Business Rates call for evidence

18 Sept 2020
To: BusinessRatesReview2020@hmtreasury.gov.uk

Introduction and background

1. The British Property Federation (BPF) represents the real estate sector – an industry which contributed more than £100bn to the economy in 2018 and supported more than 2 million jobs[1]. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.

2. Business rates in their current form were introduced in the 1990s but have failed to keep up with the times. Although the tax is supposed to be based upon market rents, it has not been responsive to the significant changes in the economy in recent times. In particular, while rents in the retail sector (outside of London) have come down by over 50 %[1] in real terms over the last decade to 2019, the business rates bills paid by occupiers (and owners of vacant property) has continued to go up in this time, which demonstrates how out of kilter business rates bills are for many businesses today. Indeed, many premises cannot even be let at nil rent, because the business rates costs alone are prohibitively high. At this point, the business rates system is not reflecting market rent – it is distorting market rent – and some cases, stifling any leasing activity at all.

3. We believe that a tax based on up to date market rents is sensible to include in the bundle of taxes borne by business. However, the system must be able to respond to changes in market rents much more quickly to avoid stifling business – and to ensure that private led investment in our towns cities remains viable.

4. We appreciate the engagement with the policy team throughout the consultation and would be pleased to discuss any aspect of this response in more detail. Please do not hesitate to get in touch if you require further information.

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Structure of our response:

Appendix 1: Executive summary and key recommendations

Appendix 2: Response to tranche 1 consultation questions

[1] https://www2.colliers.com/en-GB/Research/Midsummer-Retail-Report-2019

Appendix 1: Executive summary

5. Business rates is one of the few taxes whose yield does not rise and fall with the economy, but instead increases annually by a measure of inflation. Until now the tax rate, i.e. the Uniform Business Rate (UBR), has increased annually by the now widely discredited Retail Price Index (RPI). We welcomed the government's decision to switch recently to the more appropriate Consumer Price Index (CPI), but the consequence of almost three decades of uplift using an inappropriate rate of inflation is that the business rates burden is now unsustainably high. From a tax rate of close to a third of rents in 1990, the business rates burden is now approximately 50% of rateable values, the highest tax rate in England and the greatest recurrent property tax in the OECD.

6. While there are certain fiscally neutral changes that we would recommend, we believe that it would not be possible to make satisfactory improvements to the business rates system without allowing the total burden to reduce. Furthermore, as the way we use property continues to evolve; the business rates system needs to adapt to ensure that it is not stifling business. Our recommendations are intended to make the business rates system more agile and responsive as our towns and cities adapt to changes in our economy and consumer preferences.

Key recommendations

1. **The total business rates burden should be reduced.**
It is not sustainable for business rates to increase with inflation every year, while rental value growth has not followed the same trajectory. Business rates were roughly a third of rents in 1990 but are now over 50% of rents. This perpetual increase is not sustainable – and if it is not addressed, will continue to harm business and the viability of investment in our towns and cities.

2. **The total tax yield should fluctuate in line with the economy.**
Instead of increasing every year by inflation, the tax yield should fluctuate with the economy – to ensure that business is paying tax which is reflective of the wider economic conditions. We suggest the best way to achieve this would be to fix the tax rate (the multiplier) at a fair and sustainable level – we would recommend a fixed rate of 35% - close to the rate that was set when business rates was introduced in the 1990's.

3. **Revaluations should take place more frequently, ideally annually.**
While the business rates debate is currently focussed on high streets; the way we use real estate more broadly is evolving as we respond to structural shifts in our economy and changes in consumer preferences. The current pandemic has illustrated just how quickly market demand for different types of commercial property can shift. The tax system must be agile enough to respond to these changes across all types of property. To that end, revaluations should be conducted annually to ensure that the business rates burden reacts quickly and fairly to changes in property values of different types and geographies – and businesses are paying a tax which is reflective of the true value of the space they are occupying. In addition to more frequent revaluations, the gap between the antecedent valuation date and the revaluation coming into effect should be reduced from 2 years to one year.

Covid-related emergency measures

In addition to the key recommendations to improve the long term sustainability of the business rates system, there are a number of shorter term measures which are needed to ease the impact of the pandemic on business, which are set out below.

4. **Extend the Expanded Retail Discount beyond April 2021** – Businesses are already making decisions about what units they will keep open beyond the end of this year. The government should provide certainty to business that whilst reduced trading persists as a consequence of the pandemic, business rates relief will continue to be available. This relief should be extended to empty units, given it continues to be challenging to re-let units in many sectors at this time. Government should also consider expanding the scope to other sectors or businesses that weren't within scope of the original relief, but are also suffering hits to their trading activity – either because they are in sectors that do not easily allow working from home, or because they are in the supply chains of those businesses most immediately impacted – or a combination of factors.

5. **Material Change in Circumstance (MCC) claims should be coordinated by the VOA –** The VOA have received a deluge of MCC claims seeking RV reductions as a consequence of the pandemic. As a generality the Valuation Office Agency is not reducing assessments following the submission of a Check, thus requiring businesses to move to the formal Challenge stage, entailing both significant work and incurring substantial delay. It is inefficient to deal with the impact of the pandemic on business in this way – given there will be similar trends/impacts that will have affected different sectors and geographies in similar ways (e.g. footfall data or rent collection data could give a good oversight of impact). If the government is not minded to extend business rates relief more broadly (as suggested above), the VOA should proactively coordinate the valuation of MCC claims – and ensure that every business that is entitled to an MCC reduction receives it speedily, without the need for business to make a formal challenge or appeal (rather than reductions being applied only to those businesses that were aware of the opportunity to make challenges on the grounds of an MCC related to Covid-19).

6. **Abolish downwards phasing** – Because of the phasing mechanism, some businesses' rates bills are still based to some extent on the 2010 rating lists (which was based on valuations carried out in 2008). Given that retail rents outside of London have come down by around 50% in real terms since then, it is completely inappropriate for businesses to be paying tax based on these valuations. Abolishing downwards phasing would go some way to alleviating the hardship caused by the delay to the next revaluation. Downwards phasing should be removed from future revaluations.

Appendix 1: Responses to consultation questions

3.1 Reliefs

1. How well do current reliefs and exemptions deliver their intended outcomes and satisfy the principles of good tax design? What changes would you suggest to the system?

2. The sheer number of reliefs is symptomatic of an unsustainably high tax which is not reflective of market rental values. The number of reliefs creates complexity in the system and uncertainty around what a rate payer's final rates bill might be. With a materially reduced UBR and more frequent revaluations, the number and extent of reliefs could be reduced, such that in future they could be provided more sparingly to address unpredictable events; for example as is available now due to Covid-19 and previously to address short term issues relating to disasters such as flooding and foot and mouth disease.

2. How can reliefs be targeted more effectively? How can reliefs and their administration be simplified?

3. A lower burden for all and valuations which are more reflective of up to date market rent would reduce the need for reliefs.

4. The administration of reliefs could be simplified by ensuring that all reliefs are automatic and non-discretionary – and funded centrally. Any reliefs with local discretion should have very clear and unambiguous guidance. Reliefs should not be subject to EU State Aid rules, or their replacement under any agreement with the EU following Brexit.

3. What evidence is there on the capitalisation of business rates and business rates reliefs into rents over time? What does any evidence mean for the design of rates reliefs and business rates more broadly?

5. This Call for Evidence refers to a report in 2015 (undertaken by Regeneris) which concluded that, in the medium to longer term, changes in rates paid are reflected in corresponding adjustments in rental values. Specifically, it concluded that (with variations across asset types) approximately 75% of a change in business rates fed through to changes in rents over a 3-4 year period.

6. However, to draw – as the Call for Evidence does – from those findings that in the event of a business rates cut "landlords can raise the cost of rent, knowing that the occupier is benefitting from a reduced tax bill" is overly simplistic and ignores some of the report's other findings, including that:

6.1. the extent of capitalisation depends on the balance of power between owners and occupiers, and

6.2. the observable relationship between rates and rents started to break down from 2008 due to the historically unprecedented changes in rents paid and capital values across the country (most keenly felt in the retail sector) and the unusual situation of there having been no revaluation since 2010.

7. In our view, what the evidence on capitalisation suggests is that it is dangerous to make generalisations about the extent to which it happens. The business rates system should not assume that capitalisation takes place extensively or equally across the country. If, as we recommend, the total business rates burden were to fall then it is far from true to say that the benefit would accrue primarily to property owners, as occupiers would undoubtedly benefit – in particular, we note that:

7.1. Businesses occupying the 45% of non-rented (i.e. owner-occupied) commercial property would benefit directly.

7.2. For those businesses in rented commercial property:

7.2.1. Capitalisation of any rates reduction is highly unlikely to be 100% as occupiers' bargaining power with their property owners is higher than it is with the government. Therefore, occupiers will benefit from a reduction.

7.2.2. In some sectors (e.g. retail, where real rental values are effectively negative in many parts of the country), occupiers' bargaining power may be so significant that capitalisation into rents is minimal. In such cases, occupiers will capture most of the benefit of a reduction.

8. Finally, it takes time for changes in business rates to be capitalised into rents. If rates revaluations were carried out more frequently (e.g. every year), capitalisation would effectively not take place – or would happen on a "rolling" basis. Property owners would not necessarily increase rents following a rates cut, as they would be aware that that higher rent would feed through almost immediately at the following revaluation to a higher rates bill, which would in turn restrict occupiers' ability to afford that higher rent.

9. We would also like to highlight some interesting data trends and anecdotal evidence to illustrate how rents have responded to rates in recent years and what the impact of this has been on the market.

10. In a normal functioning market with a well-functioning business rates system (i.e. that responds to market rents), we would expect and indeed welcome a correlation between rent and rates – indeed if the purpose of the system is to extract some tax where there is some rental value, we would expect that as rents go up, business rates would go up, and as rents come down, business rates would go down. Unfortunately, over the last ten years or more, the evidence would suggest that as rates have gone up disproportionately, particularly in the retail sector – this has put pressure on the amount of rent that tenants can pay.

11. The following table shows the change in rates payable (per square meter) vs the change in the MSCI Market Rental Value indices (abbreviated to '**MSCI**' in the table below) in England over the past 20, 10 and 5 years, which illustrates how unresponsive rates have been to rents for all asset classes, and particularly retail.

MSCI MRV per sq m vs Rates Payable per sq m:

	Last 19 Years		Last 10 Years		Last 5 Years	
	Rates	MSCI	Rates	MSCI	Rates	MSCI
Offices	82%	39%	46%	61%	19%	19%
Industrial	67%	76%	22%	40%	13%	29%
Retail	87%	17%	32%	0%	11%	1%

12. Extracting the retail data, this table shows that over the past:

- 20 years - rates payable on retail units have gone up by 87% whereas retail rents have only gone up by 17%
- 10 years - retail rates have gone up by 32% while rents have stayed almost static
- 5 years - retail rates have increased by 11% and rents have increased marginally by 1%

13. Clearly there's a divergence between the rates being paid by retailers and retail rents. While there is still a misalignment between rates and the MSCI indices amongst the Office and Industrial sectors, the lack of correlation for retail is a lot more pronounced.

14. In addition to the evidence above there are numerous anecdotal examples of occupiers that are unable to let new premises, or re-let existing premises, even at nil rent, because the business rates burden is, on its own, prohibitively expensive. At this point, the business rates system is no longer reflecting market rents, it is distorting them – and in some cases stifling any leasing activity at all.

15. In order to attract private sector investment into our towns and cities, a return must be available for property owners. In recent decades, that return has been squeezed in some sectors as business rates has increased at unsustainable levels. It is right that the business rates burden should be fair and sustainable, leaving a return on investment for those investors seeking to invest in and regenerate our towns and cities.

16. By fixing the multiplier at a fair and sustainable level, and by conducting more frequent revaluations, occupiers would have greater certainty over their rates bills, and potential investors would have greater certainty when conducting investment appraisals around their likely returns.

4. What role should local authorities have in determining business rates reliefs and exemptions? Should reliefs and exemptions be set by central government or set locally?

17. Reliefs should be set centrally – and allocated automatically. If it is determined by government that a relief is needed because it would benefit the economy or our communities in some way – that relief should be rolled out as quickly and as efficiently as possible. To allow discretion at a local authority level puts pressure on the local authorities that already have the most pressure on their budgets – which in many cases will be the areas where the relief is most needed.

18. Where it is felt that local discretion is needed – there should be clear and unambiguous guidance, to allow businesses some certainty around what reliefs they can expect.

5. Are you aware of ratepayers misusing tax reliefs or other means to avoid paying their full business rates liability? What could be done to tackle this?

Empty Property Rates (EPR)

19. We understand that that the mitigation of Empty Property Rates (EPR) has increased significantly since around 2008 – when the rules changed to remove the 50% relief awarded to empty units. This has led to a flurry of litigation in the tribunals any senior courts which adds unwelcome complexity, uncertainty and costs both to ratepayers, billing authorities, and government.

20. The response to these questions seeks to address what the policy rationale is behind empty property rates, what have been the factors in driving the use of mitigation techniques, and what measures we believe are necessary to create a fairer tax environment for empty units.

What is the purpose of business rates on empty properties?

21. It would be helpful to consider whether the policy rationale for empty rates bills (particularly at such draconian levels), is justifiable or indeed achieving the policy intent. We understand that one of the government's primary objectives when changing the rules in 2008, was to ensure that landlords were incentivised to find tenants for empty units. However, we believe that it is too simplistic to assert that empty rates bills will encourage greater occupation of properties – and indeed, we would strongly refute this assertion for two principal reasons:

21.1. Landlords are already incentivised to let out property – it is the raison d'etre of their business model! Even if an investor's business model is to generate capital returns, the underlying rental income derived by a property will be the most significant factor in determining capital values – and therefore, empty units will instinctively be avoided by all property investors if at all possible as a matter of course. It is also worth noting that there are other costs of owning buildings which compel an owner to re-let a property as soon as possible – such as security, insurance, maintenance costs, loss of service charge recovery etc.

21.2. Empty rates have been set at draconian levels since 2008 – over which time vacant units have continued to increase. This alone should prompt policy makers to re-evaluate whether the policy itself is even effective.

What are the factors that have driven a rise in empty rates mitigation techniques?

22. The unresponsive nature of the business rates system has exacerbated and, in many cases, caused empty units. There are numerous examples of units which cannot be re-let even for nil rent because the business rates cost alone is prohibitively high for potential occupiers. There are many more examples where the business rates burden is several times higher than the proposed rent (due to completely outdated valuations).

23. If business rates had responded more quickly to market rents over the last decade, the business rates bills would be more reflective of the value of the space being occupied, which would have allowed for more occupiers to continue to afford the space. Of the lower levels of empty units that would remain,

the business rates bills would more closely reflect market rents, which would have been more manageable for property owners to bear, with less incentive to seek to mitigate them.

24. Given the severity of the supply/demand imbalance in the retail sector especially – coupled with unrealistically high business rates bills, many units may be unlettable for a long time, perhaps indefinitely. Given how slow the planning process is, even changing the use (to the extent this is commercially viable) would result in unrealistically high rates bills being paid for several years – which is not a cost that is sustainable for many investors.

25. Given this backdrop, it is not at all surprising that property owners find it necessary or desirable to engage in rates minimisation behaviour. When it comes to tax, the overwhelming majority just want to do the right thing; as demonstrated by the fact that HMRC collected over 95%[2] of the tax it expected to collect in 2018-19. However, where a tax feels fundamentally unfair or penal there is likely to be greater resistance to paying it. It is important to bear these considerations in mind when developing measures to clamp down on any perceived avoidance.

Impact of empty property rates

26. The requirement to pay empty rates at 100% of a hereditament's liability:

27. reduces the resource available to landlords to complete renovation works to either attract new tenants or change the use of a property.

28. accelerates landlord bankruptcy, particularly if the property cannot be let quickly (and indeed, in many cases, business rates will create a negative land value for some premises, meaning it is impossible to sell).

29. could encourage drastic behavioural responses – such as demolishing buildings or putting them in an unusable state, simply to remove them from rating list where the rates bills are unaffordable.

What would we recommend?

30. Addressing the fundamental issues with the business rates system (overall burden, frequency of revaluations etc.) will go a long way to easing the number of empty units – because the business rates value should reflect the realistic market value of the property and therefore improve their affordability. Assuming these fundamental issues are addressed and the system functions appropriately, we would not expect a significant incentive to mitigate empty rates bills.

31. We believe that the period of empty rates relief should have some relationship to the amount of time that it typically takes to re-let a property in certain sectors or geographies. The period of relief for retail and offices is currently 3 months, which is too short and does not reflect typical re-letting periods, and should therefore be increased significantly. We also consider that there should be a longer and significant period of rates relief after a new development or refurbishment has taken place – to ensure that business rates is not a barrier to speculative development and to recognise the time it takes to vacate and then re-let a property after a refurbishment. We will provide further detail on this in our response to the second tranche of questions.

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/907122/Measuring_tax_gaps_2020_edition.pdf

32. As a point of principle – if a property can't be re-let, even at nil rent (which is the case for many retail premises), this indicates that the value of the property is, or is close to, nil. Given business rates are supposed to reflect market rents, the market rent of an unlet property in theory should be close to nil. Therefore, we consider that a significant reduction in the business rates bill would be appropriate for empty units – as minimum, we would suggest reverting relief that was in place before 2008, which provided a 50% reduction to the normal rates bill, following the rate free period. Rates mitigation of the type which seems to be of concern presently, was not an issue prior to the 2008 changes.

3.2 The business rates multiplier

6. What are your views on how the business rates multiplier is set annually and at revaluations?

33. Historically the multiplier has not tracked movements in market rental values.

34. It has increased from a tax rate of close to 35% in 1990 to over 50% today. This trajectory is unsustainable – and provides uncertainty to business as to what their rates liability will be (with the only certainty being that it will be excessive).

35. We would advocate for a fixed multiplier of 35% which more closely tracks actual rents paid. This could possibly be done by using a local rental growth index in between revaluations – or our preferred approach would be to work towards annual revaluations, to ensure that changes in rental values are reflected in rates in a timely manner.

7. How could the multiplier be set in future to ensure the sustainability of public finances and support growth and productivity? What would the impact of any proposed changes be on the level of the multiplier and revenue from business rates over time?

36. A tax rate set at a fairer and more sustainable level would reduce the need for so many reliefs – which would in itself provide more stability for the tax revenues provided by business rates over time.

37. A tax rate set at a fairer and more sustainable level would help to keep businesses trading more profitably for longer – which would help ensure the sustainability of wider tax revenues and support jobs.

38. We believe that a tax rate of approximately 35% of current market rents (or rateable values) is fairer, would support productivity and jobs, and would support the sustainability of tax receipts from business as a whole over time.

39. Once set, the tax rate should be fixed and operate in the same way as all other taxes, with the tax take adjusting in line with changes to the tax base. The current process whereby the UBR adjusts at revaluations to ensure the same tax take in real terms should either be replaced with a rental value index or our preferred approach would be to move towards annual revaluations to remove the need to rely on approximate indexes.

8. How should the multiplier and any supplements relate to business rates reliefs? Should these be discrete, or should supplements fund specific reliefs?

40. As noted in response to question 4, we believe that reliefs should be funded centrally – and we do not think it is sensible to restrict how these are funded, by requiring an immediate set off within the business rates system.

41. If central government have made a strategic decision that a relief is justified (e.g. because it would support businesses, jobs or communities in some way), the wider benefits of the relief will presumably outweigh the costs in the long run. The benefits may not be directly reflected in higher rental values in the current year. As such, it seems sensible for government to use their discretion to determine how a relief should be funded having regard for the purpose and anticipated outcome of providing that relief.

42. In terms of supplements - of the few occasions that we are aware of where supplements have been introduced (notably to help fund Crossrail); we understand that businesses and investors in the local area were much more receptive to a supplement, in the knowledge that it was being directly hypothecated to fund a specific local infrastructure project.

9. What are your views on introducing additional multipliers that vary by geography, property value, or property type?

43. We would not advocate for different tax rates for different asset classes, geographies or sectors for the following reasons:

43.1. It would add complexity to the system.

43.2. It could distort otherwise market investment decisions.

43.3. The current system should already allow for different level of tax to be paid by different assets/geographies that are doing better or worse – because the rateable values should be reflective of the market rent.

44. However, we acknowledge that there may be some overriding policy or initiative that the government would like to support – and it may be appropriate for government to consider different tax rates in those cases – for example, to support the net zero carbon agenda, or where there is some other ancillary benefit to the wider community of a certain business/investment. We will touch more on the challenges with the current system in respect of incentivising investment in modern and energy efficient plant and buildings, as well as possible recommendations, in response to the next tranche of questions.