Leeds CITY COUNCIL

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Report of City Solicitor

Report to Corporate Governance and Audit Committee

Date: 27th January 2017

Subject: Business Rates – Working Group Recommendations

Are specific electoral wards affected? If yes, name(s) of ward(s):	☐ Yes	☒ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	☒ No
Is the decision eligible for call-in?	☐ Yes	☒ No
Does the report contain confidential or exempt information? If relevant, access to information procedure rule number: Appendix number:	☐ Yes	☒ No

Summary of main issues

1. During the consideration of the accounts for 2015/16, Corporate Governance and Audit Committee learned that considerable sums of public money are needed to cover costs of successful appeals against business rates. The position within the Collection Fund for business rates has deteriorated, with the closing deficit for 2015/16 standing at £70m, of which 49% will fall on the council. A significant element of this deficit (£47m) was taken into account when setting the 2016/17 budget. The outturn position therefore means that a further £23m will have to be recovered when the 2017/18 budget is set, with £11m of this falling on the council.

2. The committee wished to understand the reasons for this volatility and uncertainty as it places considerable strain on both the Leeds City Council budget and the ability of the authority to plan over the short to medium term. The committee were also concerned that should that volatility continue when local authorities become responsible for retaining 100% of local business rates – that volatility and pressure on funding services and delivering outcomes for the people of Leeds will continue to increase.

3. A small working group was established by the committee, with representation from each political group serving on the committee, to explore these matters with Leeds City Council officers and representatives from the Valuation Office Agency.

Recommendations

Corporate Governance and Audit Committee is asked to agree to the recommendations made by the committee’s Working Group on Business Rates, namely.

Recommendation 1
The Chief Officer (Financial Services) advises the Executive Board on the implications of the 2017 Ratings List early in 2017.

Recommendation 2
That the Chief Officer (Financial Services), provides a quarterly update to Executive Board on the status of business rates appeals and the impact that successful appeals are having on the council’s financial position.

Recommendation 3
That the Chief Officer (Financial Services), by way of the annual financial management assurance report to Corporate Governance and Audit Committee, keeps the committee advised of ways by which the local authority’s exposure to financial risks arising from successful business rates appeals is being managed.

1. Purpose of this report

1.1 This report presents recommendations for approval by Corporate Governance and Audit Committee following consideration of issues relating to Business Rates by a Working Group appointed by the Committee in September 2016.

2. Background information

2.1 During the consideration of the accounts for 2015/16, Corporate Governance and Audit Committee learned that considerable sums of public money are needed to cover costs of successful appeals against business rates. The position within the Collection Fund for business rates has deteriorated, with the closing deficit for 2015/16 standing at £70m, of which 49% will fall on the council. A significant element of this deficit (£47m) was taken into account when setting the 2016/17 budget. The outturn position therefore means that a further £23m will have to be recovered when the 2017/18 budget is set, with £11m of this falling on the council.

2.2 The committee wished to understand the reasons for this volatility and uncertainty as it places considerable strain on both the Leeds City Council budget and the ability of the authority to plan over the short to medium term. The committee were also concerned that should that volatility continue when local authorities become responsible for retaining 100% of local business rates – that volatility and pressure on funding services and delivering outcomes for the people of Leeds will continue to increase.

2.3 A small working group (Cllr Grahame, Cllr Harrand and Cllr J Bentley) was established by the committee to explore these matters with Leeds City Council officers and representatives from the Valuation Office Agency.

2.4 In particular the working group sought to understand:

- The roles, responsibilities and decision making processes of the Council and the Valuation Office Agency;
- The risks to the Council's budget setting process associated with business rates retention;
- Current and future trends in respect of business rate income and liabilities arising from business rate valuation appeals;
- Any impact arising from the publication by the Valuation Office Agency of the new ratings list and of the new arrangements for the dealing with Business Rate appeals.

2.5 A meeting took place with the Valuation Office Agency on the 14th November 2016.

3. Main issues – The Working Group's Findings

The Valuation Office Agency's (VOA) role

3.1 The VOA told us that their fundamental role is to establish and maintain a 'Fair and Accurate' Ratings List which details the rateable value of each business/commercial entity. In doing this the VOA sets the rateable value of non-domestic properties. We now understand that the Ratings List is taken at a snap shot in time and is based in rental value as if premises were vacant and ready to let – there is no consideration permitted to the profitability or turnover of an individual business.

3.2 We have also been advised that the current Ratings List, which became operational in 2010, is based on circumstances that were prevalent in 2008 and that a new Ratings List, based on the prevailing circumstances in 2015, will be operational from April 2017.

Leeds City Council's Role

3.3 The role of the Council is to:

- Identify the party liable for business rates at each property in the rating list and issue accounts in accordance with the rateable value in the list.
- Ensure any relevant mandatory or discretionary reliefs are applied to the accounts.
- Take appropriate action to recover payment of the business rates due.
- Notify the Valuation Office of any potential additions to the rating list or amendments to existing entries.

Collaborative Working between the VOA and the Local Authority

3.4 We have been assured that the local Leeds VOA Office and the Local Authority work collaboratively to ensure that the Ratings Lists remains up-to-date – with Leeds City Council officers being commended by VOA colleagues for how proactive and professional they are in ensuring the list accurately reflects the circumstances within the City and that the rating list contains everything it should and at the correct rateable value.

3.5 We have been told that this collaboration typically includes the VOA giving notice to the local authority of appeals received and the local authority providing details relevant to the circumstances of appeals for the VOA to have regard to in determining those appeals, and routinely advising the VOA of new planning permissions in order that they can be reflected in the Ratings List.

3.6 The authority and the Rates Retention Team at the VOA are working closely in preparation of the move towards the planned 100% retention of Business Rates.

Business Rates Retention – The position in Leeds

3.7 Local authorities now act as both principal and agent, collecting business rates both to keep and to pass to central government.

3.8 Under the current business retention scheme, local authorities retain 50% of locally collected rates, including 50 per cent of any local growth, but also bear 50 per cent of the risk if business rates fall. So benefitting from growth but exposed to financial risks should business rates fall or fail to grow as expected or should market rents show a substantial reduction generating appeals. As a result they have needed to set aside funds to make provision to meet the cost of future repayments to ratepayers following successful appeals.

3.10 Business rate income is inherently volatile and the Council's financial position can be adversely affected by a range of factors. These include:

- Slower than forecast growth;
- The impact of mandatory reliefs, particularly issues regarding charitable relief and empty rates relief;
- Government policy – for example measures in the 2016 Budget, included permanently doubling Small Business Rate Relief (SBRR) and increasing thresholds, taking over 600,000 businesses out of business rates taxation and a further 250,000 out of the higher rate. As a result we have been advised that around a third of business ratepayers in Leeds will pay nothing at all.
- Reductions in rateable value due to changes in local circumstances as determined by the Valuations Office Agency (VOA), for example the reductions applied to numerous retail properties in Leeds City Centre to reflect the impact of the opening of Trinity;
- Reductions in rateable value arising as a result of a successful appeal in one part of the country, where the basis for appeal applies more widely. In these circumstances the VOA instructs billing authorities to reduce rateable values of relevant properties in their area, whether or not they have appealed. One such recent decision related to purpose-built medical centres;
- Discounts applied due to flooding (although some grant income is received to partly offset this);
- Empty property relief
- But most significantly, reductions in rateable value due to appeals by ratepayers and their agents.

3.11 Local authorities are required by statute to account for council tax and business rates income in a 'Collection Fund', a separate accounting statement showing the amounts that each billing authority forecast it would collect and how that has been distributed. Leeds City Council complies with these requirements although forecasting the value of any appeals is complex and can't be wholly accurate due to factors beyond the council's control.

3.12 It is necessary to recognise in the budget the amount that is forecasted to be collected and any actual surplus or deficit is carried forward to the following year's budget: so a surplus one year will increase the amount of business rates income available to spend on services the following and vice versa. This approach is intended to give local authorities some time to plan for volatility in income rather than having to respond in year. By the end of this Parliament, the Government's proposals are that local authorities will be allowed to retain 100% of business rates, with an associated increase in exposure to business rate risk.

3.13 Prior to the introduction of the rates retention scheme all business rates collected were paid into a central pool and redistributed amongst all authorities on a needs based formula. Any change in rateable values had no direct financial impact on the authority.

3.14 Since April 2013 a 50% retention scheme has been in place. Leeds will collect £394 million in business rates in 2016/17, of this approximately £33 million is paid to central government as a 'tariff' – i.e. this is the amount by which the rates income exceeds the amount Leeds is deemed (by Central Government) to require. The authority can keep up to 50% of any growth. However it also has fund 50% of any loss in income due to appeals.

Business Rate Appeals

3.15 We have established that all ratepayers have the right to appeal to the VOA if they consider that their Rateable Value has been set too high at the time of the revaluation or if there has been "a material change of circumstance" that they consider should result in the Rateable Value of their property being reduced. Appeals can result in reductions being backdated to the point at which the valuation became effective. They can be made by a ratepayer, or their agent, at any time until a year after the next revaluation. Billing authorities have no right to present evidence at an appeal.

3.16 We have been learned about the basis upon which businesses can appeal the level of business rates that they are paying; we've also learned about the criteria used to assess and determine the grounds for Business Rate Appeals.

3.17 Businesses may appeal the business rates because; a) the compiled list is wrong; b) there is a material change in circumstances relating to the property; c) because of the outcome of a Land Tribunal Appeal; d) because the premises meets the criteria of an exemption; e) on receipt of a notice from the VOA advising of a change.

3.18 The VOA has told us that 28.4% of appeals in Yorkshire and the Humber are successful and these can be categorised into two main types.

3.19 The first involve reductions that are backdated to the time the valuation came into effect, i.e. the beginning of the current ratings lists. Fundamentally these are correcting valuation errors made by the VOA and have been termed "tone of the list" appeals.

3.20 Under the current list, these successful appeals result in backdated reductions to April 2010 with a refund stretching back seven years. Local authorities have to meet 50% of the costs of settling these backdated appeals back to 2010, despite the current business rates scheme only having being introduced in April 2013 so authorities had not shared the original benefit in full.

3.21 "Tone of the list" appeals are currently overshadowing Leeds' achievements in attracting growth to the city because of the 'gearing effect' of losses caused by backdating. If Leeds suffers a loss of £1 in RV from a successful appeal that is backdated to 1st April 2010 it must achieve approximately £6 in growth in RV to compensate for the cost.

3.22 The second main type of successful appeal is a "material change in circumstance" following a change in the specific building or the surrounding area. An example of this in Leeds is the reductions in RV following the opening of the Trinity shopping centre. The VOA consider that a city centre like Leeds has a certain capacity for retail and the provision of further retail space inevitably, therefore, leads to reductions in RV elsewhere in the city centre.

3.23 The working group does not support that view as this fails to take into account the unique ‘regional capital’ position of Leeds in both West Yorkshire and beyond. The working group does not support the premise that the city centre has either a fixed demand for retail space or a fixed supply capacity.

3.24 The working group understand that the consequent reductions in the RV of shops in the city centre are ongoing and are backdated to April 2013 when Trinity opened. These reductions include shops that have not lodged a formal proposal or appeal. We understand that the council currently holds provisions of £3.52 million, on the advice of the VOA, for all the properties that have not been dealt with by the VOA yet.

3.25 When Committee considered a report on Business Rates in September we were advised that at 31st July 2016 there were 6,194 outstanding appeals in Leeds, requiring the Council to set aside a provision of £23.38 million, funding that could otherwise be spent on services. When we met with the VOA in Mid-November we were advised that the number of appeals had fallen to around 5,500.

3.26 We asked the VOA whether the Council’s role in securing improvements in infrastructure and public realm is a factor that is taken into account by them in the determination of appeals, particularly whether this helps them defend the Rateable Value which was initially established in the Ratings List. The VOA has been very clear. These are not factors which have an impact in the Appeal conclusions which they reach – there overriding consideration being what the market rent would command for that property if it were vacant to available to let.

3.27 We have learned that the local authority is required by statute to make provision within the budget/accounts to cover the cost of any successful Appeals – however there is no nationwide formulae to dictate what such provisions should be and nor is the Council able to make provision for income lost due to VOA decisions which are not appeals, as mentioned earlier it is not possible to reasonably estimate a provision accurately.

3.28 Collectively, local authorities have set aside around £1.75 billion in the past three years to cover the risk of backdated appeal. Successful appeals are most commonly backdated to the start of the current Valuation List, i.e. 1st April 2010, greatly increasing the in-year impact on local authorities – this being compounded due to the delay imposed by the then Chancellor of the Exchequer in reviewing and replacing the 2010 Ratings List. As a result of this backdating, the Council needs now around £6 of rateable value growth for every £1 of rateable value lost in 2016/17 just to maintain its level of income. Because of this there continues to be a key risk to the delivery of the council’s objectives and the provision of services to vulnerable people.

Monitoring the financial impact of Appeals

3.29 We’ve been told that Business rates income is monitored in detail and reported to an officer Financial Performance Group on a monthly basis. That officer group then highlights any key issues that have emerged to Executive Board.

3.30 Our understanding is that since April 2013 the cost to the collection fund of settling appeals has been £90.11 million, Leeds’ share of this cost being £44.16 million, although this has varied from £12.95 million in 2013-14 (Leeds’ share £6.34 million) to £39.06 million in 2015-16 (Leeds’ share £19.14 million). This volatility has further added to the difficulty of managing the costs of appeals in the city.

3.31 As a billing authority, Leeds City Council receives a refreshed list of all proposals and appeals lodged with the VOA and VTE every month. It is this list that forms the basis of the provision that the Council makes each year, holding back income for future repayments due to successful appeals. In line with accounting rules Leeds City Council only makes provisions for appeals and reductions in RV about which it has specific knowledge.

3.32 We've also been informed that both financial forecasting and the in-year budget are key risks which are monitored through the Council's Corporate Risk process.

The New 2017 Ratings List and the Proposed Check, Challenge Appeal System

3.33 We've been told that the Government has made attempts to reform information sharing between the VOA and billing authorities to help with the management of appeals risk but as yet this does not seems to have helped local government manage the risk they must carry.

3.34 The VOA informed us that the Government has recently proposed a major reform of the appeals system itself called "Check, Challenge, Appeal" to attempt to reduce the time lag between the lodging of an appeal and its outcome. The Government hopes that this will reduce the amount of backdated repayments that have to be made and has confirmed it will be introduced from April 2017.

3.35 The new procedure will involve three stages and the Government intends that if an appellant or the VOA do not introduce evidence at an early stage then they shall not be allowed to do so during the final appeals stage. The three stages are: -

3.36 Check – where the ratepayer can check the information held by the VOA and attempt to agree changes, or at least agree where they disagree.

3.37 Challenge – where the VOA and ratepayer, or agent, will enter into formal negotiations about the correct RV. The ratepayer will have to submit a proposed alternative RV with evidence and there will be penalties for providing misleading information. The VOA will respond only to a complete 'challenge'.

3.38 Appeal – where disagreement persists, the ratepayer will be able to submit an appeal to the VTE, but the right to submit new evidence will be restricted.

3.39 However we remain to be convinced that this system will alleviate the uncertainty and volatility and uncertainty in the council's finances caused by Appeals. Our understanding is that the first two stages alone will still be able to continue for up to 34 months before the formal appeal is to be lodged, and it cannot as yet be estimated what effect the new system will have on backdated appeals costs.

3.40 By way of comparison the properties subject to appeal in the city of Leeds as at 31st July 2016, only 275 (just over 6%) first entered the process more than 34 months ago.

Conclusions and Recommendations

3.42 The Gross Rateable Value for the city is now estimated to be £919 million, which is less than the value prior to the opening of Trinity Centre. Although there are now more rateable premises in the city, many have lower rateable values as a result of successful appeals or decisions by the VOA. We are concerned that even in relatively successful city with good growth and evidence of positive investment prospects that the ability of the authority to fund services is subject to the vagaries of a funding system that the council has little ability to influence or control.

3.43 As has been the case in the past, the 2017 revaluation is likely to bring a fresh wave of business rate appeals which will increase the financial volatility faced by councils further, particularly as the move towards a system based on 100% Business Rate retention will by definition expose the Council to greater volatility where appeals are successful.

Recommendation 1

The Chief Officer (Financial Services) advises the Executive Board on the implications of the 2017 Ratings List early in 2017.

3.44 Whilst satisfied that Business rates income and risks associated with volatility is monitored at an officer level - the working group's view is that further routine information should be available to Executive Members at Executive Board. We particularly feel that there is a gap in the in-year reporting of the financial risk of successful Appeals.

Recommendation 2

That the Chief Officer (Financial Services), provides a quarterly update on the status of business rates appeals and the impact that successful appeals are having on the council's financial position.

3.45 The working group also feel that the annual financial assurance report for Corporate Governance and Audit Committee also feature more information specific to managing business rate risks.

Recommendation 3

That the Chief Officer (Financial Services), by way of the annual financial management assurance report to Corporate Governance and Audit Committee, keeps the committee advised of ways by which the local authority's exposure to financial risks arising from successful business rates appeals is being managed.

4. Corporate considerations

4.1 Consultation and engagement

4.1.1 The recommendations to the committee follow consideration of matters with the Valuation Office Agency, the Council's Business Rates Manager and following discussions with the Deputy Chief Executive

4.1.2 The Deputy Leader and the Deputy Chief Executive are supportive of the proposals and it is understood that the Chief Officer (Financial Services) will be responsible for implementing the recommendations.

4.2 Equality and diversity / cohesion and integration

4.2.1 There are no implications for this report.

4.3 Council policies and best council plan

4.3.1 There are no implications for this report.

4.4 Resources and value for money

4.4.1 There are no implications for this report.

4.5 Legal implications, access to information, and call-in

4.5.1 As a decision in relation to a Council function, this decision will not be eligible for Call In.

4.6 Risk management

4.6.1 This report seeks to address elements of the Council's Governance arrangements associated with the volatility of Business Rates income to the authority, particularly as a result of Business Rate appeals.

5. Recommendations

5.1 Corporate Governance and Audit Committee is asked to agree to the recommendations made by the committee's Working Group on Business Rates, namely.

Recommendation 1
The Chief Officer (Financial Services) advises the Executive Board on the implications of the 2017 Ratings List early in 2017.

Recommendation 2
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Recommendation 3
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6. Background documents[1]

6.1 None

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[1] The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.