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SCOTTISH OFFICE
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12 September 1989

CONFIDENTIAL
The Rt Hon Chris Patten MP
Secretary of State for the Environment
2 Marsham Street
LONDON
SW1P 3EB

Dear Secretary of State,

FORMULA RATING REVIEWS

See memo R.

You copied to Malcolm Rifkind your letter of 2 August to Peter Walker seeking agreement to the rateable values you propose to set for the formula rated industries in England and Wales for 1990/91, I am responding on Malcolm's behalf because he is out of the country at present. I have also seen your minute of 22 August to the Prime Minister and the reply on her behalf from her Private Secretary on 24 August.

We have been undertaking a similar exercise in relation to the same industries in Scotland and, as you will know, our officials have maintained close contact with yours throughout. It goes without saying that we must be seen to achieve harmonisation north and south of the Border in our approach to the valuation of these industries, and I agree this approach should be consistent with the general principles of valuation for rating and capable of systematic application to most, if not all, the industries.

We have examined a number of methods of determining the rateable values and I share your conclusion that a "contractor's basis" approach, based on assets valued in the current cost accounts of the industries, is to be preferred where this information is available. We accept this method is open to criticism, not least because of the use of differing conventions in current cost accounting, but we consider these values can be adjusted to equate to an "effective capital value" as determined by the assessor under conventional valuation for rating using the contractor's basis, the "effective capital value" reflecting what a hypothetical tenant would be prepared to pay for under a lease. This method is then converted to an annual rental value using the decapitalisation rate. This is altogether different from an approach to valuation based on capital values, which is being suggested in some quarters for the domestic sector. The contractor's basis, using net replacement costs, has been tested and tried in the Courts over many years and is employed for a range of classes of

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property for which inadequate rental evidence is available. It is the method which would have to be employed by Scottish assessors in most cases if these industries were to be subject to conventional valuation. Nonetheless there is no disputing that formula valuation itself is far from satisfactory and we have agreed that our officials should look into the possibility of moving these industries into conventional assessment for the 1995 revaluations.

Our officials are still discussing with the industries and with assessors the appropriate allowances to be made as part of the 1990 revaluation, and these may differ in some cases from the allowances in England and Wales. Where current cost accounts are not available we will also be looking at turnover, although we agree that this is less satisfactory. In the meanwhile we are content with your proposals for the rateable values to be set for the formula rated industries in England and Wales. Malcolm hopes to be in a position to write to colleagues soon seeking agreement to the rateable values he proposes to set in Scotland.

I am copying this letter to the Prime Minister, Nicholas Ridley, Peter Walker, Norman Lamont, Cecil Parkinson, John Wakeham and to Sir Robin Butler.

Yours Sincerely
Craig Chifford

PP JAMES DOUGLAS-HAMILTON

(Approved by the Minister
and signed in his absence.)

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