



SCOTTISH OFFICE
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The Rt Hon Christopher Patten MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

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19/12*

19 December 1989

Dear Chris,

REVIEW OF FORMULA VALUATION

As you know, my officials have been undertaking a parallel exercise to that in England and Wales in relation to those industries whose rateable values are determined by statutory formula. We have now reached a conclusion as to the net annual values which should apply to each industry in 1990/91 and I am writing to seek your agreement, and that of interested colleagues, to those values before I write to the industries concerned.

In carrying out this exercise we have been conscious of the need to harmonise our approach to a particular industry wherever possible with that adopted by you. We have, therefore, relied as far as possible on the asset valuations of an industry's rateable property as shown in its current cost accounts, and used these as the basis for a contractor's basis type valuation. Where current cost information is not available we have, like you, based the value on a percentage of turnover, which we are agreed is a less satisfactory approach. As a result, you will see that our approach in each case is in line with that set out in your letter of 2 August to Peter Walker.

I attach a table showing the net annual value I am proposing for each industry together with a commentary outlining the method adopted in each case. The table also shows the current rateable value and the uplift implied by my proposals for 1990/91. It is not possible to make direct comparisons with 1985 valuations for a number of reasons, principally because the 1985 figures were rateable valuations with an allowance, unspecified, for derating. The table does however give an indication of the increase in net annual value and, more importantly, figures of rateable value on which rates bills will be based. For some industries the uplift is well in excess of the average uplift of around 1.4 expected for all subjects at the revaluation in Scotland. The reason for this is that the method employed in setting the rateable values for these industries in 1985 resulted in them benefiting from a significant level of derating. Under conventional valuation the electricity supply industry, British Gas, British Rail and British Alcan would benefit from industrial derating and I

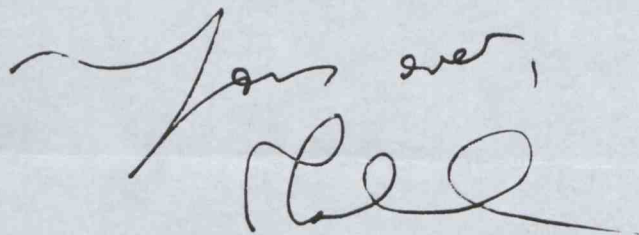
propose that only these industries should benefit in 1990 from whatever level of derating is decided for industry in general. I shall be writing to colleagues later on this once I have more details of the likely effects of the revaluation, but in the meanwhile the figures in the table show rateable values resulting from the application of the current level of derating, which is 40%, and in brackets by way of illustrating the effects of moving to reduce rating the value which would result from halving this to 20%.

I anticipate representations from some of the industries, particularly those for which I am proposing significant increases in rates bills, but I would only be willing to revise the figures if new valuation evidence was to be brought forward. Clearly because we believe that the values we are proposing are consistent with the values you have put forward for the industries in England we would expect to have regard to the relevance of arguments put forward for reductions in proposed valuations in England to the Scottish values as we assume you would on your side if arguments are advanced for reducing the values proposed for Scotland. In this context I would note my agreement with the responses you have made to John Wakeham and Cecil Parkinson about aspects of the proposed values for electricity supply industry and British Rail. Where there are significant real increases in rates bills as a result of revaluation these will be limited by the transitional arrangements for phasing in.

I agree with you that formula valuation is a generally unsatisfactory approach and I welcome our agreement to look at the possibility of returning these industries to conventional valuation for 1995.

I am conscious of the strict timetable to which we must work in having the relevant Orders in place for the revaluation. I should be grateful if you and copy recipients could let me have any comments on these proposals by 20 December.

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

A handwritten signature in black ink, appearing to read 'Yours ever, Malcolm Rifkind'. The signature is fluid and cursive, with a large initial 'M' and 'R'.

MALCOLM RIFKIND

		1985/86 £m	1990/91 £m	Uplift
Electricity Supply Industry	NAV	149.392	170	1.14
British Gas plc	NAV	40.744	51	(1)
British Telecom plc	NAV	18.386	22	1.20
Mercury Communications Ltd	NAV	-	0.5	-
British Railways Board	NAV	8.598	15.123	1.76
British Waterways Board	NAV	0.018	0.012	(1)
Docks and Harbours(2)	NAV	4.763	5.951	1.25
Water Supply Services	NAV	24.125	32.089	1.33
Glasgow Underground	NAV	0.150	0.22	1.47
British Alcan Hydro	NAV	1.682	1.358	0.81

Notes NAV for 1985-86 assumes 50% derating in determination of prescribed RV

- (1) uplift not a valid comparison because of change in coverage of cumulo
- (2) estimated figures based on sample comprising ports which are members of British Ports Federation.

COMMENTARY

ELECTRICITY SUPPLY INDUSTRY

The value proposed is derived from the industry's 1987/88 current cost accounts, making allowances for non-rateable items and for overcapacity of generating plant. Although a single value is proposed at this stage, this will require to be split to reflect the structure of the industry post-privatisation. The industry has argued for a higher allowance, based on load factor, to reflect generating overcapacity but Scottish Office (SO) remain of the view that it is the amount of property required to meet peak demand which should be the basis of the assessment. An allowance to reflect the lower return on assets of the industry in Scotland has also been included and, if industrial derating is retained, it is intended the rateable value should reflect the level of industrial derating determined for 1990.

BRITISH GAS PLC

With the agreement of British Gas, only the gas transmission and distribution system is to be formula-valued from 1990. All offices, workshops, depots etc are to move into conventional valuation. This means that the value proposed for 1990 is not strictly comparable with that for 1985. The value proposed is derived from the industry's 1987/88 current cost accounts, making allowances for non-rateable items, the piecemeal development of the system and the lower return on assets in Scotland. These allowances have been the subject of detailed discussion with the industry and the proposed net annual value is one with which industry officials are in agreement. It is proposed that industrial derating should apply to British Gas in Scotland in 1990.

BRITISH TELECOM PLC

British Telecom have produced current cost asset values for Scotland based on their 1987/88 accounts, from which they have derived a valuation with sizeable allowances for piecemeal development, over-provision and obsolescence. BT propose a net annual value of £11.7 million in Scotland for 1990/91. SO are not convinced the way in BT have calculated these allowances does not result in considerable double-counting, but it is difficult to quantify this on the basis of the limited information which BT have been willing to supply. SO have, therefore, adopted the same approach as DOE and propose an overall allowance of 25% to cover all these factors, but this is unlikely to be acceptable to BT. In addition, SO are proposing an end allowance of 20% to reflect the lower return on assets in Scotland.

MERCURY COMMUNICATIONS LTD

Mercury is to be formula valued for the first time from April 1990. The company has been able to provide rental evidence for parts of its property holdings but, where this is not available, SO have resorted to decapitalised current cost asset values. The proposed net annual value is not likely to result in strong opposition from Mercury but the company can be expected to make the same point as argued in England and Wales that cable is not rateable.

INDEPENDENT INDUSTRY GENERATORS

The Government are committed to introducing a basis of assessment for rating for independent electricity generators which is comparable with that of the electricity supply industry. SO propose to adopt the same approach as DOE with the rateable value of private generators calculated on the basis of their installed capacity using a value per MW calculated from the proposed value of the generating assets of the supply industry. On the basis of the rateable value proposed for the electricity supply industry in Scotland SO propose that the rateable value should be calculated on the basis of £6,250 per MW of installed capacity for wind-powered generators and £12,500 per MW for other generators.

BRITISH ALCAN HYDRO-ELECTRIC SCHEMES

British Alcan's Hydro-Electric schemes are currently valued by formula with the rateable value in 1985 determined in comparison with the rateable value of the electricity supply industry. It is proposed that for 1990 British Alcan's rateable value should be based upon the read across factors for private generators.

BRITISH RAILWAYS BOARD

British Rail does not produce current cost accounts and it has no separate accounts relating to its operations in Scotland. SO propose, therefore, that a rateable value is determined for GB as a whole, based on turnover, and that this is apportioned between Scotland, England and Wales on the basis of the level of arising receipts in each country. This basis of apportionment has been agreed with BR, but the level of overall rateable value is the subject of continuing discussions between BR, DOE and SO. It is proposed that BR in Scotland would benefit from industrial derating in 1990.

BRITISH WATERWAYS BOARD PLC

Like DOE, SO propose only to retain within formula valuation the canal track and its pertinences, and to move into conventional valuation all other property of the Board. BWB in Scotland is in favour of this approach but argues that the canals themselves should only attract at the most a nominal value. No current cost accounts are available for BWB and, therefore, SO have adopted the same approach as DOE and based the value on turnover. As a check a valuation has been carried out based on revenue adjusted by an estimate of the values of the property to be valued conventionally in 1990, and this supports the proposed net annual value of £12,000.

STATUTORY PORT UNDERTAKINGS

Although the approach to the valuation of statutory docks and harbours is at present similar north and south of the Border in that the rateable value of each port is calculated annually as a percentage of relevant income, the percentage used and the definition of relevant income has differed in the 2 countries. SO propose to harmonise the definition of relevant income and to include within it for the first time income arising from cargo handling. The percentage which it is proposed should be applied is 9%, the same as in England and Wales. This will result in a slight decrease in rates bill for the industry as a whole in Scotland. There will, however, be a redistribution of rates burden on ports within Scotland because of the inclusion of income from cargo handling with some ports facing increases in bills and others decreases. The British Ports Federation accept this and are unlikely to object to the proposals.

WATER UNDERTAKINGS

DOE propose to base their rateable values for water authorities in England and Wales on the decapitalised current cost asset values, and to read across from these values to the water companies which do not produce current cost accounts. The water authorities in Scotland also do not produce current cost accounts and, therefore, SO propose to apply similar read across factors to those developed for the water companies south of the Border.

GLASGOW UNDERGROUND

As in the case of British Rail, no current cost accounts are available for Glasgow Underground. SO propose, therefore, to adopt a similar approach to that for BR and to base the valuation on turnover.

Local Govt
Rates.