

NI Reval2023



Land &
Property
Services
Scirbhísí
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Department of
Finance
An Roinn
Airgeadais
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Rebalancing business rates



Consultation Exercise

NI Reval2023

Setting of Decapitalisation Rates

October 2021

Introduction

On 16th June, the Finance Minister announced that the Department of Finance would undertake the next revaluation of Non-Domestic properties, with a new valuation list to take effect on 1st April 2023. This revaluation would be the first such exercise to be undertaken following the outbreak of the Coronavirus pandemic last year.

The main purpose of a non-domestic 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.

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**.

While most properties are assessed using rental information, the Contractor’s Basis is used instead for properties where there is little or no direct rental evidence available. 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, halls, and airports, amongst others.

The decapitalisation rate 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.

This consultation seeks views on:

- whether the decapitalisation rate should be prescribed in legislation;
- how many decapitalisation rates should be prescribed; and
- how the decapitalisation rate or rates should be calculated.

This consultation applies to Northern Ireland only.

The valuation process and the Contractor's Basis

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 shops, offices, 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 profits made from the business occupying the property, for example pubs and hotels.

The **Contractor's Basis** is used when no such rental 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.

Valuation List value assessed on the Contractor's Basis

It is estimated that around 12,000 non-domestic properties in Northern Ireland will be valued using the Contractor's Basis, wholly or in part. As at the time of writing, and based on a 1st April 2020 valuation date, these properties have a total rateable value of approximately £424 million, including

Sector	Rateable value (£m)
Education	£146m
Health	£ 77m
Libraries and Museums	£ 5m
Defence	£ 11m
Sport facilities	£ 38m
Law and Order	£ 28m

The Contractor's Basis

The Contractor's Basis has evolved alongside valuation and rating case law and is based on the premise that the hypothetical tenant has an alternative to renting, namely they could purchase land and build a similar hereditament.

Rating case law has established five principal stages of a Contractor's Basis of valuation, as follows:

Stage 1

Estimate the replacement cost of the site works, buildings, rateable structures and rateable plant and machinery.

Stage 2

Apply any appropriate adjustments and allowances to reflect the difference between cost and effective capital value (ECV).

Stage 3

Add the value of the land to arrive at total ECV.

Stage 4

Apply the appropriate decapitalisation rate (The Decap Rate) to the total ECV to convert it to an annual rental value

Stage 5

Stand back and look at the resultant answer of stage 4 and make any further adjustments considered appropriate.

The Decap Rate acts to ensure that the costs and benefits of owning a property, compared to renting a property, are taken into account when calculating the rateable value.

The prescription of the decapitalisation rate in legislation

Before 1997, 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.

To mitigate that level of uncertainty since 1997 the decapitalisation rates have been prescribed in legislation here by the Department using the powers provided by paragraphs 5 and 6 of Part 1 of Schedule 12 to the Rates (Northern Ireland) Order 1977.

The primary purpose of setting the decapitalisation rate in legislation is to standardise the way that LPS valuers convert capital value into rateable value when using the Contractor's Basis. The prescribed rates therefore act to eliminate the previous uncertainty that existed regarding the rate which should be used.

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.

Prescribing the decapitalisation rate in legislation ensures that ratepayers are able to predict their non-domestic rates liability following a revaluation, with a reasonable degree of certainty. It also helps to avoid large numbers of legal challenges of valuation decisions, which can be costly and which risks destabilising the taxbase for the Executive and local government. Stability in this area is important in order to allow Councils and the Executive to set their budgets and plan effectively for future years.

By contrast, not prescribing the decapitalisation rates in legislation creates uncertainty. Allowing the Courts to consider the right rates for different classes of property may allow valuations to fit the circumstances of each case, however, it is far from clear whether the Courts could deliver the long-term stability within the taxbase through such a consideration of individual cases.

In fact, such an approach may give rise to even more uncertainty. This is because finance may be secured from such a variety of sources (ranging from private equity, public equity and commercial borrowing) which would mean that LPS valuers would have to assess the mix and nature of such finance to value individual properties.

It is likely that ending prescription of the decapitalisation rates could give rise to extensive litigation and an unacceptable level of uncertainty for those valued on the Contractor's Basis.

It is therefore proposed that the NI Executive continues to prescribe the decapitalisation rate used in the Contractor's Basis of valuation.

How many rates should be prescribed?

Since 1997, two decapitalisation rates have been prescribed in legislation. At the last revaluation in 2020, a **lower rate** of 2.67% was applied to educational, healthcare, and church hereditaments, while the **standard rate** of 4% was applied to all other properties.

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.

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.

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.

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. It is the view of the Department that 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 here and is widely understood.

How to calculate the decapitalisation rates: The appropriate rates for the 2023 revaluation

The decapitalisation rates in Northern Ireland were last set for the 2015 Revaluation and retained for the 2020 Revaluation. A lower rate of 2.67% and a standard rate of 4% was set by The Valuation for Rating (Decapitalisation Rate) Regulations (Northern Ireland) 2015.

<https://www.legislation.gov.uk/nisr/2015/32/made>

For the 2023 revaluation, LPS will consider the circumstances at 1st October 2021 (the Antecedent Valuation Date for the 2023 revaluation). The New NAV List (Time of Valuation) Order (Northern Ireland) 2021 refers.

<https://www.legislation.gov.uk/nisr/2021/245/contents/made>

Determining the decapitalisation rate is a complex matter. There are a number of different methodologies to consider, 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 Department will have regard to all the methods and factors which it considers relevant.

Factors which need to be taken into consideration

Central to the Contractor's Basis of valuation is the premise that the costs and benefits of owning a property will depend on a range of factors, including 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.

Methodology

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.

Annex A provides a description of these methods and an outline of their strengths and weaknesses.

Relative movement in rents between the valuation dates

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.

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 2020 Revaluation (1st April 2018) and the 2023 Revaluation (1st October 2021) in Northern Ireland may also be taken into consideration. This serves to act as a check upon the results of the academic methods.

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 and further examination of the valuations could be undertaken.

Consultation Questions

Question 1

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

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?

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 proposed approach for setting decapitalisation rates in Northern Ireland?

How to respond

Submit your comments by **Wednesday 15th December 2021**, in any of the following ways.

- complete our online form at:
<https://www.finance-ni.gov.uk/setting-decap-rates>
- email your response to the questions raised in the Consultation Exercise to:
ratingpolicy@finance-ni.gov.uk
- paper responses to:

Decap Rate Consultation

Rating Policy Division

Land & Property Services

Lanyon Plaza

7 Lanyon Place

BELFAST BT1 3LP

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

Your rights

Under the Data Protection legislation, you have the right:

- to be informed of the personal data held about you and to access it.
- 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.

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 tell us.

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[LPS Privacy Notice \(finance-ni.gov.uk\)](https://finance-ni.gov.uk)