

C C
AJP

CONFIDENTIAL



PRIME MINISTER

FORMULA RATING REVIEW

Your Private Secretary's minute of ~~24~~ ²⁵ August explained that you still had reservations about my formula rating proposals and asked what alternative had been considered.

In our discussions with the industries we have sought to devise a consistent approach but different circumstances and availability of data mean that no single method can be applied satisfactorily across the board. The position is in fact similar to conventional rating where valuers are obliged to use a number of different methods of arriving at satisfactory rental values in particular cases.

Some of the property of these industries such as offices and showrooms is conventionally assessed by the Valuation Office outside the formula, generally using rental evidence. But there is no rental evidence for the property which is to be formula rated. This was one of the reasons why formula rating was first introduced in the 1950s. The property concerned is too diverse for a floor area approach to be practicable; and much of the value in any event lies in the networks of pipes, cables and track of the gas, water, electricity and railway industries. Even if common physical units of measurement could be devised, that would not solve the central problem of the values to be attached to those units.

The working groups of officials and representatives of the industries which were set up in 1987 to look into this problem considered two other methods, as well as decapitalised asset values and turnover. The first involved uprating the existing values pro rata to changes in turnover. This is unsatisfactory, as Peter Walker pointed out in his letter to me of 29 August, because it assumes that the present values, dating from the mid-1970s were correct, while clearly some are not. So far as one can tell there was little objective basis for them. The second method examined used multiple regression to relate the rates bills of industry at large to

CONFIDENTIAL



measures of activity (output, wage costs etc) and applied the resulting equation to the formula rated industries. This was subsequently found not to be workable because of lack of data and the variable usage of property by different kinds of industry.

The working groups generally agreed that the asset value method should be used wherever CCA asset value information was available. As I explained in my earlier minute, the use of this method to derive a proxy for rental value is well preceded in the "contractors' basis" of conventional rating. It is quite distinct from the capital value rating which we rejected as an alternative to domestic rates. The contractors basis is a way of deriving an annual rental value from the cost of providing an asset by applying a decapitalisation rate: it assumes of course that there is a relationship between the cost of providing assets and their value - that they are worth at least the cost of provision.

For railways and ports which do not have CCA accounts, there is no alternative but to use turnover. This is less satisfactory because of the difficulty of selecting the appropriate percentage, but this method too is quite widely used in conventional rating where rental evidence is not available and this provides sufficient reference points for getting the assessment right; the existing ports formula is already based on turnover. My Department has taken the advice of the Valuation Office on the application of these two approaches.

I believe that these proposals remain the best way forward. In general the industries, while they may in some cases dispute the figures and may want more generous allowances, do not disagree with the basic approach, and we can defend the assessments as being made in accordance with rating principles. I hope therefore that you can now agree the proposals, subject to any further discussions that may be needed on the figures for some of the industries.

Although I am clear that my proposals are workable, I do not believe that it is satisfactory for my Department to be in the position of

CONFIDENTIAL



having to value these industries. This is why I have proposed that in the longer term we should return them so far as possible to conventional assessment where the Valuation Officer will exercise his judgement to arrive at an assessment which can be reviewed in the courts.

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

[Handwritten signatures]
P.P. C P

12 September 1989

(Approved by the Secretary of State
and Signed in his Absence)

LOCAL GOVT : Ratey P114

