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The Rt Hon Peter Walker MBE MP  
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*I am horrified at this approach. I do not  
accept that it is consistent with the general principles  
of rating valuation or that it can or is being  
applied systematically to most. We have consistently  
capital value and we need to look at asset value for these things - a value  
which will vary enormously and which depends on highly arguable  
figures which come from current  
cost accounting. The figures  
given show the total variation.  
What other formulae were  
considered?*

2 August 1989

Dear Secretary of State

FORMULA RATING REVIEWS

For the last eighteen months our officials have been considering how best to make assessments for those industries whose rateable values are determined by statutory formula. We have now reached a conclusion on what these should be for each industry, and I am writing to seek agreement on these from yourself and interested colleagues, before I write to the industries concerned. For the present the values are expressed as a single figure for England and Wales together; in due course you and I will need to agree the split for each industry.

In setting these levels of value we have sought an approach which is both consistent with the general principles of rating valuation and can be applied systematically to most, if not all, of the formula rated industries. Having examined a variety of methods, we have decided to rely, as far as possible, on the asset valuations of an industry's rateable property as shown in their annual accounts. This approach, which has close similarities to the "contractor's basis of conventional valuation, relies on current cost accounts to give a net replacement cost for rateable assets, which is adjusted to conform with the rating hypothesis and is then converted into an annual rateable value by the application of a 6 per cent decapitalisation rate; the Valuation Office has advised us on the rateability of different items and the proper level for the setting of allowances in the calculation. The results of the exercise generally give a fair and consistent level of assessment to each industry. Where current cost account information is not available, we have found it necessary to set rateable values as a percentage of turnover; this is inherently a less satisfactory approach, in that there is more scope for debate over the proper level of turnover to select; the figures that we have adopted on the Valuation Office's advice err on the side of moderation.

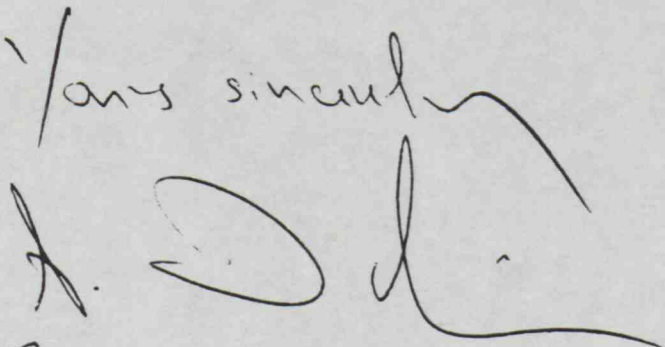
I attach a table showing the rateable values that we are proposing for each formula rated industry for 1990, together with an industry by industry commentary on the reasons for setting the value at this level. The table also shows the old (1973 list) rateable value and the uplift between the two. Comparing an industry's uplift with the national average uplift of 7.7, the table shows the extent to which that industry will experience a real rise in rateable value; it also illustrates the extent to which an industry loses or gains from the move to the unified business rate. As the commentary notes, in a few cases there may be some downward revisions as new facts emerge; our officials can keep in touch on any such changes in detail.

My officials have already reached a substantial measure of agreement as to the proper level of rateable value with the relevant officers in some industries. However, no one enjoys paying taxes and I have little doubt that other industries will claim that the assessments are excessive and will press for a downward revision. While I will listen to all such claims carefully, and consider any arguments put on their merits, my proposals reflect our best judgement as to the proper level of valuation and contain no margin for bargaining; I would only want to be persuaded to revise the figures if strong valuation evidence were presented. Where there are any real shifts in rates burden, these will be subject to the transitional arrangements.

I must say that I have not found the process of setting these values an easy task; and inevitably, there is less confidence in the outcome of this exercise than there would be if the values were determined by the Valuation Officer with appeal to the courts in the normal way. With the advent of the unified business rate one of the main reasons for the rating of these industries by formula (allocation of values at a local level) has disappeared; we are making regulations on valuation methods that will dispose of another. I am therefore proposing that we move all these industries back to conventional assessment, so far as is technically possible, for the 1995 revaluation. My officials will be considering what is involved over the next few months.

I should like to write to the chairmen of the individual industries setting out my proposals for their industry in late August. This will give them a chance to consider our proposals before we go out to consult on the details of the statutory instruments in September. Could I therefore ask you and copy recipients to let me have views on these proposals by 18 August.

I am copying this letter to the Prime Minister, Nicholas Ridley, Malcolm Rifkind, Norman Lamont, Cecil Parkinson, John McGregor and to Sir Robin Butler.

Yours sincerely  


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CHRIS PATTEN

(Approved by the Secretary of State  
and signed in his absence)

FORMULA RATED INDUSTRIES : PROPOSED 1990 RATEABLE VALUES & CHANGES FROM 1973 VALUES

	PROPOSED 1990 RV £M	1973 RV £M	UPLIFT 1990- -1973	% REAL CHANGE OVER AVERAGE 7.7 UPLIFT	% CHANGE POUNDAGE	NOTES
BRITISH GAS	535.0	62.8	8.5	+10	-7	
WATER AUTHORITIES						
ANGLIAN	40.7	4.0	10.2	+32	-3	
NORTHUMBRIAN	11.9	1.7	7.0	-9	-22	
NORTH-WEST	61.8	8.2	7.5	-3	-15	
SEVERN-TRENT	50.0	6.5	7.7	0	-10	
SOUTHERN	12.3	2.1	5.9	-23	+7	
SOUTH-WEST	15.2	1.5	10.1	+31	-5	
THAMES	52.2	10.5	5.0	-35	+9	
WELSH	31.4	2.9	10.8	+40	-13	
WESSEX	7.2	1.1	6.5	-16	-12	
YORKSHIRE	38.6	5.2	7.4	-4	-24	
TOTAL	321.2	43.7	7.4	-4	-9	
WATER COMPANIES (TOTAL)						
WATER COMPANIES (TOTAL)	88.8	12.7	7.0	-11	-6	ESTIMATED AVERAGE FOR 28 COMPANIES
ELECTRICITY						
CEGB	1234	95.7	12.9	+68	-3	POUNDAGE EFFECTS CALCULATED FOR 1986/87
DISTRIBUTION						
LONDON	44.5	13.5	3.3	-57	+15	
SOUTH EASTERN	35.5	6.6	5.4	-30	+17	
SOUTHERN	48.6	8.1	6.0	-22	+9	
SOUTH WESTERN	30.9	3.9	7.9	+3	0	
EASTERN	57.2	9.4	6.1	-21	+5	
EAST MIDLANDS	38.5	8.0	4.8	-38	-5	
MIDLANDS	45.1	9.5	4.7	-39	+3	
SOUTH WALES	19.8	4.5	4.4	-43	-3	
MANWEB	28.4	5.8	4.9	-36	-15	
YORKSHIRE	50.0	9.5	5.3	-31	-20	
NORTH EASTERN	29.3	5.9	5.0	-35	-19	
NORTH WESTERN	40.8	10.6	3.9	-49	-14	
TOTAL	1,703	191.4	8.9	+16	-3	TOTALS MAY NOT SUM DUE TO ROUNDING
BRITISH TELECOM	292.9	30.9	9.4	+22	-4	
MERCURY	14.0	0.7	20.0	+159	N/A	NEW AND GROWING INDUSTRY. 1973 LIST RV NOT COMPARABLE WITH PRESENT POSITION
PORTS INDUSTRY	40.6	3.7	11.0	+43	-2	FIGURES RELATE TO 1987/88 DATA FOR SAMPLE OF 46 PORTS
BRITISH RAIL	299.2	17.9	16.7	+117	0	
LONDON UNDERGROUND	46.6	3.5	13.5	+75	0	CURRENTLY INCLUDES DOCKLANDS LR
DOCKLANDS LR	0.8					
TYNE & WEAR METRO	1.8	0.2	9.0	+17	-26	
BRITISH WATERWAYS	0.32	0.27	-	-	0	1986/87 RV QUOTED. SUBSTANTIALLY LESS PROPERTY INCLUDED IN 1990 CUMULO

## COMMENTARY

### British Gas

The value proposed is derived from the industry's 1987/88 current cost accounts, making allowances for non-rateable items, and the piecemeal development of the system. Each of these allowances has been the subject of separate discussion with the industry. Although the industry is clearly concerned about its assessment, it has co-operated fully with DOE and the proposed figure is one with which industry officials are in agreement.

### Water Authorities

Only water supply activities are formula rated. The values proposed for each authority are derived from the current cost accounts; allowances has been made for non-rateable items and for the over-provision of dams and reservoirs (which reflect the fragmented history of the industry); allowance has also been made for the value of small water mains which are normally provided at the consumer's expense. Office premises have been removed from the formula and will in future be assessed conventionally; allowance has also been made for the transfer of property to the National Rivers Authority. These calculations have been the subject of extensive negotiation with the industry, whose officials are in broad agreement with the results. Although there is little change in the aggregate of rateable values for the industry in real terms, there are substantial changes in individual authority's values, reflecting the effects of the removal of outdated earlier assessments.

### Water Companies

The 29 statutory water companies account for about 24 per cent of all water supplied. Their accounting basis is not suitable for an asset value assessment. Instead, their new rateable values are derived from those of the water authorities, pro rata to turnover and volume of water supplied. Again, large swings between companies are expected. This approach has been agreed by the Water Companies Association.

### Electricity

Although a single value is at this stage proposed for CEGB, this will need to be split up later in the year, to reflect the new privatised status of the industry, into generating companies and a grid company. The values proposed are derived from the 1987/88 current cost accounts for the industry; some allowances have been made for non-rateable items, although less than the industry has bid. The figures for the area boards may be subject to some slight downward revision in the light of further discussions which officials are having with the industry. The industry has also claimed two further allowances that DOE does not accept. First, it has claimed a discount of around 50 per cent on the

value of the system to reflect their average load factor against maximum capacity; DOE rejects this since the amount of property required to meet peak demand (ie virtually 100 per cent) should be the basis of the assessment. Second, CEGB appear to be proposing to write off a substantial sum (perhaps up to £7bn) in their 1988/89 accounts, although the exact amount and precise justification for it have not been specified; we are not at present convinced that this can be justified in terms of the industry's rateable value but discussions are continuing at official level. The industry may be expected to come back on these points. Although the proposed rise in rateable value for the whole industry is limited, there will be major swings, both away from distribution to generation and between the distribution boards, which results from a rectification of historical anomalies; there may also be further representations on this point.

#### Private Electricity Generators (not shown in table)

The Government has agreed that these should be formula rated from 1990. This will be achieved by means of a conversion formula which gives them the same rateable value per unit of generating capacity as conventionally fired CEGB stations; separate treatment will be given to wind powered generators, and to the combined heat and power schemes. These formulae will be developed as soon as the value of CEGB generating plant is established.

#### British Telecom

Only the network of cables and associated equipment is formula rated; telephone exchanges are conventionally assessed. The value proposed is derived from current cost account figures supplied by British Telecom. BT have claimed very substantial allowances on these figures, to reflect supposed age and obsolescence, surplus capacity, inefficient provision through piecemeal development and licence obligations. They have also questioned the rateability of cables (discussed in the context of Mercury below). The cumulative effect was to discount the capital value by about 90 per cent and reduce BT's rateable value by 5/6 in real terms. DOE does not accept that allowances of this size are remotely justifiable. Instead, an overall allowance of 25 per cent has been made to cover these factors. BT are likely to object.

#### Mercury

Mercury is a very new venture and prior to 1990 its property is conventionally rated. They are currently in dispute with the Valuation Office over whether cables themselves are rateable or just the easement they occupy; if, as they contend, the latter is found to be the case in the courts, then the formula valuation (which treats cables as rateable) may need revision. Mercury's

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increase

valuation is based on recent historic cost accounts figures supplied by them; they had claimed a 90 per cent pioneering allowance to reflect the current under utilisation of the system. DOE does not accept this. Although we are awaiting further information (and may therefore need to revise our proposal) the value in the table should represent the full value of the system; but it is proposed that this be phased in over a 4 year period, starting with half the full value in 1990. Mercury may be prepared to accept this.

### Ports

Only the statutory ports are formula rated; it is a long standing grievance of the non statutory sector that their conventional assessment by the Valuation Office produces a much higher result than use of the formula would, suggesting very clearly that the existing formula results in a substantial under assessment. To achieve comparability, the statutory ports should be returned to conventional assessment as soon as possible and, in the interim, a more realistic level of formula set in place. About 70 separate ports are assessed by formula at present. The existing formula sets the rateable value of each port as a percentage of certain receipts, expressed in terms of 1976 prices (when the formula was last reviewed). For the 1990 formula, DOE propose to use a wider base of receipts for the calculation of rateable value. This will redistribute the rates burden across the ports, but provide a fairer and more uniform basis of assessment.

Because none of the ports use current cost accounting conventions, it is accepted that their rateable value is most conveniently expressed as a percentage of turnover. If the rateable values in the ports industry were to remain unchanged in real terms for 1990, this would be set at 5 per cent. However, on advice from the Valuation Office, which is confirmed by comparison with the conventional assessments of non-statutory ports, DOE is clear that the rateable value of statutory ports should be set equivalent to 8 per cent of turnover. The ports industry will not be happy with this figure, since it removes their present privileged assessment.

Information on the receipts of the 70 separate ports is not available. The figures in the table relate only to the full details we have of a sample of 46 ports.

### Railways

Prior to the last review, the valuations given to the railway boards contained 75 per cent industrial derating. In that review new values were established but a 50 per cent discount was applied to cushion the loss of derating. Hence these industries are substantially under assessed.

British Rail does not have current cost accounts at present. In the absence of this information DOE has sought other measures of the capital value of BR's assets, but data is limited. The Valuation Office have discussed a turnover based approach with BR and recommend that the rateable value be taken as 10 per cent of adjusted turnover for 1987/88. This figure is substantially below that which would result from an assessment based on asset values. DOE believes that the value proposed by the Valuation Office is the minimum that could reasonably be attributed to the BR network, and is prepared to accept it on that basis.

Partial current cost accounts are available for the London Underground. Although only historical accounts are available for Docklands Light Railway and Tyne & Wear Metro, the systems are sufficiently new for these to serve instead. However, none of these accounts show the value of all assets, including civil engineering works. The Valuation Office has also advised on assessing these networks on the basis of a percentage of adjusted turnover. This again produces figures substantially lower than would be derived from an asset value calculation. Nevertheless, in the interests of maintaining a consistent level of assessment across all rail networks, DOE has accepted the Valuation Office levels of assessment for London Underground and Tyne & Wear Metro. Because the Docklands system is very new, turnover does not provide a reliable basis for setting a rateable value; instead the figure quoted is derived pro rata from that of London Underground.

#### Canals

With the agreement of British Waterways Board, DOE is taking most buildings into conventional rating for 1990. Only the canal track itself will be formula rated and there is no current cost account value for this. Since over 80 per cent of BWB's income comes by way of grant, and it serves a major function in providing land drainage and public recreational space (neither of which is rateable), DOE judged that 5 per cent of turnover would make for a proper level of assessment of the canal track.

