Local Government Resource Review: Proposals for Business Rates Retention

Technical paper 6: Volatility

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Department for Communities and Local Government

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Chapter 1

Introduction

1.1 On 18 July, the Department for Communities and Local Government (DCLG), published a consultation paper, *Local Government Resource Review: Proposals for Business Rates Retention*.

1.2 This set out proposals for a rates retention scheme to replace the current local government finance system, under which business rates are redistributed as part of formula grant.

1.3 The consultation paper outlined the principal features of the proposed rates retention scheme. It undertook to provide further detail in a series of technical papers, to be published in August.

1.4 Taken together, the consultation paper and technical papers raise a number of questions about the proposed rates retention scheme, on which the Government is seeking views. The **consultation will close on Monday 24 October 2011**. Details of how to respond can be found on page 7 of the main consultation paper[1].

1.5 This is one of eight technical papers. The full list is:

Paper 1: Establishing the Baseline
Paper 2: Measuring Business Rates
Paper 3: Non-billing Authorities
Paper 4: Business Rates Administration
Paper 5: Tariff, Top Up and Levy Options
Paper 6: Volatility
Paper 7: Revaluation and Transition
Paper 8: Renewable Energy

1.6 All technical terms in the papers appear in italics and are explained in the Glossary of technical terms, which is attached to each technical paper as an annex.

1.7 An outline of the eight papers can be found in *Business Rates Retention – Technical Papers: An Overview*.

[1] www.communities.gov.uk/publications/localgovernment/resourcereviewbusinessrates

Chapter 2

About this paper

2.1 The business rates income which each billing authority collects is determined by reference to local rating lists maintained by the Valuation Office Agency. These lists are subject to variation, between revaluations, as a result of physical changes (either to the property or the locality) and appeals.

2.2 Chapter 3 of this paper looks at the reasons for changes to rating lists and considers the extent to which they cause instability in the rating income that billing authorities collect from one year to another.

2.3 Chapter 4 considers how, within the rates retention scheme, such income volatility could be handled. It explores the extent to which it is possible to isolate the rating effect of specific events, to enable those that are beyond the control of billing authorities to be identified; and considers different ways in which authorities could be compensated for volatility.

Chapter 3

The scale and impact of volatility

3.1 For a non-domestic ratepayer to be liable for business rates, the property that they occupy must be entered on a rating list. Billing authorities collect rates from those ratepayers entered on local rating lists. They do this on the basis of the rateable value of properties, entered on the list by the Valuation Office Agency (an agency of central government). The amount of business rates income collected by billing authorities varies year on year, because the rateable value of properties on local rating lists is not static, but changes to reflect changes in the occupation of those properties. Factors giving rise to such changes include:

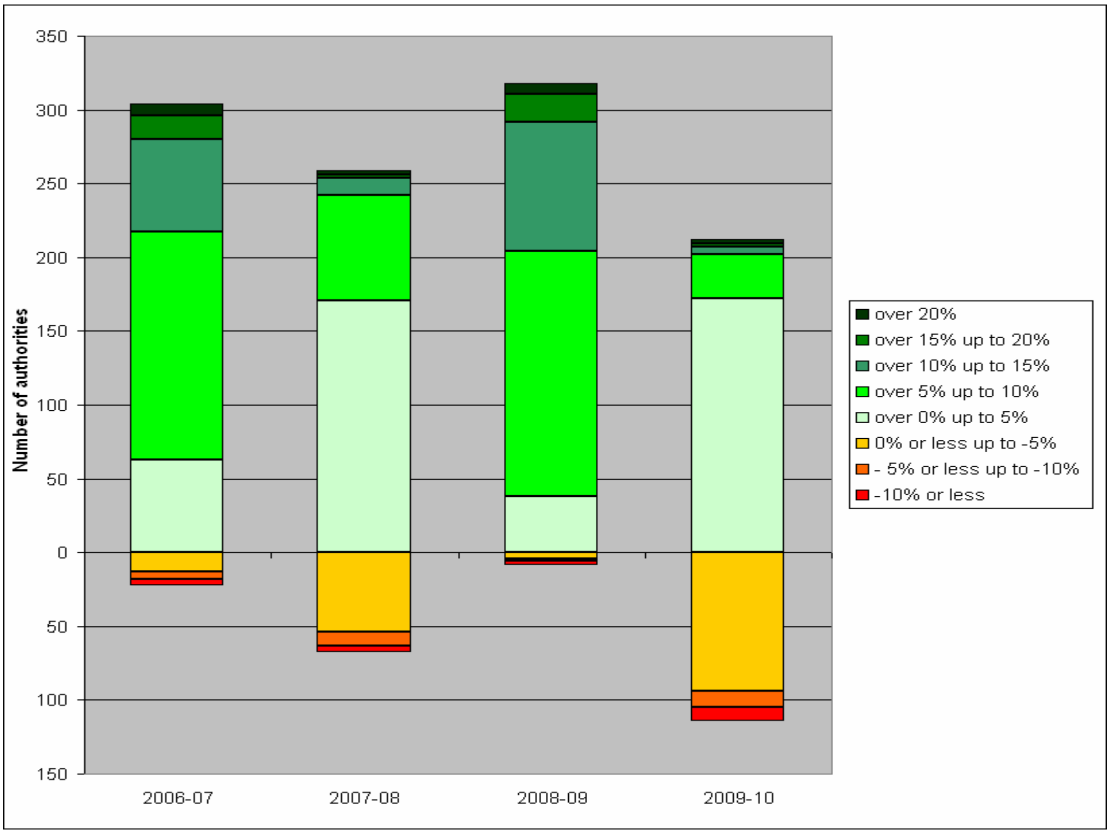
- Reductions to the rateable value of large groups of properties – most likely from appeals but sometimes from events such as flooding –which, once settled, often require billing authorities to backdate those reductions. For example, all offices in a city centre may be grouped into a single appeal "programme" which once settled can generate reductions across large amounts of rateable value. This reduction in rateable value is amplified in rates income because the local authority may have to refund several years' rates from a single year's income

- Changes to the rateable value of very large properties – in particular in otherwise small rating lists. Some local authority rating lists are dominated by very large properties (such as power stations). An appeal, physical change or, in the worst case, the deletion of these properties can have a considerable impact on the rates income in that authority; and

- Properties switching between rating lists. Large properties which cross boundaries (such as airports, ports and networks) appear in the list which contains the largest part (or for larger networks may appear on the central list). Changes in these properties could lead to large amounts of rateable value switching from one list to another.

3.2 The effect of such changes on the volatility of rates income is shown in the chart below.

Chart 1: Distribution of year-on-year percentage change in NNDR Contribution to the Pool



3.3 This shows a degree of volatility in rates income, in any one year, of between 0 per cent and 10 per cent for the majority of authorities. But a number of authorities, in any year, experience a decline in income.

3.4 *Technical Papers 1, 2* and *3* on *Setting the Baseline, Measuring Business Rates and Non-billing Authorities*, explain how at the billing authority level, each billing authority will have to make a contribution to the *set aside amount* and to any *adjustments* for the fixed sums that will fund the New Homes Bonus, police authorities and, possibly, single purpose fire and rescue authorities.

3.5 The remaining *billing authority business rates baseline (pre-tier split)* will, as necessary, be shared between each billing authority and its non-billing authorities.

3.6 Because the *set aside* and the *adjustments* are fixed in cash terms, it means that any percentage reduction in the amount of business rates that a billing authority collects, will translate into a slightly higher percentage reduction in its own and its non-billing authorities' *individual authority business rates*; and any percentage increase in the amount of business rates that are collected will produce a slightly higher percentage increase in *individual authority business rates*.

3.7 As *Technical Paper 5: Tariff, Top Up and Levy Options* explains, due to gearing, such increases, or reductions in *individual authority business rates* will generate even bigger swings in an authority's *pre-levy business rates income*.

3.8 This means that the natural volatility in the rates income that billing authorities collect may produce larger variations in the income that authorities retain under a rates retention scheme, if they are highly geared. The issue will be most acute where, in any year, there is a reduction in the business rates collected locally.

3.9 Whilst we might reasonably expect local authorities to manage the effect of volatility by building flexibility into their budgets, or through the use of reserves, excessive amounts of negative volatility as experienced by a small number of authorities in any year (see chart 1) could create problems.

3.10 For this reason, the main consultation paper proposed that a proportion of the levy pot should be used to help manage the impact of significant negative volatility. Chapter 4 discusses the options in further detail.

3.11 As discussed above, the effect of volatility in the rating list upon local income may be amplified where alterations have retrospective effect back over, potentially, several years.

3.12 The rules[2] are complex but generally an alteration has effect from the day on which the circumstances which gave rise to the alteration first occurred.

3.13 It would be unreasonable to expect the valuation officer to be aware of all changes to properties and localities throughout England as and when they occur. To do so would require a large increase in the cost of running the system, which would be disproportionate to the gains. Backdating ensures that ratepayers contribute fairly to the national rates pool from the point the property they occupy should be rated or where there is an increase in the value of their property. It also ensures that ratepayers can still receive proper refunds where the rateable value of their property is wrong or the property should be deleted from the rating list.

3.14 Each rating list runs for five years and the valuation officer has a further year after that to make amendments before the list closes, so the valuation officer may backdate certain amendments to the list for up to

[2] Set out in The Non Domestic Rating (Alteration of Lists and Appeals) (England) Regulations 2009 (SI2009/2268).

six years. No time limit applies for alterations arising from a proposal[3] (providing the proposal has been made in good time).

3.15 The Valuation Office Agency is working to improve the information and processes it uses to keep the rating list accurate and up to date. Proactively maintaining the rating list and working closely with other stakeholders such as local authorities will help ensure that, as much as possible, alterations are made soon after the list becomes inaccurate, avoiding lengthy backdating; but it will not always be possible and we will continue to see volatility in the rating system due to backdating.

3.16 We would welcome views on how the rating system might be improved to minimise volatility arising from retrospective changes to the rating list, whilst also ensuring fairness to all ratepayers; incentives for businesses to volunteer the necessary information to correctly assess their tax liabilities; consistency with other tax regimes; and affordability in terms of their impact on the business rates yield.

[3] A ‘proposal’ is the first stage of the appeal process where a submission is made to the Valuation Office Agency to alter the value of the non-domestic property on the rating list.

Chapter 4

Dealing with volatility

4.1 To manage negative volatility, there are essentially three possible approaches:

- to isolate the specific events giving rise to that volatility and provide authorities with compensation for those events
- to adopt an application-based approach, under which authorities would have to apply for support from the levy pot
- to put in place a *safety net* that provided support if local authorities *rates income* fell below pre-determined thresholds

4.2 These approaches are explored below.

An events-based system

4.3 Arguably, given that many of the reasons for decline in business rates income (but not all) are unpredictable and outside the immediate control of any individual authority, an events-based system is the most consistent with a rates retention scheme that is designed to create genuine incentives for growth. It would allow us to focus support on changes to local rating lists that were unforeseen, or outside the control of local authorities, whilst ensuring that matters linked more closely to local decision making continued to have an impact on an authority's *retained income*.

4.4 However, in practice, it is likely to be extremely difficult to devise such a system. The rating system does not currently capture the information that would be needed to systematically identify the reasons why different alterations and appeals to rating lists were made.

4.5 We could look to introduce changes to information systems in the Valuation Office Agency, to enable the reasons for list alterations to be identified. But because of the nature of the rating system, it is not clear that any changes would provide sufficiently robust information on which to base decisions about financial support. This is because it is not always possible to disentangle the reasons why a change has been made. A single amendment to the rating list often covers a number of different changes. Such a system, therefore, would rely on judgements within the Valuation Office Agency on the attribution of a single change in rateable value to a number of different events. It would make access to financial support reliant on the subjective judgements of Valuation Officers and those judgements potentially vulnerable to legal challenge.

4.6 For these reasons, the Government is minded not to pursue this option but we would welcome views of the practicalities of putting in place such an approach.

An application-based approach

4.7 An alternative way of providing financial support is through an application-based approach, under which applications for financial support would be considered on their individual merits.

4.8 But, under this approach, the Government and local authorities would be faced with many of the same problems as under an events-based approach. In order to operate the scheme fairly, the Government would have to establish clear criteria against which it would assess applications. To the extent that criteria relied on a definition of events that would trigger support, there would be the same difficulties as under the previous option of ascribing reductions in rateable values to any particular event.

4.9 Moreover, an application-based approached, being dependent on the decision of central government in response to specific applications, would provide local authorities with no certainty that their application would ultimately be successful and might therefore, be of limited help in planning for, and adjusting to, the impact of significantly reduced rates income.

A safety net

4.10 Under this approach, local authorities would be provided with financial support where their *retained income* fell below pre-determined thresholds, regardless of the reasons for that fall. It might be argued that under this approach financial support could be provided to authorities for changes to their *retained business rates income* that were, in reality, linked to local decision making. But it would also provide certainty to authorities about the support that would be available and the circumstances in which it would be provided; and would be simple and straightforward to administer on the basis of annual returns from local authorities (see *Technical Paper 4: Business Rates Administration*).

4.11 As set out in the main consultation paper, the Government is therefore minded to adopt this approach to dealing with volatility. *Technical Paper 5: Tariff, Top Up and Levy Options,* provides greater detail about how the safety net would work and about the interaction between the thresholds that might be set and decisions about the levy. The *Interactive Calculator* that is being published alongside the technical papers allows authorities to explore the effect of different safety net thresholds.

TP6 Q1: Do you agree that some financial assistance should be provided to authorities for the effects of volatility?

TP6 Q2: Of the options set out in the paper, which would you prefer? Do you agree with the Government's analysis that a safety net, instead of an events-based, or application-based approach offers the best way of managing volatility?

Annex A

Business Rates Retention: Glossary of technical terms

Adjustments
After deducting the *set aside* from the *forecast national business rates* further adjustments will be made to fund the New Homes Bonus, police authorities and potentially single purpose fire and rescue authorities.

Reference: *Technical Paper 1: Establishing the Baseline*, Chapter 4

Allowable deductions
A deduction made to a billing authority's business rates income, when calculating its *proportionate share*. Examples of where allowable deductions will be made are for rate reliefs and cost of collections.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 4

Banded levy
Authorities assigned to their different levy bands with different pence in the pound levy rates based on the ratio of their *individual authority business rates baseline* and their *baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

Baseline funding level (or **individual authority baseline funding level**)
A fair starting point based on formula grant distribution, within the overall expenditure controls set out in Spending Review 2010.

Reference: *Technical Paper 1: Establishing the Baseline*, Chapter 5

Billing authority business rates baseline (pre-tier split)
Derived by dividing the *national business rates baseline* between *billing authorities* on the basis of their *proportionate shares*.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 5

Flat rate levy
The same pence in the pound levy rate for all authorities.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

Forecast national business rates
Forecast of national business rates for England in 2013/14 and 2014/15. Based on the 2012/13 national non-domestic multiplier, uprated for *Retail Prices Index* and the latest published information from the national non-domestic rates returns.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 3

Gearing effect
The relationship between *individual authority business rates baseline* and the *individual authority baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 2

Individual authority business rates baseline
Derived by apportioning the *billing authority business rates baseline (pre-tier split)* between billing and non-billing authorities on the basis of *tier splits*.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 5

Individual authority business rates
The amount of business rates income which each authority receives before payment of *tariffs and top ups*.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 5

Interactive Calculator
Enables users to explore the principal features of the proposed rate retention scheme by entering their own inputs and varying components.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 7

Levy
To manage the possibility that some local authorities could see disproportionate financial gains, the *levy* will recoup a share of this disproportionate benefit. Applied to the change in *pre-levy income* (either all growth or growth above *Retail Prices Index*), as measured against the *individual authority baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

National business rates baseline
The *forecast national business rates* less *set aside* and *adjustments*.

Reference: *Technical Paper 1: Establishing the Baseline*, Chapter 5 and
Technical Paper 2: Measuring Business Rates, Chapter 5

Post-levy income
Individual authority business rates minus/plus the *tariff* or *top up*, minus any *levy*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 3

Pre-levy income
Individual authority business rates minus/plus the *tariff or top up*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 3

Proportional levy
Individual pence in the pound levy rate for each authority so that percentage growth in *retained income* is proportional to growth in *individual authority business rates*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

Proportionate shares
Used to apportion the *set aside*, *adjustments* and *national business rates baseline* between billing authorities. Equals a billing authority's business rates income (after *allowable deductions*) as a proportion of total business rates yield (after *allowable deductions* and exclusive of the impact of transitional relief).

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 4

Retail Prices Index
A measure of inflation in the UK.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 2

Retained income
Individual authority business rates minus/plus *tariff* or *top up*, minus any *levy*, plus any *safety net* payments.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

Revaluation adjustment
An adjustment to tariffs and top ups to ensure that authorities do not experience gains or losses as a consequence of a revaluation.

Reference: *Technical Paper 7: Revaluation and Transition*, Chapter 3

Safety net
The safety net offers: i) annual protection against a decline in *retained income* and ii) protection against a decline in *retained income* relative to the *individual authority baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 5

Set aside
The share of the *forecast national business rates* that will be set aside to meet the overall expenditure controls set out in Spending Review 2010. The set aside will be apportioned between billing authorities and non-billing authorities on the basis of their *proportionate shares*.

Reference: *Technical Paper 1: Establishing the Baseline*, Chapter 3

Tier splits or **tier split shares**
Applied to *billing authority business rates baseline (pre-tier split)* to establish the *individual authority business rates baseline.*

Reference: *Technical Paper 3: Non-Billing Authorities*, Chapter 3

Tariffs and top ups
Assigned to a local authority to achieve a fair starting point. An authority will pay a *tariff* if their *individual authority business rate baseline* is more than their *baseline funding level*. An authority will receive a *top up* if their *individual authority business rate baseline* is less than their *individual authority baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 3

Transitional adjustment
An adjustment to ensure that authorities do not experience gains or losses as a consequence of granting transitional relief.

Reference: *Technical Paper 7: Revaluation and Transition*, Chapter 4

Volatility
The degree to which individual authority business rates in a particular area may change.

Reference: *Technical Paper 6: Volatility*, Chapter 3

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