Consultation Response

Business rates: delivering more frequent revaluations consultation

Response by London Councils

London Councils represents London's 32 borough councils and the City of London. It is a cross party organisation that works on behalf of all its member authorities regardless of political persuasion.

Introduction

1. London Councils welcomes the opportunity to comment on the discussion paper *Business Rates: delivering more frequent revaluations* (March 2016). This submission builds on our previous responses to the Government's structural review of business rates in June 2015, and its review of business rates administration in June 2014. It firstly sets out London Councils' general comments, followed by responses to discussion points raised in the consultation document.

2. London Councils is concerned that the focus of the paper is, again, primarily directed towards ratepayers, with the funding consequences for local government being secondary to the need for the system to "work better for businesses". Since 2013, local government has retained half of the business rates it collects, and from 2020 this will increase to 100 per cent, representing around two thirds of local government funding. London Councils believes that due consideration to the funding of local public services should be given equal importance by Government to equity and fairness for ratepayers.

3. Reforms to the operation of the system such as shorter revaluation cycles, and changes to valuation methods should not be considered in isolation from the discussions around rates localisation as the former has a direct impact on the latter. While this discussion paper is a helpful first step in opening up debate, any reforms along the lines of those discussed in the paper would need to be developed in significantly more detail in close consultation with a range of representatives across the local government sector to ensure that they are consistent with wider local government finance, localisation and public sector reforms.

General comments

Fundamental principles

4. London Councils believes any system of funding for local government should be underpinned by the fundamental principles of stability, certainty and transparency. As such, we welcome the four year funding settlement following the 2015 Spending Review. We also welcome the move to 100 per cent business rates retention which, if implemented in the right way, could deliver relatively stable, if not necessarily certain,

funding allocations over the medium term, and potentially in a much less complex and more transparent way than under the present finance system.

5. However, ensuring the right balance of risks and incentives will be vital. The current 50 per cent retention system has significantly increased the level of financial risk borne by local government without a corresponding uplift in the opportunity for financial gain. The central reason for the increased exposure to risk is because of the way the current system treats appeals, with authorities having to make a provision for potential losses on appeal, before they actually happen. This has a disproportionate impact in London, where by April 2017 it is expected that London local government will have set aside over £1.3 billion in provisions for rating appeals.

6. It is vital that the tax operates effectively and provides local authorities with the opportunity to grow their business rates tax bases, and benefit from that growth. The current system does not do this because the growth incentive has been weak as:
   - boroughs only receive 30 per cent of any growth;
   - appeals have clouded any relationship between genuine business rates growth and retained growth;
   - growth is only retained for the period between additional value appearing on the rating list, and the subsequent revaluation, creating a perverse incentive to delay development to maximise revenue returns; and
   - growth is measured as physical rather than revaluation growth, which fails to reward authorities that have invested in the making their local areas more attractive as a business destination.

7. London Councils believes any reforms to the business rates system must primarily redress this imbalance of risk and reward.

8. The frequency of revaluations has implications for both sides of the risk-reward equation. As the discussion document points out, more frequent revaluations under the current valuation method would significantly increase opportunities to appeal (albeit that the level of volatility may reduce as both the size of appeals, and the backdating impact, would be smaller). Similarly, under the current retention system, more frequent revaluations would also be likely to reduce the level of growth incentive, as growth is effectively neutralised at each revaluation.

9. The two key competing questions are therefore: how can the valuation system be reformed to ensure it is as accurate and responsive as possible, whilst also delivering a strong growth incentive for local authorities?

10. London Councils believes the answer is to separate out revaluation from redistribution so that resources are not necessarily redistributed at each revaluation (see paras 23-25 below for fuller explanation). This should be fully considered as part of the work being undertaken by DCLG and the sector to establish the system design principles for the 100 per cent retention scheme.

A proportionate approach to valuations

11. The discussion document focusses on two potential options for delivering more frequent revaluations: self-assessment and a formula based approach. Our view is that, on their own, both options have drawbacks but if combined could play a useful role in a reformed system that could benefit both local authorities and ratepayers.

12. London Councils believes successful delivery of more frequent revaluations requires a proportionate risk based approach to valuation. As HM Treasury (HMT) points out, the top 5 per cent of properties by value make up more than 60 per cent of the total rateable value of all non-domestic properties. By contrast, the

bottom 80 per cent of properties by value, make up only 18 per cent of total rateable value[1]. It is further acknowledged by HMT that revenues derived from the lower end of value have decreased as a result of enhanced small business rate relief (SBRR). This trend will continue with the introduction of significantly enhanced reliefs for occupants of lower value hereditaments from April 2017. This raises the question of how much time and resource should be invested in establishing the rateable value of these hereditaments.

13. Broadly speaking, a proportionate approach needs to reflect the relative value of the hereditament and therefore the revenue risk to the billing authority. As value is often considered as a proxy for the size of the occupant, proportionality also carries benefits to rate payers. As such, we suggest that proportionality could be provided for through a valuation approach with three main components as follows:

    i. A simple formula based approach to the lower end of value along the lines set out in chapter four of the discussion document. This would enable the small firms that typically occupy low value hereditaments to quickly and easily assess their rateable value without incurring the cost of professional support, delivering speed and certainty for both rate payers and billing authorities.

    ii. A choice of whether to use the relevant formula or a self-assessment methodology for the occupants of mid-range hereditaments. This would allow firms to decide which methodology is more appropriate to their circumstances: the speed and simplicity of a formula, or the greater sophistication and accuracy of a bespoke valuation.

    iii. A system based on bespoke self-assessment for higher value hereditaments from which most revenues are generated, along the lines set out in section 3 of the paper. This would ensure that the system asks the most of those who are best placed to deliver, and who have the greatest interest in establishing an accurate valuation early.

14. Under a self-assessment system the role of the Valuation Office Agency (VOA) in ensuring compliance would need to be considerably increased. In order to minimise the impact on the level of resources needed, we suggest they should also be targeted in a proportionate risk based way. This could allow for some staff to specialise in agreeing high value assessments more quickly, while others carry out spot checks based on risk profiling.

Reducing uncertainty – by reforming appeals

15. Delivery of more frequent revaluations can only be viable if the valuation method, and appeals process, is reformed. If a self-assessment approach is introduced in 2020 with more frequent revaluations, it will have the practical effect of inverting the orientation of the appeals process. Currently, the VOA provides a valuation and rate payers can challenge it. Under self-assessment, it would be for the enforcing authority to decide whether it wants to challenge a valuation made by the rate payer. This raises questions around how the Check Challenge Appeal (CCA) process would work. On current expectations this could see a system set up to deliver CCA going live from April 2017, but having to be significantly reformed soon after introduction in order to take into account the changes required ahead of self-assessment and triennial revaluation.

16. Appeals under self-assessment could potentially still follow a three stage process based on CCA, but it would be the enforcing authority checking the accuracy/completeness of information from the rate payer, and it would be for the enforcing authority to formally challenge the valuation where necessary. The onus would then be on the rate payer to either accept the proposed changes to the valuation provided by the enforcing authority, or lodge an appeal with the Valuation Tribunal for England.

[1] HM Treasury, "Business rates review: terms of reference and discussion paper" March 2015, p 21

17. Either way, it is essential to improve the speed and consistency of the appeals process, and we would advocate a light touch fast track appeals process for low value hereditaments, as the current CCA proposals still allow for a process to take in excess of three years. This would clearly be unviable in a system of triennial revaluations.

18. Overall, self-assessment could provide significant benefits from a local authority perspective as it would effectively remove speculative appeals from the system, freeing up more resources to resolve the remaining cases, and releasing funds that would otherwise have been retained to cover appeals risk.

19. The introduction of self-assessment and a three year revaluation cycle could also reduce volatility as valuations would typically require a lesser degree of correction than would be the case under the five year cycle. Volatility could be further dampened as the quantity of monies required to cover appeals risk would be likely to fall considerably as a result of fewer appeals and a shortening of any backdating period.

20. However, consideration of a new approach based on self-assessment and three year cycles raises the question of what is paid by the rate payer while the valuation is being contested. The answer has implications for local government funding, particularly as the likelihood is that many challenges would focus on the more complex valuations of higher value hereditaments. Assuming that the rate payer must continue to pay rates at some level during the process, two options for determining the level of payment suggest themselves:

    - The rate payer's valuation remains in place until agreement is reached on a revised valuation or the VTE issues a decision. In this scenario, backdating risk sits with the rate payer as loss at appeal would require them to make good on the under payment. This would be in addition to any penalties that may be considered appropriate.

    - The billing authority/VOA's valuation becomes the default basis for payments from the point where the formal challenge is presented to the rate payer, until agreement is reached on a revised valuation or the VTE issues a decision. In this scenario, backdating risk is transferred to the billing authority as, if their challenge fails, they would have to return the excess monies collected.

21. On balance, the former of the two options is probably optimal from both local authority and rate payer perspectives. This is because, although monies are collected more quickly through the latter, they would be likely to be held in abeyance until the appeal is concluded. As a result, they are of limited benefit to the authority, and could be a detriment if they are to be included in the calculation of available funds. The latter arrangements would also do little for relations with the business community given the potential impact on their cash flow.

22. Finally, under the proposed system, the VOA would have to distinguish between appeals that were either a result of inaccurate applications of the formula and/or erroneous self-assessments, and those valuations that the ratepayer believes is correct but which significantly vary from the market value.

Ensuring an appropriate growth incentive

23. While more frequent revaluation theoretically makes the system more responsive to changes in economic conditions, if applied to the current system, it would also have the unhelpful side effect of reducing the duration of the period during which a local area benefits from the growth in rates revenues. This would weaken the incentive to promote growth. Furthermore it would strengthen perverse incentives to delay projects and programmes to fit with the revaluation/rebasing schedule. Subnational economic growth policy should be looking to the long term interests of the sustainable economic growth in those areas, and incentives should be supportive of this aim.

24. The issue of how to address this problem is complicated by the intention to retain 100 per cent of revenues "in sector" by 2020. One hundred per cent retention, while welcome, introduces a significant element of

uncertainty concerning the redistribution mechanisms, additional duties, needs assessment and transitional arrangements. If regional level business rates redistribution mechanisms follow a similar approach to the current national system, that looks to reward successful local economic policy, then the impact on baselines will need to be considered. The government's approach to baselining for the 2017 revaluation will also need careful consideration as part of the evolving discussions on this agenda.

25. The interrelationships with other parts of the business rates reform agenda and the evolving nature of discussions on them preclude a concrete view at this stage. However, in broad terms, we suggest that careful consideration be given to how rebasing and revaluation could be decoupled, with the former happening on longer time scales. This would provide greater certainty of funding for local authorities, as well as strengthening the incentives to promote sustainable growth and encouraging longer term decision making.

26. London Councils believes there is a strong case for exploring the potential to "de-couple" London from the national valuation system as a means of strengthening incentives to grow outside of the capital. Currently London's economic growth is artificially constricting rateable values in the rest of the country at each revaluation. Doing so would also put London in a strong positon to test self-assessment, and potential options for local management of resets as part of the wider devolution agenda.

Resourcing of the Valuation Office Agency

27. Whichever option is chosen for reforming the valuation process, it is vital that the VOA is properly resourced to carry out its duties. It is clear from the sheer volume and backlog of business rates appeals in the system under the current 5 year valuation that neither the appeals process, nor the capacity of the VOA is adequate.

28. Prior to 2013, the effectiveness and efficiency of the VOA, while obviously important to the running of the tax as a whole, held less importance for local government funding – with all business rates pooled centrally and redistributed via formula grant. Since 2013, there is now a more visible impact on local funding, with business a large backlog of business rates appeals (a particular issue in London), meaning local authorities having to make large provisions in their funding estimates each year.

29. At the same time, funding for the VOA has stayed broadly flat in real terms. Were the method of valuation to remain the same and valuations became more frequent, this would obviously require even greater levels of resources. The suggestion above of a proportionate system based on a hybrid self-assessment/formula basis would not only make more frequent revaluations viable from a practical administrative perspective, they would be much less resource intensive and may ultimately mean less resources required by the VOA.

30. London Councils is aware that the funding of the VOA from business rates revenues has been suggested by the sector under the new responsibilities working group as part of the work undertaken by DCLG and the LGA around the move to 100 per cent rates retention. While there are potential drawbacks, in terms of possible conflicts of interest under the current valuation arrangements, London Councils believes this proposal should be properly considered, particularly if it were to mean a properly resourced Valuation Office Agency.

London Councils
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Detailed response to discussion points

The challenges of delivering more frequent revaluations under the current system

- **Particular stages of the valuation process where reforms would be needed to deliver more frequent valuations**
- **The effect of more frequent revaluations on appeals**
- **The increased risk of appeals and how could this be avoided or managed**
- **Accessing the skills to deliver more frequent revaluations**
- **How the delivery of rating valuations could be reformed to support more frequent revaluations**
- **Collection and analysis of information to support more frequent revaluations, including the role of ratepayers**

31. London Councils' view is that more frequent revaluations cannot be delivered under the current system without significantly increasing the resources available to the VOA to meet the likely surge in valuations needed (and therefore subsequent appeals). As such, we see self-assessment along the lines referred to previously as the only practical means of delivering more frequent revaluations.

32. The current proposals for reforming appeals outlined in Check Challenge Appeal (CCA) are unlikely to provide sufficient improvements to make more frequent valuations viable under the current valuation system. With the current CCA proposals allowing for a process to take in excess of three years, many hereditaments may become almost permanently subject to appeal. It is difficult to see how CCA would deliver faster resolution of cases within the current revaluation arrangements, and it is even more difficult to see how it could do so on a three yearly cycle.

33. When the combined effect of CCA and 100% retention are considered together, it seems likely that a different approach to valuation and appeals is required.

34. Furthermore, it is clear that valuation processes, appeals, and 100% rates retention and localisation must be developed together going forwards, as well as being understood as part of a much wider reform programme in England. .

A self-assessment alternative

- **The publishing of rental information by the VOA to assist ratepayers when they self-assess**
- **The publication of rateable values of all properties under a self-assessment system**
- **The role for ratepayers**
- **Specific issues relating to smaller businesses or other ratepayers for whom self-assessment could be particularly challenging**

35. London Councils supports the publication of rental information by the VOA, where such information is to play a role in valuation. However, this information could be restricted to the rate payer and or their representative, and rental comparisons need not be an essential component of the methodology for self-assessment of low value hereditaments.

36. Where rental information is used, it should be made available to the rate payer and or their representative at the earliest opportunity. The appeals system currently contains a significant proportion of appeals that may not have come forward had the ratepayer had access at the very start of the process to the full information on which their assessment had been based.

37. Low value hereditaments yield little as a proportion of revenues, and are typically occupied by smaller enterprises. It is therefore reasonable to conclude that an approach proportionate to the value of the hereditament would be of benefit to both smaller rate payers and billing authorities. This is particularly so if

there is to be a self-assessment element to the process, and it is worth considering the role of rate payers in terms of their relative size and setting roles and expectations at a fair and realistic level accordingly.

A formula alternative

- **The associated move away from a link to market values**
- **The classes of property that would be suitable for a formula approach**
- **The factors that would need to be included in the formula beyond class of the property, size of the property and location**
- **The balance of efficiency, simplicity and certainty that a formula approach would provide against any desire to retain valuations that take greater account of the individual characteristics of properties**
- **The implications for businesses of different sizes**

38. London Councils is not concerned by the associated move away from the link to market values that would accompany a formula alternative, as assessed values often vary from actual rents in any case, and this variance tends to increase with the passage of time.

39. Of more importance is to find a simplified formula for assessing low value hereditaments that is operable by smaller firms without the support of a rating surveyor. The widespread application of such a formula based approach would then need to be carefully modelled to understand the impact on revenues.

40. For higher value assessments, we suggest the retention of a bespoke assessment system as the sums under consideration merit a more accurate approach to valuation. We see this as working along similar lines to that of a normal tax return. Rate payers would prepare a valuation with proportionate supporting evidence and argument, and this would be subject to similar arrangements for inspection and enforcement as used in other parts of the tax system. This would require, for example, compliance guidance, online advice and support, and guidance for how the VAO would undertake spot checking and more detailed audits.