THE PRACTICALITIES OF SETTING GROWTH BASELINES (AND MEASURING GROWTH) UNDER THE ALTERNATIVE MODEL

As explored in previous papers, under the Alternative Model, we would need to set a growth baseline against which growth in business rates could be measured for the purpose of the "stage 2" calculation.

The growth baseline would be set using either:

i. NNDR data returns – and would be measured as the "in-year" *net rates payable*; or

ii. VOA data on rateable values – necessitating the use of an *adjustment factor* – broadly representing the ratio of *net* to *gross rates payable*.

The Government aims to introduce reforms to business rates retention from 1 April 20201. This paper looks at the practicalities of setting the first growth baseline , in the event that the Alternative Model is adopted.

The Working Group is invited to consider the options.

"Lagged" and "Non-Lagged" Systems

1. As discussed previously by the Working Group, growth under the Alternative Model could operate on a "lagged", or "non-lagged" basis.

2. Taking 2021-22 as an example, in a "lagged" system, growth would be measured on the basis of 2021-22 NNDR3s. Authorities would not see the benefits of that growth until tariffs and top-ups were calculated in 2023-24 – ie the first financial year following the submission of certified NNDR3 data for 2021-22.

3. In order to run a "non-lagged" system, growth would have to be capable of being measured at the time authorities completed their 2021-22 NNDR1s, in January 2021. The calculation of tariffs and top-ups for 2021-22 would take account of the amount of growth estimated on the basis of the NNDR1. Following the submission of 2021-22 NNDR3s, in July 2022, the difference between actual and estimated growth would be calculated and reflected in a "reconciliation adjustment" to the 2023-24 tariff/top-up calculation (see fig 1).

Fig.1

	2021-22				2023-24		
	BFL	**1000**				1020 (indexed)	
		NNDR1		**NNDR3**		**NNDR1**	
	NNDR Income	1200		1400		1500	
	LA share (75%)	900		1050		1125	
	CG share (25%)	300		350		375	
Non-Lagged	**Tariff/TU calculation**				**Non-Lagged**	**Tariff/TU calculation**	
	Stage 1 (BFL - NNDR1 income)	100				Stage 1 (BFL - NNDR1 income)	-105
	Stage 2 (growth)	250		400		Stage 2 (growth)	300
						Growth Reconciliation (21-22)	150 *(ie 400 actual growth - 250 estimated growth awarded in 2021-22)*
	Final Tariff/TU	350				**Final Tariff/TU**	345
	LA Income					**LA Income**	
	LA Shareof NNDR1 Income	900				*LA Shareof NNDR1 Income*	1125
	Tariff/TU	350				*Tariff/TU*	345
		1250	*(ie BFL + "estimated" growth)*			1470	*(ie BFL +23-24 growth +21-22 reconcilation)*
Lagged	**Tariff/TU calculation**				**Lagged**	**Tariff/TU calculation**	
	Stage 1 (BFL - NNDR1 income)	100				Stage 1 (BFL - NNDR1 income)	-105
	Stage 2 (growth)	0				Stage 2 (growth)	400 *(actual growth 21-22)*
	Final Tariff/TU	100				**Final Tariff/TU**	295
	LA Income					**LA Income**	
	LA Shareof NNDR1 Income	900				*LA Shareof NNDR1 Income*	1125
	Tariff/TU	100				*Tariff/TU*	295
		1000	*(ie BFL)*			1420	*(ie 23-24 BFL + actual 21-22 growth)*

Setting the Growth Baseline for a "Lagged" system

4. Under a lagged system, the growth baseline could, in principle, make use of the data contained in 2021-22 NNDR3s, since the calculation of the "2021-22 growth" would not need to be made until early in 2023 when tariffs and top-ups for that year were calculated.

Using VOA Data

5. If we were using VOA data, setting the growth baseline and the subsequent operation of the system would be relatively straightforward.

6. NNDR3 (2021-22) data for "in-year" *gross rates payable* and "in-year" *reliefs* would be used to set an *adjustment factor* (either at the national or individual local authority level). The *adjustment factor* would be multiplied by a "notional" *gross rates payable* figure, calculated as the RV on 1 April 2021 (from VOA data), multiplied by the 2021-22 small business rating multiplier. This would establish a growth baseline for each authority.

7. The "growth" to be taken into account in setting 2023-24 tariffs and top-ups would be the difference between:
    a. the "in-year" *gross rates payable* recorded in the 2021-22 NNDR3, multiplied by the *adjustment factor*; and

    b. the growth baseline.

Using NNDR data

8. Using NNDR data to set the growth baseline is altogether more problematic. Prima facie, it might appear to be straightforward to use the "in-year" *net rates payable* figure from the NNDR3 (2021-22) to fix a growth baseline. However, there are two inter-linked reasons why this might be less than perfect:
    a. Firstly, NNDR3s measure the rates payable over the whole year, and so, by using the NNDR3 (2020-21) we would not be establishing a baseline for the first day of the new system, 1 April 2021, but in respect of the first year; and

    b. If we were then to use the same NNDR3 (2020-21) to determine the "in-year" *net rates payable* for comparison against the baseline, it follows that in respect of 2021-22 there would not be any growth, since we would be using the same figure for both the baseline and the year's net rates payable! Hence authorities would have to wait until 2024-25 to benefit from any growth in their business rates bases.

9. Nor is it easy to see how this deficiency could be overcome. Because 2021-22 is a Revaluation year, using the previous year's NNDR3 data (ie 2020-21) to set a baseline against which growth in 2021-22 could be measured, would be problematic, since we could not make a direct comparison between one year's data and the next.

Other issues

10. If under a lagged system, we wanted to use the NNDR3 (2021-22) to set the growth baseline, or the *adjustment factor* element of it, we would need to amend the 2021-22 NNDR3, which is due to be sent to authorities in March 2021, to ensure that there is a breakdown between "in-year" and "prior-year" gross rates payable figures. This is because, currently, the *gross rates payable* figure in NNDR3s is not broken down between "in-year" and "prior year adjustments". Therefore, we should need to ensure that any updates to software could be made in sufficient time for authorities to complete the NNDR3 return.

Setting the Growth Baseline for a "Non-lagged" system

11. Under a non-lagged system, the intention would be for authorities to estimate growth at the time they completed their NNDR1s. The estimate would be used to set tariffs and top-ups for the year in question. Growth would be reconciled two years later, when NNDR3 data became available – see paragraph 3 and figure 1.

12. To run a non-lagged system, authorities would need to know, or to be able to calculate, their growth baselines at the time that they completed NNDR1s (2021-22) in January 2021.

Using VOA Data

13. If we were using VOA data to establish baselines, the necessary calculations could be relatively straightforward. But there are a few practical issues which would need ironing out.

14. We would use VOA data for the RV on a local list at 1 April 2021. This could be published and available to authorities immediately before they had to complete NNDR1s. The RV figure would be multiplied by the small business rating multiplier to establish a "notional" *gross rates payable*. The "notional" *gross rates payable* figure would then need to be multiplied by an *adjustment factor* in order to establish the growth baseline.

15. Self-evidently, the *adjustment factor* could not be set on the basis of outturn data (NNDR3s). NNDR3s for 2020-21 would not exist; and NNDR3s for 2019-20, the latest year available, would reflect differences between gross and net rates payable before the 2021 Revaluation and, arguably might not be directly comparable with the pattern of reliefs post-Revaluation.

16. Using 2021-22 NNDR1s does not in itself cause a problem – the pattern of reliefs based on NNDR1 data, arguably, represents as good a basis of setting the adjustment factor as using NNDR3s, since it is based on a snapshot of the reliefs that would be awarded to ratepayers for the year, on the assumption that there were no changes to occupation and valuation ie something more like a day 1 pattern of reliefs.

17. If we were setting adjustment factors at individual local authority level, the use of NNDR1 (2021-22) presents no problem in timing terms. We could provide authorities with instructions on how to calculate their adjustment factors using the data from their completed NNDR1s. They would be able to work out their individual growth baselines as soon as they had completed their NNDR1s; and could use those baselines to calculate the "growth" that would be taken into account in setting tariffs and top-ups for 2020-21.

18. But if we wanted to set a *national adjustment factor*, we would be unable to do so until after we had access to the data from all completed NNDR1s (2020-21). Assuming, that all authorities returned NNDR1s by 31 January, and the Department was able to complete its checks by middle of February (as currently), the Department would be able to publish the national adjustment factor in mid-February. **But is this too late for authorities' budgeting process**?

19. If it is too late, the alternative might be to bring forward the return date of the 2021-22 NNDR1 – eg to end of December (or earlier).

Using NNDR data

20. It is difficult to see how a non-lagged system could be operationalised if we were using NNDR data.

21. The problem of setting a 2021-22 baseline is explored in paragraphs 8 and 9 above. On the face of it, this would appear to preclude calculating an estimated "growth" number for 2020-21 in much the same way as under the lagged system, because there is no practical difference between measuring the growth baseline and the in-year growth on the basis of NNDR1s or NNDR3s. In either case, the baseline and in-year amounts will be the same.

22. There will also be practical difficulties revising the growth baseline for year two (2022-23). Because, in order to revise the baseline under the "NNDR data" option, one would need to know the "prior-year adjustments" in respect of the base year (2021-22). Tas things stand, this data will not be available until NNDR3s are published in July 2022, six months after authorities will have had to set their budgets for 2022-23, complete their (2022-23) NNDR1s; and five months after the Department will have had to set 2022-23 tariffs and top-ups.

23. It might be possible, for authorities to estimate the revised growth baseline in January 2022, when they complete NNDR1s, by analysing the data they hold in respect of "prior-year adjustments" for the first 3 quarters of the 2021-22 financial year. But this would appear to increase the burden on local authorities, not least, because the department would require additional certified data returns in order to provide assurance for the 2022-23 tariff and top-up calculations.

<u>Conclusions</u>

24. The practicalities of setting *growth baselines* and measuring growth against them suggest that:
    a. We could run a lagged system using either the NNDR or VOA variants of "measuring growth";

    b. Under the NNDR variant, growth in 2021-22 would be "zero"

    c. An unlagged system could most easily be run by using the VOA variant of "measuring growth";

    d. That the NNDR variant of measuring growth would be very complex in an unlagged system (if it was practical at all);

    e. The VOA variant of measuring growth in an unlagged system, would be simplest to operate if the adjustment factor were calculated at an individual authority level;

f. Setting the adjustment factor at a national level, might mean having to bring forward the return date of the NNDR1.