Annex M: Retained Business Rates Assumptions and Methodology

Introduction

Business rates (also known as the national non-domestic rate) are based on the rateable value of a commercial property, which is a proxy for the annual rent that it could let for on the open market. The tax is calculated by multiplying rateable values with the Uniform Business Rate (UBR), which is a multiplier set by central government.

Rateable value is the open market rental value based on an estimate by the Valuation Office Agency (VOA). Rateable Values are updated by the VOA usually every 5 years to reflect changes in the property market. It should be noted that the Government's recent business rates review includes plans to move to 3-yearly revaluations from 2023.

The standard business rate multiplier to be used where the rateable value is £51,000 or more is 51.2p in the financial year 2021/22.

In practice, the multiplier is inflated by CPI each year between revaluation dates. Any increase in average rateable values at the point of revaluation are 'neutralised' by reducing the business rates multiplier. The most recent revaluation came into effect on 1 April 2017 based on rateable values from 1 April 2015.

Local authorities will be permitted to retain the growth in non-domestic rating income in the Freeport tax sites, guaranteed for 25 years above an agreed baseline. In recognition of the pan-Solent approach to delivery of the Freeport, all four Local Authorities (Eastleigh Borough Council, New Forest District Council, Southampton City Council and Havant Borough Council) have agreed to pool the retained business rate growth generated on the Tax Sites (Dunsbury Industrial Park, Navigator Quarter and Southampton Water). This commitment to pooling was outlined in the Memorandum of Understanding (MOU) agreed by the four Relevant Authorities that will collect Retained Business Rates within the Tax Sites, Portsmouth City Council in its role as Accountable Body, the Solent LEP and the SFCL and is reiterated in the letters included in Annex F of this FBC.

Section 1.4.3 Retained business rates provides further detail around the 'mechanics' for making retained business rates available for Freeport programmes and projects, and the structures and processes that will be put in place to determine how the funds will be deployed over the 25-year retention period. It should be noted that this FBC does not identify the specific schemes or projects that will be funded from retained business rates over the 25-year retention period.

Financial Model

A financial model has been built in Microsoft Excel with the purpose of forecasting the quantum and timing of retained business rates across the Freeport Tax Sites. The financial model consists of a quarterly timeline throughout the Freeport set up period and operational phase covering a modelling horizon to financial year 2046/47.

The forecast retained business rates income is used in the financial model to meet the costs of Freeport Operations (incl. the operating costs for SFCL, the administrative costs for Ratings Authorities and the Accountable Body, and contingency). The MOU shows the remaining retained business rates income will be used to invest in Skills, Net Zero, Innovation, Regeneration and

enabling infrastructure and Local investment priorities (also known as the 'Core Investment Programme'), which is the principle purpose of the retained business rates as a Freeport policy lever.

It should be noted that the quantum of business rates to be retained on each Tax Site will be based on the methodology established by DLUHC and calculated with reference to the designation of the Tax Site and the establishment of a baseline agreed with DLUHC. Discussions between the Local Authorities and DLUHC on the establishment of this baseline is expected to be finalised post-FBC.

It must be stressed that the retained business rates income shown in this FBC are forecasts only and will in practice be driven by the timing and pace of investment, the rateable values determined by the Valuation Office Agency (subject to appeals and review), and any future reform of the business rates system (including changes to the multiplier).

Approach

The calculation methodology applied in the financial model to estimate the value of the retained business rates income over the 25-year retention period is as follows:

Total Retained Business Rates per annum = [(New RV/per unit measure x New developable Floorspace) **–** (Existing RV/per unit measure x Existing developable Floorspace)] **X** Inflation **X** business rates multiplier **X** (1 - Provisions and contingency allowance)

The high-level estimate of the quantum and timing of retained business rates shown in section 3.1.4 is based on the latest developable floorspace assumptions from land owners. Table M1 below shows the development completion dates for each tax site (in some instances tax sites will be developed in phases so we have indicated the dates at which the earliest phase is complete) which indicates when retained business rates will begin to become available.

Table M1: Tax Site Development Completion Dates

Tax Site (Rating Authority)	Broad timing of development
Dunsbury Park (HBC)	FY23 to FY34
Navigator Quarter (EBC)	FY26 to FY28
Southampton Water - Redbridge (SCC)	By FY26
Southampton Water – Fawley Waterside (NFDC)	FY24 to FY31
Southampton Water –Solent Gateway (NFDC)	FY24 to FY27
Southampton Water – Strategic Land Reserve (NFDC)	By FY27

Key assumptions

Key assumptions used in modelling the potential retained business rates income stream are as follows:

- Business rates will be retained over the period from 1 April 2022 to 31 March 2047
- The standard business rates multiplier of 51.2p remains constant over the 25-year retention period
- Developable floorspace assumptions have been provided by landowners based on the footprint of the proposed development and reviewed by Local Authority's where the development is taking place
- Rateable Value benchmark assumptions have been provided by landowners and Ratings Authorities

- Rateable values are assumed to inflate by CPI each year. CPI is forecast at 2% per annum. This assumption is a proxy for the revaluation process i.e. it assumes that a revaluation points, rateable values are uplifted by the compounded CPI since the previous valuation.

Rateable value assumptions

Only the Valuations Office Agency can determine the rateable value of a specific property. The VOA determines the rateable value of a property once it has been completed on a case-by-case basis. The VOA may apply a number of different methodologies to estimate the open market rental value of properties. The specific methodologies that the VOA may use to determine the rateable value are not publicly available. Estimating the potential rateable value for the sample of end use propositions is therefore challenging.

Benchmark rateable value assumptions have been sourced from the Landowners and Ratings Authorities in order to estimate the rateable value for the proposed end-use propositions. The benchmark data varies for each landowner. The majority of the landowners have calculated a rateable value benchmark by calculating an average rateable value per square metre or another unit of measure for existing developments on their land.

Identifying applicable benchmarks that are specific for the end use proposition in question is particularly challenging given the unique nature of some of the propositions (e.g. port-centric manufacturing of advanced composite materials as an alternative to steel) and the fact that many Tax Site end-users will be operating in new and emerging sectors with little precedent for such valuations.

The SFCL have also worked closely with Ratings Authorities who have reviewed and provided challenge to the estimated baseline for retained business rates. In several instances this led to the RVs being revised down.

Net retained business rates income

Per DLUHC's Business Rates Baseline Template, we recognise some businesses may be eligible for business rates reliefs (outside of the ones available through the Freeport policy levers). We also need to consider provisions for bad debt and appeals. Indicative provisions and contingency allowances for these specific risks are set out below. This is based on historical averages from the Accountable Body, Portsmouth City Council and agreed by the four Ratings Authorities:

Table M2 Provisions and contingency allowance assumptions

Provision/ contingency allowance	Assumption
Bad debts provision	2%
Appeals provision (current government guide 4.7%)	5%
Voids Provision	5%
Total provision	**12%**

For the avoidance of any doubt, the forecasted retained business rates in Section 3.1.4 reflect the net retained business rates income after accounting for the provisions and contingency allowances noted in the table above.