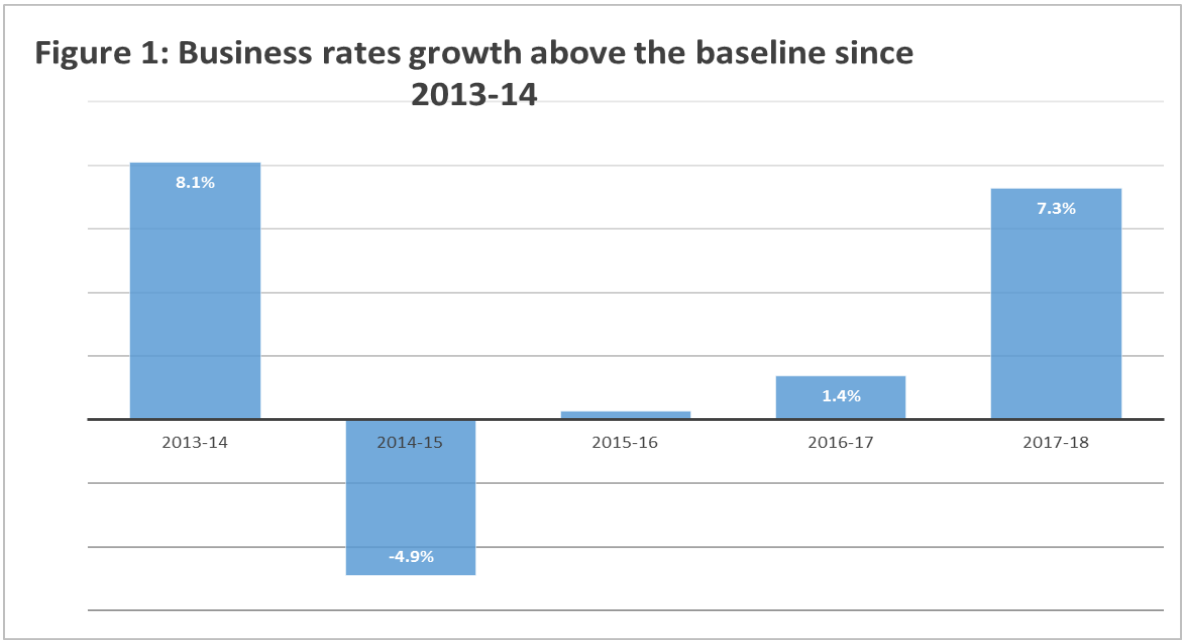
Appendix 1: The continuing volatility of business rates income – updated to 31/12/18

Introduction

1. The key difference between business rates income and grant income is its uncertainty. Although business rates income in Leeds has included growth above the baseline in every year since the beginning of the retention scheme except 2014/15, from year to year the income has been very volatile (see **Figure 1** below). This volatility has presented a significant challenge for medium-term financial planning.



2. The volatility of business rates income is mainly caused by a series of factors that are largely outside the control of local authorities including: -

- Ratepayers' appeals to the Valuation Office Agency (VOA) against their Rateable Value (see **paragraph 3** below).
- The national economic environment affecting local growth, 'Empty Rates Relief' and non-collection of income (see **paragraph 9** below).
- Decisions about valuation methods elsewhere in the country that affect similar classes of properties locally (see **paragraph 13** below).
- Policy decisions by central government that affect business rates income (see **paragraph 17** below).
- Legal decisions affecting matters other than Rateable Value (see **paragraph 19** below).

Appendix 1: The continuing volatility of business rates income – updated to 31/12/18

Ratepayers' appeals against Rateable Value

3. Ratepayers have a right to lodge appeals against the valuation given to their property by the VOA, usually because they believe the original value to be wrong or following a material change in the property or local area. The result of an appeal can be backdated to the beginning of the relevant ratings list.

4. Leeds City Council, along with all other billing authorities, have no right to present evidence at an appeal or have any other part in the decision-making process, but must meet its share of any cost, including any backdated refund.

5. The cost of successful appeals has varied significantly from year to year since the introduction of business rates retention in 2013/14 (see **Table 1** below). The total cost incurred in year includes costs relating to the current year and also costs arising in the current year but relating to a previous year. The Council has been able to smooth the costs to some extent with the use of provisions, but their inherent volatility has made forecasting the level of provisions required particularly difficult. The provision we make is a cost to the General Fund and can impact on our revenue position in the year it is set.

Table 1: The total cost of appeals and Valuation Officer Reports to Leeds City Council as at 31 December 2018

Year	Cost (£)	Share	Total cost to Leeds (£)
2013/14	12,948,390	49%	6,344,711
2014/15	29,070,661	49%	14,244,624
2015/16	39,061,572	49%	19,140,170
2016/17	21,947,570	49%	10,754,310
2017/18	32,623,545	49%	15,985,537
2018/19	6,618,340	99%	6,552,156
TOTAL	**142,270,078**		**73,021,508**

6. There were a large number of appeals lodged against the 2010 ratings list. By 31st December 2018 there were 21,171 individual appeals affecting approximately 13,061 businesses in Leeds, and 6,330 resulting in reductions to Rateable Value. 1,466

appeals remain outstanding, and 9 are still outstanding against the 2005 list. Further details about the settlement of appeals in 2018/19 are given in **Appendix 2** to the main report, along with the incidence of the creation and use of provisions since 2013/14.

The Government, after significant pressure from local government, has made a number of changes to the appeals system to try and reduce this volume of appeals and help local authorities manage the costs, with varying degrees of success, including: -

- In 2016 the Government made statutory provision to allow the VOA to release more information about individual appeals to billing authorities. However, the VOA, part of HMRC, take a very restrictive view of this power and the information remains minimal.

- During the lifetime of the 2010 ratings list, a ratepayer could simply lodge an appeal against their Rateable Value without giving any substantive argument. Local government argued this led to many speculative appeals and a lot of small alterations to the list which were cumulatively having a significant impact on local authority budgets. The Government has reformed the process with a new system coming into force for the 2017 list called 'Check, Challenge, Appeal'. Under this system ratepayers have to put forward a suggested alternative Rateable Value for their property, and give arguments why this Rateable Value should apply. There are also strict rules about when new evidence can be submitted to the process and strict deadlines for each stage of appeals process. Although it is too early to be certain, this appears to have had a significant impact on the volume of appeals, and it is hoped it will greatly reduce delays. However a new portal, allowing ratings agents to lodge appeals on behalf of multiple clients, is to come online in the Autumn of 2018, which may at least partially reverse this trend.

- The Government has discussed with local government the possibility of centralising the cost of some appeals known as 'tone of the list' appeals. These are appeals that result in reductions of Rateable Value stretching back to the beginning of the current ratings list and, under the proposals, would be assumed to be as the result of an error in the original valuation by the VOA which local authorities should not have to fund. If such a system had been in force during the 2010 ratings list it is estimated that, of the 6,330 appeals that resulted in a reduction to Rateable Value, 3,300 would have been funded by a central fund. It should be noted, however, that this central fund would be funded by a top-slice from the funding available to local authorities through the Settlement process and careful analysis is required to see if the savings from not having to meet the costs of 'tone of the list' appeals locally are outweighed by the reduction in Settlement funding.

Appendix 1: The continuing volatility of business rates income – updated to 31/12/18

7. With the introduction of the 2017 ratings list there appears to have been a much reduced level of appeals compared to the 2010 list (see **Table 2** below for a comparison of the volume of appeals at the same stage in the life of the two lists). A number of explanations have been put forward for this difference including: -

   - The 2010 ratings was set at a date (1st April 2008) at the height of the commercial property boom, but came into force once the financial crisis had happened, encouraging ratepayers to appeal their high valuations.

   - The 2017 ratings is simply more accurate than the 2010 ratings list.

   - The new Check, Challenge, Appeal system has deterred speculative appeals from ratepayers and ratings agents.

Table 2: Comparison of the number of appeals after 18 months of the 2010 list and the 2017 list

	No. of appeals after 18 months (in Leeds)
2010 ratings list	5,804
2017 ratings list	1,243

There remain a number of risks in assuming this situation will continue. As mentioned in **paragraph 6** above, a new portal for ratings agents to lodge appeals is being launched this Autumn and there have been a number of problems with the introduction of the new appeals system for the 2017 ratings list which, when resolved, could see a return to a higher level of appeals being received by the VOA.

8. Taking into account all the uncertainties about appeals, Leeds City Council at 31st December 2018 holds provisions against losses from appeals of £17.19m, and estimate maintaining the required level of provisions will cost the Council's General Fund £9.04m in 2018/19.

The National Economic Environment

9. The national economic environment affects the ability of local authorities to generate growth in their area as demand for new premises reduces during an economic downturn, and yet most of the levers that can improve the national economic climate are held by central government.

10. Economic downturns also increase Empty Rate Relief. Although full business rates (known as 'Empty Rates') have to be paid by a landlord after a property is empty for 3

months (6 months for industrial properties), there are an increased number of business failures during a downturn, and relief can be claimed indefinitely by a company in administration. In 2013/14, the first year of the business rates retention scheme and still feeling the effects of the financial crisis, in real terms Empty Rate Relief reduced business rates by £22.61m in Leeds. In 2018/19 it will reduce business rates income by £19.50m and has been reducing for a number of years.

11. Finally there is an increased level of written-off debts during a downturn as it becomes clear that it is not economical to collect money owed for business rates. During the last financial crisis the provisions for non-collection held by Leeds City Council increased from 1% of net amounts billed to 1.2%, although it has returned to 99% collection since. If 1.2% had to be applied to provisions again in 2018/19 it would cost the authority an additional £1.75m.

12. Leeds City Council currently hold bad debt provisions of £6.85m on 31st March 2018 for all as yet uncollected amounts, with the estimated cost to the General Fund of maintaining the required level of provisions being £3.65m in 2018/19.

Valuation Officer Reports

13. Weekly the Council receives notices from the VOA instructing the Revenues department to increase, or reduce, a property's Rateable Value. These can be in response to a billing authority report to the VOA about a change to a property (usually resulting in an increase), a change encountered by VOA inspectors or a change in valuation practice outside the Leeds area but affecting a class of property locally and about which the Council has no prior notice.

14. In Leeds, billing authority reports to the VOA, usually as a result of visits by Council inspectors, increased business rates by approximately £7.27m in 2017/18, with the Council's share of that income being £3.56m.

15. The most recent example of action in an area outside of Leeds affecting properties within the Leeds area was the reduction of Rateable Value, by around 50%, of all purpose-built medical centres in 2015. The reductions were backdated to 1st April 2010 because the method of valuation was changed and this cost Leeds City Council an estimated £7.5m.

16. The future cost of Valuation Officer Reports cannot be estimated reliably from year to year and therefore it is impossible for the Council to hold any provisions for these losses using proper accounting practices. However, taking this uncertainty into account, we currently estimate that Valuation Officer Reports will cost Leeds City Council's General Fund £0.68m in 2018/19.

Appendix 1: The continuing volatility of business rates income – updated to 31/12/18

Central Government policy decisions that affect business rates income

17. Local government usually receives compensation for Government policy decisions that directly affect business rates income. For example Government recently mandated a series of reliefs that were to be given by billing authorities to help businesses transition to the new 2017 ratings list. The Government meets the cost of lost income to authorities through a grant. The Government also changed the rate by which the multiplier increases from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) and pays the losses this causes to councils through a grant.

18. However there are other policies that have affected business rates income that are not compensated for. For example, when a school is controlled by a local authority it must pay 100% of business rates but an Academy School can claim 80% Mandatory Charity Relief (along with private schools). As the number of Academies increases, this reduces income to the local authority for which there is no compensation.

Legal decisions affecting matters other than Rateable Value

19. In recent years there have been a number of legal decisions that have affected matters other than Rateable Value and yet have a direct impact on local authorities' business rates income and challenge long-held general practice.

20. For example, in 2016/17 a case was taken to the Court Appeal arguing that an office covering two floors in an office block, but separated by a common staircase should be treated as two separate properties rather than one (the 'Mazaars' case). This has had a significant impact on some authorities' business rates income where a single property becoming two separate properties has resulted in both becoming entitled to Small Business Rates Relief. In Leeds it was estimated that this change of practice would have little direct effect on our Revenues, because our properties tend to have high values and therefore Small Business Rates Relief is not an issue, and also in some cases two separate properties generated more income than a single property. However the Government has since introduced legislation to override the decision of the Court of Appeal, but only where it adversely affects the ratepayer. This will have an adverse effect on the Council's income.

21. There is also a legal case being brought by a number of Foundation Hospital Trusts arguing that they should be treated in a manner similar to Academies and receive 80% Mandatory Charity Relief backdated to 1st April 2010. Legal advice has been sought by CIPFA and stated that the argument put forward by the hospitals should not be successful and therefore, following proper accounting practice, no provisions have been made. However if the case is successful it is estimated this could cost Leeds City Council as much as £5.43m, with an ongoing cost of approximately £0.75m a year.