Surveying business rate decentralisation

The performance of commercial real estate will become vital to local authorities under the devolution agenda, report **Kevin Muldoon-Smith** and **Paul Greenhalgh**

It is well know that England has historically had one of the most centralised systems of government in the world. The announcements from the Conservative administration on devolution and decentralisation signal a move away from this. Yet there has been very little debate about what these changes mean for the commercial property sector and professional surveyors. This deficit is particularly notable in relation to the full localisation of business rates. Without doubt, following business rate decentralisation, local business rates – and by extension the performance and potential growth of local commercial real estate markets – will become a central concern not only for local authority financial planning and investment, but also the wider business sector and local electorate. However, just because everything is going to be different doesn't necessarily mean that anything will change. Let us consider why, and what this means for the commercial property profession. Reflecting on these issues now will help inform and influence the consultation.

Implications

The original business rate retention scheme (BRRS), introduced in 2013, gave local authorities the potential to retain 50% of business rate income and up to 50% any of growth in revenue from this stream, which is synonymous with construction of new employment (i.e. commercial and industrial) floorspace. The remainder was returned to central government and redistributed in England in a similar way to the previous formula grant method of funding. The Chancellor's announcement at the 2015 Conservative Party conference, later confirmed in the Autumn Statement and Public Spending Review, has extended the 50% principle to 100%. However, the reality is that local authorities are only really able to benefit from business rate retention through new additions to the statutory rating list. This is because they already receive empty property rates – notwithstanding the problem of empty property rate avoidance – on existing property, while any relative value uplift on existing property is effectively stripped out during the national revaluation exercise. This means that any location that has no space to accommodate new construction, or does not have the underlying rental values to support new development, will be at a disadvantage, leading to an uncertain future. It seems certain, however, that local authorities will now need to lean on the property profession for advice on commercial property development appraisal and will themselves (i.e. local authorities) become more assertive as a market actor as service delivery and its ongoing viability, will depend on the performance of commercial real estate.

Local flexibility

The Chancellor has said that local authorities will now have the power to lower the rate of business rate taxation in order to attract new enterprises. This is potentially a positive development for businesses and landlords. However, it is important to note that the uniform business rate has not been abolished, despite what the Chancellor has implied. It still exists, and all that has changed is the ability for councils to lower this rate at the local level if they so wish. It is difficult to imagine most authorities, which are already facing severe budgetary pressures, agreeing to further decreases in local taxation. Presumably, only those authorities with a surplus will have sufficient budgetary tolerance to accommodate potential change. There is also some uncertainty as to the flexibility of any reduction in the local business rate level. Will it be uniform at the local level, or will local authorities have the discretion to adjust taxation for different types of property, businesses and locations? For instance will it be possible to remove small businesses from business rate taxation altogether to reduce the burden on the retail sector, or to vary the level of empty property rates faced by commercial landlords? The Scottish administration announced a degree of flexibility for local authorities to lower the business rate against local criteria such as the type of property, its location, occupation and activity. So far, this level of detail on the English proposals has not been released. This is a pity, because a more locally responsive business rate system would allow councils to address local property market conditions, in particular the different requirements of different types of commercial property.

Empty property rates

Surprisingly, the recent announcements have largely ignored the issue of empty property rates (EPRs). Under business rate retention, the higher rate of empty property liability means that local authorities are not rewarded with any additional income from attracting new businesses into vacant premises; small businesses, for example, pay a lower rate of business rate taxation. Failure to include EPRs in the recent announcements is a missed opportunity. If the government abolished EPRs or empowered local authorities to alter the rate, this would encourage them to promote indigenous economic growth by rewarding them for creating conditions whereby vacant space is reoccupied; rather than the current situation, in which they are effectively penalised. This would provide a welcome boost to small businesses and the managed workspace sector that supports this new economy. However, the current situation is rather dispiriting, as empty property rates are a drag on business and there is no incentive for local authorities to improve their local business infrastructure. This is a key policy issue on which RICS should lobby, as it gives the Treasury a clear justification for reforming EPRs.

Governance

A further question is how the new mayoral local infrastructure fund (LIF) will work in practice. At first glance, this extra levy on business rates looks like classic business improvement district (BID) arrangements, under which, following a local ballot, businesses in a defined area agree to pay an extra level of rates to fund local improvements. Importantly, in a BID, a majority of businesses have to vote in favour of an uplift in property tax. In contrast, under the LIF, there is no provision for a local ballot; rather, an elected mayor need only secure the agreement of a majority of private-sector local enterprise partnership(LEP) members. This opens up a wider debate around the democratisation of fiscal decentralisation, especially on who decides and who pays for new local infrastructure.

All change for 2020

It is worth summarising the current situation by way of conclusion. First of all, it is important to note that there isn't any new funding in the Chancellor's announcement, only the potential for business rate growth – therefore in some locations, conceivably 100% of nothing! The issue of risk is particularly pertinent in relation to the rateable value appeal process, with many local authorities already finding that the cost of successful backdated appeals more than outweighs the proceeds of any growth. Without revision, the new proposals will only make this issue worse. Consequently, local authorities and the Valuation Office Agency (VOA) will need to foster close working relationships with property advisors, planners and the investment community in order to ensure that they get these new development schemes right and that the correct mix of employment premises is retained in local areas. Most commercial property agencies already employ rating specialists, yet the traditional emphasis has been on mitigating rate liability on behalf of the landlord, particularly navigating the complex rules and regulations involved in valuation for rating purposes, submitting appeals and negotiating with the VOA. In future, the same rating specialists may also operate on behalf of the local authority only the roles will be reversed, with the emphasis firmly on rateable value growth and retention. Finally, there is still a great deal of uncertainty as to the 2020 business rate changes and what the practical implications will be for local authorities throughout England (Scotland is moving ahead even quicker). What seems certain is that change is around the corner both in England and the devolved administrations, and that local authorities will be expected to fend for themselves through a new model of civic financialisation and entrepreneurialism. At the local level, net borrowing is sure to increase as the Office for National Statistics has reported a £2bn increase in this financial year, while central government borrowing decreases. Historically, the cost of borrowing at the local level hasn't been an issue, as councils' credit ratings have been closely aligned with the UK's sovereign rating. However, the turn toward fiscal decentralisation and civic financialisation means that local authorities will from this point on be measured on their own merits with regard to lending security, which may well provoke a fragmentation of local authority credit ratings, lending criteria and rates. In the near future, those local authorities with sub-optimal commercial business rate portfolios may be viewed by the investment community as junk.