Appendix:
Unmodelled costs report

YKY-PR24-DDR-12-CE-Unmodelled-cost-report-appendix

YorkshireWater

Lambert Smith Hampton

6th August 2024

T +44 (0)121 236 2066
www.lsh.co.uk

Lambert Smith Hampton
Interchange Place
Edmund Street
Birmingham
B3 2TA

[redacted]
Yorkshire Water Services Ltd
Western House
Western Way
Halifax Road
Bradford
West Yorkshire
BD6 2SZ

Our Ref: MLC/eaa

[redacted]

Re : Rating Revaluation 2026

Further to our recent discussions I set out below my thoughts with regards to the 2026 rating revaluation which will take place on the 01 April 2026 based on an antecedent valuation date of the 01 April 2024.

Looking specifically at the water industry and in particular water and sewerage companies (WASC's), portfolios incorporate a range of property types although the 2 asset classes which incur the greatest rate liability are the water supply networks and waste water treatment works.

Both asset classes are specialist in nature and rarely if ever traded in the open market and where there is a lack of if any conclusive rental information on which to base an assessment. They are not as a result, valued by reference to traditional valuation methods and I discuss each class in more detail below.

Waste Water Treatment Works

This classification of property is valued by reference to the contractor's basis of valuation, the overall aim of which is to arrive at the effective capital value (ECV) which is then converted into annual rental value. The underlying theory behind the method is a cost exercise related to the notional reinstatement of the actual works subject to the valuation being suitably adjusted.

The principal issue for this classification is the indexation of the civil costs. As a guide we have looked at the BCIS General Civil Engineering Cost Index which between the years April 2021 and April 2024 namely the antecedent valuation dates for the 2023 and 2026 rating lists increased by 24.9%. Thus, it would not be unreasonable to expect assessments to increase by the percentage suggested.

As we are aware, the VOA have had reference to different indices on previous revaluations but for the 2023 rating revaluation they took advice from an external cost consultant which resulted in a significant increase in the value applied to individual assets on sites. So, whilst BCIS provides a guide, assessments could increase over and above the indexed changes outlined should actual costs of assets found on a waste water works such as steel tanks, digesters or steelwork be identified and support such.

The assessment of waste water sites will also be impacted by capital investment programmes. The ongoing and continual improvement of processes to satisfy compliance procedures result in the construction of new assets which when operational invariably lead to increases in assessment over and above that for an existing works.

Another potential factor which will impact on an assessment at revaluation is the statutory decapitalisation rate which converts the capital cost into a rental equivalent. The current rates were set in calendar year 2016 for future rating lists and remained unchanged for the 2023 revaluation at 4.4% for all properties other than education, healthcare, and defence where the rate is set at 2.6%. There has been no suggestion at this stage that the existing rates will change.

In addition to the actual valuation mechanism there are external factors that will impact on 2026 and in particular, legislative changes introduced by the government. The Non-Domestic Rating Act 2023 has implemented various changes to the system of non-domestic rates including a new "duty to notify" provision which is being phased in, making it mandatory for ratepayers to notify the VOA of any changes to a property that may affect its rateable value and the requirement to provide information on property where a party would be the ratepayer if it were included in the rating list. These changes will have particular relevance to sites that have never been assessed or those where significant changes have been undertaken but not previously picked up by the VOA.

Clean Water Sites

Water supply networks are valued by reference to the receipts and expenditure method of valuation. The method is based on the trading receipts and expenditure for the property as the rent for such is likely to be driven by the actual or anticipated profit of the business carried out at the property.

The valuation model for this classification has evolved over the course of the last 4 rating revaluations and it is our understanding from the lead valuer within the VOA that it is their intention to use the same model that was adopted for 2023 when carrying out the 2026 revaluation.

The mechanics of the valuation are such that expenditure is deducted from receipted revenues to give a divisible balance which is then split between the tenant, as tenants share with the remaining balance the landlords share or rent/RV.

For Price Review 24, it is my understanding that revenues are increasing to fund capital investment programmes as part of the process of upgrading water and sewage systems and yet operating costs I understand will not increase as significantly as revenues. As a result, the gap between revenues and operating costs will widen and when inputted into the receipts and expenditure valuation model highlighted above it will inevitably result in the divisible balance increasing.

Furthermore, in order to apportion the divisible balance, the tenants' share is determined by reference to a return on capital approach by applying a WACC to the value of the tenants' assets. Although the WACC at 3.72% has increased over the revaluation period, it is still considered too low and thus will give a lower tenants share thus leaving a greater proportion of the divisible balance as landlords share or rent.

Given the abovementioned factors it is not unreasonable to expect a significant increase in the assessment for the water supply network at the 2026 revaluation.

Uniform Business Rate

The uniform business rate (UBR) is set by government and increases annually in line with CPI (formerly RPI), albeit given the challenging economic climate it remained static through the period 2020/2021 to 2023/2024. At revaluation it is re set to deliver the same tax yield in real terms to the government. The level at which it is set depends on the movement in all rateable values over the revaluation period. Following revaluation 2023 the figure remained static although increased in 2024/2025. There has been no indication at this stage as to the likely level of UBR at revaluation but if values remain static and based on current levels for CPI it would not be unreasonable to expect a rate in excess of 55p in the £.

Yours sincerely

[redacted]

[redacted]
Director

[redacted]