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Consultation – summary of responses

Technical consultation on setting the decapitalisation rates for the Non-Domestic Rates Revaluation 2017

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1. Introduction

- 1.1 A revaluation of non-domestic properties usually takes place every five years. A revaluation was due to take place in 2015. A decision was taken by the Welsh Government to postpone the revaluation until 2017 following a decision by the UK Government to defer the revaluation in England.
- 1.2 The primary purpose of revaluation and the setting of the multiplier is to adjust the liability of properties *relative* to others within the NDR tax-base. This ensures the rates liability is spread fairly between ratepayers, and is based on up-to-date rental values. At each revaluation, all properties are assigned a new up-to-date rateable value. The multiplier is then reset by the Welsh Government to ensure the NDR tax-base can broadly generate the same level of revenue after revaluation as before.
- 1.3 Preparations are now underway for the 2017 revaluation for a new ratings list to be introduced in Wales from 1 April 2017. The VOA is responsible for compiling and publishing the new ratings list and will ensure all non-domestic properties are assigned a new rateable value based on their estimated annual rental value as at the Antecedent Valuation Date (AVD) of 1 April 2015.
- 1.4 The VOA uses three methods for calculating the rateable value of a non-domestic property depending on the available evidence. The Contractor's Basis is used for specialised properties, when there is little or no direct evidence of actual rents available. Approximately 20% of non-domestic properties are valued on the Contractor's Basis in Wales. These properties include utilities, schools, hospitals, heavy industry, fire and police stations, and airports, amongst others.
- 1.5 The decapitalisation rate is a key part of the Contractor's Basis. It is a percentage figure which is used to convert capital value into an annual rental value. It also ensures the costs and benefits of owning a property, compared to renting a property, are taken into account when calculating the rateable value of a property.
- 1.6 The Welsh Government invited respondents to submit views and any evidence relating to setting the decapitalisation rate in respect of the 2017 Revaluation. The six-week consultation began on 14 August 2015 and respondents were asked to submit their responses by 25 September.
- 1.7 The consultation sought views on whether the decapitalisation rate should be prescribed in legislation, how many rates should be prescribed and how the rate(s) should be calculated.

2. Responses

2.1 The consultation asked respondents a number of questions on setting the decapitalisation rates. Eleven responses were received. A low response rate was expected due to the highly technical nature of the consultation.

2.2 The breakdown of responses is as follows:

- 4 Property consultancy/real estate firms¹
- 3 Rating/Taxation Professional Associations
- 2 Local Authorities
- Welsh Local Government Association
- 1 Police Force

The organisations which responded are listed in Section 3.

2.3 The consultation asked for views on the following four questions:

- **Question 1: Do you agree Welsh Government should continue to prescribe the decapitalisation rates used in the Contractor's Basis of Valuation**
- **Question 2: Do you agree that the Welsh Government should continue to prescribe two decapitalisation rates in Wales?**
- **Question 3: What are your views on the methods for setting the rate (including any suggestions for alternative methods), the range of values generated by each method, and the merits or otherwise of each method?**
- **Question 4: Do you agree with the Welsh Government proposed approach for setting decapitalisation rates in Wales?**

A summary of the content of the responses is provided in the next section.

¹ It should be noted one property consultancy firm submitted a response on request from The Sports Council Trust Company. The Company is a registered charity and subsidiary of The English Sports Council.

3. Summary of Comments

3.1 A summary of the content of the responses is given below under each of the consultation questions. Due to the technical nature of the consultation, this summary should be read with reference to the main consultation document.

Q1: Do you agree the Welsh Government should continue to prescribe the decapitalisation rates used in the Contractor's Basis of Valuation?

3.2 All responses generally agreed that Welsh Government should continue to prescribe decapitalisation rates, as long as they were set fairly and in line with existing case law. Although there were some concerns about certain points (which are detailed below) there was a general consensus that on balance, the advantages of prescribing decapitalisation rates outweighed the disadvantages.

3.3 Many responses highlighted the increased risk of appeals if decapitalisation rate(s) were not prescribed and that, historically, these have proved very costly to administer. Some responses did note however that there would be some benefits to allowing the Courts to decide matters.

Q2: Do you agree that the Welsh Government should continue to prescribe two decapitalisation rates in Wales?

3.4 The majority of responses agreed that the Welsh Government should continue to prescribe two decapitalisation rates. While some methodological issues were discussed and many alternative proposals put forward, the general consensus was that on balance, the advantages of maintaining the status quo and continuing to prescribe two decapitalisation rates outweighed the disadvantages. It was acknowledged by most respondents that while there were calls to move to a single decapitalisation rates or multiple rates, it was a system that worked and was well understood by practitioners.

3.5 Two responses received from Local Authorities suggested the lower rate could be applied to some additional groups of public properties (such as leisure centres and police stations). These responses argued that reducing the non-domestic rates liability for these properties would make it more affordable for local authorities to keep and maintain these buildings and provide public services.

3.6 One property firm also suggested that as well as applying the lower rate to additional groups of public properties, the lower rate should also be applied to 'heavy industry' in order to promote economic growth and jobs.

3.7 A different property firm argued that one single decapitalisation rate should apply to all properties, because setting the decapitalisation rate(s) is not an exact science and if there are multiple rates there are always going to be borderline cases, which may lead to litigation.

3.8 Three responses raised specific methodological issues which in turn raised questions on how many rates should be prescribed, and what groups of property they should apply to.

3.9 The Institute of Revenue, Ratings and Valuation (IRRV) said that in order to apply the full extent of the case *Cardiff City Council v Williams (VO) RA/46/1973*², three rates should be prescribed according to the occupier's ability to pay. The highest rate should apply to commercial property, a middle rate should be considered when the occupier can expect to gain some financial benefit from its occupation and the lowest group should be applied when the occupier has no realistic hope of any tangible benefit.

3.10 Two responses stated the general approach for setting decapitalisation rate(s) should take account of the Land Tribunal's (now the Land's Chamber of the Upper Tribunal), decision in relation to the case *Allen (VO) v English Sports Council/Sports Council Trust Company RA/4/2006*³.

3.11 The property consultancy firm who responded on behalf of the Sports Council Trust Company, argued that as the impact of grant monies cannot be taken into account at Stage 1 of the Contractor's Basis (the cost of the build), the most equitable way to deal with this was to apply the lower rate in relation to 'sports hereditaments and community based facilities' in order to reflect the occupiers ability to pay.

3.12 Another property consultancy firm also referred to the above decision. However it argued that two decapitalisation rate(s) should continue to be prescribed and that adjustments should be made to the Contractor's Basis to take account of the issues highlighted within the Land Tribunal's decision.

Q3: What are your views on the methods for setting the rate (including any suggestions for alternative methods), the range of values generated by each method, and the merits or otherwise of each method?

3.13 Five responses did not have any views on the methodology for setting the rates. The remaining responses noted that the approach for setting decapitalisation rate(s) should be set within the confines and precedents of existing case law. Namely, they should be set in reference to the two methods sanctioned by the Courts:

- The 'traditional method' (cost of securing capital to build the alternative property from borrowing) and

² Their response also acknowledged case law in relation to *Monsanto v Farris (RA/217/1998)* as well as *Eastbourne BC and Wealden DC v Allen (VO)*

³ Further information on this decision can be found on the Valuation Office Agency's (VOA's) Ratings Manual <http://manuals.voa.gov.uk/corporate/publications/Manuals/RatingManual/RatingManualVolume4/sect7/f-rat-man-vol4-s7-app2.html>

- The 'economists approach' (the cost of securing capital to build the alternative property from debt and equity or the 'real' cost of borrowing).

3.14 Two responses specifically stated the decapitalisation rate(s) should not be set with reference to the third method 'Property Investment Yield Approach' outlined in the consultation. They said that this method does not derive from English or Welsh case law. One of these responses argued that the contractor's test is applied from the point of view of the ratepayers and not the landlord and that a ratepayer's decision in relation to an appropriate annual rent will be based on the costs of capital. Therefore the landlord's investment targets and property investment yields are irrelevant. The other response noted the method was only supported in Scotland to the extent of an effective capital value yield and not a market (transfer value or value in exchange) yield.

3.15 Three responses made specific comments on the rates generated by each method, and each provided a calculated rate for each method. Using the 'traditional method', the figures calculated for the standard decapitalisation rate were between **1.9% and 3.5%**. Using the 'economists approach' the figures calculated for the standard decapitalisation rate were between **2.1% and 3.65%**.

3.16 The Rating Surveyor's Association noted their concerns that the difference between the standard and the lower rate had widened. The proposed lower rate is 55% of the standard rate, however currently the lower rate is 66% of the standard.

Q4: Do you agree with the Welsh Government's proposed approach for setting decapitalisation rates in Wales?

3.17 Three responses argued that Welsh Government should align its rates with those set in England and Scotland.

3.18 In addition, the IRRV noted the importance of ensuring the frequency of revaluation is maintained to ensure the ratings system is fair. The IRRV suggested that money markets can be subject to even greater fluctuations than the property market. Therefore, occupiers of buildings valued on the Contractor's Basis can face greater difficulty in paying their rates bills than occupiers of properties valued by other methods. This was particularly the case in times of 'economic adversity'.

4. List of Respondents

4.1 Responses were received from the following organisations.

Cardiff Council

Pembrokeshire County Council

Welsh Local Government Association

South Wales Police

Wilkshead and Eve, Chartered Surveyors and Town Planners Consultancy Firm

CBRE, commercial real estate services and investment firm

GL Hearn Ltd, property consultancy firm

JJL, property consultancy firm

UK Petroleum Industry Association Ltd

The Rating Surveyors' Association

Institute of Revenues, Ratings and Valuation