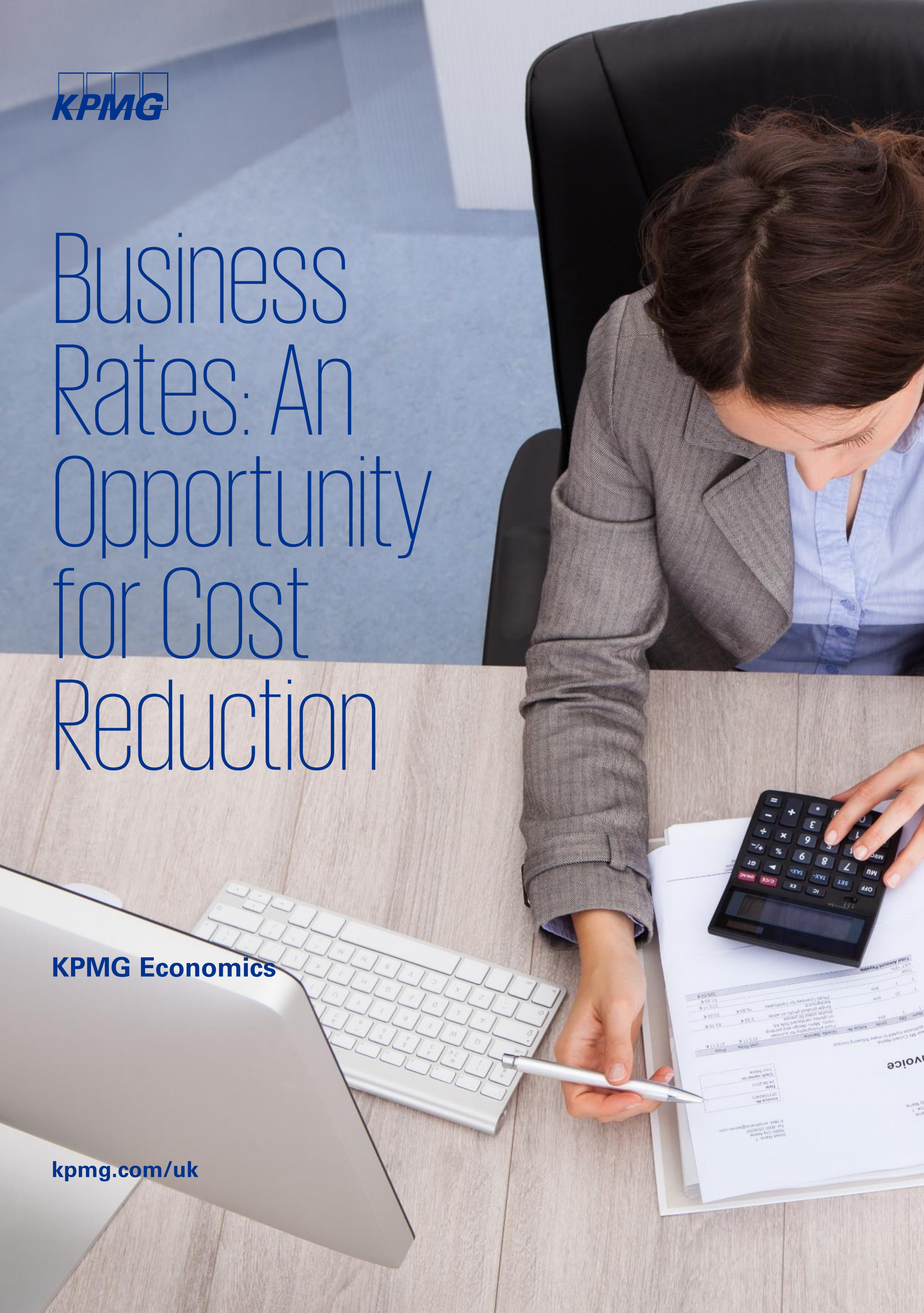


Business Rates: An Opportunity for Cost Reduction

KPMG Economics

kpmg.com/uk

What's the issue?

What is it?

- Business rates are a tax roughly equivalent to household council tax paid to government for property not in domestic use.
- Business rates represent one of the largest cash Opex costs.
- The business rates liability is a product of the Rateable Value of an asset and the Uniform Business Rate (UBR).
- KPMG can provide expert advice on how to manage the Rateable Value, and therefore overall non-domestic rates liability.

How much is it?

- Business rates represent roughly 10% of Opex.
- Companies tend to spend significant amounts on business rates but also may regard the cost as 'non-controllable'.

Why now?

- Rateable values are usually assessed every five years. The next assessment period starts in 2017, after a two year delay.
- The forecasts for the next rating period are based on data available in March 2015.

Why us?

- We understand the rating environment.
- Our team combines strong industry, economic, financial and operational expertise and can leverage our practical knowledge for your benefit.
- We have a strong track record of developing independent analysis to support disputes and negotiation processes.
- **We use a radically different approach to the business rates calculation compared to the traditional approach used by rating advisors.**
- **We will work with you and your rating advisors, bringing our world class financial and analytical skills to create the best possible factors for a successful outcome.**

A typical business pays c.10% of its Opex in business rates; we can help you make significant savings in your business rates liability.

How are business rates calculated?

The rateable value and therefore the business rates liability is based on an assessment of ‘rent’.

There are three methods to arrive at the rental value:

The rental method

— If a rental market exists for the asset type then this is primary evidence and should be preferred to all other methods. Shops and office space are assessed on this basis.

The 'receipts and expenditure’ method

— If the asset cannot be used for any other purpose and is occupied to generate a profit the “R&E” should be used. The rental value of the asset should be proportional to the cash that the asset can generate. Most large infrastructure assets are assessed this way.

The 'contractors’ method

— Usually the method of last resort. Based on the modern equivalent asset replacement cost of the asset which is then decapitalised to generate a rental equivalent.


10,791
68,051
701
6,971
196,804
11,476
18,268
6,548

The R&E construct

Estimating the hypothetical market rent

1

A hypothetical landlord and a hypothetical tenant negotiate over how much rent the tenant will pay the landlord.

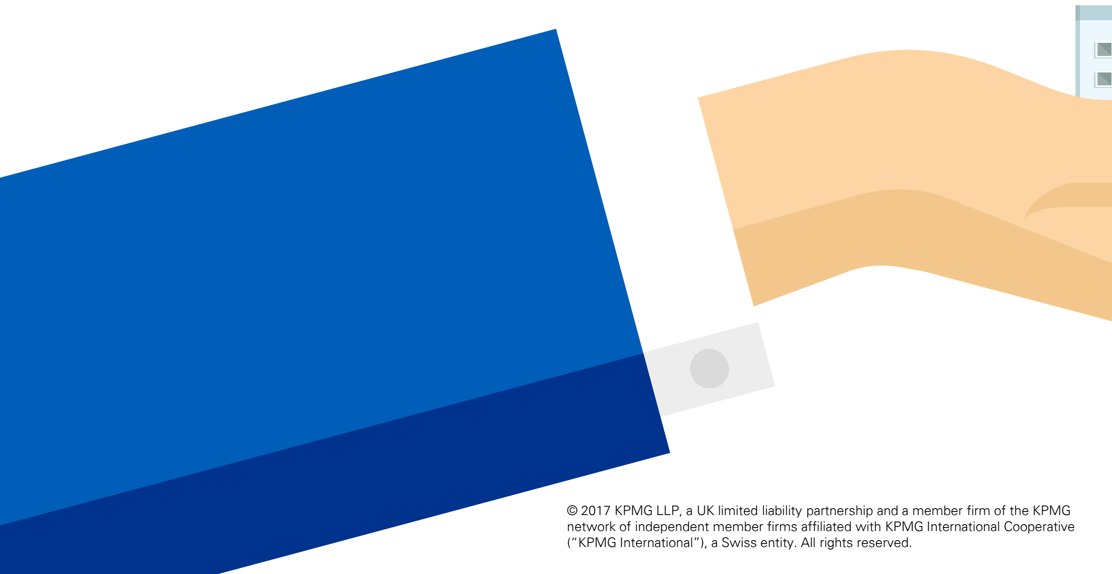
The tenant and the landlord each have assets which, when combined, generate the business revenue and cost profiles.

2

The method estimates the maximum amount the tenant would be willing to pay to rent the landlord's assets by considering the profit/cash that can be made from the business conducted using the combined assets.

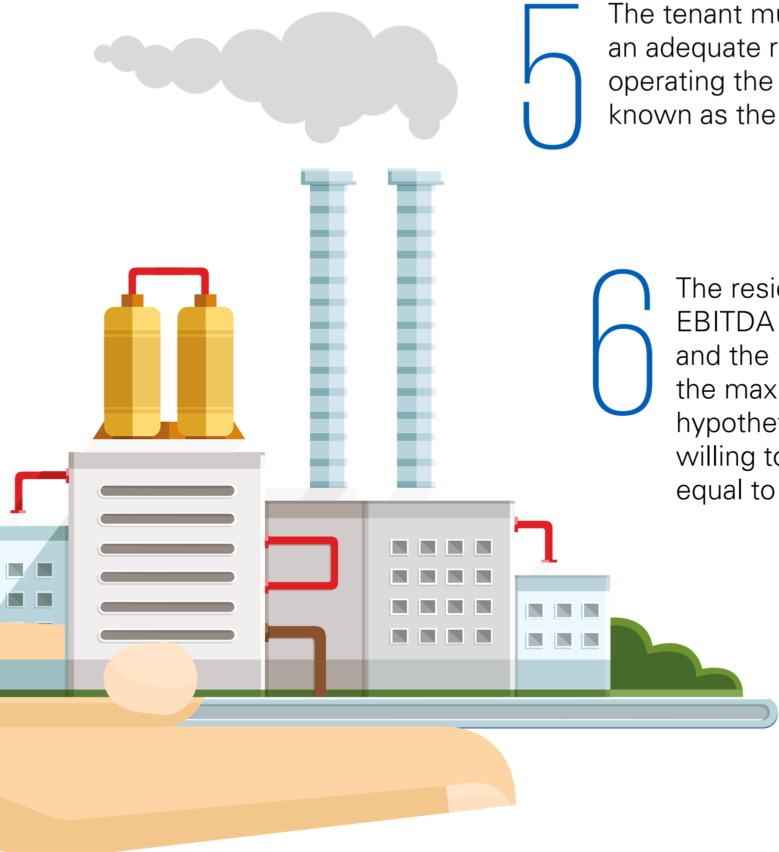
3

The EBITDA is the cash left over once the costs have been deducted from the revenues. However, this is not the amount that is bargained over for rent.



4 The tenant has a statutory obligation to maintain the landlord's assets so that they remain "in a state fit to command the rent". This is usually very different to the 'real life' maintenance spend.

5 The tenant must also receive an adequate return for operating the business, known as the 'tenant's share'.



6 The residual value (i.e. EBITDA minus 'maintenance' and the 'tenant's share') is the maximum that the hypothetical tenant should be willing to pay in rent. This is equal to the Rateable Value.

The business rates calculation simulates a negotiation between a hypothetical landlord and a hypothetical tenant. The hypothetical landlord owns the land, buildings and other typically longer life assets and the hypothetical tenant owns the IT, vehicles, electronics and other typically short life assets. The negotiation agrees the 'rent' that the hypothetical tenant should pay to the hypothetical landlord.

Next steps and considerations

Applicable time frame and time-sensitivity of project

- Business rates are based on multi-year free cash flow forecasts.
- The next rating period starts in Apr 2017.
- The forecasts for the next rating period are based on data available in Mar 2015.
- The valuation agencies will be publishing ‘draft’ valuations in late 2016.
- New bills and liabilities will accrue from early 2017.

Impact of ‘optimistic’ in-house forecasts on rateable value

- Internal forecasts built for purposes such as investor relations, regulation, planning, etc., are likely to be used for rates calculations.
- Actually, these forecasts tend to be ‘optimistic’, therefore resulting in higher rates liabilities than may be necessary.

Methodology and mitigation

- Expertise and advice regarding various rating rules which potentially lead to lower annual liabilities and refunds for historic overpayment.
- Forecasts created specifically for the purpose of negotiating rates, but aligning with a credible market story, drawing on our industry experts.
- Forecasts, calculations and analysis will be fit-for-purpose for discussion with the VOA/SAA and potential tribunal review.

KPMG risk advisory can help you minimise your business rates liability

— **We use a radically different approach to the business rates calculation compared to the traditional approach used by rating advisors.**

— We have a strong track record of developing independent forecasts, supporting negotiations and building highly credible analysis.

— Our team combines strong industry, economic, financial and operational expertise and has an excellent understanding of the issues and challenges.

— We have a long history of dealing and negotiating with regulatory and tax authorities.

Notes

Nick Morris

Director, Regulatory Finance

T: + 44 (0) 207 311 5156
M: +44 (0) 7879 631 381
E: nick.morris@kpmg.co.uk

Momin Hayee

Associate Director

T: + 44 (0)207 311 3018
M: +44 (0) 7702 834 923
E: momin.hayee@kpmg.co.uk

Sanjay Raja

Assistant Manager

T: + 44 (0) 207 694 2886
M: +44 (0) 7879 608 938
E: sanjay.raja@kpmg.co.uk

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