Alistair Townsend

Business rate retention is still very much on the agenda and in need of local authority attention

Still analysing feedback...

"It is well established that the most volatile area of forecasting is the provisions for losses, so whilst this approach will reduce the in-year financial impact on authorities, it won't make it any more accurate."

At the time of writing, over six months have passed since the Ministry of Housing, Communities and Local Government (MHCLG) closed the consultation **'Business Rates Retention Reform – Sharing risk and reward, managing volatility and setting up the reformed system'**. According to the website, the government is still **'analysing feedback'**.

Reform of such a complex matter as rates retention in time for April 2020 was always going to be tight, but delays such as this compound the uncertainty and financial difficulties faced by local government.

The consultation contained a number of open questions, such as how resets should operate, how tier splits should work and what measures could be used to incentivise pooling. However, there were also a number of more closed questions in relation to the government's proposed approach or indeed some areas where the government's intention was set out but there was no invitation to comment on it at all – just questions on how it might work.

One such example (being the one that causes most significant difficulties currently) was in relation to what have become known as **'losses on appeal'**. The consultation has basically redefined losses on appeal and grouped them into one of two categories:

- valuation changes, *and*
- physical changes.

Valuation changes are defined as changes that occur at any stage of the Check, Challenge, Appeal process and also updates made outside this process by the Valuation Office Agency. These are all changes to an authority's local list backdated to the first day of the list (i.e. the beginning of the revaluation cycle).

Physical changes are changes that are not backdated to the start of the list. These would cover any other alteration to a list, such as Material Changes in Circumstance, deletions and physical reductions, etc.

There is a quite a significance to these different categories. The fundamental difference is that the government is minded to top slice business rates income in order to compensate local authorities for valuation changes, but local authorities will not receive compensation for physical changes – these will be a matter of the risk and reward inherent within the rates retention system.

The issue of appeals within rates retention reform has formed into two primary questions – how to measure the compensation due to authorities and how to mitigate the impact of provisions on in-year finances. Measuring compensation could be fairly straightforward by using a proxy to top slice. How to mitigate the impact is more complex. This is mainly because the current ideas are either unacceptable under accounting standards or unacceptable to government.

The government has therefore suggested that the answer would be to reform the administration of the rates retention system. This starts by authorities estimating their own business rates baseline each year. This would basically be the rates income, net of provisions. There would also need to be a system of floating top-up and tariff payments, which would be used to reconcile differences between the initial estimates of business rates income provided in the NNDR1 form and the out-turn figures available after the end of the financial year through NNDR3 forms.

Because the out-turn would invariably differ from the original estimate, the top-up and tariff payments for the following year would be adjusted to reconcile the difference. It is well established that the most volatile area of forecasting is the provision for losses, so whilst this approach will reduce the in-year financial impact on authorities, it won't make it any more accurate.

Whilst there are high levels of uncertainty (not just in relation to local government finance!), there are some aspects of this consultation that appear clear. Throughout the paper, it is reaffirmed that the government is committed to the principles of rate retention, being the rewarding of local authorities that grow their business rates and to a business rates retention system that balances risk and reward for local authorities generally. The system will therefore continue to benefit those authorities that focus on ensuring rates yield is maximised.

Of course, from a local government point of view, removing volatility is extremely welcome but it will not make the administration of rates retention much simpler. Whatever way it changes, and even if the in-year financial impact of appeals is reduced, accurate forecasting of losses will remain crucially important. If the calculation of the business rates baseline changes and top-ups and tariffs become floating, it will arguably be more important to ensure that provision forecasts are even more detailed, to ensure the predicted yield losses reflect the relevant financial year when the loss will occur, so as to avoid large discrepancies between NNDR1 forecasts and NNDR3 out-turns and the resultant financial impact this might have.

Since there is no intention to protect authorities from physical changes, provisions will still need to be created to meet accounting standards. Such changes can be complex in valuation terms and from beginning to end can take some considerable time to be settled one way or the other. It is worth noting that in the appeals forecasting I have been involved in for both the 2010 and the 2017 lists, more changes relate to what would now be considered physical changes than those that would be considered valuation changes and the value of these changes can be extremely high. It is therefore crucial that local authorities retain the correct level of expertise to address this.

Alistair Townsend FIRRV CMgr MCMI is Junior Vice President of the Institute and Chair of its Local Taxation and Revenues Faculty Board. The views here are his own.