WSX-C23 – Business rates

Response to Ofwat's PR24 draft determination

Wessex Water
YTL GROUP

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Representation reference: WSX-C23

Representation title: Business rates

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1. Summary

The position on business rates included in the draft determination (DD) is not consistent with the current rating methodology.

The rateable value is a function of the real RCV growth and the allowed returns for water supply. For wastewater, it is based on the replacement cost of existing assets as determined by the Valuation Office Agency and the additional capital investment. In addition, key aspects of the Non-domestic Rating Act 2023 are scheduled be introduced in 2026 which is likely to have a significant impact on wastewater.

The above factors create significant upward pressure over the next five years. These pressures will be further exacerbated due to the existence of 3 business rating lists (2023, 2026 and 2029) during the period.

We, and the industry, provided a range of empirical analyses to demonstrate the expected increases in business rates over 2025-30.

Our work was based on a clear rationale of how the Valuation Office Agency would likely set out rateable values over 2025-30 and reflects the increase in capital spend and increase in allowed returns.

We would encourage an updated view on business rates that takes this empirical evidence into account, given this is a known cost that can be estimated today.

As proposed the DD does not give the company any opportunity to manage this risk, creating a downward skew in the exposure over 2025-30.

Updating our proposed business rate models, accounting for information that was known at the antecedent date results in the forecast for business rates set out in Table 1 that we have included in our plan.

Table 1 – DD response business rate proposal

	DD allowance (£m)	DD response (£m)	Change (%)
Water supply	56.8	70.5	+24%
Wastewater	62.9	84.5	+34%

Alongside this representation we have included our business rates model (see WSX-C23 – Appendix) that can easily be applied across the industry.

2. Water supply

The next cumulo rate valuation period is due to begin in 2026. As of today, we see no reason to assume a different methodology as the antecedent date of 1 April 2024 has passed. This date is the reference period for the 2026 list and all known information at the antecedent date should be used to determine the rateable value.

At that date, Ofwat had already shared its early view of the WACC which was higher than the one used for the 2023 list (which had a 2021 antecedent date and used PR19 Final determination data). Not reflecting this is inconsistent with other areas decisions reflecting future changes.

In line with previous lists, the VOA have adopted a simplified model to determine the level of rateable value when the antecedent date does not align with Price Reviews. These models have been shared by the VOA and were used by the VOA to agree the 2017 and the superseded 2021 valuation list. We have continued to use this model as part of the PR24 both for the original submission and this submission.

The principle underpinning this approach is that the profit for the water supply hereditament can be proxied by considering the RCV and the WACC. This can then be allocated following an established methodology between the hypothetical tenant and the landlord.

For the valuation period we have considered the average RCV, which is then multiplied by the wholesale WACC to give a divisible balance. We have then applied a tenant's share based on the latest asset split, and adjusted for a 15% risk premium, as included in the current valuation (even though not guaranteed), before subtracting the expected hereditaments to give a forecast RV. To which we apply the 22-23 UBR to give a forecast business rates bill in 22-23 prices.

Full details are included in our supporting business rates model.

3. Wastewater

For wastewater, the business rates liability is determined on a site-by-site basis, using the contractor's test. Under the principles of the contractor's test, most of the assets on a site are valued using the VOA's cost guide for each individual item. The value of each item is dependent on the size and type of material used. The VOA's costs guide is determined by the VOA at each antecedent date and indices have demonstrated that the prices have historically increased at rates above inflation. This means that absent anything else, the business rates liability will increase above inflation over time. Our model reflected this which was particularly important as we have a further 2 revaluation periods during the period 2025-30.

In addition to this, as evidenced by the company's business plan, significant expenditure is due to be incurred across the wastewater assets. None of this expenditure has been incorporated in the existing rateable value which will have a clear impact on the business rates liability.

In addition the Non-domestic Rating Act 2023 is expected to have a significant impact on the timing of the increase in business rates liability and also the level of information required to be provided to the VOA. The Duty to notify will put significant burden on companies and also accelerate the timing when assets will be included in the rating list.

To reflect this, we have increased our rateable value each year by the forecast real RCV growth. Similarly to water supply we apply the 22-23 UBR to give us a forecast business rates bill in 22-23 prices.

Full details are included in our supporting business rates model.

4. Customer protections

We recognise that there is ongoing uncertainty around the future of business rates with the introduction of the Non-domestic Rating Act 2023 and proposals from the New Government to reform this area. Although it is not certain we expect the overall business rates burden to increase for sectors such as ours.

If an assessment, reflecting a consistent VoA methodology is undertaken then, the proposed sharing rates offer an appropriate allocation of risk between companies and customers.

However, if assessment was as per the DD, the increased cost sharing does not provide sufficient protection. Even if companies only bear 10% of overspend, this will represent a significant cost which will have to be self-funded when significant other investment is required. This is not an allocation of risk that is consistent with an overall balanced package.

At its worst this will divert investment away from delivering key customer benefits to business rates.

In this scenario the only equitable way forward is that business rates are treated as a passthrough cost for the period 2025-30 and with a review of the business rates process undertaken ahead of the next price review. In order to deal with the significant adverse cashflow disadvantage, it is our conclusion that business rates should be included within the annual in period determinations.