

Business Rates Reform

JULY 2007

"there are parts of the country where significant amounts of land and property are not in use. This seems at odds with the joint environmental and economic objectives of efficient use of developed land and efficient markets for commercial property" The Barker Review of Land Use Planning, December 2006

"the Government today announces its intention to modernise empty property relief from business rates" HM Treasury, Economic and fiscal strategy report, March 2007

"the Government's decision to restrict empty property rate relief could have significant adverse effects on commercial property... Properties are not left vacant deliberately and placing a charge on empty property will not be an effective way of encouraging the redevelopment of vacant sites... This is purely a revenue raising exercise with no thought of the potential consequences, which will undoubtedly affect many businesses." RICS view: Empty Property Rate Relief, March 2007

Response to The Lyons Inquiry

1.0 Introduction

Earlier this year, Sir Michael Lyons delivered his report into Local Government funding. A number of his recommendations could have a serious impact upon business rates payers and, consequently, rental and investment values.

1.1 It has been the Government's stated intention to implement many of Lyons' recommendations. To this end, the Rating (Empty Properties) Bill has been put before both Houses of Parliament and passed its third reading in the House of Lords on the 3rd of July. A limited consultation in respect of some parts of the Bill has now commenced (see paragraph 3.13 for more details on the consultation). It is important to note that the consultation period ends on 1st October 2007.

1.2 There follows a list of the recommendations that affect UK business rates payers, investors, developers and their consultants; we evaluate their impact and provide CBRE's response and advice on each.

2.0 Recommendation 8.2 – Local Rates Supplement

The existing national arrangements for business rates should be retained at present, but a new local flexibility to set a supplement on the current national business rates should be introduced.

2.1 Paragraph 8.73 (p304) of the final report states:

"In the short term a local supplement on business rates will increase the cost of property occupation for tenants and owner occupiers, who will have to pay higher taxes, as well as (for tenants) their current rent. In the longer term...the evidence suggests that business rates will be passed on to owners in lower rents. ...owner occupiers and landlords may see some reduction in the capital value of their property compared to what would otherwise have happened without a supplement, as a result of the value of future rents being reduced."

2.2 Impact

Currently the national rate poundage (Uniform Business Rate) is set centrally at the beginning of a revaluation. It is increased annually for each subsequent year of that revaluation by reference to the increase in RPI. The existing RPI cap on annual increases in the Uniform Business Rate will remain for the time being, and it would seem any change is unlikely before the 2010 revaluation.

2.3 The introduction of a locally set supplement on the national business rates will give local authorities the right to charge an additional amount on top of the existing Uniform Business Rate. An additional 4 pence in the pound has been talked about and this would equate to an increase in business rates liability in the order of 9% per annum.

2.4 Commentary

One of Lyons' principle desires seems to be to get commercial rents, "which are amongst the highest in the world" lower. The impact on investors, shareholders and pensions, etc. does not seem to have been thought through. Any increase in tax is compensated for by a fall in rent seems to be his objective and is justified by the observation in paragraph 8.75 (p304): *"This is a potentially significant impact for property owners and investors, although small compared to recent increases in the value of commercial property."*

Local Rates Supplement cont.

- 2.5 Lyons notes that supplementary powers should be designed in a way which can gain credibility with business and the wider community. He proposes that local authorities be required to consult local businesses and the wider community before introducing a supplement with a clear proposal and timetable. Authorities should also be required to make an assessment of the impact of a supplement on the local economy and the potential economic benefits. He also states Business Improvement Districts (BIDs) should also remain in 'shire districts and London Boroughs'.
- 2.6 Lyons stops short of handing back the power to Local Authorities to collect and spend business rates although grants a fairly sizeable concession in recommending that a portion is set locally. This will be in addition to any BIDs which may currently be in place, and have been generally been accepted by ratepayers as a positive way of raising additional revenue for specific projects. This new proposal would appear to do away with the need to identify what the additional revenues will be spent on. Local control for specific projects has long been talked about with possible business rates supplements for Crossrail, and Olympics 2012 already being lined up.
- 2.7 **Advice**
- There are no definite plans to introduce this recommendation, although the relative success of existing BIDs and the desire to introduce a measure of local control would suggest a firm commitment to this recommendation. Questions about the current level of Uniform Business Rate must be raised as this was set in 2004 for the period 2005 – 2010 and before Lyons recommendations were known. Changes to primary legislation may take some time to be enacted particularly if a consultation process is granted.
- 2.8 Ratepayers should be aware of these potential changes and that there could be as many as 2 or 3 additional supplements appearing on their rates demands over the coming months and years. CB Richard Ellis will monitor the position and provide further advice as soon as the proposed legislation becomes law.

3.0 Recommendation 8.4 – Empty Property Relief

The Government should reform and reduce the empty property relief by:

- *Retaining the existing 100% relief for short term empty property (up to 3 months).*
- *Reducing the rate of empty property relief thereafter, and*
- *Providing factories and warehouses with the same level of relief as other properties.*

3.1 Impact

Currently, once a property becomes vacant a three month exemption from business rates is granted after which rates are payable at 50% of the full occupied charge and this continues for as long as the property is vacant. There are a number of exceptions, where business rates are not payable all the time the property remains unoccupied; the most significant of these exceptions are industrial buildings (factories, workshops and warehouses), listed buildings and those buildings with a rateable value of £2,200 or less. Only one period of three months rates free is given per period of vacation - a change of tenure (from tenant to landlord for example) does not qualify for an additional three month exemption - and is granted provided there have been 6 continuous weeks of occupation prior.

- 3.2 The proposal would see full rates payable on all the main classes of vacant property following a short exemption of 3 months (6 for industrial). As mentioned above, the legislative process to introduce these measures is already well underway.
- 3.3 Exemptions to empty rates liability are provided for in the cases of vacant properties held by charities and community amateur sports clubs, provided the property appears likely next to be used for the purposes of the charity or club.

3.4 Commentary

Empty rates relief currently costs the government about £1.3bn per annum, and it would appear the reason for this recommendation is to recover the majority of this. The proposal is to end empty relief after 3 months meaning business rates on empty space are payable thereafter at 100%. It will be widened to encompass industrial property which has previously enjoyed 100% relief for the whole period of vacancy, although the 3 month rates free period will be extended to 6 months.

Empty Property Relief cont.

- 3.5 The justification for this appears to have a complete disregard for the economic cycle and the impact on investors, developers and occupiers that hold surplus empty space or empty space for future expansion: *“The increased taxation would encourage the owners of empty property to find ways to make better use of it, either through using it themselves, attracting new tenants (by reducing rents) or redeveloping the site for a new use. The effect across the economy would probably be a fall in future rents that would benefit property occupiers. This might be accompanied by a fall in capital values, which would have no impact on current owner occupiers (assuming that they wanted to continue using the same property in the future) and a positive benefit for future purchasers.”*
- 3.6 It seems extremely unlikely that large holders of property will reduce rents in order to offset an increase in taxation; maintaining asset value of the portfolio and ultimately shareholder value is likely to be paramount. It is possible, however, that incentives will become more prevalent in some markets. The increase in taxation will however present a significant additional burden and is likely to encourage landlords and holders of vacant space to explore ways of tax avoidance. We have already become aware of landlords demolishing surplus property in anticipation of the change.
- 3.7 The introduction of a full rate liability after either 3 or 6 months could potentially jeopardise speculative development, particularly if occupational demand weakens. Developers will be conscious that an increased liability will have a substantial impact on their development appraisals and will erode profit rapidly should letting periods be drawn out. Effectively, development risk is increased and this could limit supply dramatically, particularly in locations that are traditionally difficult to let where viability is already marginal. Such a manifestation will have broader negative economic impacts potentially discouraging inward investment due to limited availability of suitable (speculatively built) accommodation and make England and Wales uncompetitive compared to European competitors.
- 3.8 Development land values are likely to be reduced where letting periods are anticipated to be above the 3 or 6 month ‘rate holiday’. Those developers and valuers who have previously overlooked rates in their appraisals, or made only a minor adjustment in the yield will have to think a little harder about how they deal with this overhead.
- 3.9 Fund managers may well see fit to contact their valuers to see how they intend to reflect the changes. They will no doubt be less than keen to see a reduction in value due to this, and arguably values should not be adjusted until evidence of its effect is established in the market place.

3.10 Advice

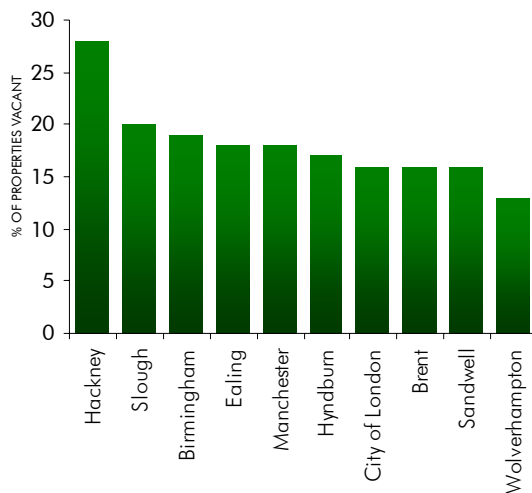
Under the law as it presently stands, there is only one certain way of avoiding rates on new buildings and this is to keep in a shell and core condition. Equally if an existing building is stripped back to shell and core and all services removed and capped at the riser, any entry in the rating list should be removed. This may influence developers and their marketing strategies, whereby only a small portion may be completed and utilised for marketing purposes while the remainder of the development might be held at shell and core and completed on an as let basis. This will probably require a change to current market practices, although may be less valid in a strong market.

- 3.11 Quite how this can be developed to encompass industrial property is a little unclear with shell and core conditions not normally associated with such buildings. We are however working closely with our Building Consultancy Division and will be pleased to advise on receipt of specific scheme or property details.

- 3.12 Partial decommissioning of existing buildings remains an option so as to render the building unfit for purpose and beyond reasonable economic repair, (i.e. would a reasonable landlord spend the sum of money required to reinstate the building to a condition that it could achieve a market rent). Works and expenditure required to obtain a deletion from the rating list will vary from building to building and we will be pleased to advise on this issue as appropriate.

LOCAL AUTHORITIES WITH HIGHEST RATES OF VACANCY

(Source: DCLG)



Empty Property Relief cont.

- 3.12 Partial decommissioning of existing buildings remains an option so as to render the building unfit for purpose and beyond reasonable economic repair, (i.e. would a reasonable landlord spend the sum of money required to reinstate the building to a condition that it could achieve a market rent). Works and expenditure required to obtain a deletion from the rating list will vary from building to building and we will be pleased to advise on this issue as appropriate.
- 3.13 As mentioned, the above 3 paragraphs relate to the current legal position. However, the Bill before parliament gives the Secretary of State power to enact secondary legislation aimed at combating 'avoidance'. Details of these provisions are subject to a 12 week consultation process, which commenced on 9th July. We believe many parties affected by the measures will be disappointed at the consultation's limited scope. The consultation paper is published on the consultation section of the Department of Communities and Local Government website: <http://www.communities.gov.uk/index.asp?id=1017165>. Depending on the anti-avoidance measures adopted following the consultation, some of the above strategies may not be feasible. We are closely monitoring the development of the secondary legislation and will be taking an active part in the consultation.
- 3.14 One aspect of the anti-avoidance legislation that has already become clear is that the measures may come into force before April 2008. This means that property owners seeking to take action along the lines mentioned above from 3.10 to 3.12 should do so at the earliest opportunity in order to avoid their decommissioning measures being deemed null and void under the law.
- 3.15 Letting to a charitable organisation would be sufficient to achieve a minimum 80% reduction in business rates liability, although they must be in occupation in order to claim the relief. Upon vacation charities will not pay any empty rates under the Bill, although for a charity to claim empty relief they must be entitled to possession and when the property is next in use it must be wholly and mainly used for charitable purposes, whether of that charity or of that and other charities. This area is open to further review and Lyons recommends a review of all exemptions and reliefs to consider the scope for removing inappropriate subsidies and distortions.
- 3.16 All leases should be worded so as to make tenants and subtenants responsible for full occupied rates for the whole term of their lease. The date an occupier leaves a building is the date void rates commence even if that occupier's lease has not expired. Often the outgoing occupier receives the whole benefit leaving the landlord or head lessee to pay empty rates after the void period. With the onset of 100% rates being payable this highlights the need for correctly worded leases in order to protect the lessor's interests.
- 3.17 It is understood that these measures will come into force on 1st April 2008; In the meantime it is important that ratepayers continue to take advantage of the appropriate rate reliefs and exemptions that are available.

4.0 Recommendation 8.5 – Derelict / Brownfield Property

The Government should develop proposals for the taxation of derelict property and brownfield land and consult on those with stakeholders.

4.1 Impact

This recommendation would have the effect of making the owners of derelict property and brownfield sites liable for business rates.

4.2 Commentary

This recommendation is probably a reaction to recommendation 8.4 and a safeguard against deliberate decommissioning. Attempting to establish a rental value for land or buildings where no rental value exists will require a lot more thought to implement than Lyons has devoted, and would require substantial rewriting of existing legislation and the close scrutiny of long established case law. For this reason this change is unlikely to happen within the life of the 2005 revaluation.

4.3 Advice

This recommendation is probably a long way from becoming reality. Our advice is to make note of the recommendation only. The first stage would appear to be a consultation process and we will issue further advice if and when this occurs.

5.0 Additional

One final point to note is the recommendation to include a review of the case for the continuing existence of the agricultural exemption, and to consider the costs and benefits of undertaking a valuation of agricultural land at the 2010 revaluation in order to accurately assess the value of the exemption.

5.1 Impact

This recommendation would see agricultural holdings being responsible for paying business rates - with the amount of rates payable bearing a direct relationship to the rental value of the land and holdings. The rental value will be that as at 1st April 2008, with the tax first becoming payable on 1st April 2010.

5.2 Commentary

Establishing the costs and financial benefits of undertaking a valuation of agricultural holdings for rating purposes seems to be the primary factor behind this recommendation irrespective of the correctness in law or otherwise of such holdings being rateable. Lyons identifies the potential amount of revenue between £300m and £450m. This review will be the first step of a lengthy process and the ultimate outcome is unclear at this stage.

5.3 Advice

The earliest that this recommendation could come into force will be 1st April 2010. Practitioners in this area should however be aware of this proposal and the timescales involved and advise their clients accordingly. CBRE will issue further advice once it is known.

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