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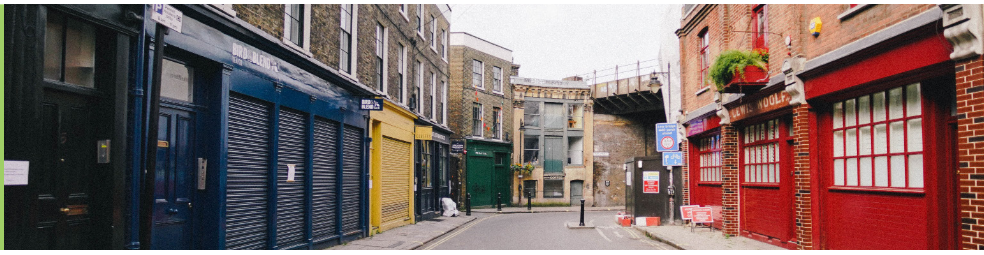


Reforming business rates

Technical report

Contents

The business rates challenge

Why business rates reform?

In March 2020, the Chancellor announced a fundamental review of business rates for England. The terms of reference of the review state that the Government believes revenue should continue to be raised through the taxation of non-residential land and property. However, it also has stressed the need to modernise the tax system and to ensure that it does not impinge unfairly on certain ratepayers, particularly on the high street. While business rates are a key component of local government finance, it is important to recognise that the tax will not be able to resolve future funding pressures emerging from issues such as social care. That said, ensuring that the tax works better for both local government and for businesses should be a key public policy objective.

This review follows on from the 2019 Treasury Select Committee's inquiry into the impact of business rates, which argued that the current system is broken. Indeed, the idea that the current business rates system is no longer fit for purpose is widely held.

Box 1: Business rates in the four nations

Business rates are fully devolved to Scotland and Northern Ireland but only partially to Wales. The organisation responsible for rating properties is the Valuation Office Agency (VOA) in England and Wales. In Scotland, this role falls to assessors which are specific to each region of the country and in Northern Ireland, this role is fulfilled by the Land and Property Service (LPS). Rateable values in England, Wales and Scotland are based on rental values in April 2015 whereas in Northern Ireland they are more up to date, based on rental values as of April 2018.

The uniform business rate (UBR) also varies between the four nations with different standard rates as well as differing bandings depending on the size and rateable value of properties. The UBR in Northern Ireland is a combination of a regional rate and a district rate. Reliefs also vary, with all four providing some form of small business rate relief although the rates, bandings and methods differ.

As the British Property Federation noted in their submission to the Select Committee: "The crux of the issue comes down to the business rates system not accurately valuing property in real time. The way we use property will change. Certain properties will become more valuable or less valuable. Taking online retail as an example, as that industry grows, presumably those kinds of distribution warehouses – last-mile distribution points and click and collect points – will have value. There will be physical premises that they are using that will become more valuable. If the business rates system was more adaptable and reflected those values in real time, the burden that different industries paid would be more equally shared."[1]

The Government's desire to undertake a fundamental review of the tax is therefore to be welcomed. Yet, while key stakeholders have been extremely clear in their criticism of the tax, it is less clear what they would prefer to have in its place.

Any reform of the tax needs to address the key underlying issues raised by the major stakeholders in the payment and receipt of business rates. A detailed analysis of the submissions made to the Select Committee inquiry identifies four key underlying issues with the tax.

The four fundamental problems with the business rates system

Centre for Cities has undertaken a detailed analysis of more than 130 submissions made to the Treasury Select Committee review on business rates in conjunction with other analysis on business rates. The underlying issues associated with business rates can be summarised into four areas: timeliness, complexity, disincentives for investment, and disincentives for local growth.

1. Timeliness: business rates do not reflect local economic realities

For business rates to be a fair and effective tax, they must reflect the real economic conditions that ratepayers experience. However, the approach to valuing properties means this is very much not the case. For instance, the infrequent valuation periods cause rates to be paid on values that can be as much as seven years out of date (which was extended to nine years due to the delay of the 2015 valuation to 2017). And while the Government planned to reduce the time period to a valuation every three years from 2024, the valuations used for rates will still be as much as five years out of date. Due to the Coronavirus pandemic the 2021 revaluation has been postponed until 2022, thereby pushing back the start date for three-yearly revaluations. This mismatch is compounded by the transition scheme after each valuation which perpetuates disadvantages for some firms for several years following a revaluation.

1 Treasury Select Comittee (2019) Impact of business rates on business. https://publications.parliament.uk/pa/cm201919/cmselect/cmtreasy/222/22207.htm

2. *Complexity: the system is dogged by complexity*

While HM Revenue and Customs has attempted to make the UK tax system simpler, more customer focussed and more efficient in recent years, business rates have become more complex. There are two main ways this manifests itself. The first is how valuations are created. The current approach to valuing properties is a slow process, which is partly related to the lack of a systematic and transparent valuation methodology. Once the VOA has set a common value per square meter for an area, it then proceeds to adjust the value using property specific characteristics. This has been a key obstacle in moving to annual valuations, as it would make a long-winded process even more burdensome. In addition, the reported rents may not take into account incentives and discounts, which are further impacted by upward only rent reviews.

A number of reforms to the system can potentially remove this complexity. For example, a switch to landlords holding the responsibility for business rates instead of tenants was considered by a handful of stakeholders. These were either research or central government groups who described how such a change would both simplify the process overall as well as reducing friction between changes in business rates and rent adjustments which are often slow.

The second challenge is the complex and arbitrary web of reliefs. Business rate reliefs in England total almost £5 billion, over 15 per cent of the overall amount collected. The reasons for reliefs are diverse, but most have been introduced due to the fact that valuations do not reflect market prices. Reliefs therefore have provided a sticking plaster to deal with an underlying fundamental problem.

Views towards the **abolition of reliefs** were the most varied. While no stakeholder was completely in favour of the abolition of reliefs, the most common critique was that reliefs were generally too complex. At the same time, numerous stakeholders put forward cases for industry and size-specific reliefs[2], particularly to support businesses that deemed themselves to offer a wider social benefit. Empty property reliefs were a particular topic of contention with arguments for either their extension or abolition. A specific issue raised by local authorities is that they should be given greater control, with more reliefs being made discretionary at this level.

3. *Promoting investment: the current system disincentivises investment*

Britain's productivity record over the last decade has been poor compared to other developed countries. One reason behind this is due to lower levels of investment as a percentage of GDP. This is not helped by the disincentive to invest in plant equipment and machinery generated by the business rate system.

For those stakeholder groups where **capital expenditure relief** was relevant, there was agreement that some form of relief would be key in accelerating investment. Many stakeholders, primarily business groups, commented on

2 Three groups submitted more written evidence than any others: pubs, book sellers and nurseries.

business rates being a major factor holding back investment decisions. Notably no stakeholders expressed views that were not in favour of some type of relief. The Scottish Business Growth Accelerator Relief programme was mentioned by stakeholders across groups. The programme offers a 12-month relief on improvements or expansions on properties that increase rateable value.

4. *Promoting local growth: the system does not incentivise local growth*

There are two main problems with the structure of the current business rates system that do not incentivise local authorities to support growth across the economic geography within which they operate.

The first is that local authorities get to keep only a half of any growth in revenues, although a pilot has been recently undertaken on 100 per cent retention. The second is that different parts of a local economy play different roles. For example, city centres often have clusters of high-skilled jobs, while suburbs provide the key input to city centre businesses – workers. This causes a number of problems for local tax policy by distorting incentives between local authorities within one economy.

The following sections will highlight specific details of the issues and solutions raised in the summary document.

Section 1: How a lack of timeliness affects the system

This section sets out how a lack of annual valuations impacts the operation of business rates.

1.1 Why a shift towards annual revaluations is needed

While criticisms of business rates are widespread, there is still a general acceptance by ratepayers that paying tax based on property values is reasonable. However, one of the main challenges with the tax as it currently stands is that it does a poor job of representing property values. This causes a number of problems.

Problem 1: Rents do not reflect economic conditions

As the recent financial crisis demonstrated, rental values can fall in a relatively short space of time, hence it is imperative to ensure that business rate valuations are up to date. Between 2007 and 2012, average rents fell by between 15 and 20 per cent – but business rates actually went up due to rates being linked to inflation.[3] The COVID-19 crisis has also had a rapid effect on declining rents in the retail sector,[4] but current valuations are based on 2017 valuations and will not be changed until 2022. And, because bills are linked to inflation, they will continue to increase. Hence even with a shift to three-year valuations, due to the two-year delay in assembling the information, rateable values will still be as much as five years out of date when compared to actual rental values.

Problem 2: This is compounded by the transition scheme in place

Revaluing every five years creates a cliff edge for businesses as rates bills can undergo large corrections. To address this existing transitional relief acts to phase in the effects of these changes by limiting the amount that a bill may rise following a change in rateable value.

In order to fund these set limits following an upward revaluation, there is also a downward limit following a downward revaluation. This means that if the rateable value of a property falls following a revaluation, the maximum annual fall is also capped. Under the transition scheme, the limits continue to apply to yearly increases and decreases until the correct amount is due. The cap on increases and decreases in business rates is dependent on the rateable value of the property, as shown in Table 1.

3 Commercial News Media (2013) GVA warns of business rates time bomb http://www.commercialnewsmedia.com/archives/18756

4 Hickey M, Arnold J (2020) Market in Minutes: Central London Retail https://www.savills.com/research_articles/255800/303470-0

Table 1: Transitional Relief Limits, 2020-21

Size	Rateable Value	Decrease Limit	Increase Limit
Small	Less than £20,000	55%	15%
Medium	Less than £100,000	25%	25%
Large	More than £100,000	5.8%	16%

Source: Gov, 2020

Businesses that face a downward revision to their rateable values lose out because of transitional relief and those that see upward revisions gain. And there is a geography to this. While on average the rateable value of properties has increased by 9 per cent over the most recent revaluation period, the disparities between places are significant. At one end of the spectrum, businesses in Hackney saw a 46 per cent increase in average rateable value, whereas Redcar and Cleveland saw a 20 per cent fall and some areas such as Wyre saw no change.

Box 2: Issues raised with transitional relief

The main critique of transitional relief raised by a number of stakeholders in the Treasury Select Committee was simply that downward transitional relief exists. A number of property groups, retailers and research institutions described how downward transitional arrangements were a major detriment to businesses and breached the fair tax pillar of good tax policy as outlined by the Treasury. Stakeholders acknowledged that upward relief is necessary to protect businesses who would otherwise face large increases in their business rate bills following an upward revaluation. However, they found the condition that business rates must be fiscally neutral has led to a scenario where the benefit of upward relief for some businesses is matched by the disadvantage of downward relief to others. Stakeholders expressed frustration at the fact that making those ratepayers who have seen a fall in rateable values fund transitional relief adds insult to historic injury, by unfairly penalising businesses whose rateable values were previously overestimated.

"Transitional relief is frustrating for companies experiencing a downturn in their profitability as it keeps them paying the same level despite changing economic conditions" Energy and Utilities Alliance.

When the rateable value of a property falls, businesses do not see an immediate benefit because of transitional relief. Additionally, because of the annual caps on downward transitional relief, they may never pay business rates based on their new rateable values. This is especially true for large businesses for whom the downward transitional limit is the smallest.

"Transitional relief ... further compounds this volatility by preserving values

that are not reflective of the market movement. Revaluations become an arbitrary exercise, especially for larger retailers who are subject to complex caps, constraints and exclusions from relief." - Boots Walgreens

This is discussed in the submission from the Royal Institute of Chartered Surveyors (RICS), which describes the experience for large businesses that faced a downward revaluation in 2017. The maximum reduction was 4.1 per cent, which after offsetting by a 2 per cent rise in inflation represented a net maximum reduction of 2.1 per cent. This downward limit for large businesses remains below 6 per cent for the life of the 2017 rating list, meaning this business will see only slight reductions in their rates bills. In these instances, liabilities remain tied to rateable values from 2008, potentially even for the 2022 rating list depending on the size of the revaluations.

"We are aware of countless instances of units that are let at nil rent by the landlord because the rates liability is so high". – RICS

One solution proposed by some stakeholders was to fund upward transitional reliefs through general taxation rather than through downward transitional relief. This system has been implemented in Wales.

Another issue with transitional relief that was raised less frequently was that upward transitional relief was not adequately large. Gerald Eve LLP, a real estate adviser describes how although transitional arrangements were introduced to cushion the impact of revaluation, they have in recent years done little to cushion the change. Since 1995, the largest increase in rates payable in the first year of a revaluation was capped at 12.5 per cent (before inflation adjustment) but at the revaluation in 2017, large properties faced immediate increases of 42 per cent (plus inflation). It is worth noting that since 2017, the upward limits for large businesses have been reduced with the limit for 2021/22 set at 6 per cent.

Example: Storengy - despite a significant fall of rateable value, the business saw hardly any reduction of the business rates bill

Specific evidence was provided in the submissions to the select committee, putting figures to the issues outlined. The Confederation of British Industry (CBI) put forward the experience of an energy storage company, Storengy. Although the facility saw their rateable value fall by 59 per cent in the revaluation, due to the transitional arrangements the business has not been able to reap any of the benefits with their business rates bill reduced by only 1 per cent. Furthermore, in 2017, business rates accounted for 45 per cent of their total operating expenditure and 40 per cent of revenues, meaning the business had not become profitable at the time of the submission.

The CBI also finds that for certain critical industries, such as gas storage and gas-fired power generation, downward transitional reliefs have led to large distortions, with businesses paying rates in excess of double their 'true' liability. As with other industries, this is likely to last for the lifetime of the 2017 rating list with liabilities still tied to the 2008 rating. CBI estimates that if the transitional relief scheme remains in this form, many businesses in these vital industries will be mothballed or prematurely closed.

Example: Fashion Retailer - despite a fall of rateable value by 50 per cent, the company must pay over £100,000 annually in transitional reliefs for the five years after the revaluation

Other businesses in different sectors have had similar experiences. CBRE, a real estate company, provided the account of a retail unit leased to a leading fashion retailer as evidence. The business saw their rateable value fall by over 50 per cent between the 2008 and 2017 valuations which would have seen their business rates liabilities fall by a similar amount in the absence of downward transitional relief. The CBRE describes how, in actuality, the business will continue to pay over £100,000 annually in transitional reliefs for the five years after the revaluation. The effective UBR of this firm at the time of the next revaluation will be 0.94 whereas the actual UBR ought to be 0.50. In recognition of these high rates, an offer was made to allow the business to continue occupying the property with no liability for rent or service charge, with the tenant only required to pay business rates. The CBRE described how the liability was still too high and the business closed, the firm kept a similar business with lower business rates open. The tenant would at no point pay rates based on the 2017 rateable value and, if transitional caps were maintained, would also likely not pay rates based on the 2022 rateable value either.

Table 2: Business rates accounts for leading fashion retailer

2017 RV	£242,000
2010 RV	£520,000
Base Liability	£251,680

Tax Year	Unphased Amount (2017 RV x UBR) (£)	Actual Rates Payable (£)	Transitional Surcharge (£)	Effective UBR	Actual UBR
2017/18	115,918	249,334	133,416	1.03	0.48
2018/19	119,306	245,056	125,750	1.01	0.49
2019/20	121,968	236,019	114,051	0.98	0.50
2020/21	124,388	226,899	102,511	0.94	
	481,580	957,308	475,728		

Source: CBRE, 2017

Example: Gerald Eve LLP - keeping a UBR more than double the level it would be in absence of the reliefs for many years

Gerald Eve LLP, provided the accounts of one of its clients below, showing similarly high transitional relief payments keeping the UBR more than double the level it would be in absence of the reliefs for many years.

Table 3: Business rates accounts for 23 St Georges Street, Canterbury

2017 RV	£123,000
2010 RV	£275,000
Base Liability	£136,675

Tax Year	Unphased Amount (2017 RV x UBR) (£)	Actual Rates Payable (£)	Transitional Surcharge (£)	Effective UBR	Actual UBR
2017/18	58,917	131,795	72,878	1.07	0.48
2018/19	60,639	129,532	68,893	1.05	0.49
2019/20	61,992	124,994	63,002	1.02	0.50
2020/21	63,222	120,161	56,939	0.98	
	244,770	506,482	261,712		

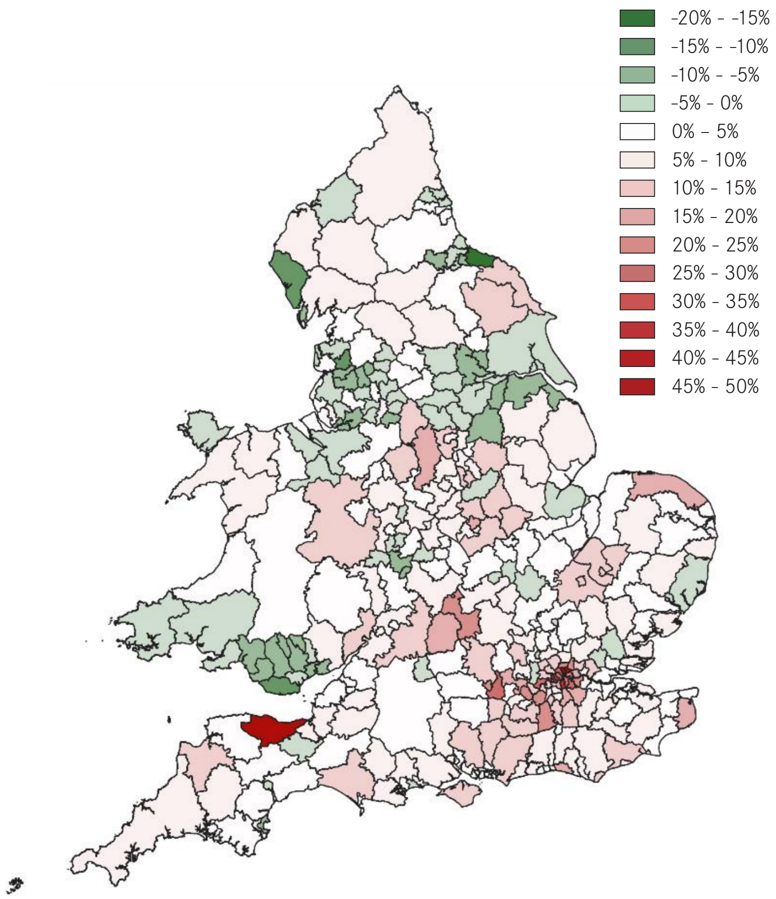
Source: Gerald Eve LLP, 2017

Example: Boots Walgreens UK - businesses with multiple properties loosing out

Many businesses with multiple properties qualify for both upward and downward transitional relief, Boots UK is one example that loses out on aggregate. In the 2018/2019 tax year, downward transitional relief cost the business £4 million across 305 properties whilst upwards transitional relief benefited £1.1 million across 350 properties. In the year prior to the next revaluation (ending 31 March 2021), it is forecast that 112 properties will still be paying in total a little over £1.7 million more than their estimated rates liability, as the decrease is capped. In contrast, the cap on transitional relief for increased rates is forecast to save only a little over £270,000 for 102 properties in that year.

As shown in Figure 1, areas which have seen the largest increases in rateable values are primarily located in the Greater South East with the largest decreases primarily outside of this area. Downward transitional relief is therefore at odds with the Government's 'levelling up' agenda. Growth in areas that are less successful outside of the Greater South East is hampered by a mechanism that forces struggling ratepayers to overpay whereas in areas where businesses are thriving, they underpay.

Figure 1: Average change in rateable value, 2008-2017 (%)



Source: CBI analysis on VOA administrative data as at 31 March 2017

A move towards annual valuations would enable rateable values to quickly adapt to changing economic conditions as well as making the tax consistent with standardised commercial real estate valuation techniques. This would remove the need for transitional relief entirely, and would reduce the number of appeals, as evidenced by the over 80 per cent fall in appeals when the Dutch system shifted to annual valuations. It would also bring valuations in line with European Valuations Standards for market participants who are required to value their properties annually.

Such a change was supported by a large number of stakeholders in the Treasury Select Committee submissions. Two main objections to this were raised though. First, some stakeholders, particularly property groups, questioned whether the VOA would be able to cope with the increased demand for their services. The second issue that was raised, particularly by local authorities and other local stakeholders was that a switch to more regular valuations could increase uncertainty for revenue streams and limit councils' ability to plan into the future. Both of these concerns are looked at in turn below.

1.2 How annual valuations can make the system more cost efficient

When the issue of annual valuations has been raised in the past, it has resulted in significant resistance within government and the VOA. In 2016 it was argued that:

"Providing individual valuations for around 1.8 million properties requires the VOA to collect significant amounts of information relating to properties, rents and occupation. Under the current system this evidence collection phase takes around two years and requires significant amounts of resources. Without reform, increasing the frequency of revaluations would mean that this activity needed to take place constantly, increasing the cost of operating the system significantly. Therefore, to deliver more frequent revaluations the government would need to reform the way it collects and uses evidence for rating valuations."[5]

But these concerns that the bureaucratic burden will increase when moving to annual valuations seem unjustified when looking at the Dutch case. After moving to annual valuations, costs for valuation felt by 20 per cent and the number of appeals decreased by 80 per cent.

The reason why the Dutch system was reformed in the 1990s was that the way in which properties were valued was not only a hindrance to moving towards annual valuations but that it was a costly and cumbersome process, and it ignored a great deal of other available information as part of the valuation process. For example, it can often take time for certain information to become available due to the prolonged nature of contractual and rent review negotiations. However, in the meantime, other properties of a similar nature in the same location may have concluded such agreements providing useful information on the nature of up to date rental values. In addition, when the Dutch system moved from four years to annual valuations, the ongoing annual costs for valuation fell by 20 per cent.[6]

The Government has also raised concerns about annual valuations increasing complexity due to the maintenance of multiple rating lists. However, this fails to recognise that one of the main drivers of the need to maintain multiple lists is the high number of appeals, and many of these appeals are made precisely because the valuations are not annual. Indeed, the prior government's logic appears to

5 HMG (March 2016) Business rates: delivering more frequent revaluations

6 Property Valuation and Taxation in The Netherlands, A case study conducted by the Netherlands Council for Real Estate Assessment 2015

be wrong-headed as it has argued that increasing frequency of valuations would result in more appeals. **Evidence from the Dutch system's shift towards annual valuations demonstrates the opposite is the case where it experienced an immediate fall in appeals by over 80 per cent.**[7] Over the life of the 2010 rating list there more than a million appeals in England,[8] hence this would substantially reduce the overheads to deal with appeals.

Annual valuations would also address the criticism levelled at the system which links the payment of rates to inflation. If rents increased annually at the rate of inflation this would not matter, but rental values can vary substantially including falling in value as well rising faster than inflation. In essence, a valuation based on actual annual rental values would no longer need to have any inflation linkage.

1.3 A shift towards annual revaluations should not increase volatility in the system

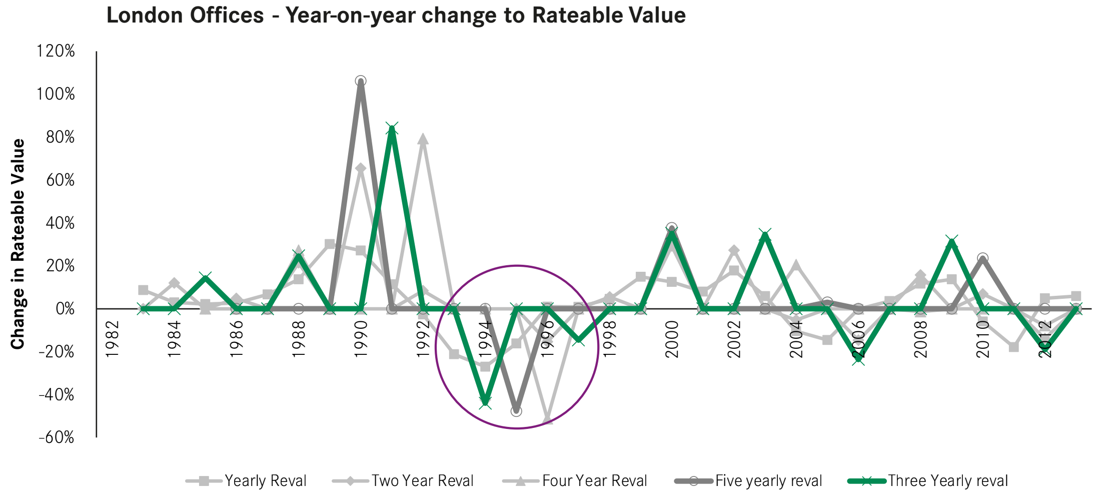
A move towards annual valuations would enable rateable values to quickly adapt to changing economic conditions as well as making the tax consistent with standardised commercial real estate valuation techniques. This would remove the need for transitional relief entirely, and would reduce the number of appeals, as evidenced by the over 80 per cent fall in appeals when the Dutch system shifted to annual valuations.

One criticism that has been raised with annual valuations is that they would increase volatility in business rates revenues for local authorities. Prior analysis by the Government does not indicate that moving towards annual valuations will increase the volatility of revenues, instead it merely brings forward the fall in revenues as shown in Figure 2. While pushing out the inevitable decline in revenues for local government may have some benefits in managing short term revenues, it is not positive for firms trying to stay in business. Indeed, the evidence suggests that annual revaluations may help businesses stay afloat which may be why revenues from annual valuations do not fall as much as they do with three- and five-year revaluations.

7 Current State of Property Taxation in the Netherlands, Council for Real Estate Assessment 2014

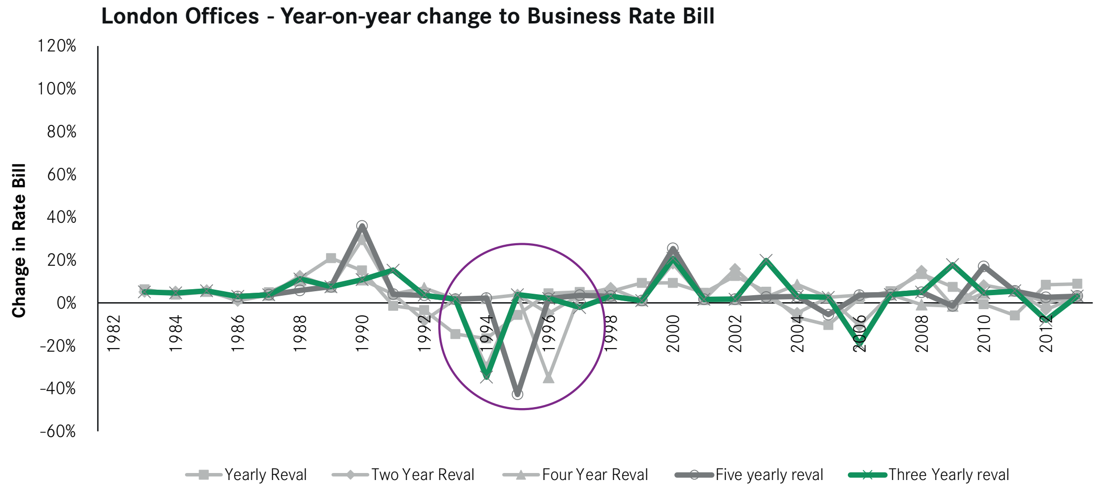
8 LGA (2018) Technical paper 3: Spreading the Risk of Valuation Losses across the Local Government Sector to Reduce Volatility https://www.local.gov.uk/sites/default/files/documents/Item%208%20-%2018%20Apr%20Spreading%20the%20risk%20of%20valuation%20loss%20%28SG%20version%29.pdf

Figure 2: London offices - year-on-year changes to rateable value under different revaluation options, 1982-2013



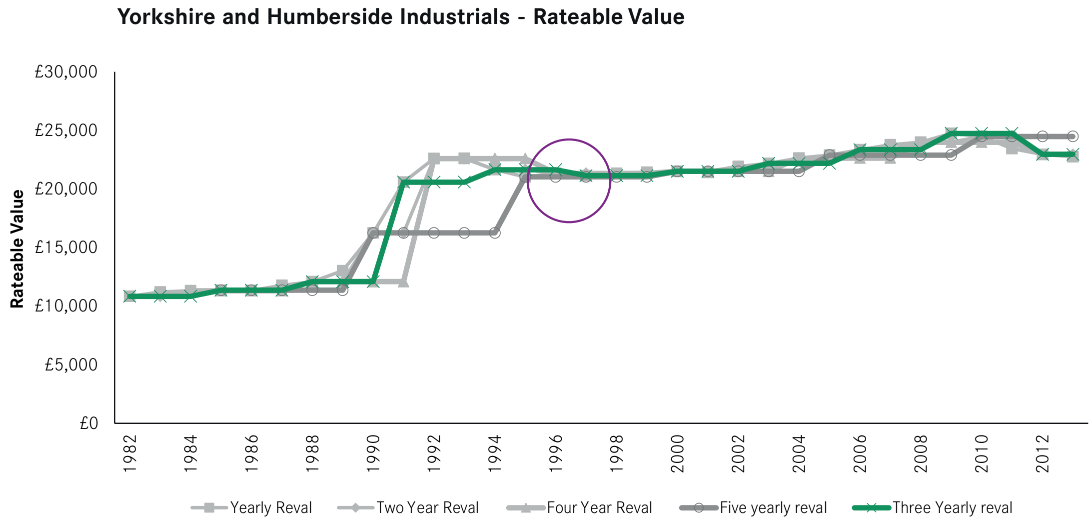
Source: Valuation Office Agency

Figure 3: London offices - year-on-year changes to business rate bill under different revaluation options, 1982-2013



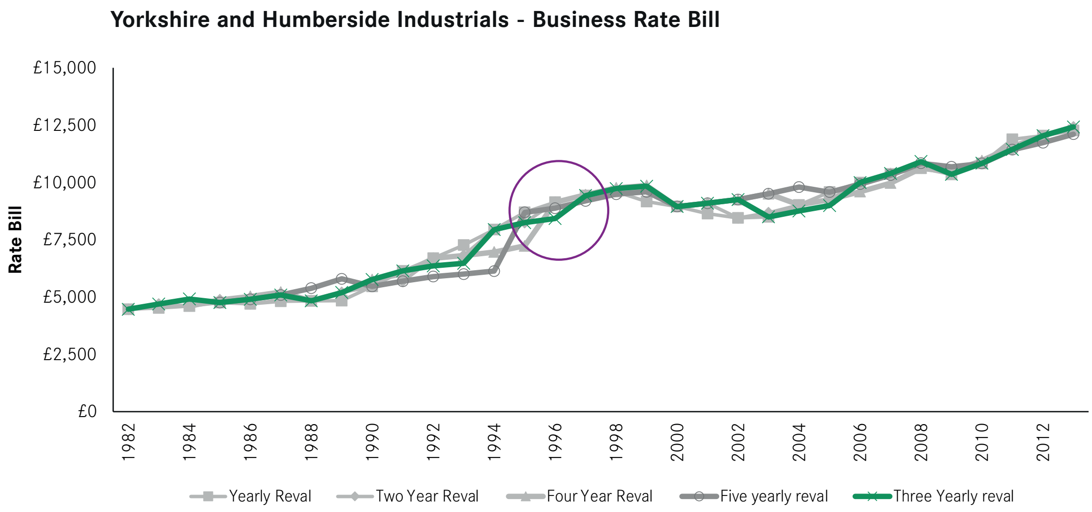
Source: Valuation Office Agency

Figure 4: Yorkshire and Humberside industrial - rateable values under different revaluation options, 1982-2013



Source: Valuation Office Agency

Figure 5: Yorkshire and Humberside industrial - business rate bill under different revaluation options, 1982-2013



Source: Valuation Office Agency

1.4 Options for who should do annual revaluations

More stakeholders raised criticism of the VOA than with any other angle considered. Criticism focused on two interconnected issues: the valuation process and the appeals process. Box 3 sets these issues out in more detail.

Box 3: Issues raised about the VOA

A number of issues were raised with the VOA in submissions to the Treasury Select Committee:

- **Lack of transparency in how valuations are reached.** General business groups and retailers commented on how valuations were often founded more in case law and that often external advice was needed to determine how valuations were reached. The consequent valuation process was often perceived as opaque as the VOA would not disclose how it comes to their rateable values. Critics often refer to other taxes for which "all of the inputs are known or easily obtainable by the taxpayer"[9] while the business rates assessment is based upon a valuation opinion which is not accessible to the ratepayer. Logistics and manufacturing firms also critiqued the fact that the method used for valuations was often not the industry standard or best suited to industrial processes.
- The whole process is **shifting the burden of proof onto the ratepayer** which is a particular issue for businesses with multiple properties for which multiple individual appeals must be put forward. The solution that was most often mentioned to this problem is to make the VOA provide their evidence on how it came to the rateable value upfront. This would be similar to the Dutch system which has been mentioned as a best practice for reaching high levels of transparency: rent payers in the Netherlands receive an official assessed value of their real estate together with the justification for the assessment.
- **Lengthy timescales.** The timescales introduced by the Check Challenge Appeal (CCA) system were considered as too lengthy. After having challenged the VOA, many businesses obtained a correct rateable value for their company often with considerable delays (one submission referred to up to 34 months after the initial Check has been filed). But during this period, they still have to pay rates based on the original 'inflated' rateable value.

9 Jerry Schurder FRICS FIRRV on behalf of Gerald Eve LLP

- **Outdated and less user-friendly IT system** used for registrations of appeals. Apart from a range of technical flaws, several stakeholders complained about the burden to register every property separately. This poses a challenge mainly for national retailers with thousands of stores but also for institutions such as the NHS.

Whilst the VOA and its procedures are often criticised heavily, most stakeholders acknowledge the lack of capacity the agency is facing and assume that an increase in funding is necessary to reach any improvements.

If the valuation process is to be reformed, and given the criticism, this raises the question as to which body ought to take responsibility for annual valuations. There are at least three options – continuing with the VOA; devolution to upper-tier authorities; or devolution to fire authorities. It's worth noting here that the valuations process was centralised in 1948. Prior to this, local authorities conducted their own valuations.

Option 1: Restructure the VOA

Restructuring the VOA would require changes to the existing valuation processes. While this is a potential option, it is unclear whether the VOA would be able to undertake such a shift given the level of institutional criticism it is already under. As such there may be a case to devolve the valuation process back to the local government. Indeed, local stakeholders are better equipped to understand both the businesses in their area and wider local conditions, hence this responsibility may be better placed with them.

This poses another challenge: at what level of local government might take on the responsibility for valuations. Given the complex structures which are currently in place outlined in Box 4, thinking about the devolution of powers when it comes to the valuation process is a challenge. In absence of broader local government reform, the simplest way to distribute powers is to use the structures already in place and choose a level that uniformly covers the entire country. Their institutional structures can then be used to carry out the more frequent revaluations.

Box 4: The current system of local governance in England

The picture of devolution in England is very complex, made up of an irregular patchwork of structures and powers. In most of the country there is now two-tier local government, with powers split between county and district councils as outlined in Figure 6.

Figure 6: Local economic powers across England

Local economic powers	Two-tier			Single tier	
	District	County	LEP	Unitary	Metro mayor/LEP
Education and skills		✓	✓	✓	✓
Transport					
Parking	✓	✓		✓	
Passenger transport (buses) and transport planning		✓	✓	✓	✓
Highways, street lighting and traffic management	✓	✓	✓	✓	✓
Concessionary travel		✓		✓	
Planning					
Housing	✓			✓	
Planning	✓	✓	✓	✓	✓
Building regulations	✓			✓	
Economic development					
Economic development	✓	✓	✓	✓	✓
Licensing	✓			✓	
Tourism	✓	✓	✓	✓	
Income					
Council tax	✓			✓	✓
Business rates	✓			✓	✓

Source: Centre for Cities, 2020

The reforms of the last 20 years mean that today there are different bodies across England in terms of local economic governance, each with their own boundary challenges. These include counties, unitaries, districts and combined authorities. Local Enterprise Partnerships add another element of complexity.

Unitary economic authorities:

Unitaries: Around 10 million people in England have a unitary local authority, meaning they only vote in one local election and all local government powers are held by one institution. These authorities do not face the challenges of multi-tier co-ordination or competition. Urban unitaries like Nottingham, Leicester and Milton Keynes as well as county unitaries like Northumberland, Wiltshire and Shropshire have no vertical fragmentation.

Greater London: In 2000, Greater London gained a directly elected mayor and assembly. Local economic powers – over transport and strategic planning – were moved up to be held by the Mayor of London with the creation of the role.

Two-tier economic powers:

Two-tier England: County and district councils cover 40 per cent of people (22 million people).[10] Economic powers are split between these two tiers of government. For instance, planning decisions for housing are made at the district level, and new roads to support housing or school transport for children who live in these houses are provided by the county.

Devo Deal England:[11] Large urban areas outside of London have been the focus of devolution policy over the last decade, from Wave 1 City Deals to the creation of the West Yorkshire Mayoral Combined Authority in March. Around 15 million people will live in areas with a metro mayor, including most people living in areas within the Northern Powerhouse. All of these areas had unitary local government before, except for Cambridgeshire, where voters now have three separate local elections to vote in.

Option 2: Devolve to all upper-tier authorities and assign single unitary authorities to their respective (ceremonial) county

An alternative level to devolve the valuation process to is the upper tier authority level. That means that the valuation function would lay at the combined authority level where these are in place and alternatively at the county council level. One problem with this approach are single unitary authorities which are not part of any combined authority and may be too small. They would need to become part of their respective (ceremonial) county as outlined in Table 4.

10 District Councils Network https://districtcouncils.info/who-we-are/

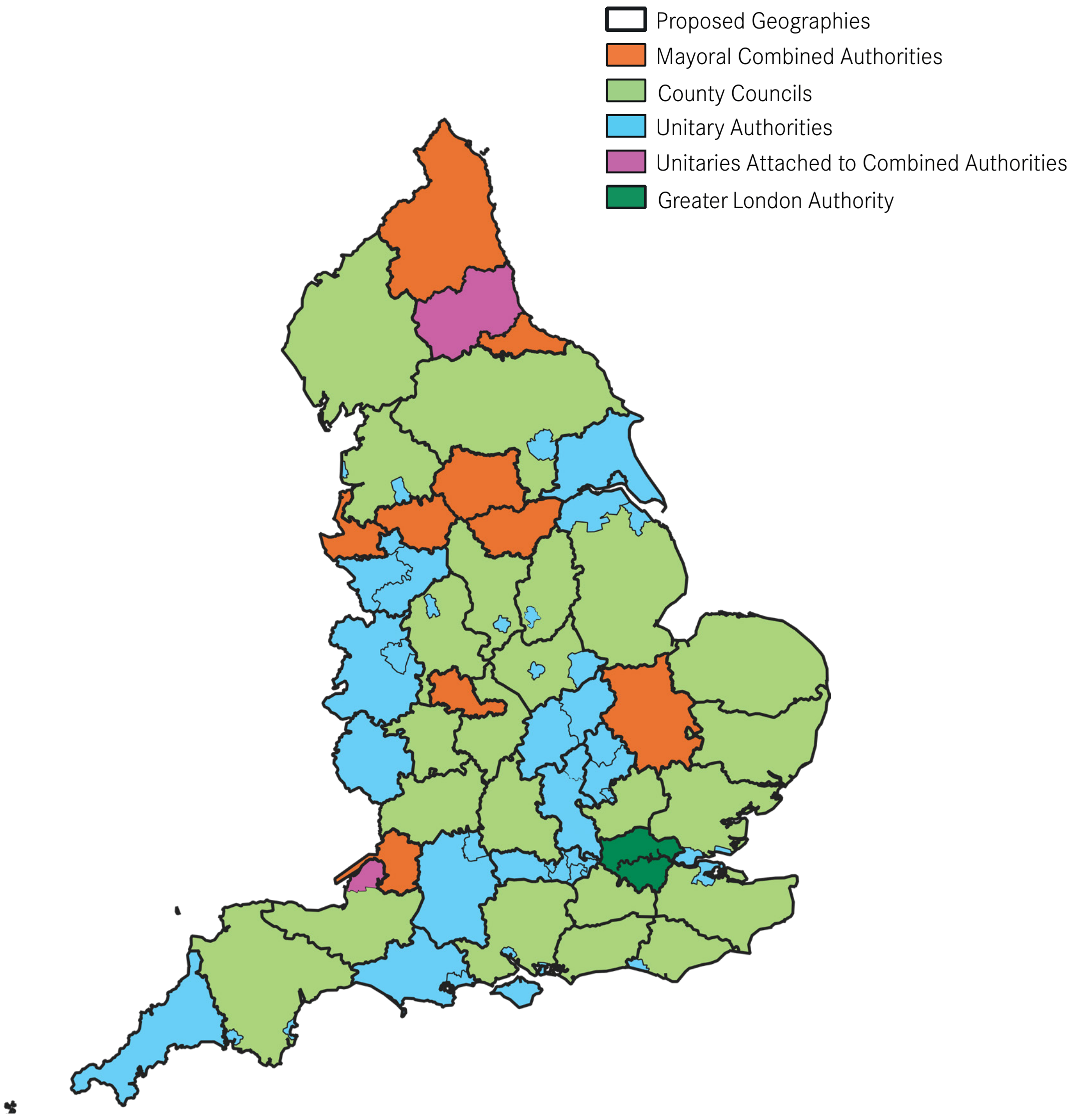
11 Cornwall could get a devolution deal but without the requirement for a directly elected mayor, so is unique as a devolved and unitary area

Table 4: Unitary authorities and their chosen destination county

Unitary authority	Suggested county in charge of the valuation process	Unitary authority	Suggested county in charge of the valuation process
Warrington	Cheshire	Medway	Kent
Blackburn with Darwen	Lancashire	Bracknell Forest	Berkshire
Blackpool	Lancashire	West Berkshire	Berkshire
Kingston upon Hull, City of	East Yorkshire	Reading	Berkshire
East Riding of Yorkshire	East Riding of Yorkshire Council	Slough	Berkshire
North East Lincolnshire	Lincolnshire	Windsor and Maidenhead	Berkshire
North Lincolnshire	Lincolnshire	Wokingham	Berkshire
York	North Yorkshire	Milton Keynes	Buckinghamshire
Derby	Derbyshire	Brighton and Hove	East Sussex
Leicester	Leicestershire	Portsmouth	Hampshire
Rutland	Leicestershire	Southampton	Hampshire
Nottingham	Nottinghamshire	Isle of Wight	Isle of Wight
Herefordshire, County of	Herefordshire	Cheshire East	Cheshire
Telford and Wrekin	Shropshire	Cheshire West and Chester	Cheshire
Stoke-on-Trent	Staffordshire	Shropshire	Shropshire
North Somerset	Somerset	Cornwall	Cornwall
Plymouth	Devon	Isles of Scilly	Cornwall
Torbay	Devon	Wiltshire	Wiltshire
Swindon	Wiltshire	Bedford	Bedfordshire
Luton	Bedfordshire	Central Bedfordshire	Bedfordshire
Southend-on-Sea	Essex	Bournemouth, Christchurch and Poole	Dorset
Thurrock	Essex	Dorset	Dorset

This would leave England with 46 authorities responsible for the valuation process as outlined in Figure 7. While having counties take on the responsibility of valuing properties in a unitary authority over which they have no jurisdiction might make sense from a geographical perspective, it may raise political challenges in addition to the legal changes that would need to be made. While these political issues are not insurmountable, having an additional option of local government to potentially take on this responsibility would be valuable.

Figure 7: Alternative structure for the (re)valuation process



Source: Centre for Cities

Option 3: Devolve (re)valuation powers to the fire authorities

Another statutory body where valuation powers could be devolved to are fire authorities which cover several local authorities and are made of a committee of local councillors. One advantage is that these authorities already exist as discrete administrative units with clear jurisdiction over an economic geography. While valuation is clearly not part of the current function of the fire service, a valuation agency could be added into this existing structure and provide this function. An additional advantage of choosing this local government structure is that these authorities already have some knowledge of the commercial properties in their jurisdiction for fire safety reasons.[12]

Fire Rescue Authorities (FRAs) oversee all fire and rescue services in an assigned area. Their organisational setup depends on the area they are covering:

- 'Where fire and rescue services share a boundary with a single upper tier council, the council is the fire authority'.[13] This is the case for 13 county councils and the unitary authority Cornwall and the Council of the Isles of Scilly
- 'In non-metropolitan areas where the fire and rescue service's boundary incorporates more than one upper tier council, a standalone combined fire authority (CFA) is responsible for its governance.' These CFAs consist of elected councillors - their number depends on the relative population size. Currently, there are 23 CFAs in England.
- In metropolitan areas similar arrangements are in place to those with CFAs.
- In London and Manchester, the fire service is under control of the mayor

Figure 8: The Structure of different FRAs across England

Fire Rescue Authority	Council	Non - metropolitan CFA	Metropolitan CFA	London Fire Commissioner	Mayor of Manchester
Structure	FRAs share boundaries with a single upper tier authority	Non -metropolitan areas where the fire and rescue service's boundary incorporates more than one upper tier council	Similar to non - metropolitan CFAs with members being appointed from constituent metropolitan councils	Functional Body for fire in GLA	Supported by a Fire Committee comprising 15 members
Geography	13 county councils and Cornwall UA and Isles of Scilly	23 CFAs in England	Five FRAs in England	London	Manchester

Source: Centre for Cities

The FRA members are responsible for determining the policy direction of their FRS; setting a budget to fund delivery of that policy direction and 'undertaking scrutiny to ensure that intended outcomes are being achieved economically'. FRAs must appoint several statutory officers such as a head of paid services and a monitoring officer. 'In practice, many of the FRAs' legal responsibilities and other functions are assigned to sub-committees of the authority, or to senior officers via formal schemes of delegation.'

Ultimately the best geography for devolution of these powers would be to reformed local government, which Centre for Cities has set out in detail. However, the options above provide pragmatic suggestions in absence of any such reform.[14]

12 Home Office (2018) Fire and Rescue National Framework for England

13 LGA (2017), Fire and rescue services in England - A guide for police and crime panel members https://www.local.gov.uk/sites/default/files/documents/10.8%20-%20Guide%20to%20the%20fire%20and%20rescue%20service_WEB-2.pdf

14 Jeffrey, S (2020), Levelling up local government in England, https://www.centreforcities.org/publication/levelling-up-local-government-in-england/

Section 2: How complexity affects the system

This section focuses on aspects around the complexity of the current business rates system.

2.1 How taking systematic account of both individual properties and other local information can improve the valuation process - the Dutch system as best practice valuation approach

When the Dutch system moved towards annual valuations during the mid-1990s, the Government assessed best practice valuation models and came to the conclusion that commingling both property-specific and other local information would improve valuation estimates and reduce errors. The dramatic fall in appeals is testament to this in addition to the cost savings achieved.

Prior to the Real Estate Assessment Act (1995), revaluations were undertaken centrally every four years. Valuations are now done locally on an annual basis in order to:

- Provide a better explanation to the taxpayer
- Reduce the number of appeals
- Increase efficiency

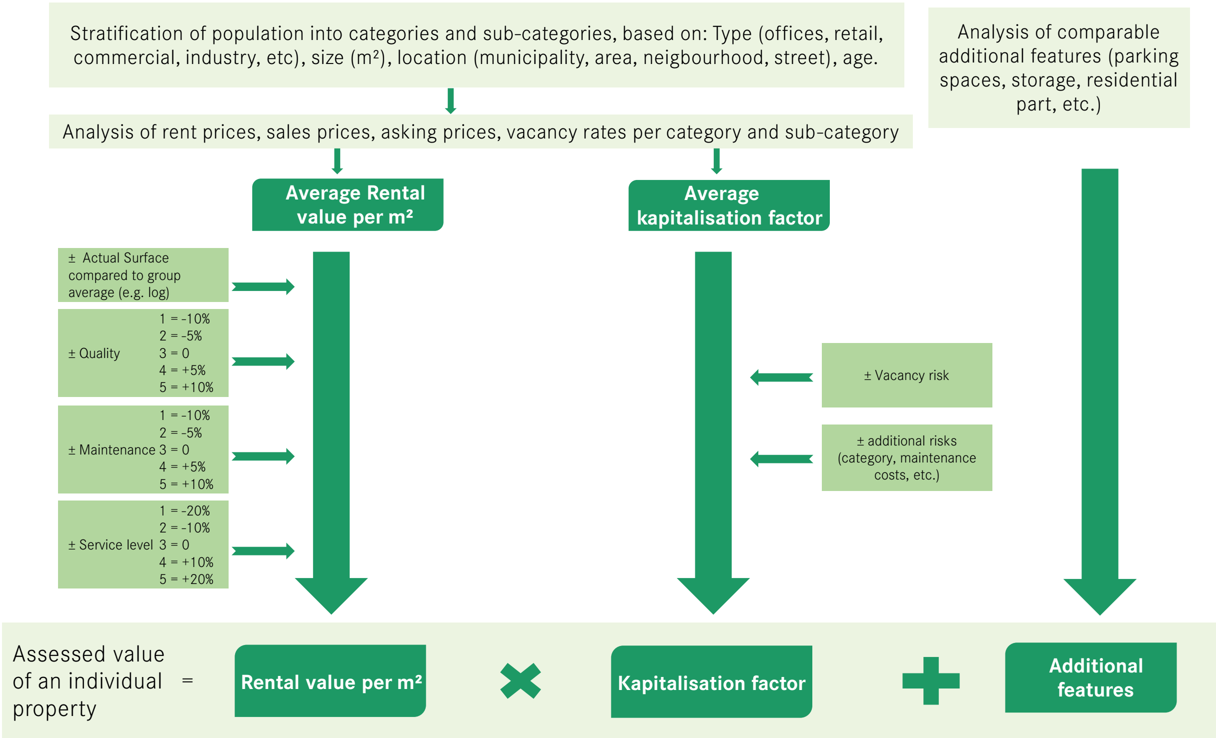
The market value for non-residential property is derived from annual rents with data on individual units required to perform the valuation including plot size, location, sales of units, new leases including owner and tenant identification and rental value. Other data focuses on the individual units including type of building, size of building including annexes, year of construction, maintenance situation and quality of materials used. The VOA collects similar kinds of information. The below methodology is a graphical illustration of how the Dutch valuation model works. Although the Dutch system generates a capital value the general approach could be used for rental data.

The Dutch approach does not require valuers to use a specific valuation method, although the capitalisation method is widely used which capitalises rental values based on an expected yield adjusted for location, property type, risk, size, age, quality and level of maintenance. Where units are not rented out such as power plants, the Dutch method is similar to the VOA and uses a cost replacement method.

In addition, the annualised Dutch system has been forced to address known valuation issues around vacancies and incentives in a more methodical manner given the use of quantitative models.[15] With regards to vacancy risk, guidelines are provided to adjust the capitalisation factor taking into account the actual vacancy of a building. After two years, a property is considered to be affected by structural issues which need to be identified. This may be due to the relative demand and supply at this location, the level of rent, or the quality of the property itself.

15 Taxatiewijzer en kengetallen – Huurwaardekapitalisatie 2019 Vereniging van Nederlandse Gemeenten

Figure 9: Illustration of Dutch valuation model



Source: Waarderingskamer

With regards to incentives such as rent-free periods and rent discounts, the Dutch system makes it clear that such incentives result in cash flow losses which result in the tenant paying less and the landlord receiving less than the formally agreed rental price. The impact of these cash flow losses should therefore be expressed as discounts on the gross annual rental value, hence a lower valuation. This is an important factor as it eliminates price distortions from the market caused by landlords wanting to maintain higher valuations for a variety of reasons.

In summary, valuing commercial property on an annual basis is in line with the current financial regulations and best practice. As the Dutch system has demonstrated, it is quite possible to transition to annual valuations and see a reduction in costs and appeals, however, to achieve this it is vital to consider the nature of the valuation process itself. While the VOA may have strong arguments not to shift the current valuation process to an annual one, there appears to have been very little questioning of the valuation process itself. This must be given a much higher priority by the Government as it seeks to reform business rates.

The current approach undertaken by the VOA to valuing properties is cumbersome and has been a key argument used against moving to annual valuations, as it would make a difficult process even more burdensome. In addition, the VOA does not systematically consider the most up-to-date local information as part of the estimation process and instead relies more on untimely rental information from leases, which they recognise is a challenge. Although the VOA believes this to be the most recent and representative information on market values, these values may ignore crucial and more up-to-date information.[16]

16 See Appendix B for more information on the current valuation approach.

2.2 How market distortions of rateable values can be minimised

While annual valuations are critical as part of the process of improving the relationship between tax liability and rental valuations, it is important that the market for commercial property is structured in such a way that enables the price mechanism to work effectively. In the event that local aggregate demand falls, rents should fall given that some businesses may no longer be sustainable, reducing demand for space at previous rent levels. However, there are a number of distortions to the price mechanism that actively prevent rents from falling to a new equilibrium level.

Upward-only rent reviews prevent rents from falling should the rent review arise during a period of an economic downturn. While the length of leases has shortened over the last 20 years, traditional upward-only rent reviews remain dominant across the UK commercial property market.[17] This continued widespread use of upward-only rent reviews within long leases therefore merely distorts the market mechanism, thereby potentially increasing business rates liabilities. The Republic of Ireland banned such clauses from commercial leases in 2010. In the UK both Conservative and Labour Governments have opted instead for self-regulation to try and move towards greater flexibility. However, the evidence suggests that encouraging the use of more flexible leases through, for example the 2007 Code of Practice for Leasing Business Premises, has had little effect.

It is possible that the ongoing COVID-19 pandemic will result in a more competitive market with fewer long leases and, where there are longer leases, open market value reviews. Hence it is recommended that this situation be closely monitored given the potential damage upward-only rent reviews can cause through distortions to the price mechanism resulting in firms overpaying for both rent and rates.

A further distortion is that **headline rents that are often used to set valuations do not reflect actual rent paid**. Confidential agreements that might provide tenants with some form of rent relief are not generally captured by the current valuation process, thereby resulting in potentially persistent overvaluations and hence higher tax liabilities.[18]

Higher valuations are beneficial to landlords as they can be used to indicate a higher value of the site from a capital value perspective. Furthermore, this is beneficial in supporting other financing arrangements where higher collateral values might reduce the cost of capital or increase equity withdrawal. Tenants of course prefer lower valuations which would correspond to lower rental values and a lower rates liability.

17 McCalmont-Woods N (May 7 2020) Is it time for upward & downward rent reviews? http://www.mccalmont-woods.com/is-it-time-for-upward-downward-rent-reviews/

18 Financial Times (2018) The mystery of commercial rents: boom or bust? September 7 2018 https://www.ft.com/content/6ba2aee8-68d5-11e8-aee1-39f3459514fd

If this is to change then all confidential side letters to leases including incentives and discounts must be provided to the valuation agency so an estimate of actual rents can be made as opposed to the artificial headline rent.[19] While landlords might object to this information on confidentiality grounds given that tenants might use the information to negotiate down their rents, there is no reason why the valuation agency cannot maintain this information as confidential as is done for pubs today.

2.3 Why the landlord should take on at least 50 per cent of the business rates liability

One effect of the conflict between landlords and tenants in trying to agree on the actual value of a property has been the increasingly widespread use of Company Voluntary Agreements. A Company Voluntary Agreement (CVA) is an insolvency procedure particularly suited to firms that have large numbers of leasehold units which need to be restructured where rent and rates liabilities are no longer viable.

In the event that at least 75 per cent of the value of the firm's unsecured creditors agree to the CVA, then landlords are obliged to accept the outcome. Creditors, who are mostly landlords, often agree to CVAs as having some income from fewer units is better than the liquidation of the whole company resulting in the termination of all rent payments. Hence, CVAs to a certain extent can be seen as a manifestation of the distortion of the price mechanism where rents and rates have not adjusted to market conditions.

While there is a lot of evidence that these agreements have been used appropriately by tenants, there is some evidence that tenants are using this as an opportunity to cut their rents to increase profits. Indeed, one retailer has stated its intention to insert a CVA clause into any future lease agreements that would give it the right to receive a reduction on rent should a neighbouring shop have its rent slashed by a CVA.[20] This has resulted in the British Property Federation claiming that CVAs are being used by retailers to merely shed non-performing assets rather than to stave off liquidation.[21]

The issue of who pays therefore needs to be addressed as maintaining the status quo merely provides ongoing incentives to distort the price mechanism, thereby artificially raising valuations and the business rates liability. Such distortions to the price mechanism are one reason why there have been consistent calls from businesses for rate relief, which in turn increases complexity of the tax system.

One option that has been raised is just to make the landlord pay business rates to better align incentives. This also has the benefit of reducing the number of people who are billed thereby reducing the cost of collecting the tax.[22] While this approach should be considered further, there is also a case to make both

19 A template used by the Dutch system to capture this information is provided in Appendix B

20 Clarence-Smith, L (2018) BPF slams Next over 'CVA clause' https://www.egi.co.uk/news/bpf-slams-next-over-cva-clause/

21 Drapers (2018) BPF calls for urgent government review of CVAs https://www.drapersonline.com/news/bpf-calls-for-urgent-government-review-of-cvas

22 This would reduce the number of businesses paying from 2 million to around 800,000, Corlett, A (2018) Replacing business rates: taxing land, not investment, https://www.libdems.org.uk/autumn-18-replacing-business-rates

landlord and tenant pay, particularly as this was successfully introduced in the Dutch system.

Indeed, two Business Improvement Districts (BIDs) in London, following the Business Improvement Districts (Property Owners) (England) 2014 regulations, require both the occupier and the owner to pay the levy.[23] The main driver behind this support for both parties to pay is that incremental investment can help improve long term capital values as well as increased footfall for retailers. In essence, what matters for these kinds of levies or taxes is that they are used to pay for local services that also benefit local businesses.

Box 5: How liabilities between landlords and tenants are shared in the Dutch system

The Dutch valuation system has two policy levers to prevent these price distortions and confrontational issues on valuation arising. First, all confidential side letters are required by law to be provided to the valuers although this information is not made public. The Dutch Supreme Court has judged that all incentives in effect reduce valuations, therefore headline rents are insufficient for valuation purposes. The second, is that the landlord must always pay a fixed percentage of the value, which in turn reduces the incentive to maintain high rents with incentives as it only increases the tax liability for the landlord.

Table 5 indicates landlords on average pay 56 per cent and the tenant 44 per cent of the tax liability. The owner rate is set slightly higher to ensure that less revenue is lost when properties are empty, and to maintain a sufficient incentive for landlords to move rents in line with market prices rather than to distort them.

Table 5: Average rates of owners and occupiers

	Owner Rate (%)	Occupier Rate (%)
Amsterdam	0.15	0.12
The Hague	0.26	0.22
Utrecht	0.31	0.25
Rotterdam	0.36	0.26
Groningen	0.52	0.42

Source: Waarderingskamer

Any shift towards both the tenant and landlord taking joint liability for rates would require a transition phase, as was the case when the Dutch system made the move. This is because leases longer than five years would need to adjust over

23 Sandford, M (2018) Business Improvement Districts, House of Commons, http://researchbriefings.files.parliament.uk/documents/SN04591/SN04591.pdf

time to reflect these changes. While some concerns have been raised about the complexity of knowing who the landlord is to invoice, such a system would be based on the current approach used for empty property payment where whoever has the right of occupation pays. In operational terms there would be no significant changes required to the current system

2.4 Which reliefs should be kept and which should be abolished

Over the years, a number of reliefs have been introduced by governments to provide financial relief for organisations paying business rates. The reasons for reliefs are diverse, but most have been introduced due to the fact that valuations do not reflect market prices.

To date the following reliefs have been introduced, which Appendix A discusses in more detail:

a. Small business rate relief
b. Rural rate relief
c. Charitable rate relief
d. Enterprise zones
e. Exempted buildings
f. Empty buildings relief
g. Hardship relief
h. Retail discount
i. Local newspaper relief
j. Telecoms relief
k. Transitional relief

In general, there is a strong case to remove most of the reliefs in a system of annual valuations, with a handful of mandatory exceptions and continue to allow local authorities to provide discretionary relief given that this may have greater financial benefits for the community. The following paragraphs make the case for each relief in more detail.

Figure 10 gives an overview on the costs of business rates reliefs in England. It shows that **small businesses** have been one of the main beneficiaries of tax relief as they were hit badly after the financial crisis when the fall in demand for goods and services affected rental values. This ought to have been followed by a fall in the business rate liability, however, due to the delay in valuation and the link of business rates to inflation, this was not the case. Hence these reliefs have been introduced to resolve the issues created by a slow and outdated valuation methodology.

Figure 10: Reliefs in England, 2020-21

Rate / Relief (2020/21)	£m
Gross Rates	32,128.21
Net Transitional Arrangements	49.64
Net cost of SBRR	1,378.68
Mandatory: Charity Relief	2,036.26
Mandatory: CASCs	20.80
Mandatory: Rural	4.30
Mandatory: Telecomms	0.33
Mandatory: Total Reliefs	**3,046.30**
Mandatory: Partially Occupied	19.58
Mandatory: Empty Properties	874.43
Mandatory: Total Unoccupied	**894.00**
Discretionary: Charity	48.54
Discretionary: Non-Profit Bodies	36.28
Discretionary: CASCs	1.33
Discretionary: Rural shops	0.32
Discretionary: Small Rural Businesses	0.97
Discretionary: Other	22.95
Discretionary: Total Relief	**110.39**
S31: Rural	4.42
S31: Supporting Small Businesses	15.12
S31: Discretionary Relief Scheme	4.57
S31: Retail Discount	495.11
S31: Total Reliefs	**519.22**

Source: MHCLG

In addition, traditional bricks-and-mortar retailers have been hit as more consumers shift online to buy goods. The increased demand for logistics centres, which are a critical component for online distribution, has also resulted in a divergence between the two property types which can be seen in the UK-wide data. [24] However, the failure of the current methodology to generate up to date valuations showing higher values for logistics centres relative to bricks and mortar retail has merely resulted in a temporary subsidy for online shopping.

24 JLL (2019) Industrial market continues to outperform other property sectors, https://www.jll.co.uk/en/newsroom/industrial-market-continues-to-outperform-other-property-sectors

Indeed, logistics sites have become even more valuable than residential property as demonstrated by Amazon recently outbidding a site that was earmarked for residential property.[25] Hence, it is hard to justify the ongoing relief for small businesses in a system of annual valuations where the price mechanism is efficient.

In addition, the zoning approach used for valuation increases the tax liability per amount of floor space used for smaller firms which would no longer be applicable.[26] In instances where small firms are in financial difficulty, but they provide crucial local services, local authorities should continue to provide **discretionary relief**.

Retail discounts are also related to the dysfunctional system of valuations. As argued above for small business relief, an annual valuation system that functions in a rental market without price distortions will generate more accurate valuations. As such there does not appear to be much logic for this to continue. The same goes for **local newspaper relief** which was temporary in nature only. The recent COVID-19 lockdown may have forced a rethink on the need for office space for local newspapers anyway given desktop publishing and remote working.

Charitable relief is the largest grouping that benefits from rate relief. While there may be strong arguments for charities to be provided with some form of financial relief, a relief on space causes significant distortions in the allocation of land, resulting in other negative effects. In principle such a blanket mandatory relief ought to be questioned from a policy perspective. Furthermore, charities are often contributors to BIDs as they also benefit from investment made in local communities. Hence there is no necessary reason why charities should not contribute more to business rates, given that this income stream should be used to invest locally.

The Barclay Review of Business Rates in Scotland recommended that charitable relief should be restricted to a much smaller number of recipients. Scotland has since moved towards removing the relief for private schools. The same argument could be applied to private charitable hospitals.

There are potentially stronger arguments that community sports clubs might continue to be exempt given the health benefits from promoting exercise and maintaining green space for such activities in communities. The same goes for nurseries given the cost of childcare, however, some nurseries are not registered charities, hence there may be an argument for nurseries to be provided with mandatory relief. The Barclay Review recommended that a distinction should be made between community-based clubs rather than member clubs with significant assets which do not require relief and that there should be some relief for nurseries.

Rural rate relief supports businesses that provide amenities for local residents

25 Roser, E (2020) Amazon swoops on BTR site in last-mile logistics play, EGI, https://www.egi.co.uk/news/amazon-swoops-on-btr-site-in-last-mile-logistics-play/

26 Business rates fit for a devolved 21st century economy, Aubrey & Reed 2015 HM Treasury Submission

in settlements with fewer than 3,000 people that are just not sustainable. To a certain extent if the business is not sustainable then this should be reflected in rental values and hence ultra-low valuations, which raises further questions on the valuation methodology. But this also raises other questions such as to what extent such communities might need to expand and become sustainable including the need to increase planning permissions for residential housing. Given these points, there may well be reasons for local authorities to provide some form of relief, but this ought to be at the local authority's discretion.

Enterprise zones have mostly underperformed[27] and hence it is hard to substantiate this relief. While existing agreements on rate relief ought to be protected, there appears to be little value to continue with this approach.

With regards to **transitional relief**, the evidence provided on the issues with downward transitional relief, especially for large businesses and in areas that are economically less well-off is clear. Annual revaluations would remove the need for these arrangements and ensure that rateable values move in line with economic performance, hence it could also be eliminated.

There is now far less of an argument to maintain a difference between the six months **empty property relief** for industrial property versus three months for other commercial property, particularly given the underperformance of retail compared to industrial units. In addition, the criteria to reduce potential tax avoidance should be tightened as noted by the Barclay Review. Cases whereby landlords have attempted to avoid paying rates have become increasingly ingenious and should be clamped down upon. In one recent case, the landlord attempted to "convert" its property into an agricultural production unit for snail farming.[28] In addition the current six-week reset period should be increased to at least six months to eligible empty property relief.

Exempted buildings including places of worship, buildings for disabled people and agricultural land should remain intact, however, there is a stronger argument to rate agricultural buildings where the relief is to a certain extent arbitrary. As noted above any building located on agricultural land involved in storage, drying, cleaning, grading or packing is not rateable, whereas if these activities were not carried out on agricultural land they would not be eligible for relief. The manufacture of cheese on a farm which provides all the milk is exempt but a cheese maker that buys in milk is not. Finally, listed buildings should not be given a blanket empty relief, given this merely reduces the incentive for property owners to adjust rents to market values in addition to reducing the incentive to bringing properties back into use. Listed building relief could be implemented for 12 months only.

While rates are now required to be paid on empty properties, this does raise questions on the need to rate non-agricultural land at use value given that this has created an incentive to knock down properties to avoid paying rates on empty properties. This may help support more efficient use of land.

27 Swinney P (2019), In the zone? Have enterprise zones delivered the jobs they promised? London: Centre for Cities
28 BBC (2020) Bradford: Snail farms used to avoid business rates, https://www.bbc.co.uk/news/uk-england-leeds-51489011

Section 3: How the current system does not incentivise investment

Britain's productivity record over the last decade has been poor compared to other developed countries. One reason for this is the lower levels of investment as shown when expressed as a percentage of GDP. This is not helped by the disincentive to invest in plant and machinery generated by the business rates system. The current valuation process of estimating the value of plant and machinery is cumbersome and slow and hence does not fit well with a shift towards annual valuations. The Netherlands removed plant and machinery from the valuation process when it moved to annual valuations which reduced the cost and complexity of the valuation process. A similar step should also be undertaken in Britain to incentivise investment and support productivity growth.

3.1 Why plant and machinery were originally included in valuations and why it should be removed

The rating of plant and machinery was part of the Rating and Valuation Act 1925 and since then has been considered central to the valuation of a hereditament. The Third Schedule of the 1925 Act indicated the classes of plant and machinery that were to be deemed to be a part of the hereditament and therefore subject to valuations. These included plant and machinery for power generation, building services, driving motors, lifts and elevators, rail tracks and named structures. The inclusion of plant and machinery in valuations particularly impacts manufacturing and energy production firms and can be seen as a financial penalty for investment. The 1923 committee that was set up to enquire into the rating of plant and machinery recommended that loose tools and machines operated manually and should be exempt from rates, but all other plant and machinery was required to be taken into account in valuing a property.

Although government policy has been to tax investment through the inclusion of plant and machinery in the rating process, it has simultaneously provided incentives for investment. The Government has relieved certain industrial undertakings of a portion of the rate burden through the industrial derating process which terminated in 1960. The policy of relieving certain industrial undertakings of rates re-emerged in 2001. At this time, the policy exempted specified plant and machinery from the rating process. This plant and machinery exemption applied to combined heat and power stations which are fully or partially exempt from the climate change levy and which produce (at least in part) electric power. These regulations also sought to exempt equipment from the valuation where it is used for the generation, storage, transformation or transmission of power which is mainly or exclusively for sale for distribution to consumers.[29]

These largely arbitrary exemptions merely serve to highlight that the foundations of the rating process, which include plant and machinery as part of the valuation, are not only incoherent with macroeconomic policy, but may also result in

29 VOA Rating Manual Section 6 Part 5

a potentially endless flow of exceptions. Furthermore, the inclusion of plant and machinery in the valuation process also adds significant complexity and overheads to the valuation process itself. For example, the rating manual requires valuers, where possible, to take photos of the plant or machinery found on site, together with any identification plate showing the type, size and output of the item.[30] The identified machines then need to be valued by assessing price information in the second-hand market to generate the replacement cost of the items. Even back-up diesel generators that are rarely used are considered rateable, given that they exist with the intention to use them in the event that the mains power fails.

Removing plant and machinery from the valuation process would not only result in an increase in incentives to drive up the level of investment, but it would also substantially reduce the costs of the valuation process itself. The Dutch undertook this route when it moved to annual valuations where plant and machinery are ignored from the valuation process. The valuation process for manufacturing plants in the Netherlands that are owned and for which there is no available rental data are evaluated using a building cost replacement process which exclude plant and machinery but includes the value of the land that it sits on.[31]

30 VOA Rating Manual Section 6 Part 5

31 As most modern office blocks are built with lifts as part of the structure of the building, the definition of plant and machinery would not necessarily be extended to all definitions described in Info Box 8 given this would likely increase the complexity of the valuation.

Section 4: How the system does not incentivise local growth

There are a number of problems with the structure of the current business rates system that mean it does not necessarily incentivise local growth.

First, although business rates are referred to as part of local taxation, the amount of revenue that local authorities receive from them is not directly determined by how much is raised in their area. The tax is collected locally, but then some of the revenue is sent to central government, which redistributes it back to local areas.

Second, although there have been changes in recent years, local authorities do not get to keep all of the growth in business rates, blunting incentives for growth. The cap on revenues (meaning that the total amount of business rates in the country cannot increase with a growing economy, unlike every other tax) amplifies this issue.

Third, the interaction between the structure of local government and the business rates system distorts incentives for local growth. For example, city centres often have clusters of high-skilled jobs, while suburbs provide the key input to city centre businesses – workers. The problem is that if these different parts of local economies are in different local authorities (as is the case around London, Nottingham and Newcastle, for example), authorities that may house the workers of new businesses located in neighbouring authorities do not get to benefit from any growth in business rates. This incentivises potentially unhelpful competition between authorities within one economy.

4.1 How business rates revenue is currently raised and distributed

The current business rates system

From 1990 to 2012, business rates were collected and passed on in their entirety to central government who redistributed it back to councils in the form of a formula grant.

Since 2013/14, the business rates retention system was created under which councils are able to keep 50 per cent of their business rates revenues (after top ups/tariffs and safety nets/levies have been applied) as well as an equivalent proportion of any growth in business rates in subsequent years. The remaining 50 per cent is sent to central government and pooled nationally before being redistributed in a number of grants. The baseline funding and need levels are reset in the system periodically every seven years, but this has not been done since it was first created in 2013. The next reset was intended for 2020, but has been pushed back again as a result of the pandemic to April 2022. The general idea behind the need for a reset is that over time, financial needs and revenues can change and it is important that the system responds to this.

Local authorities vary in how much they are able to raise in business rates and how much they need to provide necessary services and functions for residents. To deal with this there are a series of top ups and tariffs in place and a levy paid on growth in business rates that funds the safety net.

The Ministry of Housing, Communities and Local Government (MHCLG) calculates the business rates baseline and the base funding level for each local authority. A local authority must pay a tariff if its business rate baseline is greater than its baseline funding level and will receive a top-up if it is less than its baseline funding level. This means every local authority in the country is only left with a sum of money equalling its funding baseline. The amount that an authority receives through top ups or is tariffed is the same for the entire period before a reset occurs.

In some years, authorities may experience gains or losses that are disproportionate. To stop authorities benefitting too much from gains or being hit too hard by losses, their growth is adjusted by the safety net and levy. An authority that experiences growth in its business rates income that is disproportionate will have that growth reduced by paying a levy. And any disproportionate loss suffered by an authority sees this loss is cushioned by the safety net.

The formula for calculating the levy rate is:

1- (spending baseline) / (business rates baseline)

The levy rate is capped at 0.5. This means that the most that a local authority could gain each year with the current system is 50 per cent of any growth in business rates.

The safety net is currently set at 92.5 per cent of predicted need meaning that total rates collected are never allowed to fall by more than 7.5 per cent of predicted need.

One unique characteristic of business rates is that the cap on the total amount of business rates that can be generated annually as this total yield is determined in advance. This is the opposite to the situation with most other taxes - where the value of the tax base varies but the tax rate remains constant. In the business rates system, the expected yield is set and the tax rate (i.e. the multiplier) is calculated so that the predetermined yield is generated from the total rateable value of all properties.

Because of the cap, the multiplier changes at each revaluation to reflect the changes in rateable values and ensure the overall system generates the same amount as the previous year before inflation. The overall yield then is adjusted each year in line with inflation.

4.2 What role do different areas play in the urban economy and what areas should business rates be pooled in?

Different parts of a local economy play different roles. For example, city centres often have clusters of high skilled jobs, while suburbs provide the key input to city centre businesses – workers. This causes a number of problems for local tax policy by distorting incentives.

When an authority performs well economically, it attracts more businesses and business rate revenues increase. To accommodate this growth those areas may require an expansion of housing and other public amenities. And they may be built in neighbouring authorities. The result is that while the neighbouring authority provides a key input to an economy - workers - it doesn't benefit from the extra business rates revenue it helps generate. To incentivise growth it is important that the benefits of growth are spread across the entire geographical economic area. As a result, greater levels of business rate retention and future investment need to be planned at the functional economic area across the different local authorities.

One of the important aspects of all mayoral authorities is that within any economic geography there will be areas with higher and lower need as well as varying capacities to raise business rates, so such revenues must be redistributed in an appropriate manner via the pooling mechanism. Some local authorities already pool their business rates covering certain county or metropolitan counties and assign one lead authority. This was the case for pools in combined authority areas such as Greater Manchester and the London Pool.[32] Here mechanisms exist at scale to provide a means to make policy over strategic planning, infrastructure and skills to maximise aggregate business rates revenues as well as sharing that growth across the different authorities.

To maximise the economic outcomes of a pool and to reach wider economic benefits, the pool should therefore reflect the economic and administrative structures of an economic geography and would need to require sharing between the participating authorities.

To date, such a combination which align economic and political structures and have elected mayors can only be found in Combined Authorities and the GLA.[33] The following administrations should consequently become eligible for pooling revenues, and this should be straightforward given that some of these areas have previously participated in similar pooling pilots:

- Cambridgeshire and Peterborough
- Greater Manchester
- Liverpool City Region
- North of Tyne
- Sheffield City Region
- Tees Valley
- West Midlands
- West of England
- West Yorkshire
- Greater London Authority

Local authorities that would like to form a mayoral combined authority, or new mayoral unitary authorities that cover a functional economic area, should automatically receive the same powers to retain 100 per cent of growth in business rates revenue.

Similar to recent pilots, the safety net that supports local authorities who see a smaller growth in their business rates revenue should be raised to 97 per cent given the increased proportion of funding at stake. And some grants should be forgone to make the change to 100 per cent retention of the growth in business rates revenue neutral.

32 Principles on page 3 of this leaflet: https://www.londoncouncils.gov.uk/sites/default/files/Policy%20themes/Local%20government%20finance/Business%20Rates.pdf

33 NE Combined Authority not included as it does not cover a functional economic area. Cornwall's economic and political structures do align but it currently has no elected mayor and is consequently not considered.

A change that should be implemented from this move to 100 per cent growth retention is to remove the no detriment clause. In the pilot schemes, the no detriment clause meant that no authority would be worse off under the pilot than if they had not participated. This clause should not be introduced if the changes were to be made permanent.

As part of the agreement to take on 100 per cent of growth in business rates revenue, the overall level of grant funding needs to be reduced in a revenue neutral manner. For example, the 100 per cent rates retention pilot for Greater London resulted in the GLA foregoing its revenue support grant and the Transport for London investment grant. Greater Manchester went without its revenue support grant as well as its transport and highways maintenance grant. Which grants are forgone, above and beyond the Revenue Support Grant, should be the decision of the relevant authority.

By maintaining revenue neutrality, there is no immediate discrimination to those authorities that remain in the current system, although longer term they will not derive the economic benefits of 100 per cent retention. While it is feasible that revenues might drop due to the removal of plant and machinery, this in turn might increase investment which would drive up local valuations.

To ensure that additional funds are best spent on local economic priorities, a body should be given responsibility for distributing some of the incremental revenues based on local priorities, similar to the strategic investment pot in London's pool.[34] For example, the GLA received 37 per cent of the business rates retention as part of the 100 per cent revenue retention pilot, after setting aside 15 per cent for a strategic investment fund, although other pilots did not require sharing of business rates revenues. To ensure that funds are invested appropriately it is likely that a separate independent body accountable to the mayoral authority would need to take the lead in pooling rates and in recommending how a share of the incremental funds should be invested. If there is some relationship between increasing business rates and investment in infrastructure, housing and skills, then there is likely to be more support from local ratepayers.

For those local authorities that do not wish to organise themselves in line with their local economic geography, there will be no change to the current system of business rates retention.

4.3 Why the cap on total business rates revenue should be lifted

The cap on total business rates yield is a key issue with business rates retention in incentivising growth. This is due to the requirement for a fixed yield in the system (which then requires the multiplier to adjust accordingly). Two problems result:

1. The cap artificially restricts the total amount of business rates revenue that can be generated, which ultimately means there is less money for redistribution.
2. Only relative growth is rewarded, which acts as a disincentive to growth. Local authorities that have experienced a higher level of growth in

34 London Gov (2018), London Business Rates Pool – Strategic Investment Pot, https://www.london.gov.uk/decisions/md2358-london-business-rates-pool-strategic-investment-pot

rateable value than the national average see their income increase and authorities that experienced a level of growth that was below the national average instead see their incomes fall, despite experiencing net growth.[35]

Removing the cap would deal with these problems.

Box 6: Reforming council tax

It is unclear to what extent the COVID 19 pandemic will permanently change property usage and so have a negative impact on future business rate receipts. If there is a shift towards more home working, this will place increasing pressure to resolve the valuation flaws for council tax.

For example, in Greater London the level of council tax in Croydon, which is a poor borough is double that of Westminster, which is the wealthiest borough in the UK. The retention of differential council tax rates as part of a shift towards creating a pooled level of local government at the economic geography in the long run is not sustainable.

The challenge for council tax reform is that there is no political appetite for it given that the outcome will almost certainly be higher rates for the wealthiest 20 per cent of the population. Furthermore, the council tax valuation process is plagued with even more severe structural issues than business rates given that it is still based on a 1991 valuation.

If there were a political appetite to reform council tax, it could be approached in the following way. Authorities that move towards the pooling of retained growth in business rates could also be required to take on an annual council tax valuation within their devolved rating system. The Dutch system requires the municipalities to value both domestic and non-domestic properties. Methodologically this is a reasonably simple process given the availability of house price data alongside the existing cadastral information. A flat percentage would be paid on the value of the dwelling such as 0.5 per cent, ending the regressive nature of council tax and ensure that wealthier authorities are not under charging for land use, which would normalise tax rates across an economic geography. Prior analysis suggests that this would mean council tax bills would be lower or the same for around 80 per cent of the population, but higher for the top 20 per cent.

Central government could disassociate itself from such reform if it permitted Mayoral authorities to pursue this path only following a successful vote in a local referendum. That way, central government could not be blamed for higher rates for the wealthiest 20 per cent of households. The Localism Act 2011 introduced the power for the Secretary of State to provide that any rise in council tax above a set threshold must be approved by a binding local referendum. Central government would though still need to prepare the way from a legal/constitutional perspective, but the ultimate decision would then rest with local communities.

35 Bessis H (2017) Room For Improvement. https://www.centreforcities.org/wp-content/uploads/2017/12/17-12-07-Business-rates-maximising-the-growth-incentive-across-the-country.pdf

Appendix A: Reliefs in the business rates system

Small Business Rates Relief: In 2004 the Government introduced the small business rates relief to address what it saw as the, "disproportionate burden that business rates place on small businesses compared with larger concerns like chains." The legislation applied a small business rates multiplier to hereditaments that had a rateable value of less than £21,499 in Greater London and £14,999 outside London. In 2005 this was 41.5p compared to 42.2p for all other hereditaments.

In addition, a sliding scale was introduced for hereditaments with a rateable value up to £10,000 enabling up to a 50 per cent reduction in rates liability. In 2010 following the Global Financial Crisis, 100 per cent relief was provided for eligible properties that had a rateable value up to £6,000, with a sliding scale of discounts up to £12,000. This has since been updated and 100 per cent relief is now for all properties with a rateable value of less than £12,000, with a sliding scale up to £15,000. The small business multiplier which is 49.1p compared to 50.4p is levied on businesses with a rateable value below £51,000.

Rural rate relief: The Local Government and Rating Act 1997 provided a mandatory 50 per cent rate relief to the sole village general store and post office in rural settlements. The proposals originated from a commitment in the 1995 rural white paper and were designed to help rural communities by sustaining rural shops and post offices, which supply essential goods and services and provide a focal point for village life.

The Rating (Former Agricultural Premises and rural Shops) Act 2001 aimed to encourage farm diversification by establishing a 50 per cent mandatory rate relief scheme for land and buildings formerly used for agricultural purposes. Local authorities have a discretionary power to increase the relief to 100 per cent.

These proposals stem from a commitment contained in the Action Plan for Farming, announced by the Prime Minister in March 2000, which aims to "help chart a way out of the current crisis" in British farming. In addition, the village shop relief scheme was extended to:

- Public houses which can be an important focus for communities, particularly where other facilities such as shops and post offices have closed
- Garages and petrol filling stations in rural areas that also provide other facilities in an area where these are not otherwise provided
- Small (particularly food) shops that are not the sole shop in settlements under 3,000 people.

Today, a business is eligible for 100 per cent rate relief in small settlements if the only village shop or post office has a rateable value below £8,500 and public houses and petrol stations with rateable values up to £12,500.

Charitable rate relief: In the 1961 Rating Valuation Act a provision was introduced that all charities should have a mandatory rating relief of 50 per cent. This followed on from the recommendations of the Pritchard Committee. A number of charitable institutions, mainly universities, though were unable to claim exemption and had to pay in full.

The 1955 Rating Act had given local authorities the power to reduce rates for charities. Today, charities and community amateur sports clubs can apply for mandatory charitable rate relief of up to 80 per cent if a property is used for charitable purposes. In addition, charities can apply for relief on the final 20 per cent to their local authority.

Charitable status has however created a significant issue where private charitable schools and hospitals are eligible for relief whereas public sector schools and hospitals are required to pay full rates. Scotland has recently decided to end private school rates relief and they will start to pay business rates from September 2020.

In England, the recent shift of schools from local education authorities to academies will mean that state schools will be designated as charities. This will potentially further reduce local government revenues.[36] During the parliamentary debate of the 1961 Act, there were many interventions that questioned the reasonableness of enabling charities to be eligible for mandatory rate relief.

While there may be strong grounds to provide charities with a form of tax relief, it is not clear whether doing this based on a charity's use of space in valuable areas is the most appropriate given potential crowding out effects of the private and public sector.

Enterprise Zones: Firms located in an enterprise zone can receive relief of up to £55,000 per annum for a period of five years. Enterprise zones were set up in 1980 by the Thatcher administration following a general criticism of regional policy that it merely transferred jobs from one part of the country to another without creating many new permanent jobs.[37]

Enterprise zones were exempt from business rates in order to attract firms to relocate. Although there is some evidence of new permanent jobs being created, the majority of jobs created in enterprise zones were merely transferred jobs from areas outside enterprise zones into the zones themselves. The Thatcher government eventually admitted that after many years of effort there was nothing to show for regional policy, and that it could not solve the problem of regional unemployment.[38]

Enterprise zones were reincarnated during the coalition government, however, again the results have proven to have been poor, with only a fraction of the jobs created than were expected.[39]

36 Marrs, C (2016) Academy school policy to cost hundreds of millions in lost business rates, Room 151, https://www.room151.co.uk/funding/academy-school-policy-to-cost-hundred-of-millions-in-lost-business-rates/

37 Harrison, J (206) The political-economy of Blair's "New Regional Policy."

38 Hanson, Higgins and Savoie (1990) Regional Policy in a Changing world, Eds.

39 National Audit Office (2013) Funding and structures for local economic growth

Exempted buildings: Agricultural land and buildings have traditionally not been liable for business rates which stems from the Rating and Valuation (Apportionment) Act 1928. The 1988 Local Government Act codified that fish farms are also exempt. The 1955 Act also exempted from rates buildings used for training or the welfare of disabled people. Buildings registered for public religious worship or church halls have always been exempt from rates.

While non-agricultural land owned by farmers is rateable, there remains a debate as to whether agricultural buildings should be rateable. For example, any building located on agricultural land involved in storage, drying, cleaning, grading or packing is not rateable. Whereas if these activities were not carried out on agricultural land they would not be eligible for relief. Such a divide appears somewhat arbitrary given that for example buildings used to manufacture cheese on a farm which provides all the milk is exempt but a cheese maker that buys in milk is not.

Empty buildings relief: Under the Rating Act of 1925, empty properties did not have to pay rates as the tax was liable on occupation. This changed in 1966 when the owners of unoccupied hereditaments could find themselves liable for empty property rates. In 2007 the Rating (Empty Properties) Act 2007 made empty properties liable for 100 per cent after three months, although it is six months for industrial premises.

There are some exemptions to this with regards to listed buildings until they're reoccupied, buildings with a rateable value under £2,900 and properties owned by charities as long as the property's next use will be mostly for charitable purposes. The same applies to community amateur sports club buildings. Empty property rates are payable by the person entitled to possession, which is usually the leaseholder if there is one, or the freeholder if not.

Hardship relief: Section 49 of the Local Government Finance Act 1988 gives the council a discretionary power to reduce or remit the payment of non-domestic rates by granting Hardship Relief. The Government only reimburses the council with 75 per cent of any Hardship Relief granted, so 25 per cent of the cost falls directly on local council taxpayers. Thus, the council must ensure that the granting of Hardship Relief benefits the wider community as well as the ratepayer concerned.

To be eligible, the local authority must be satisfied that the business is both in financial difficulty and is in the interests of local people. This to a certain extent can be considered similar to rural rate relief and might include:

- Village Shops
- Starter Units
- Small specialist shops unique to an area
- New ventures filling gaps in the market
- Areas facing a decline in trade
- Neighbourhood shopping parades

Retail discount: The Government announced in the Autumn Statement in December 2013 that it will provide a business rates discount of up to £1,000. Properties that will benefit from the relief will be occupied hereditaments with a rateable value of £50,000 or less, that are wholly or mainly being used as shops, restaurants, cafes and drinking establishments.

The Government also provided funding to local authorities for a 50 per cent rates discount for 18 months for those businesses that moved into retail premises that have been empty for a year or more. The 2018 Autumn Budget 2018 announced a one-third discount for eligible retail businesses with a rateable value of less than £51,000 for shops, restaurants, pubs, cinemas and other hospitality or leisure businesses.

The COVID-19 outbreak resulted in the Government providing 100 per cent relief on these businesses given that they were forced to shut as part of the quarantine restrictions.

Local newspaper relief: In 2016 the government announced that property used for the publication of local newspapers will be eligible for a business rates discount. The idea behind the temporary relief is to help local newspaper publishers adapt to industry changes and put themselves on a long-term sustainable financial footing. The relief is a £1,500 reduction in business rates for properties used as office premises for journalists and reporters on a local newspaper.

Telecoms relief: In 2018, the government passed the Telecommunications Infrastructure Act enabling 100% business rates relief for operators who install new fibre on their networks.

Appendix B: Overview of valuation methodologies

The Dutch valuation approach[40]

The valuation of non-residential property in the Netherlands is the highest of the market value or the depreciated replacement cost. The approach taken to generate a market value is to capitalise annual rental values based on an expected yield which is adjusted for location, risk, size, age, quality and level of maintenance. The depreciated replacement cost approach is typically used for properties where no market exists for rents such as schools and power plants. A single national body is charged with data collection for building costs that all municipalities use which is supplemented with data on local land use values.

In addition to collecting rental data for commercial properties, the Dutch valuation system uses commercial property transactions to benchmark capital values and their relationship to rental values. An additional benefit of using capital values is that they can be compared to residential property for broader economic and fiscal policy analysis.

The Dutch approach follows industry best practice of an all-risks yield (ARY) methodology which is derived from the yield applicable to a market-rented investment or the observed market rent divided by observed gross market price. The ARY subsumes assumptions about future cash flows but they are not explicitly modelled. An alternative approach is to use a discounted cash flow approach where the future cash flows are modelled while adjusting for inflation and allowing for costs and maintenance with an exit yield.[41] Although the Dutch system explicitly permits a DCF valuation, the inherent uncertainty in modelling 10 years of cash flows in addition to estimating an exit yield means it is hardly used.

Informational requirements

In terms of informational requirements, guidance is provided on what data is required to perform accurate valuations which are in line with the European Valuation Standards.[42] These include property specific details, the legal situation of the property including lease and rental details as well as broader market information to ensure that plots are valued in the market context. Rental value adjustments are applied to each group of properties taking account of differences in size, age, quality, level of maintenance, risk and adjustment for location.

40 Taxatiewijzer en kengetallen: Huurwaardekapitalisatie 2019

41 RICS (2010) RICS Guidance Note: Discounted cash flow for commercial property investments https://www.rics.org/globalassets/rics-website/media/upholding-professional-standards/sector-standards/valuation/discounted-cash-flow-for-commercial-property-investments-1st-edition-rics.pdf

42 EVS (2016)

Table 6: Informational requirements for valuations

The property		
	Location	
	Description	Plot size (floor & ancillary area)
		Year of construction
		Type of building
		New building activity
	State of repair	Quality of materials, improvements
	Cost of ownership	Vacancy costs
		Unrecoverable service costs
		Unrecoverable management costs
		Letting and review costs
		Purchase and sale costs
	Environmental aspects of the property including EPC, contamination etc.	
	Technical equipment - Note where plant and machinery is excluded from valuation	
The legal situation		
	Tenure - including length, covenants, restrictions or obligations that might affect value	
	Tenancies - names of owners & tenants and information on lease terms, rents & provisions	Unit rental data from both tenant & owner
		Market rental data from letting agents
	Town planning - information on current zoning in terms of permitted use	
The market		
	Market definition & categorisation within which the property falls	Type of property
		Size
		Age
		Location
	Provision of broader market information for this grouping	Sales prices, new leases & recorded transactions, rents
	Comparables - information on transactions involving comparable properties	
The valuation		
	Define methodology used	
	Make key assumptions clear including capital values, rental values and yields	
	Provision of additional assumptions such as vacancy risks	
	Use of recent transactions as evidence of value	
	Valuation uncertainty should be made clear where there is an high level of uncertainty	
	Special assumptions - details of use of other inputs	

Additional adjustments[43]

Rental values must also be adjusted for investments, incentives and any confidential changes made to a lease. Incentives such as rent-free periods and rent discounts result in cash flow losses which means that the landlord receives less than the rental price formally agreed in the lease. Hence, the impact of these cash flow losses should be expressed as discounts on the gross annual rental value. Investments made by the landlord do not increase the rental value, because the rent that the tenant pays depends on this investment. However, if the investment of modifications to the building is paid by the tenant, this partly increases rental value.

Rental values must also be adjusted for vacancy periods including determining whether a property is structurally vacant if it exceeds a period of two years. This may be due to the location and supply and demand characteristics or the quality of property. Vacancy periods need to be adjusted for costs including management costs, letting costs.

As any confidential changes to a lease including the use of side agreements effectively amend the value of a property, it is critical that such data is collected annually. This information is treated confidentially by the valuing authority and a template is provided to capture this information.

Annual rental templates for landlord and tenant[44]

- Is the part rented by the tenant lockable?
- Does the parted rented by the tenant have a private toilet?
- Does the parted rented by the tenant have a private kitchen?
- What is the maintenance level of the unit?
- What is the current rental price per unit of time? (excluding VAT and service costs)
- What is the starting date and term of the lease? Are there any break clauses?
- Is the rental price fixed or indexed? When will the rent be increased for the first time?
- Has the tenant invested in the building? (If yes, which type? (e.g. partitions, central heating, lighting)
- How much has been invested? Is there a rent-free period? Have other rental discounts been agreed?
- Does the rental price also relate to elements other than the immovable property? (E.g. movable property, presence of reception, parking spaces) Please indicate the separate rental prices that have been agreed.

43 Taxatiewijzer en kengetallen: Huurwaardekapitalisatie 2019
44 Taxatiewijzer en kengetallen: Huurwaardekapitalisatie 2019

- Have any agreements or side letters been made between the tenant and the landlord outside of the lease? (E.g. rent discount, rent free period or investments made by the landlord) All such information will be treated confidentially.

Capitalisation factor

Once the rental value of a property is estimated, it is then capitalized using a market derived capitalization factor which the Valuation Chamber prescribes as being the Gross Initial Yield.

Valuation based on capitalisation method:

Hence, the capitalisation factor = Resale value / Gross annual rent

Capitalisation factors are determined for each group of properties with automatic adjustments made for differences in size, age, quality, level of maintenance, risk and adjustment for location. With regards to vacancy rates, capitalization factors would be adjusted by 0.5 if a property is vacant for half the year.

The model outcome is checked by the valuer to verify that the valuations are in line with the market, and to what extent comparable properties are valued equally. All data are compared to prior years to check for discrepancies, particularly for sub-market transactions which might raise data concerns that could have a material impact on valuations. Although the Valuation Chamber exists to provide quality control on all the models used by municipalities, it does not prescribe the use of a certain type of model. The idea behind this policy was to maximize the use of market competition in the development of valuation systems.

VOA valuation approach

The VOA approach to valuing commercial property is a rentals-based approach, which stems from the original idea of business rates being a tax on occupancy. As part of its process, the VOA assesses each property taking into account the property type, the location as well as specific attributes of each hereditament.

According to the VOA,[45] a property's rateable value represents the rent the property could have been let for on a specific date set in law, although it may not be the actual rent paid on this date. For most properties that are rented, there are three stages to a valuation:

1. The VOA collects rental data evidence including rent and lease agreement details for most non-domestic properties. This evidence is analysed and adjusted by VOA surveyors taking into account the type of property
2. For most properties, the VOA sets common basic values per square metre for similar properties in the same area. Larger properties may have

45 VOA How non-domestic (business) properties are Valued 2017

a lower value per square metre, in the same way that buying items in bulk will usually mean a lower individual price per item.

3. The VOA then adjusts the basic value per square metre to reflect the property's individual features and applies this to the floor areas.

The VOA groups similar properties to make sure that they value them fairly and consistently based on a 'valuation scheme' derived from local groupings of properties which will be given a value from within a range.

Plant and machinery is then added to the value of a property which adds substantial complexity to the valuation process. Plant and machinery includes:

- Air conditioning system
- CCTV security system
- Fire protection system
- Lifts
- Renewable energy items
- Cold stores
- Standby generator

Shops are generally valued on a 'zoning' basis, starting from the window. Typically, each zone has a depth of 6.1 metres although this can vary depending on the location of the property. Zones become less valuable the further they are from the window/entrance. Zone A, which is the closest and is the most valuable as it has the highest potential to generate business for the shop. Zone B is next, then Zone C. Anything after Zone C is usually defined as the remainder. Shops are generally valued using the net internal area (NIA) which is the total usable area of each floor within a building measured to the inside face of the boundary walls.

Offices or industrial property are valued on a 'main space' basis which is the main area of the hereditament. The gross internal area (GIA) is measured to the internal face of the external walls at each floor level is generally applied to industrial property such as warehouses or manufacturing units.

Properties that are not normally rented, such as hospitals and schools, are valued using the replacement value.

To ensure a property is correctly rated, it is important to know how many parts of the property need to be separately rated or how many distinct hereditaments there are. Properties are rated with an assumption that they're in reasonable repair, although refurbishment works might include improvements, extensions and changing a property's use.

There are typically around two million properties in the English and Welsh local rating lists at any one time.[46] Around 80 per cent of the rateable values are

46 VOA 2017 Compiled Rating List Data Specification

supported by a regular site and building survey. Such properties tend to be valued in bulk once the requisite characteristics have been collected. The remaining 20 per cent use more specialised surveys or are based on construction costs or annual accounts.

Another additional complexity of the system in England and Wales is that different parts of a property have different relative values depending on their specific use which has generated over a 100 different Valuation Scale references. Each type of business has its own valuation scale reference. Table 7 shows the scale reference for abattoirs and slaughterhouses as an example.

Table 7: Valuation scale reference for abattoirs and slaughterhouses

Code	Description	GF	1	2	3	M1	B1	LG	4	05 to 10	11 & up
ANO	Office	1.1000	1.1000	1.1000	1.1000	1.0000	1.1000	1.1000	1.1000	1.1000	0.0000
ASI	Internal storage	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000
ASO	External storage	0.7500	0.4875	0.3000	0.3000	0.3750	0.3750	0.5625	0.3000	0.3000	0.0000
AUS	Area Under Suported Floor	0.7000	0.4000	0.3000	0.2000	0.3500	0.3500	0.5250	0.2000	0.2000	0.2000
BAY	Loading Bay	0.5000	0.4000	0.0000	0.3500	0.2000	0.3000	0.4000	0.0000	0.0000	0.0000
BRD	Boardroom	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
CAN	Canteen	1.1000	1.1000	1.1000	1.1000	1.0000	1.1000	1.1000	1.1000	1.1000	0.0000
CHL	Chill store	1.1500	0.7475	0.4600	0.4600	0.5750	0.5750	0.8625	0.4600	0.4600	0.0000
CLD	Cold store	1.3000	0.8450	0.5200	0.5200	0.6500	0.6500	0.9750	0.5200	0.5200	0.0000
CNP	Canopy	0.1500	0.1500	0.0000	0.0000	0.1500	0.0000	0.1500	0.0000	0.0000	0.0000
COM	Computer room	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
FPA	Food Processing Area	1.1000	1.1000	0.4500	0.4500	0.5000	0.4500	1.1000	0.0000	0.0000	0.0000
GAR	Garage	1.0000	0.6500	0.4000	0.4000	0.2000	0.5000	0.7500	0.4000	0.4000	0.0000
GTH	Gatehouse	1.0000	1.0000	1.0000	1.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
HIT	Hi Tech Accommodation	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
KTN	Kitchen	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
LAB	Laboratory	1.1000	1.1000	1.1000	1.1000	1.0000	1.1000	1.1000	1.1000	1.1000	0.0000
LFT	Lift Shaft	1.0000	0.6500	0.4000	0.4000	0.2000	0.5000	0.7500	0.4000	0.4000	0.0000
LOK	Locker room	1.1000	1.1000	1.1000	1.1000	1.0000	1.1000	1.1000	1.1000	1.1000	0.0000
LRH	Abattoir Lairage	0.7500	0.4850	0.3500	0.2500	0.2500	0.0000	0.7500	0.2500	0.2500	0.2500
MSR	Mess/Staff room	1.1000	1.1000	1.1000	1.1000	1.0000	1.1000	1.1000	1.1000	1.1000	0.0000
OFF	Office	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
OWK	Works office	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000
PKN	Portable Building	0.7500	0.5000	0.5000	0.0000	0.5000	0.5000	0.0000	0.0000	0.0000	0.0000
PLT	Plant room	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000
PRD	Production Area	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000
RAO	Retail Area	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
REC	Reception / Entrance	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
SGY	Surgery	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
SHD	Shed	0.2500	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
SOV	Ground Floor Sales	1.2000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
SPU	Store	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000
STR	Strongroom	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
WCE	Public toilets	1.2000	1.2000	1.2000	1.2000	1.1000	1.2000	1.2000	1.2000	1.2000	0.0000
WCS	Staff toilets	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000
WHS	Warehouse	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000
WKS	Workshop	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000
XNC	Unclassified area	1.0000	0.6500	0.4000	0.4000	0.5000	0.5000	0.7500	0.4000	0.4000	0.0000

Source: VOA (2020) Rating Manual section 6 part 3: valuation of all property classes – Section 5: abattoirs and slaughterhouses

Comparison between the Dutch and England/Wales approaches

The Dutch system aims to provide regular market valuations of capital values in line with best practice real estate valuation taking into account confidential changes to leases. The England approach focuses on rental values while attempting to take into account a great deal of detail such as plant and machinery, zoning as well as adjusting valuations of specific areas of the property depending on the type of business. While there may be some value in trying to disentangle the complexity of rental valuations by type of business, zoning and plant and machinery, this comes at the expense of market values. Given that valuation best practice is on valuing assets once a year,[47] the approach taken by the VOA appears overly complex, outdated and hence less useful from a fiscal policy perspective.

47 EVS Standards

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