

Manchester City Council Report for Information

Report to: Audit Committee – 17 July 2014
Subject: Business Rates Retained Income 2013/14
Report of: City Treasurer

Purpose of report:

To provide an overview of the latest position on business rates and highlight the inherent risks within the current system

Recommendations

The audit committee is recommended to note the report

Financial consequences for the revenue budget

The business rates base calculation informs the overall resources for the revenue budget. The approach taken in closure of the 2013/14 accounts has a significant impact on managing the council's risk for business rates appeals.

Financial consequences for the capital budget

There are no direct consequences for the capital budget.

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Background papers

The non-domestic rating (rates retention) regulations 2013

1. Introduction and Background

- 1.1 The Local Government Resource Review (LGRR), which came into force on 1 April 2013 resulted in significant changes to the methodology for funding local government. There was a move away from funding based on need distributed via the Formula Grant to Local Authorities retaining a share of business rates income and a share of the potential benefits and risks on the level of income generated. Previously Business Rates were paid over to Central Government and redistributed via Formula Grant so there was no direct link between the amount of business rate income collected within a local authority area and the funding they received. Further, the risk of any reduction in local Business Rates yield due to closure of businesses or appeals against rateable values lay with Central Government, and similarly they benefitted from any increase in local Business Rates yield.
- 1.2 As part of the LGRR reforms local authorities now retain 49% of business rate income in each financial year with 1% to be paid to Fire and Rescue Authorities and 50% to central government. The risks and benefits are apportioned on the same basis. This brings a higher level of uncertainty in council resources and has implications for how the budget is set.
- 1.3 The government have assumed a level of business rates for Manchester in 2013/14 looking at the average position from two prior years (2010/11 and 2011/12) returns with an assumed level of growth built in. The assumed level of Business Rates baseline funding within the council's 2013/14 settlement was £148.938m. This means that approximately 24% of the council's resources are now funded by retained business rates.
- 1.4 The actual calculation made by the Council has to make assumptions for growth, collection rates and outstanding appeals. This is submitted via a NNDR1 return which has to be with the Secretary of State by 31 January and forms part of the formal budget setting process. The return includes estimates of the amount of business rates due. This is then adjusted for reliefs, costs of collection, the estimated collection rate and appeals.
- 1.5 It should be noted that DCLG previously accounted for appeals on a cash basis (i.e. what was settled in each year). Under the new arrangements Local Authorities need to account for these on an accruals basis (i.e. make provision for their share of the total historic risks of appeals). Therefore in the first year there will be a significant 'hit' against the level of business rate income accounted for as the accrual was made in full. This will cover the one off backdated costs to the appeal date (which could be back to 2005 or 2010).
- 1.6 Business Rates are accounted for as part of the Collection Fund. This means that any gain or deficit on the level of business rate income is accounted for, in budget terms, in a subsequent year in the same way as it is for Council Tax.
- 1.7 Finally, the retained business rates income is subject to a safety net and local authorities are protected at 92.5% of their base line funding which compares assumed Business Rates income and any top up payments.

2 Budget Assumptions

- 2.1 Due to both the lack of accurate information on outstanding appeals and the lack of clear guidance in this area the assumptions that have been made about the potential appeals liability have changed considerably.
- 2.2 As at January 2013 the estimate of outstanding appeals was made using national guidelines which suggested that an appeal success rate of 5% (i.e. the overall reduction in the total RV of those who had appealed would be 5%) was used. Based on the full RV of outstanding appeals against the 2005 list of £33.943m and the 2010 VOA list of £302.825m suggesting a total liability of c£55m of which the council's share would be £27m. The overall position on business rates after including the appeals provision was a shortfall of £10.77m against the start up funding assumption of £148.938m. As the safety net was set at £11.7m the council fully budgeted for the shortfall.
- 2.3 As at January 2014 the appeal success rate was increased to 6% based on the best information available at the time. This showed a revised liability of £71.445m, (the Council is responsible for 49% of the liability - £35.008m). The Council was also informed that the grant to offset the costs in the increase of Small Business Rates Relief would be received as a S31 grant outside of the Business Rates Collection Fund. The grant is included in the calculation of the amount of safety net payment due.
- 2.4 Based on the revised appeals provision the revised 2013/14 forecast business rates position was a deficit of £27.704m (MCC share £13.575m). The Council was now estimated to be entitled to a safety payment of £10.315m because the 92.5% threshold had been breached.
- 2.5 This was to be accounted for as follows (see appendix One for more detail):
- The Collection Fund deficit of £13.575m is included in the budget for 2014/15.
 - This will be offset by the Safety Net payment (£10.315m) and the SBRR grant (£2.312m). These have to be accounted for in the year they fall due, 2013/14, and have been transferred to a reserve to be used in 2014/15 to offset the Collection Fund deficit.
 - This leaves a net deficit of £0.948m.
- 2.6 These were the assumptions included in the Revenue Budget Report for 2014/15. The reserves schedule assumed £10.315m for the Safety Net payment and £2.312m SBRR grant to be applied in 2014/15.
- 2.7 A separate reserve of £10m was also established to cover risks relating to business rates including an increase in the level of successful appeals in 2014/15 and later years.

3 Annual Accounts 2013/14

- 3.1 Prior to the completion of the Final Accounts more work was carried out to review the latest information on appeals. With more detailed information being available and a better understanding of how the appeals system operates this was used to calculate the average RV reduction from a successful appeal against the 2005 list. This was determined to be 14.9%. This percentage has been used to calculate the effect of outstanding or known appeals as at 31 March 2014, resulting in an increase for the estimated liability on known appeals to £78.9m.
- 3.2 In addition further guidance has been received on the treatment of appeals, although clear national guidance on how this should be calculated is still not in place. The guidance suggests that the provision should include 'unknown appeals', that is including appeals against the 2010 list relating to financial years 2013/14 and earlier which are anticipated but have not yet been received, if they can be reliably estimated. In order to calculate this additional work has completed looking at the total reduction in rateable value due to appeals on the 2005 list and the trends to date on the 2010 list. The total expected fall on the 2010 RV list has then been calculated based on the level of reductions on the 2005 list. This suggested a total reduction of 10.9% which is equivalent to £108.8m by 31/03/2014. After taking into account the impact of known appeals this has resulted in a forecast cash impact of unknown appeals of £33.8m
- 3.3 Including some small adjustments for charitable relief and other reductions, a provision of £111.5m for outstanding appeals against rateable values is now required. The Council's share of these potential losses is £54.6m.
- 3.4 The overall position on business rates in the Collection Fund is now a deficit of £83.2m with the Council's share being £40.8m. This has resulted in a Safety Net claim of £37.65m.
- 3.5 As set out above the safety net payment has been accounted for in 2013/14. For the Collection Fund the 2013/14 deficit as estimated at 31 January 2014 (£13.6m) will need to be accounted for in 2014/15 and the variation between the actual and estimated deficit (£27.2m) in 2015/16.
- 3.6 The value of the safety net payment and the small business rate relief grant is included as a reserve. As a result this reserve is £27.247m higher than estimated when the budget was set.
- 3.7 Due to the paucity of accurate information and the lack of clear guidance there is no consistent approach between councils on how the appeals liability has been calculated. The external auditors will need to determine whether they believe the calculation has been done on a reasonable basis. The council has worked closely with Grant Thornton who agree with the Council's assessment that it is appropriate to estimate a provision for the potential impact of both lodged appeals and appeals that may subsequently arise. If the advice changes this could impact on the assumptions made in the accounts.

Appendix 1 – 2013/14 Retained Business Rates - Summary of key figures at each stage in the process

	Budget 2013/14	Revised Budget 2013/14	Outturn 2013/14
	At January 2013	At January 2014	At June 2014
	£,000	£,000	£,000
Business Rates Baseline per CLG	148,938	148,938	148,938
Less shortfall budgeted in 213/14 budget	(10,766)	(10,766)	(10,766)
MCC Initial Estimate of Retained Rates	138,172	138,172	138,172
Less Updated MCC Estimate of Retained Rates	138,172	124,597	97,343
2013/14 MCC share of Deficit	0	13,575	40,829
Less Funding anticipated:			
Safety Net Funding Due*	0	10,315	37,650
Small Business Rates relief due	0	2,312	2,212
Total Funding anticipated	0	12,627	39,862
Net Shortfall (£948k budgeted for in 2014/15 budget)	0	948	967
Appeals provision	27,067	35,008	54,642
Assumed Appeals success rate %	5%	6%	14.9%

* The safety net threshold for the council for 2013/14 was £11.713m. When the 2013/14 budget was set the shortfall against the CLG baseline was £10.766m, which was £948k short of the threshold therefore it was not anticipated that any Safety net funding was due.

