Relationship between reliefs, Adjustment Factors and growth under the alternative arrangements

Introduction

1. The Working Group has previously discussed local authorities' own national non-domestic rating (NNDR) data and rateable value data from the Valuation Office Agency (VOA) as the two data sources available for measuring business rates growth under the proposed alternative arrangements.

2. This paper is focused on the rateable value option for measuring growth. In particular, the paper sets out different scenarios for the setting of Adjustment Factors (AFs) under this option, and discusses the relationship between reliefs, AFs and business rates growth. The current proposal to set AFs as the ratio between gross and net rates payable means that any AF scenario would be dependent on the amount of reliefs awarded by local authorities, and that therefore this indirectly effects the amount of growth coming through the system.

3. The paper suggests that in setting the AFs, we should give consideration to the principles and policy outcomes that different AF scenarios would promote. The paper also discusses theory of what the impact of different AF scenarios could look like at local authority level but warns against decision-making on this basis.

4. The paper concludes that a national level AF that was fixed for a period of time could offer the best combination of certainty, stability and simplicity.

5. Members of the Working Group are invited to discuss the following:

   - *What are the principles that should be driving the setting of Adjustment Factors?*

   - *Are there any other approaches to setting Adjustment Factor)?*

Background

6. The alternative model seeks to decrease volatility in the current business rates retention system by stripping out the impact of provisions from the way in which business rates growth is measured. In order to do this, members of the Working Group have previously discussed how the sequencing for calculating non-domestic rating income (see Table 1) suggests that under the alternative arrangements, growth would need to be measured either at the level of Gross Rates Payable (GRP) or Net Rates Payable (NRP), i.e. before accounting adjustments for provisions have been made.

Table 1: Sequence for calculating non-domestic rating income

Gross rates payable (rateable value of businesses multiplied by the business rates multiplier)
Less reliefs (transitional, mandatory, unoccupied property, discretionary and hardship)
Net rates payable
Add/Less accounting adjustments (losses on collection and provision for alteration of lists and appeals)
Collectible rates
Add/Less transitional protection payment *Less cost of collection* *Less special deductions* *Less disregarded amounts*
Non-domestic rating income

7. The GRP figure does not account for the mandatory and discretionary reliefs that local authorities award to rate payers. As such, if the GRP figure was used to establish growth baselines (i.e. baseline against which business rates growth was to be measured), we would risk exaggerating the amount of growth in the system by not taking account of the reliefs awarded to rate payers. On this basis we have previously concluded that it would be more practicable to measure growth at the level of NRP.

8. Using the rateable value data for setting growth baselines, we would need to find a way of converting the GRP figure into a corresponding NRP figure, so that this number could then be compared against the non-domestic rating income outturns in local authorities' NNDR forms. We have previously suggested doing this through the use of AFs, which could be derived from the ratio between net rates payable and gross rates payable.

9. In principle, this proxy NRP figure would take account of all reliefs deducted from GRP, including mandatory reliefs and those that are within the discretion of local authorities themselves to award. We also ought to recognise that whilst certain reliefs are mandatory to all local authorities, authorities themselves often have little manoeuvre over which types of businesses choose to set up in their areas. This means that two authorities with similar rateable values could have very different non-domestic rating outturns depending on the number of businesses eligible for mandatory reliefs in their respective areas. Therefore, there is a separate question of whether all reliefs should be accounted for when we set the AF, or whether certain reliefs should be left out of the calculation.

10. It is also worth noting that the calculation of AFs is (i.e. ratio of net rates payable to gross rates payable) is an approximation for the rates collected in respect of an individual property. For example, provided that the AF was set at 0.9, a local authority hosting businesses not eligible for reliefs, would only receive 90% of the yield instead of the full amount. At the same time, that same authority could be hosting businesses that are eligible for significantly more relief than implied by the 0.9 AF.

11. For the purposes of this paper and the discussion to follow, we will continue to assume that the proxy AF should be set on the basis of the ratio between GRP and NRP, as the simplest and most practicable way of conversion.

Principles for setting Adjustment Factors

12. We have previously discussed how the AFs could be set either nationally or locally, either once at the outset of the reformed scheme or by adjusting them each year. It is important that we consider carefully what the impact of different AF scenarios could be on local government, and what are the principles and policy outcomes that different AF scenarios would promote.

13. **A national AF would help ensure that every authority benefits equally from the same type of business rates growth.** That is, if two different authorities each attracted a new business of the same rateable value, they would be rewarded for growth equally (see discussion in paragraph 9). **A national AF would also promote system simplicity,** as it would be simpler to operate than many local level AFs.

14. **A set of different AFs for each local authority would promote a more tailored approach, taking account of local differences in reliefs.** That is, if a particular local authority pays out more or less relief than authorities on average, then one could argue that this should be taken into account when calculating their growth reward. However, as discussed in paragraph 9, in many cases the types of businesses that an area attracts is not within the area's own control and therefore a local approach could limit perceived fairness in the system.

15. **A fixed AF improves stability, certainty and simplicity**. If the AF were fixed over a reset period, it would provide authorities with certainty and stability over their growth reward. However, a fixed AF would also effectively bake-in the pattern of reliefs in the baseline year and would mean that authorities would pick up or benefit from the marginal cost of changes in reliefs.

16. **A variable AF better reflects changes in the take-up of and eligibility for reliefs.** The take-up of reliefs can change over time, as can the number and value of businesses eligible for relief. A variable AF would allow us to take account of these sorts of changes. Fixing the AF means that authorities would bear the cost of increased reliefs, but gain from any reductions in reliefs. On the other hand, if the AF were recalculated each year authorities would not be able to plan as effectively.

17. In summary, the choice between a national and local level AF must be balanced between the principles of simplicity and complexity, as well as with what is seen as a fair way to reward authorities for growth when the effect of reliefs on that growth is accounted for. The choice between a fixed and variable AF on the other hand will be between the principles of stability, certainty and simplicity against the potential monetary costs. On the whole, it might be argued that a national factor that was fixed for a period of time would offer the best combination of certainty,

stability and simplicity, but there is a question of whether this seems like the best combination of principles to aim for, and whether authorities would be willing to accept any associated trade-offs.

Impact of reliefs on Adjustment Factors and growth

18. We will now build on this theory of principles by studying the relationship between reliefs, AFs and growth more carefully. The aim is to understand the impact that changing profile of reliefs and different AF scenarios could have on the amount of growth coming through the business rates retention system under alternative arrangements at local level.

19. For the purpose of the discussion below, net growth is defined as:

RV Growth x Small Business Rates Multiplier x Adjustment Factor

20. **This means that, all else equal, authorities will get higher growth if:**

    a. The rate of change of their RV is higher;
    b. The small business rates multiplier is higher;
    c. Their AF is larger.

21. AF is the ratio of net and gross rates payable (NRP/GRP) and can be expressed as:

$$\frac{RV*MP-R}{RV*MP} = 1 - \frac{R}{RV*MP}$$

where:

    a. RV – in year rateable value
    b. MP – small business rates multiplier
    c. R – reliefs (mandatory/discretionary)

22. **This means that, all else equal, Adjustment Factor is higher when:**

    a. The "in-year" RV is higher;
    b. The small business rates multiplier is higher;
    c. The amount of reliefs is lower.

23. Assuming positive growth, and on the basis of the definitions above, the impact of the choice of AF on the measure of growth is summarised in Table 2 below.

Table 2: The impact of the choice of Adjustment Factor on the measure of growth

	Moving	***Fixed***
Individual	LA reliefs < National level reliefs LA reliefs < LA 1st year reliefs	LA reliefs < National level reliefs LA reliefs > LA 1st year reliefs
National	LA reliefs > National level reliefs LA reliefs < LA 1st year reliefs	LA reliefs > National level reliefs LA reliefs > LA 1st year reliefs

24. **Individual AF recalculated yearly would give higher level of growth for local authorities:**

    a. where reliefs as a proportion of their gross rates payable is lower compared to the national level.
    b. where reliefs as a proportion of their gross rates payable is lower in any following year compared to the first year of the scheme.

25. **National AF recalculated yearly would give higher level of growth for local authorities:**

    a. where the individual AF is lower than the national factor, because their reliefs as a proportion of gross rates payable is higher than the national level.
    b. if national level of reliefs is lower in any following year compared to the first year of the scheme.

26. **Individual AF fixed at the beginning of the scheme would give higher level of growth for local authorities:**

    a. where more reliefs were given in any years compared to the national level reliefs in the first year of the scheme.
    b. where reliefs as a proportion of their gross rates payable is lower compared to the national level.

27. **National AF fixed at the beginning of the scheme would give higher level of growth for local authorities:**

    a. where the individual AF is lower than the national factor, because their reliefs as a proportion of gross rates payable is higher than the national level.
    b. where reliefs were more generous in the following years compared to the first year of the scheme this way decreasing the AF.

28. The impact of the choice of AF would be different if growth was negative.

Conclusion

29. Whilst the setting of AFs is a technical matter, it seems right that the way in which the AF is set should give consideration to the principles and policy outcomes that different AF scenarios would promote. Given that the impact of different AFs on local authorities is dependent on any future changes to reliefs, it would also be challenging for individual local authorities to make predictions on the optimal AF scenario on any other grounds.

30. This paper has suggested that a national factor that was fixed for a period of time could offer the best combination of certainty, stability and simplicity. Authorities may also have different perceptions on whether reliefs that other authorities award either mandatorily or within their own discretion should have an impact on the amount of growth experienced elsewhere.