

Number: WG37394



Llywodraeth Cymru
Welsh Government

Welsh Government Consultation Document

Technical consultation on setting decapitalisation rates for Wales
for the Non-Domestic Rates Revaluation 2021

Date of issue: 8 March 2019

Action required: Responses by 30 May 2019

Mae'r ddogfen yma hefyd ar gael yn Gymraeg.
This document is also available in Welsh.

Overview

The Welsh Government is seeking views on the decapitalisation rates to be adopted for the 2021 non-domestic rates revaluation in Wales.

How to respond

Responses can be emailed or sent direct to:
Non-Domestic Rates Policy Branch
Cathays Park
Cardiff
CF10 3NQ
Email: LGF1Consultations@gov.wales

Further information and related documents

Large print, Braille and alternative language versions of this document are available on request.

Appendix A - Methodological Approaches for Calculating Decapitalisation Rates

Contact details

For further information, or queries regarding this consultation, please email: LGF1Consultations@gov.wales

Non-Domestic Rates Policy Branch
Cathays Park
Cardiff
CF10 3NQ

General Data Protection Regulation (GDPR)

The Welsh Government will be data controller for any personal data you provide as part of your response to the consultation. Welsh Ministers have statutory powers they will rely on to process this personal data which will enable them to make informed decisions about how they exercise their public functions. Any response you send us will be seen in full by Welsh Government staff dealing with the issues which this consultation is about or planning future consultations. Where the Welsh Government undertakes further analysis of consultation responses then this work may be commissioned to be carried out by an accredited third party (e.g. a research organisation or a consultancy company). Any such work will only be undertaken under contract. Welsh Government's standard terms and conditions for such contracts set out strict requirements for the processing and safekeeping of personal data.

In order to show that the consultation was carried out properly, the Welsh Government intends to publish a summary of the responses to this document. We may also publish responses in full. Normally, the name and address (or part of the address) of the person or organisation who sent the response are published with the response. If you do not want your name or address published, please tell us this in writing when you send your response. We will then redact them before publishing.

You should also be aware of our responsibilities under Freedom of Information legislation. If your details are published as part of the consultation response then these published reports will be retained indefinitely. Any of your data held otherwise by Welsh Government will be kept for no more than three years.

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- to require us to rectify inaccuracies in that data
- to (in certain circumstances) object to or restrict processing
- for (in certain circumstances) your data to be 'erased'
- to (in certain circumstances) data portability
- to lodge a complaint with the Information Commissioner's Office (ICO) who is our independent regulator for data protection.

For further details about the information the Welsh Government holds and its use, or if you want to exercise your rights under the GDPR, please see contact details below:

Data Protection Officer:

Welsh Government

Cathays Park

CARDIFF

CF10 3NQ

The contact details for the Information Commissioner's Office are:

Wycliffe House

Water Lane

Wilmslow

Cheshire

SK9 5AF

Tel: 01625 545 745 or

0303 123 1113

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e-mail:

Data.ProtectionOfficer@gov.wales

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Introduction

1. A revaluation of non-domestic properties usually takes place every five years with the next revaluation due to take place in 2022. The Welsh Government decided to bring forward the next revaluation to 2021 in line with England¹.
2. The main purpose of revaluation, and the associated setting of the multiplier, is to adjust the liability of properties relative to others within the non-domestic rates (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 rateable value. The multiplier is then reset by the Welsh Government to ensure the NDR tax-base can broadly generate the same level of funding after revaluation as before.
3. Preparations are underway for new ratings lists to be introduced in Wales from 1 April 2021. The Valuation Office Agency (VOA) is responsible for compiling and publishing the new ratings lists and will ensure all non-domestic properties are assigned a new rateable value based upon its estimated annual rental value as at the Antecedent Valuation Date (AVD) of 1 April 2019. The VOA is independent of the Welsh Government.
4. The VOA uses three methods for calculating the rateable value of a non-domestic property, depending on the available evidence. This consultation concerns a feature of one of these methods, the Contractor's Basis. Most properties are assessed using rental information. The Contractor's Basis is used for specialised properties where there is little or no direct evidence of actual rents available. Approximately 6,000 non-domestic properties in Wales are valued using the Contractor's Basis. These properties include utilities, schools, hospitals, heavy industry, fire and police stations, and airports, amongst others.
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 of a property into an annual rental value. It 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.
6. This consultation seeks views on whether the decapitalisation rate should be prescribed in legislation², how many rates should be prescribed and how the rate or rates should be calculated.
7. This consultation applies to Wales only.

¹ Welsh Government, Cabinet Written Statement - Non-Domestic Rates Revaluation
<https://beta.gov.wales/written-statement-non-domestic-rates-revaluation>

² The current rates are prescribed in the The Non-Domestic Rating (Miscellaneous Provisions) (Amendment) (Wales) Regulations 2015
<http://www.legislation.gov.uk/wsi/2015/1759/contents/made>

What is the Decapitalisation Rate?

(i) The Valuation Process and the Contractor's Basis

8. The VOA uses three methods for calculating the rateable value of a property depending on the available evidence. Rental Comparison is used whenever there are sufficient numbers of comparable properties to provide reliable evidence on rental values.
9. The Receipts and Expenditure method is used when there is insufficient information to compare rental values and when rent is likely to be based on the profits made from the business occupying the property, for example pubs and hotels.
10. The Contractor's Basis is used when no such evidence exists. It is generally used for specialised properties, for example large industrial buildings, schools and hospitals. Properties such as these are rarely let and therefore their rental values are determined by reference to construction costs.

(ii) Rateable Value on the Contractor's Basis

11. At the last revaluation in 2017, about 6,000 non-domestic properties in Wales were valued using the Contractor's Basis. These properties had a total rateable value of approximately £356m, as follows.

Sector	Rateable value (£m)
Utilities	39
Education	133
Industry	55
Local Government	42
Health	56
Other Government	22
Defence	8
Other	10
Total	365

(iii) The Contractor's Basis

12. The Contractor's Basis has evolved through rating case law over some 200 years. It is based on the premise that the hypothetical tenant has an alternative to renting and they could purchase land and build a similar hereditament.
13. Rating case law has established six principal stages of a Contractor's Basis of valuation, as follows.
 - i. Estimate the cost of replacing the building and any rateable items such as certain types of plant and machinery.
 - ii. Make deductions to reflect the actual property being valued to adjust for age and obsolescence.
 - iii. Add the land value to arrive at the total capital sum.

- iv. Decapitalise the total capital sum at the appropriate decapitalisation rate (or interest on capital rate). This converts capital value into an annual equivalent, or rental value.
 - v. Stand back and look at the resultant answer to reflect any matters which would affect the rental value, as opposed to the capital cost.
 - vi. Consider the differences between the landlord's and tenant's viewpoints (in practice this stage is often combined with stage (v)).
14. Stage (iv) of the Contractor's Basis above is the decapitalisation rate. It is a percentage figure which is used to convert capital value into an annual rental value. It 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. The higher the decapitalisation rate, the higher the resultant rateable value will be.

The prescription of the decapitalisation rate in legislation

(i) Why is the decapitalisation rate prescribed in legislation?

15. Before 1990, the Courts had great difficulty in deciding how the decapitalisation rate should be derived and at what level it should be set when determining the rateable value of a property. This gave rise to a series of appeals which created uncertainty as to the rates liability for these properties and, ultimately, the level of non-domestic rates (NDR) income.
16. For the previous six revaluations – 1990, 1995, 2000, 2005, 2010 and 2017 – the decapitalisation rates have been prescribed in legislation by Ministers via amendments to the Non-Domestic Rating (Miscellaneous Provisions) (No.2) Regulations 1989.
17. The primary purpose of setting the decapitalisation rate in legislation is to standardise the way that Valuation Officers convert capital value into rateable value when using the Contractor's Basis. It therefore eliminates any uncertainty regarding the rate which should be used.
18. If the decapitalisation rate is prescribed in legislation, it has a fixed value and therefore has a demonstrable effect on the rateable value of those properties valued by the Contractor's Basis – the higher the decapitalisation rate, the higher the rateable value of these properties. In turn, therefore, the decapitalisation rates will also have an indirect effect on how the rates liability is distributed by exerting pressure on the multiplier. If the decapitalisation rate increases, it exerts a downward pressure (albeit minor) on the multiplier, and vice versa.
19. Prescribing the decapitalisation rate in legislation ensures that ratepayers are able to predict their NDR liability following a revaluation, with a reasonable degree of certainty. This helps to avoid large numbers of legal challenges of valuation decisions, which can be costly. It also reduces the risk for the Welsh Government and local services which require NDR income to remain relatively stable in order to set their budgets and plan effectively for future years.

20. It has previously been suggested that decapitalisation rates should not be prescribed in legislation and that, in the long term, uncertainty as to the rate is best dealt with by allowing the Courts to consider the right rates for different classes of property. In turn, this should allow valuations to fit the circumstances of each case. However, it is far from clear that the Courts could deliver long-term stability through the consideration of individual cases.
21. In fact, such an approach may give rise to more uncertainty largely because finance is secured from a variety of sources ranging from private equity, public equity, commercial borrowing and the Public Works Loans Board. As a result, the VOA would have to assess the mix and nature of such finance to value individual properties. This means that ending prescription of the rate could give rise to extensive litigation.
22. It is likely ending the prescription of the decapitalisation rate would lead to an unacceptable level of uncertainty for those valued on the Contractor's Basis. It is therefore proposed that the Welsh Government continues to prescribe the decapitalisation rate used in the Contractor's Basis of valuation.

Question 1	Do you agree Welsh Government should continue to prescribe the decapitalisation rates used in the Contractor's Basis of valuation?
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How many rates should be prescribed?

(i) Should a lower and a standard rate continued to be prescribed?

23. Since 1990, two decapitalisation rates have been prescribed in legislation – a standard and a lower rate. At the 2017 revaluation, a lower rate was applied for educational, healthcare, defence and public convenience hereditaments, while the standard rate applied to all other properties.
24. The lower rate was applied to certain public sector properties to reflect the fact that the occupiers of these properties have access to cheaper forms of financing such as public loans or grants and, in some cases, donations. As a result, the decapitalisation rate (which in part reflects the cost of financing) should be lower compared with hereditaments on the higher rate.
25. In the past, there have been calls for a single decapitalisation rate for all properties. This would simplify matters but would also mean the special characteristics of public sector bodies (such as schools and hospitals) on the lower rate would no longer be taken into account when calculating the rateable value of these properties.
26. Conversely, it has also been argued that more than two decapitalisation rates should be prescribed in legislation. More rates would enable the system to reflect the circumstances and characteristics of different types of properties but adding

new rates would also increase complexity of the system and could result in litigation around the boundaries of the rates.

27. It is proposed that a standard and a lower decapitalisation rate continue to be prescribed in legislation and that the existing groupings will remain unchanged. Moving to a single rate, moving to multiple rates or altering groupings would lead to ratepayers facing significant changes in their rates bill for reasons unconnected to revaluation. A change in approach would also disturb a system which has worked well and is widely understood.

Question 2	Do you agree that the Welsh Government should continue to prescribe two decapitalisation rates in Wales?
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How to calculate the decapitalisation rates

(i) The Appropriate Rates for the 2021 Revaluation

28. The Welsh Government last set the decapitalisation rates for Wales for the 2017 revaluation having regard to circumstances at 1 April 2015. A lower rate of 2.1% and a standard rate of 3.8% were set. For the 2021 revaluation, the Welsh Government will consider the circumstances at 1 April 2019 (the Antecedent Valuation Date for the 2021 revaluation).
29. Determining the decapitalisation rate is a complex matter. There are a number of different methodologies which each has its advantages and disadvantages, as well as a number of other factors such as changes in the value of land or in building costs. In setting the rates, the Welsh Government will have regard to all the methods and factors which it considers relevant.

(ii) Factors which need to be taken into Consideration

30. Central to the Contractor's Basis of valuation is the assumption that cost equates to value but this is not always the case. The costs and benefits of owning a property will depend on a range of factors, such as building costs and the ongoing cost of financing, as well as the economic situation and the availability of similar properties. For example, there may be instances in some sectors where construction costs have increased but returns have fallen.

(iii) Methodology

31. There are a number of academic methods available for calculating the decapitalisation rates to be prescribed in legislation. Each method produces a wide range of possible percentage rates, largely because they rely on an array of economic variables.
32. Annex A provides a description of these methods, an outline of their strengths and weaknesses, and the range of values they produce to inform the decapitalisation rate.

(iv) Relative Movement in Rents between the Valuation Dates

33. The academic methods detailed in Annex A provide a broad range of possible values and do not therefore offer a definitive answer as to what the decapitalisation rate should be.
34. As the primary function of the decapitalisation rate is to convert capital values into rental values, the relative movements in rents between the valuation dates for the 2017 Revaluation and the 2021 Revaluation in Wales should also be taken into consideration. This acts as a check upon the results of the academic methods.
35. In principle, the movement between the valuation dates for properties assessed on the Contractor's Basis should not, overall, be significantly out of line with the general movement in rental values. If movements in rateable values on the Contractor's Basis were significantly out of line with movements for other properties, this might indicate that the results of the method had departed, to some extent, from the value of the properties.
36. This check was used when setting the decapitalisation rates for England, Scotland and Wales in respect of the 2017 Revaluation, and also for Northern Ireland in respect of its revaluation in 2015. While England and Scotland aligned their decapitalisation rates, the Northern Ireland Executive and the Welsh Government prescribed their own decapitalisation rates with reference to the rental movements within their own tax-bases.

Question 3	Do you have any views on the methods for setting the decapitalisation rates (including any suggestions for alternative methods), on the range of values generated by each method, or on the merits or otherwise of each method?
Question 4	Do you agree with the Welsh Government's proposed approach for setting decapitalisation rates in Wales?

Welsh Language

Question 5	The Welsh Government would like your views on the effects these proposals would have on the Welsh language, specifically on: i) opportunities for people to use Welsh; and ii) on treating the Welsh language no less favourably than English. What effects do you think there would be? How could positive effects be increased, or negative effects be mitigated?
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Question 6	<p>Please also explain how you believe the proposed policy could be formulated or changed so as to have:</p> <ul style="list-style-type: none">i) positive effects or increased positive effects on opportunities for people to use the Welsh language and on treating the Welsh language no less favourably than the English language; andii) no adverse effects on opportunities for people to use the Welsh language and on treating the Welsh language no less favourably than the English language.
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Next Steps

37. Once the consultation has closed, all responses will be analysed and used to inform the setting of the decapitalisation rates and regulations to prescribe the decapitalisation rates.

CONSULTATION RESPONSE FORM

SETTING THE DECAPITALISATION RATES FOR THE NON-DOMESTIC RATES REVALUATION 2021

Your name:	
Organisation (if applicable):	
Email / Telephone number:	
Your address:	

The Welsh Government is interested in comments you may have about setting the decapitalisation rates for the Non-Domestic Rates Revaluation 2021.

- Q1 Do you agree Welsh Government should continue to prescribe the decapitalisation rates used in the Contractor's Basis of Valuation?
- Q2 Do you agree that the Welsh Government should continue to prescribe two decapitalisation rates in Wales?
- Q3 Do you have any views on the methods for setting the decapitalisation rates (including any suggestions for alternative methods), on the range of values generated by each method, or on the merits or otherwise of each method?
- Q4 Do you agree with the Welsh Government's proposed approach for setting decapitalisation rates in Wales?
- Q5 The Welsh Government would like your views on the effects these proposals would have on the Welsh language, specifically on:
iii) opportunities for people to use Welsh; and
iv) on treating the Welsh language no less favourably than English.
What effects do you think there would be? How could positive effects be increased, or negative effects be mitigated?

- Q6 Please also explain how you believe the proposals could be formulated or changed so as to have:
- iii) positive effects or increased positive effects on opportunities for people to use the Welsh language and on treating the Welsh language no less favourably than the English language; and
 - iv) no adverse effects on opportunities for people to use the Welsh language and on treating the Welsh language no less favourably than the English language.

Q7 We have asked a number of specific questions. If you have any related points which we have not specifically addressed, please use this space to record them.

Please enter here:

Responses to consultations are likely to be made public on the internet or in a report. If you would prefer your response to remain anonymous, please tick here: