CONFIDENTIAL

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The Rt Hon Nigel Lawson MP
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Ch/X and H alarming. We have commissioned urgent advice on all this report 2/3

Dear Nigel

VALUATION FOR RATING: THE "ADDIS" AND "CAKEBREAD" CASE

You may recall that Peter Walker briefly mentioned the "Addis" case in Cabinet on 25 February. I am now writing to seek your and copy addressees urgent agreement to a change in rating law, with immediate effect from the date of an announcement, to reverse the recent House of Lords judgement in this case, which concerned the basis on which properties are valued for rating between general revaluations. The change would be given effect by amendments to the Local Government Finance Bill. Without it, there will be a continuing serious loss of income for rating authorities, and an unmanageable increase in Valuation Office workload at the same time as they are preparing for the 1990 revaluation. There is also a Court of Appeal judgement in another recent case ("Cakebread") which will similarly result in a loss of rate income to authorities for no good reason, and which I propose to reverse from 1 April 1988.

Background: Addis

The law provides that when a property is valued between general revaluations, as for example if it is new, or on appeal, it shall be valued as it would have been at the last general revaluation except that the state of the property and locality is taken as at the time of the actual valuation. Thus - in order that those valued later do not face higher values as a result of general inflation - the general level of rents, or "tone of the list" is taken to be as it was in 1973. The way this has been interpreted in practice is that the valuer looks at the physical state of the property and area as it is now, but considers what it would have been worth in the world of 1973. Thus it has always been thought that economic shifts since 1973 - eg the recession in manufacturing in the North - could not be taken into account between revaluations. We had proposed to retain these provisions for the new system, but, of course, with a return to quinquennial revaluations. The words at issue in the "Addis" case are repeated verbatim in the Bill.

The "Addis" case concerned a factory close to but outside an enterprise zone in Swansea. It was agreed that the value had fallen by about 20% following the establishment of the zone in 1981. The case turned on whether this was a matter of the "state" of the locality, or of the "tone of the list". The House of Lords, overruling the Court of Appeal, held that it was the former, and could therefore be taken into account at once. In doing so, they appear to have remade the law, and given us an entirely different valuation system, in which apart from the value of money, the crucial distinction between matters to be taken as at the date of the list, and matters to be taken as they are now, no longer has any clear meaning.

Consequences of the judgement

So why on earth did no-one give any thought to what we should do if appeal successful?

The consequences are both direct and indirect. Firstly, direct, there are some 8000 appeals relating to properties near to enterprise zones, many dating back to 1981, which have been held in abeyance pending "Addis". These will now be decided in favour of the ratepayers, who will be able to recover rates overpaid in past years. The affected local authorities - some of the 20 or so in the near neighbourhood of EZs - will have to meet these repayments. We can as yet quantify the amount at stake only very roughly. The Chief Valuer's Office's provisional estimate is that the loss of rate income is around £12m pa, and that with backdating, it could amount to around £35m. At national level, this is not very significant, but for some authorities, the amounts could be very large: £5-10m or possibly 10% of their annual rate yield. Under present practice, authorities would normally get no compensation through block grant for past years, and will have to increase their rates to recover these amounts. They will, with some justice, blame the increases entirely on the Government which set up enterprise zones. [But why should Govt be held responsible for their failure to plan for contingency of successful appeal?] Secondly, indirect. The principles which the House of Lords applied in Addis appear capable of far wider application. The judgement refers to "intangible factors affecting the state of the locality". It seems to us that on this basis it would be open to, say, the occupier of a warehouse in Liverpool to argue that the switch of trade to the east coast ports was a matter of "state" rather than "tone". Appeals on this basis would not be backdated before April 1987, but could start to go down now that the judgement is public; there is an incentive to get them in by 31 March to get the benefit for the full 1987/88 financial year.

The implications for both rate income, and Valuation Office and tribunal workload, are potentially very serious indeed. Effectively, the system of general revaluations would be overridden, and there would be continuous rolling revaluation at the initiative of the ratepayer. Manufacturers in the North could appeal now to secure the benefits we are expecting them to get in 1990. (In principle, these losses could be offset by Valuation Officers proposing increases for those whose values ought to be higher, but in practice they have no capacity to do this). The non-domestic rate base would be seriously eroded for the last

three years of the old system, and other ratepayers in the affected areas, including domestic ratepayers, would have to pick up the bill, probably without any offsetting increase in grant.

The implications for the new system are not much less serious. Loss of rate income ceases to be such a problem, since the changes would in any case have taken place on revaluation. The problem of Valuation Officers having to deal with a continuing flow of appeals relating to changes in the economy, while at the same time coping with the peak resulting from the 1990 revaluation, would however remain.

Proposed course of action

I do not think that we can live with these consequences of the judgement. There will be a continuing serious loss of rate income for 1988/89 and 1989/90, possibly much more than £100m pa if my fears about the wider implications are realised. There is also likely to be an intolerable increase in Valuation Office workload at a time when they should be concentrating on the 1990 revaluation.

The action that would be required is to amend the General Rate Act 1967, s.20, to make clear that when a property is valued between revaluations, the only factors to be taken into account as at that date are, broadly, physical changes in the state of the property or amenities of the locality, not intangible matters affecting the general level of rents in the area. I have yet to consult Parliamentary Counsel, but I think that broadly the desired result can be achieved. The same provision would be made for the post 1990 system. The changes would be made by way of amendments in the Lords to the Local Government Finance Bill; subject to the House authorities' views, this appears to be within the scope of the Bill.

If we are to act at all, we need to act fast. The reason for this is that now the judgement is public, professional rating surveyors will soon become alert to the wider implications, and we can expect them to be urging their clients to put in immediate appeals, since those made before 31 March secure backdating of any reduction to 1 April 1987. An amendment operating from 1 April 1988 would therefore not be effective in heading off the upsurge in Valuation Office workload, and would lead to a further loss of rate income for 1987/88.

I therefore propose that I should make an early announcement that the law will be changed to reverse the judgement with effect from the date of the announcement. What this means is that any proposal for a change in valuation made after that date would be considered on the new basis, ie on the same basis as before Addis. Proposals made before that date would be considered as required by the judgement: strictly speaking, the Valuation Office could then serve counter-proposals reversing those changes with effect from the announcement date, but given the impending general revaluation I envisage that they might refrain from doing so.

There are bound to be loud protests from the Opposition and private rating surveyors that not only is the Government once again overturning a judgement it doesn't like, but also that this is retrospective legislation, even though it would not affect any appeals made before the date of the announcement and would apply only to the current and future financial years. I believe, however, that the approach is justified by the scale of the problem and by the odd nature of the rating appeal system which means that appeals lodged on 31 March can have their effect backdated for up to 12 months. I should, however, be particularly grateful for Patrick Mayhew's comments on this aspect.

"Cakebread"

This is a much simpler case, without the far-reaching implications of Addis. The Court of Appeal has held that an unintended by-product of the legislation setting up water authorities in 1973 was to change the scope of a reference in the General Rate Act so that the rates the authorities pay centrally are deemed to cover sewage works, offices etc as well as water supply, although the basis on which these amounts were calculated has no regard to these factors. The direct loss is larger than for Addis, around £100m for past years and £40m pa continuing loss. There is no reason on the merits why water authorities should receive this windfall, which effectively means that sewage functions are not rated. It would however seem oppressive to claw it back for past years, and there is no point in acting from the date of an announcement since all water authorities will by now have entered their appeals. I therefore propose to reverse the position with effect from 1 April 1988.

Losses for past years

There is a rather separate issue, of the amounts of money that rating authorities with enterprise zones will lose through having to reimburse the 5000 successful appellants for overpayments in past years back to 1981. They will no doubt press us to reimburse them, either by re-opening the RSG settlements for those years or by some other means. They will argue that there is a moral obligation, both because the losses result indirectly from the Government's enterprise zone policy, and because they would have been compensated through RSG if the reduction in rateable value had been known at an earlier stage. As noted above, I cannot yet fully quantify the problem, in particular not as it affects individual authorities, nor how serious the pressure will become. I am afraid the case for compensation is very compelling. The losses arise directly from the imposition by Government of the enterprise zones. We already accept that losses of rate income arising within the zones should be fully compensated for. I would find it very difficult to justify not providing assistance with the direct carry over costs associated with the enterprise zones.

There are at present no powers to give such compensation and I would need to take one. I suggest this might best be achieved by amending the existing specific grant power within Schedule 32 of the 1980 Act. Where other losses arise, either from the decision

of the House of Lords, or the "Cakebread" case, which are not directly connected with the existence of an enterprise zone, I would propose to take the line that the existing provisions in Section 67 of the Local Government Planning and Land Act 1980 - which are provided for just such a purpose, should be followed through where appropriate. That would involve compensating authorities where annual losses amounted to more than 2½% of rateable value.

Conclusion

I should therefore be grateful for your and copy addressees' agreement to my reversing the Addis and Cakebread judgements by amendments to the Local Government Finance Bill, and for the amendments in the case of Addis to be effective from the date of an announcement, which I would hope to make by 8 March. I should also be grateful for agreement to announce that we propose to compensate for losses arising from the existence of an enterprise zone. I should therefore be grateful for your views no later than 4 March.

I am sending copies to the Prime Minister, to other members of E(LF), to the Lord Chancellor, to the Attorney General, to First Parliamentary Counsel and to Sir Robin Butler.

NICHOLAS RIDLEY