GVA Briefing note to the REA on Business Rates for Renewable fuelled power generation plants

General Background

Rates are charged on non-domestic premises against a Rateable Value (RV). The RV will apply for the period of the Rating List which currently runs from April 2010. The RV is based on the estimated annual rental value of the property at a baseline date two years before the Rating List comes into force. The next Revaluation is now due to apply from April 2017, and thus any market and cost evidence as at 1st April 2015 (Antecedent Valuation Date) will be analysed and used to set the rateable values the next Revaluation period.

To arrive at the actual annual rates payable, the RV is multiplied by a national multiplier known as the uniform business rate for each rate year April to March. The multiplier is increased annually in line with inflation, but there are commonly small adjustments and supplements made largely to benefit small businesses. Rates are payable independently of the level of operation, although temporary relief may be claimed for short term closures.

Assessing the Rateable Value

In the case of mainstream commercial properties such as offices or industrial units there is normally sufficient rental evidence available to establish the level for the rateable value. However in specialist sectors such as renewable energy where direct comparable open market rental evidence is scarce the Valuation Officer (VO) may adopt one of two other approaches. These are either the Contractors Test or Receipts & Expenditure method depending on the facts of the case. The key determining factor to which of these is adopted is the origin of the fuel and whether this is considered to be a "waste" product. Those plants fuelled by "waste" are assessed on a Contractors Test and the remainder on the Receipts and Expenditure basis. Although both approaches are theoretically expected to arrive at the same result, there are certain implications and uncertainties via the second route.

The Contractors Test establishes the effective replacement capital cost of the property, including all items of rateable plant & machinery. These are defined in Statute, and will be identified on an item by item basis following a detailed inspection of the plant and plans. The capital cost will be adopted from a national Cost Guide or actual costs may be analysed and backdated to the set values date.

A Statutory decapitalisation rate of 5% is then applied to arrive at the Rateable Value.

The Receipts & Expenditure method analyses the actual or expected net profits of the operation and then adjusts and apportions that between the landlord and tenant share. Those items supplied by the tenant are deemed to be non-rateable and due allowance must be had for these items and what is considered a fair return for the industry. The final step is to decide how much of the remaining "Divisible Balance" is available to pay to the landlord as rent. This should reflect his provision of the building, land and any rateable plant etc. The apportionment of the divisible balance between the tenant and landlords share has often been difficult to agree and has caused much argument and cases of dispute.

<u>What is rateable?</u>

The main rateable items are the buildings and infrastructure items such as open storage and roadways. In addition, statutory regulations set down those items of plant of plant and machinery which are deemed to attach or provide benefit to the landlord's premises. These are primarily those large structural items that cannot easily be removed or provide services to the site. Any on-site power generation is assessed with the premises unless it meets the following exemption criteria;

> *(d) "excepted plant and machinery" means plant and machinery on a hereditament used or intended to be used for the generation, storage, transformation or transmission of power, where* ***the power is mainly or exclusively for distribution for sale to consumers****.*

<u>Key considerations</u>

The Valuation Office is under an obligation to enter new facilities in the Rating List as they are occupied. They are under increasing pressure from Local Authorities to do so as they are now able to retain a larger percentage of the rates paid. The assessment should only be from the hand-over date of commercial operation, but the following represent a summary of some of the key issues that operators need to be aware of;

1. The composition of the fuel as "waste" or not is significant in the valuation approach adopted.
2. In the case of Contractors Test the Valuation Officer will normally adopt actual evidence obtained at the antecedent valuation date (currently 2008 for the 2010 Rating List), although with new or bespoke technology this is not always possible.
3. For the receipts and expenditure method the Valuation Officer will base their analysis on the projected profit forecasts, where there is no actual past track record. These may often be based on full projected capacity, which is not achieved for some time.

4. The income figures under the receipts and expenditure method include all grant funding and any revenue that might be received by the operator for the acceptance of the fuel.
5. The Valuation Officer has scope to consider allowances for "new technology" facilities, where the plant is expected to require a period of review and redesign to reach full commercial operation.
6. The final apportionment of the profit will take into account the tenants depreciation on non-rateable items and the expected rate of return. The former may be easier to evaluate but both are normally assessed on an industry standard. Where there is no clear established trend for new bespoke sectors of the industry, this could lead to disagreement.

With the establishment of more facilities the base evidence will become clearer, but it is possible that the Valuation Officer may make decisions based on incomplete information or assumptions. This is complicated by the need to adjust any current data back to the values date in 2008.

<u>Case Examples</u>

AD Plant – waste food fuelled, with notional re-build cost of £3.5M on the rateable items, equates to £175,000 RV, plus £25,000 RV for the land to give a total Rating List entry of £200,000 RV. Based on the English 2014/15 multiplier of 48.2p gives current rates payable of £96,400 per annum. The bulk of the value is commonly in the large digester tanks.

Landfill Gas – annual therms consumed are converted to RV at approx. £3.60 RV per 1 MW/hr. Additional element for fixed site infrastructure will give typically £35,000 RV for a 1MWe plant and rates of around £17,500 per annum.

Wind Farm – assessed on receipts and expenditure method utilising annual income including grants and subsidies. Costs deducted will include operating costs and depreciation on tenant's capital items. Gross profit apportioned between landlord and tenant. Expected wind load factors applied can have significant impact on new facilities. A Welsh wind farm at 15 MWe installed is valued at typically £15,000 RV per MWe, so £225,000 RV at the 2014/15 Welsh multiplier of 47.3p gives £106,400 rates payable.

Biomass Plant – assessed on receipts and expenditure method utilising annual income including any potential gate fee revenue attached to receipt of fuel. The typical range is around £40,000 RV per MWe, although there is a wide range of fuels, capacities and locations. Example of wood fuelled plant at 15MWe could be £600,000 RV giving say £300,000 per annum rates payable.

<u>Looking Forward</u>

With the valuation basis for the forthcoming 2017 Revaluation tied into a snapshot of the market in 1st April 2015. New projects now being commissioned will provide the key evidence base for all assessments in the 2017 Rating List period to 2022. The Valuation Officer will therefore need to establish where there is evidence to set the "tone" for the new Rating List. As there is a two year period before the List comes into effect this will give some opportunity to lobby and seek to influence their preparations. A draft List will be published in advance, so it should be able to establish the range of figures for those facilities that are already assessed and subject to Revaluation.

Collection of the following evidence as at 1st April 2015 is likely to be key to any future opportunities to challenge rateable values in the 2017 Revaluation;

a) A "State of the Industry" summary for each technology.
b) A schedule of the market costs and pricing for inputs and outputs.
c) A comparison between established and emerging technologies.
d) An analysis of the expected rate of return by sector.
e) A snapshot on the current expected forecast projections for the next
f) A List of construction contracts that provide the current best evidence.

Although there will be a General Election soon after the 2015 Antecedent Valuation Date it is not expected that any future government will make significant changes to the principles of assessment and collection of business rates. There may be small adjustments to the supplementary charges, although based on past experience the charges will remain just under half what is considered to be the market rental for the site.

GVA have provided the above for the benefit of members of the REA and to highlight the background and key issues involved. We have widespread experience within the field and have advised on a range of technical and budget requirements for our clients. For further clarification and specific advice please contact me on 0207 911 2849 or at mark.deans@gva.co.uk to discuss how we may be able to assist.

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