2019

Posted to Local Government Finance Settlement Team

Ministry of Housing, Communities and Local Government

2nd floor, Fry Building

2 Marsham Street

London SW1P 4DF

Enquires should be made to:

Email: BRRSystemDesign@communities.gov.uk

LG Futures' Support

6.2. LG Futures is also able to:

- Provide support to local authorities to analyse the local implications of the consultation paper
- Provide support to authorities in drafting their responses to the consultation questions
- Provide advice regarding the potential financial implications of the Fair Funding Review and Business Rates Retention consultations

6.3. If you have any queries about this note or for further information about our support, please contact Lee Geraghty at lee.geraghty@lgfutures.co.uk or by telephoning 07738 000368.

Annex A – Consultation Questions

Question 1: Do you prefer a partial reset, a phased reset or a combination of the two?

Question 2: Please comment on why you think a partial/ phased reset is more desirable.

Question 3: What is the optimal time period for your preferred reset type?

Question 4: Do you have any comment on the proposed approach to the safety net?

Question 5: Do you agree with this approach to the reform of the levy?

Question 6: If so, what do you consider to be an appropriate level at which to classify growth as 'extraordinary'?

Question 7: What should the fall-back position be for the national tier split between counties and districts, should these authorities be unable to reach an agreement?

Question 8: Should a two-tier area be able to set their tier splits locally?

Question 9: What fiscally neutral measures could be used to incentivise pooling within the reformed system?

Question 10: On applying the criteria outlined in Annex A, are there any hereditaments which you believe should be listed in the central list? Please identify these hereditaments by name and location.

Question 11: On applying the criteria outlined in Annex A, are there any listed in the central list which you believe should be listed in a local list? Please identify these hereditaments by name and location.

Question 12: Do you agree that the use of a proxy provides an appropriate mechanism to calculate the compensation due to local authorities to losses resulting from valuation change?

Question 13: Do you believe that the Government should implement the proposed reform to the administration of the business rates retention system?

Question 14: What are your views on the approach to resetting Business Rates Baselines?

Question 15: Do you have any comments at this stage on the potential impact of the proposals outlined in this consultation document on persons who share a protected characteristic? Please provide evidence to support your comments.