# COUNCIL RATES

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#### THE FRAMEWORK

 "The world of rating appears, to one unfamiliar with the arcane, to be cloud cuckoo land, a world of virtual unreality from which real cuckoos are excluded (although it seems that permission to land will be granted to a cuckoo flying in from the real world if it can demonstrate that its presence in cloud-cuckoo land is essential, not merely accidental)."

China Light and Power Company Ltd. v Commissioner of Rating and Valuation [1996]

### THE SYSTEM

- The rates system in Ireland is designed to tax commercial property at local level by way a rental based assessment.
- Rates demands consist of two elements: a) the valuation and b) the council's multiplier (ARV).
- Assessments in a rating area are all valued at the same base date, to ensure equity and uniformity.
- The ARV is set by dividing the total of all the valuations in a given rating area into the total amount that the council needs to raise.

## THE PROBLEM

- There is no rental evidence for wind farms.
- That is not to say that projects do not have a 'rented' element i.e. the land but this does not reflect the rented scenario envisaged. The idea is that a hypothetical landlord builds an entire windfarm with the specific purpose of letting it to a tenant.
- In the absence of rental evidence, there are only 2 accepted ways of establishing a notional rent:
  - a) Receipt and Expenditure
  - b) Contractors
- The reality is that both methods, unadjusted, give very high values as the income is high relative to annual costs, and the construction cost is substantial.
- Though both methods have been discussed by all parties ad nauseum, the system has concentrated on receipts and expenditure.

## RECEIPTS AND EXPENDITURE (R&E)

- The idea behind a receipts and expenditure valuation is to reach a net profit, known as divisible balance, to split between the landlord as rent and the tenant as his profit.
- The method traditionally focuses on the property's own accounts and fundamentally consists of 4 stages:
  - a) Income
  - b) Expenditure
  - c) Divisible balance
  - d) Stand back and look

## INCOME - THEORY

- Hypothetical income for wind farms consists of two elements: Generation (MWh) x Contract Price(€/MWh)
- Instead of using individual PPA values, the Commissioner and Valuation Tribunal have concentrated predominantly on REFIT reference prices, with an addition for the balancing payment.
- The megawatt hours are generally established on a 3 year average prior to the valuation date, or if such is not available, wind energy reports.

## INCOME - PROBLEMS

- As and of this moment, there are significant issues with curtailment and constraint in the market, which are not reflected adequately by the Commissioner.
- Equally, if 3 good years are used to create the average for generation, it may not be fully reflective of the true state of the project over the lifespan of the assessment.
- In regards to the contract price, problems have predominantly arisen in the case of the balancing payment and i-SEM. At the present time, the Tribunal attributes 100% of the balancing payment to the generator, which is unrealistic and not borne out by market PPAs. Equally, there has yet to be any allowance for i-SEM, which compromises the contract price still further.

## EXPENDITURE - THEORY

- Any legitimate expenditure of the hypothetical tenant is allowable. The key to this, however, is 'tenant'. A tenant does not incur any of the following costs:
  - 1. Capital financing (i.e. loans to banks or investors)
  - 2. Depreciation
  - 3. Rent (as the calculation is designed to find the rent)
  - 4. Directors Remuneration
- This changes the parameters of the costs considerably. Ultimately, the tenant will have to replace the turbines at the end of their useful life, and therefore a sinking fund is created for this. This is effectively 'depreciation-lite' as only the turbines and not the grid connection etc. form part of the allowance.
- The system also allows for tenant's chattels, which is effectively what a tenant would have to spend on items specific to the project.

# EXPENDITURE - PROBLEMS

- The principle problem with expenditure in windfarms is that it rises year on year in almost all instances. This is primarily due to maintenance of the wasting asset.
- Therefore, if one looks at the costs pertaining to a 3 year old wind farm and uses these to inform a bid for the following 10 year period, one would substantially underestimate the actual costs which would be incurred. Instead, one must attempt to reasonably define the costs over the lifetime of the rental bid something which the Commissioner denies.
- The Commissioner seeks to apply a flat cost of €15-16/MWh for costs with no regards for individual costs, nor the rising nature of same.
- The Commissioner refuses to accept the Tribunal's judgement that the sinking fund should be established over 15 years, as opposed to 20 years.
- The Commissioner is also seeking to cap tenant's chattels at a maximum of €100,000 total, having been previously €12,500/MW installed with no cap.

## DIVISIBLE BALANCE - THEORY

- Once the legitimate expenses have been deducted from the revenue, one is left with the net profit which must be shared between the landlord (as rent) and the tenant (as profit).
- In reality, these deals are not done but if they were they would be done on an even split 50:50, which is where best practice evolved from. Nonetheless, over the years, the divisible balance has been split different ways on a number of different types of property, including:
  - Nursing Homes (55:45)
  - Toll Roads (90:10)
- Ultimately, the higher the landlord's share as rent, the higher the rates as they are charged on the rent.

## DIVISIBLE BALANCE - PROBLEMS

- The Commissioner of Valuation originally assessed wind farms on a 70:30 split.
- The Tribunal ultimately judged the appropriate split to be 65:35 for large wind and 60:40 for single turbine small wind.
- The Commissioner has refused to accept the Tribunal's decisions in regards to the divisible balance.
- All of the above ignores the fundamental fact that if a deal like this were to ever be done in the real world 50:50 would be most likely.

## STAND BACK AND LOOK - THEORY

- Once a rental valuation has been reached, one must stand back and look at the resultant value to ensure that it accords with similar properties and/or businesses.
- In wind farm context, the obviously means other wind farms but can also mean other forms of generating plant, as they all produce the same product in the same market.
- If the valuation does not accord, it should be scrapped in favour of a new approach, or adjusted as appropriate.

#### STAND BACK AND LOOK -PROBLEMS

- The Commissioner and the Tribunal refuse to carry out this exercise.
- The Commissioner compares wind with wind only. In effect, this is a fait accompli, as all wind farms are valued by the same scheme hence they will naturally all accord with one another.
- The problem, naturally, is that the wind farm valuations do not remotely accord with the valuations as applied to other forms of generation (normally 200-300% premium).
- The Tribunal have attempted to dodge the question by referring to section 19 (5) of the Valuation Act 2001 which states that comparison must be made with properties from the same rating area – i.e. if there are no other forms of generation in your county, you can't even attempt the comparison.

# COMMISSIONER VS TRIBUNAL

	LARGE WIND		Small wind	
	Valuation Office	Tribunal	Valuation Office	Tribunal
Income (€/MwH)	76.6	52 80.18	82.99	82.99
Costs (€/MwH)	1	Per project's own 6accounts	16	Per project's own Saccounts
Sinking Fund	€1m/MW @ 2.5% over 20 vears	€1m/MW @ 2.5% over 15 years	€1m/MW @ 2.5% over 20 vears	€1m/MW @ 2.5% over 15 years
Tenants Chattels	, €12,500/MW, capped €100,000	, €12,500/MW, no cap	€12,500/MW, capped €100,000	, €12,500/MW, no cap
Divisible Balance	Landlord 70% : Tenant 30%	Landlord 65% : Tenant 35%	Landlord 70% : Tenant 30%	Landlord 60% : Tenant 40%

# QUESTIONS?