

Rebalancing business rates



Report on the Department's October 2021 Consultation
Exercise:

NI Reval2023, Setting of Decapitalisation Rates

January 2022

1. INTRODUCTION

A revaluation of non-domestic properties usually takes place every five years, with the next revaluation originally scheduled to take place in 2025. The Minister of Finance decided to move the next revaluation to 2023, factoring in the current economic impacts. The Minister has also decided to move a three-year cycle for non-domestic revaluations commencing with the revaluation in 2023.

The main purpose of a revaluation, and the associated setting of the multiplier, is to adjust the liability of properties relative to others within the non-domestic rates (NDR) taxbase. 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 regional rate multiplier is then reset by the NI Executive, with a similar process undertaken by local councils, to ensure the actual revaluation process is 'revenue neutral', i.e. it will generate the same level of funding after revaluation as before.

Preparations are now underway for the new non-domestic valuation list to be introduced in Northern Ireland from 1st April 2023. Land & Property Services (LPS) is responsible for compiling and publishing the new valuation list. This will value all non-domestic properties based upon their estimated annual rental value at the Antecedent Valuation Date (AVD) of 1st October 2021.

LPS uses three methods for calculating the rateable value of a property depending on the available evidence. **Rental Comparison** is used where there are sufficient numbers of comparable properties to provide reliable evidence on rental values, for example in the valuation of shops, offices and warehouses. 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 potential profits made from the business occupying the property, for example in the valuation of pubs and hotels. The **Contractor's Basis** is used when little or no rental, or turnover, evidence exists. It is generally used for specialised properties, for example, schools and hospitals. Properties such as these are rarely let and therefore their rental values are determined by reference to construction costs.

This consultation is concerned with a specialised method of valuing property, known as the Contractor's Basis, and its use of a mechanism known as the decapitalisation rate.

Approximately 12,000 non-domestic properties in Northern Ireland are valued wholly or in part using the Contractor's Basis. These properties include schools, universities, hospitals, fire and police stations, and halls, amongst others.

The decapitalisation rate (the 'decap') is a key part of the Contractor's Basis. It is a percentage figure which is used to convert the effective capital value of a property into an annual rental value. Its use ensures that 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.

2. PROPOSALS

The consultation focused on whether the decap rates should continue to be prescribed in legislation, the number of prescribed rates, and how the rates should be calculated.

3. ENGAGEMENT

Views were invited as part of an 8-week consultation period which began on 20th October, and ended 15th December 2021. The consultation was published on the consultation pages of the Department of Finance and also on Citizen Space. A public announcement was published in the Belfast Telegraph, Irish News and the News Letter. The consultation was also publicised on the Department's Social Media outlets.

Respondents were able to submit their views and comments by paper, email or online.

4. OVERVIEW OF RESPONSES

In total, the consultation received 12 responses, 11 of those responses were representative bodies and 1 general response from an individual ratepayer.

A full list of respondents is given at [Annex A](#).

5. SUMMARY OF RESPONSES

This document is a summary of the responses received. It does not aim to capture every point raised by respondents, only to highlight the key themes.

Question 1

Do you agree the Department should continue to prescribe the decapitalisation rates used in the Contractor's Basis of Valuation?

Responses

The majority of the respondents agreed with the proposal, with some commenting that as long as they were set fairly and are transparent, prescribing rates is the only way to overcome the valuation of properties where rents or receipts and expenditure details are lacking. It was also stated that it provides certainty through this method. A respondent added that it is important that the process does not become a slave to inflexible theoretical models that result in excessive liabilities.

The point being made that there are merits to continued prescription of decap rates, subject to proper consultation and within the context of existing case law. They also added that this review could be conducted by an independent body in order that rates are reflective of accurate values.

One respondent's concern was not with regards to the methodologies used but more with the politics and favouring particular businesses and organisations.

Another respondent advised that while there was no 'right' answer to this issue, they believed the advantages of certainty and the knowledge that a prescribed decap rate brings are justified.

It was suggested by one respondent that the setting of these rates may be causing distortion in the rating system and ideally should be removed. The prescription of rates does not accurately value hereditaments not valued using the Contractor's Basis and this is exacerbated by the use of the lower decapitalisation rate.

Conclusion

The Department will continue to prescribe the decapitalisation rates for the Contractor's Basis of Valuation. This is the preferred method among the majority of the respondents.

Question 2

Do you agree that the Department should continue to prescribe two decapitalisation rates in Northern Ireland i.e. a standard rate and a lower rate?

Responses

The majority of respondents agreed that Northern Ireland should continue to prescribe two decap rates. Some respondents suggested that the existing grouping may need to be reviewed and consulted upon.

A number of respondents suggested that there was an argument for an increased number of decap rates given the diversity of the building stock. Two respondents made a suggestion to introduce three prescribed rates which would be applied according to the nature of each actual occupation; 'ability to pay' has been held to be a factor in determining the measure of liability in each contractor's test case.

One respondent advised while the use of lower decap rate may be justified, if these properties are disproportionately concentrated in a particular district it could affect revenue and the local multiplier. They would prefer to see one rate or the other defined more generically.

Another respondent raised concerns that there is evidence that the lower rate is too low in many cases and causes considerable distortion compared to other hereditament classes.

Conclusion

The Department will continue to prescribe two decapitalisation rates for the forthcoming revaluation and continue to consider the merits of general policy in the longer term.

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?

Responses

Some respondents recognised that the Contractor's Basis for rating reflected a situation that was hypothetical but yet realistic which takes into account the assumed cost of buying of land, constructing the property and the cost of borrowing. They added they had concerns about the use of property investment yields.

It was suggested by one respondent that due to the difficulties and uncertainties created by COVID 19, together with the increased construction costs caused by the pandemic restrictions and supply difficulties, a reduction in the headline decapitalisation rate to 3.4% should be considered.

Another respondent advised that while there is a clear alignment in some parts of the public sector between a borrowing cost – the cost of funds provided by government and the annual cost of providing the facility being valued, it is claimed that the association is less clear in the private sector. This has led to the assumption that the cost of borrowing is higher in the private sector and so they should pay more rates. However, they added that when the Contractor's Basis is chosen, it is correct that calculation of rates starts with the borrowing cost. This respondents also looked at the alternative methods and advised that they would be at best problematic and could be irrelevant.

Two respondents addressed the issue of interest rates, in particular that they should reflect the principles of rating and therefore it is vital that affordability is reflected in the rate adopted. They also advised that a low or lower decapitalisation rate places additional pressure on properties which are valued using other methods, as it lowers the rateable value and can result in a higher multiplier.

One respondent thought the value of capital costs are subject to great uncertainty and if they continue to fluctuate in line with market forces, this may introduce a further risk to valuation lists.

Another suggestion from the respondents advised that they preferred the cost of securing capital from borrowing approach.

Conclusion

The Department will consider all the factors, including the changes in the construction costs when determining the appropriate rates.

Question 4

Do you agree with the proposed approach for setting decapitalisation rates in Northern Ireland?

Responses

The majority of the respondents agreed with the proposed approach set out in the consultation document. Some added that the methodology employed should be fair and transparent. Two respondents added that it should be subject to consultation in the interest of fairness and to seek to avoid litigation. Also suggesting that the evidence must be seen to be complete as at the antecedent valuation date, and would welcome an early consultation.

It was also suggested by two respondents that while the intention of reducing administration and providing a degree of certainty is a good one, they added that accountability is also key and if prescribed rates are to be used, this should be consulted on.

One respondent suggested that Northern Ireland could benefit from the results of the earlier exercise carried out by the Welsh Assembly Government on this issue and lower the decapitalisation rate as their Welsh counterparts have already proposed.

One respondent advised that any changes to the Northern Ireland rating system should be viewed alongside the other taxes borne by businesses e.g. National Insurance and Corporation Tax as any tax system should allow businesses to plan ahead with certainty.

Conclusion

The Department will continue to set decapitalisation rates in line with the approach outlined in the consultation document.

6. NEXT STEPS

The consultation responses will be used to inform the setting of decap rates for the 2023 revaluation which will be prescribed in legislation.

The Department will consider the broader points raised by respondents as part of the wider process of making non-domestic rates policy.

We would like to thank everyone who has taken the time to respond to the consultation. Your views were important in informing the decisions on setting the decap rates for Northern Ireland. We are grateful for your contributions.

Sharon Magee
Director of Rating Policy

List of Respondents

Irish Football Association (IFA)
Farebrother Chartered Surveyors
Fermanagh and Omagh District Council
UK Petroleum Industry Association (UKPIA)
Lisburn and Castlereagh City Council
Jones Lang LaSalle (JLL) Ltd
NI Water
Institute of Revenues, Rating and Valuation (IRRV)
Northern Ireland Transport Holding Company
Belfast City Council
Anonymous Business
Anonymous Ratepayer