Non-domestic rates: decapitalisation rates for the 2023 revaluation

Analysis of Consultation Responses

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Executive Summary

On 20 December 2021, the Scottish Government launched the consultation '*Non-domestic rates: decapitalisation rates for the 2023 revaluation*' which sought views on the prescription of the decapitalisation rate(s) to be used when non-domestic subjects are valued using the contractor's basis for the next revaluation.

The consultation closed on 13 March 2022 and received 13 responses. Of those, 12 were from organisations and one was from an individual. A list of respondents and links to their responses is available in Annex A where permission has been given to publish this information. We would like to express our sincere thanks to those that submitted a response to the consultation.

The responses to the consultation have informed policy development in relation to the decapitalisation rate(s) for the 2023 revaluation.

Summary of responses

The consultation asked for views on four questions:

1. Should the Scottish Government continue to prescribe decapitalisation rates to be used for the contractor's basis method of valuation at the 2023 revaluation?
2. Should the Scottish Government continue to prescribe two decapitalisation rates?
3. If prescribing two decapitalisation rates, should the Scottish Government continue to maintain the current groupings of properties in each rate?
4. Do you have any further views on the decapitalisation rates for the 2023 revaluation?

In summary, respondents reported they would welcome the continued prescription of decapitalisation rates by the Scottish Government for the 2023 revaluation, and all respondents either supported or had no objection to there being two decapitalisation rates (standard and lower).

Five of the thirteen respondents felt that there should be no change to the current groupings for the two rates, or had no strong views on the matter. Some respondents suggested there should be standardisation across the UK, while one respondent suggested that Scottish Water be included in the grouping for the lower decapitalisation rate. The Scottish Assessors Association (SAA) cautioned that any change to groupings should be carefully considered so that commercial organisations do not inadvertently benefit from the lower rate. Jones Lang LaSalle Limited suggested that the groupings for each rate should be defined more generally than they currently are.

Two respondents expressed concern over using property yield information to determine the decapitalisation rates (method 3 in the consultation document) while respondents including the Scottish Assessors Association, Institute for Revenues, Rating and Valuation and Jones Lang LaSalle Limited acknowledged that this method had been favoured by Scottish case law prior to prescription of decapitalisation rates.

Six out of thirteen respondents noted the relevant decapitalisation rates used in other UK administrations and suggested that these rates be used as benchmarks when considering the appropriate rates for Scotland.

Seven respondents, or just over half, asked that the Scottish Government provide a clear and transparent reasoning and analysis when setting the decapitalisation rates.

About the analysis

As with all consultations it is important to bear in mind that the views of those who have responded are not representative of the views of the wider population. Individuals and organisations who have a keen interest in a topic – and the capacity to respond – are more likely to participate in a consultation than those who do not. This self-selection means that the views of consultation participants cannot be generalised to the wider population.

It is worth noting that a number of responses had very similar or identical wording in some parts, and also that a number of the organisations who responded are also members of other organisations that provided a response.

For this reason, the approach to consultation analysis is primarily qualitative in nature. Its main purpose is not to identify how many people held particular views, but rather to understand the full range of views expressed.

Next Steps

Responses to the consultation have informed policy development in relation to prescription of the decapitalisation rate(s) for the 2023 revaluation. Additional analysis of the information received in response to this consultation can be found below.

Detailed Analysis

The Scottish Government invited members of the public and stakeholders to provide their views to four questions set out within the consultation document.

The feedback received will be used to consider the decapitalisation rate(s) for the 2023 revaluation.

Question 1
Should the Scottish Government continue to prescribe decapitalisation rates to be used for the contractor's basis method of valuation at the 2023 revaluation?

All respondents supported the proposal that the Scottish Government should continue to prescribe the decapitalisation rates. Eleven respondents noted that this practice would provide certainty for assessors and ratepayers, and should provide a greater degree of certainty in financial planning for taxpayers. The Institute of Revenues, Rating and Valuation commented that "ending prescribed rates would bring significant uncertainty to local government rate income; and this is particularly significant for local authorities as they struggling [sic] to cope with the financial impact of the pandemic". Respondents including the University of Edinburgh and the UK Petroleum Industry Association also noted that prescription of decapitalisation rates provides the Scottish Government with an element of certainty of budgetary forecasts. Gerald Eve LLP, the Royal Institution of Chartered Surveyors (RICS) and Scottish Property Federation further stated that prescribing decapitalisation rates "is an important factor in setting the Uniform Business Rate for the 2023 Revaluation".

A number of respondents noted that the prescription of decapitalisation rates reduces expensive litigation and avoids delays in the disposal of appeals that would otherwise occur. The SAA further highlighted that "the potential for extensive, time consuming legal dispute must also be considered against the background of an imminent move to a three yearly revaluation cycle".

Respondents including Scottish Water, Gerald Eve LLP, RICS, the Scottish Property Federation, and the Institute of Revenues, Rating and Valuation, highlighted that in their view, the decapitalisation rates must be set in an objective and transparent manner. Scottish Water and Gerald Eve LLP suggested that further consultation take place with stakeholders on the decapitalisation rates to be adopted, while RICS suggested "that such rates should be reviewed by an independent body to ensure rates are reflective of accurate market values". The Institute of Revenues, Rating and Valuation added: "it is important however that the process does not become a slave to inflexible theoretical models that result in excessive liabilities".

With regards to a general policy for decapitalisation rates, RICS noted that "prescription of the same rates, without considerable consultation and technical input can lead to rates that are distant from the relevant market and rating hypothesis".

In their response, Jones Lang LaSalle Limited advised that there may be "no 'right' answer to this issue" however they added: "in these circumstances, the advantages of certainty and the knowledge that a prescribed decapitalisation rate brings are justified”.

One respondent suggested that certain public sector properties should be exempt from rating due to what they deem to be “circular money”.

Question 2
Should the Scottish Government continue to prescribe two decapitalisation rates?

All of the respondents either supported or made no objection to there being two decapitalisation rates, with respondents such as Scottish Water, Gerald Eve LLP, the University of Edinburgh and the Scottish Property Federation noting: “it is established and understood by stakeholders that the application of two decapitalisation rates is sensible and therefore should continue”. These respondents, along with the UK Petroleum Industry Association, also expressed that if two rates were not prescribed, this would lead to appeals that would take considerable time and expense to resolve.

RICS stated that “adding further rates could potentially cause confusion and challenge – though where there is a clear evidence basis for doing so, this should not be ruled out”. The Scottish Assessors Association was also “of the view that different decapitalisation rates may be applied to different property types where the different rates are supported by the methodology used to derive these rates”, however they cautioned that it can be challenging to identify which properties should fall into each category due to new emerging business operating models.

The Scottish Assessors Association highlighted that if the difference between the lower and standard decapitalisation rates became more extreme, then “there is greater potential for ‘cliff edge’ impact on the valuation” which could lead to increased litigation.

The Institute of Revenues, Rating and Valuation explained that “the decapitalisation rate is a factor used in local authority Tax Incremental Finance (TIF) scheme modelling, so continuity of approach would be welcome”.

The National Day Nurseries Association stated “even though nurseries are currently exempt from paying business rates we would support two decapitalisation rates continuing to take account of the fact that nursery businesses are different from other consumer facing businesses.”

Jones Lang LaSalle Limited stated that if there was a disproportionate concentration of properties on the lower decapitalisation rate in a particular area, this may have an impact on the local tax base.

Question 3
If prescribing two decapitalisation rates, should the Scottish Government continue to maintain the current groupings of properties in each rate?

Responses to this question were mixed. 5 of the 13 responses felt that there should be no change to the current groupings or reported they had no strong views on the matter. The remainder of the responses to this question offered a variety of views.

Scottish Water suggested that as their borrowing is at a similar rate to that provided to other public sector providers within health, education, etc. rather than the commercial rate, their properties should be valued using the lower decapitalisation rate.

Some respondents such as Gerald Eve LLP, the University of Edinburgh, RICS, the UK Petroleum Industry Association and the Scottish Property Federation called for the Scottish Government to adopt a consistent approach in the application of the lower decapitalisation rate in comparison to England, Wales and Northern Ireland, however RICS also added: “RICS believes that decapitalisation rates more broadly should be reflective of the specific evidence in each individual market”.

The Scottish Assessors Association stated that “the SAA considers that the grouping of properties is a matter for government policy makers as it may be that policy makers may wish to use the decapitalisation rate to drive policy aims”, however they also noted: “if certain classes or groups of property are to benefit from application of a lower decapitalisation rate, great care should be exercised to ensure that the properties which fall into that class or group are carefully defined to avoid potential for litigation by occupiers seeking a lower decapitalisation rate and also so that commercial organisations do not inadvertently benefit from application of a lower decapitalisation rate”.

Jones Lang LaSalle Limited noted that they “would prefer to see the properties subject to one rate or the other defined for generically. In our opinion not-for-profit institutions and those which rely on public or private charitable funding should benefit from the lower decapitalisation rate, and ‘commercial’ operations pay the higher rate. Each ratepayer would then be able to claim the benefit of the lower rate if they fulfil the stated criteria.”

Question 4
Do you have any further views on the decapitalisation rates for the 2023 revaluation?

Two respondents suggested that a revaluation with a tone date of 1 April 2022 would be inappropriate as a result of the COVID-19 pandemic, uncertain finance rates and inflation rates, and the impact of Brexit on the cost of labour and materials. A further one suggested a tone date of 1 April 2022 may lead to an acrimonious appeal settlement phase. They further added that the decapitalisation rate set by Government is usually accepted by all parties but has potentially been too low for some classes of property, plant and machinery in previous revaluations and noted that the impacts of COVID-19/Brexit on interest rates may justify to higher decapitalisation rates.

Some respondents noted the decapitalisation rates set by other UK administrations. Some members of RICS suggested that the decapitalisation rates should be lowered "to ensure that the Scottish Ratepayer is not at a material disadvantage in comparison to similar properties located elsewhere in the UK." WYM Rating felt that the decapitalisation rate in Scotland for the 2023 revaluation should be no higher than it is in England.

Other respondents including Scottish Water, Gerald Eve LLP, the University of Edinburgh, the UK Petroleum Industry Association, and the Scottish Property Federation felt that the decapitalisation rates should be guided those set by the Welsh Government as a benchmark, "ensuring Scottish ratepayers are not materially disadvantaged", while acknowledging the difference in the respective tones dates in England and Wales in comparison to Scotland. These respondents along with RICS also asked that "the Scottish Government provide detailed reasoning with clear and transparent analysis undertaken in setting the appropriate rates", a suggestion also supported by Jones Lang LaSalle Limited.

Gerald Eve LLP stated: "as Scotland and the rest of the UK exits this period of uncertainty and transition from COVID-19 Pandemic, the Scottish Government needs to consider the affordability to ratepayers when considering setting the appropriate rates for the 2023 Revaluation."

RICS noted the three methods of determining rates set out in the consultation document and "recognise[d] the strengths and weaknesses of these methods", further adding "we are particularly cautionary around the use of property investment yields, as these are presumably generated from active rental and capital markets and therefore do not fit in with the concept behind the Contractor's Basis which is one where a prospective tenant considers constructing a similar property and borrowing or using their own funds (the opportunity cost of capital)." Jones Lang LaSalle Limited also noted their concerns regarding the use of property yields to determine the decapitalisation rates: "Regarding property yields, we do not support their use in setting the decapitalisation rate. This method of assessing the decapitalisation rate has found little favour in the English courts although it has some support in Scottish law. In our opinion, the use of property yields is based on a confusion between what is a "cost" and what is a "return" and felt that "interest rates are the main and perhaps the only justified means of setting the decapitalisation rate and the other methods examined in Annex A are not as pertinent or reliable."

The Scottish Assessors Association conversely noted that prior to prescription of the decapitalisation rates "Scottish case law determined that the best means of arriving at decapitalisation rates was to compare with investment property yields (Consultation Method C)" which is in contract to the position in England and Wales where the judicial authority supported the use of borrowing to fund a replacement property (Consultation Method A). They added "the SAA recognise that Method C also has significant benefits. However, it is recognised that yield evidence for some types of property, such as that developed for philanthropic use, may be limited." They also noted that the difference between the approach in Consultation Method A and Method C has continued to widen since 2008, noting that since then the Bank of

England Rate has reduced from 5.25% to 0.5% while “over this same period changes in market yields in Scotland have been less dramatic”.

RICS also noted the proposal in the Welsh Government’s consultation regarding a general policy for prescribing decapitalisation rates at future revaluations where the Welsh Government would gather evidence at each valuation date, consider whether the current decapitalisation rates remained within the range of possible outcomes and should remain unchanged if so or undertake a consultation on new rates if outwith the range of possible rates. They added: “As proposed in Wales, RICS would welcome the principle of introducing a general policy for setting decapitalisation rates in future Scottish revaluations, subject to appropriate public consultation and stakeholder input. This could help reduce administration and provide a further degree of certainty. However, accountability is also key, and we are of the view that keeping rates as well as setting new rates should be publicly consulted upon.” They also suggested that an independent body to set decapitalisation rates should be considered.

Jones Lang LaSalle Limited finally suggested “that the Government should look at setting the decapitalisation rate at a level which means that the 22% of the Valuation Roll assessed under this method does not experience an atypical change in rateable value compared with other subjects. A revaluation is supposed to redistribute the burden of taxation fairly amongst ratepayers. Having a section of the Roll move in a manner that does not reflect [sic] the wider property market should be avoided.” They also noted that “we anticipate real uncertainty will attach to any overly mathematical approach [to determining the decapitalisation rate]. That is why we consider an overall view taking into account the movement overall in the property market should be used instead.”

General Comments

In their response, the National Day Nurseries Association stated their strong support for the non-domestic rates relief available for Day Nurseries, and said that “evidence from members suggests this helps make them sustainable and allows them to invest in the environment, staffing, CPL and also to help minimises price increases to parents”.

Annex A – Consultation Responses

See below a list of organisations that responded to the consultation and where permission was granted to publish the response:

- Gerald Eve LLP
- Institution of Revenues, Rating and Valuation
- Jones Lang LaSalle Limited
- National Day Nurseries Association
- Royal Institution of Chartered Surveyors (RICS)
- Scottish Assessors Association
- Scottish Property Federation
- Scottish Water
- UK Petroleum Industry Association
- University of Edinburgh
- WYM Rating

The published responses to the consultation can be viewed on the Scottish Government's website.

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