



Rating (Empty Properties) Bill

Regulatory Impact Assessment



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1. Title of Proposal

1.1 Reform of empty property relief in business rates.

2. Purpose and Intended Effect

Policy Objective

2.1 This Regulatory Impact Assessment considers the reform of the existing Empty Property Relief (EPR) in business rates. The Government's objectives for this reform are:

- To improve UK competitiveness, by increasing incentives for property that is empty to be either re-let or for the property and site to be re-developed and thereby reduce rents and prices for new and existing businesses.
- To improve efficiency in land and property markets, by matching the incentives for the efficient use of property in use with similar incentives for use of the empty stock.
- In doing so to reduce the need for development of business premises on greenfield sites, and to provide opportunities for re-development of brownfield land for both housing and business property.
- To remove distortions in the tax treatment of different forms of commercial property, in particular the significant tax advantage given to long term empty warehousing and industrial premises over retail and office space.
- To raise revenue in the most efficient and simple way, with as few distortions to the economy and to incentives for efficient allocation of resources as possible.

Background

2.2 EPR is the most generous of the statutory reliefs in business rates, and is currently costed at £1.3 billion per year in England. It is available to owners of commercial property who register their property as empty with the billing authority. On being re-occupied, the property loses the relief from business rates.

2.3 At present, empty warehouses and industrial premises receive full relief from business rates on an ongoing basis, and empty retail and office premises receive full relief for three months and 50% relief thereafter.

2.4 The purpose of the proposed reforms is to modernise relief from business rates for empty property in England and Wales, and apply the full business rate to properties that have been empty for three months or more, or six months in the case of industrial and

warehouse property. The Government proposes to exempt charities and community amateur sports clubs from paying business rates for empty properties they own.

- 2.5 The Scottish Executive has no plans to change empty property relief in Scotland. If Northern Ireland wishes to make parallel amendments to empty property relief, there would be no implications for the Government's proposed Bill.

Rationale for Government intervention

- 2.6 The proposal to reform EPR was announced in the Budget 2007 in response to recommendations made by Kate Barker's Review of Land Use Planning and Sir Michael Lyons' Inquiry into Local Government Finance. The rationale for reform is a combination of competitiveness, efficiency and fairness.

- **Competitiveness.** High business rents are a key driver for reform. A series of recent reports by the private sector – by CB Richard Ellis in 2006, and by DTZ Research 2004 and 2005 – have identified UK rents as amongst the highest in the world. The fact that West End office space in London is regularly ranked as the most expensive in the world reflects a variety of influences, of which land supply will be an important contributing factor. However, as London is the world's financial capital, it is less surprising to find high rents in the capital than to find office rents in cities such as Birmingham, Manchester, Leeds and Edinburgh ranked as more expensive than Manhattan, Madrid, Frankfurt and Sydney by these reports. At the same time, 16% by value of City property stood empty in 2004–05; 18% in Manchester; and 19% in Birmingham.
- **Efficiency.** As Kate Barker noted in her independent review of Land Use Planning, the planning system enables and manages sustainable development. However, she recommended that land granted planning permission should then be used as efficiently as possible, a principle that supports both economic, environmental and social policy objectives. EPR – as a £1.3 billion relief for unused, but usable, empty commercial property – therefore does not seem necessary or appropriate, given the Government's wider land use objectives. Kate Barker suggests, and Sir Michael Lyons has agreed, that reform can help to improve incentives for better use of the stock of property in the UK. Since stocks, rather than flows, dominate the UK property market, improving incentives for the stock will have immediate effects and will reduce the need for more land to be consumed to meet future growth in demand for commercial property or housing.
- **Fairness.** The current structure of empty property relief discriminates in favour of warehousing and industrial premises, which receive 100% relief no matter how long they remain empty, whereas retail and office premises enjoy 100% relief for three months only, after which the relief is halved. This creates a distortion in the use of land which might be justified if, for example, the risk of holding industrial property were greater than holding office property. However, Kate Barker found that this was not the case, and that there is very little justification for favouring the owners of empty industrial premises over the owners of empty offices. This is not to say that there is no reason to treat these types of property in slightly different ways, and these are discussed below in the detail of the proposal for reform.

3. Consultation

- 3.1 The extension of Sir Michael Lyons' independent Inquiry into Local Government until the Budget provided an opportunity to gather views from a wide variety of external stakeholders on Kate Barker's recommendations in relation to EPR reform. This was achieved through the release of a consultation paper by Sir Michael Lyons that included requests for responses to the Barker recommendations (as well as recommendations impacting on local government in the Leitch and Eddington reports).
- 3.2 Local authorities and local government representative bodies were in favour of reform. Planners and the regional economic development offices were also in favour, recognising the positive implications for land supply for both housing and commercial redevelopment.
- 3.3 Valuers and surveyors favoured a wide assessment of all reliefs in business rates, which was subsequently recommended by Sir Michael Lyons in his report and accepted by the Government, as announced in the Budget.
- 3.4 Business responses to Sir Michael's consultation were more mixed. The Federation of Small Businesses reiterated their support, saying on Budget day that they were delighted with the Chancellor's decision. In their response to Lyons' request for comments on Barker's original recommendation, the British Retail Consortium favoured reform that moved us closer to land value taxation, one of the outcomes of reforming empty property rates relief. However, since then they have moved against the reforms. The British Property Federation – representing the owners of property – were against. The CBI said that the reform may limit the flexibility of businesses, given that changes to property use may take some time.
- 3.5 To try and overcome these issues, the Budget also announced that the Government will consider the tax treatment of onerous leases, which may limit tenant's flexibility to occupy alternative properties, and results in the retention of property that may otherwise be released to the market. The Government also intends to set out proposals for improving speed, responsiveness and efficiency in land use planning in a White Paper this spring, in response to Kate Barker's conclusion that there is scope for the planning system to take a more positive approach to development.
- 3.6 Many of the negative responses to consultation were made without reference to the rest of the business tax package, and especially to related changes to the tax incentives aimed specifically at renovation and redevelopment of land and commercial property, or at the tax treatment of commercial leases. Business rates remain unique amongst taxes in terms of enjoying a statutory bar on any real terms increase in yield. The Government has since accepted Sir Michael Lyons' recommendation that this link between yield and the Retail Price Index be retained – thereby maintaining the tax burden on property that is in use by business at the same level as it was in 1990. Reforms to the liability of empty property for business rates are set firmly within a broader package of measures that seek to increase UK competitiveness and provide stronger incentives to bring vacant land and property into productive use.

- 3.7 The Government intends to consult widely on the detail of the reforms – including exemptions from empty property rates and anti-avoidance measures – over the summer, before bringing them into force by means of secondary legislation.

4. Options

- 4.1 Three options have been considered for maximising the effectiveness of EPR as a fiscal instrument that contributes to the efficiency of commercial property markets. They are:

Option 1: Do nothing

- 4.2 Continue to provide over £1bn of tax relief to owners of empty commercial property with the economic and environmental implications outlined above and placing an equivalent burden on other tax payers.

Option 2: Reform EPR

- 4.3 Reform EPR to enhance UK competitiveness, with significant benefits to the efficiency of the UK land and property markets and to the fairness of the UK tax system. This reform will help to bring more empty property forward to be re-let and thus increase the flexibility of the commercial property rental market.
- 4.4 The Government considers that, as in the current form of EPR, all property should receive an initial period of relief from business rates when it first becomes empty. The process of turning over tenants or vacating and selling property is an important part of an efficient property market. The proposed reforms therefore provide that the initial three month period of 100% relief from business rates for all empty property be retained. The Government does not propose to extend this period, as this would amount to increasing state aid to some forms of property, and would also further distort the property market.
- 4.5 The Government has also examined the case for a slightly extended period of rates relief for industrial and warehouse property. Despite the apparent equivalence of risk in owning these premises, demonstrated by Barker, moving qualifying industrial premises on to the same three month rate free period would represent a major reform to the tax relief for the sector. The Government therefore proposes to offer industrial premises a further three month exemption from business rates from the date they first fell empty, bringing the total rate free period to six months.

Option 3: Abolish EPR

- 4.6 Abolish empty property relief completely, so that all property owners are liable to pay 100% of business rates as soon as a property falls empty (with no distinction between property types).

5. Costs and benefits of reform

Benefits

5.1 The Government anticipates the following benefits from reforming EPR:

- A reduction in commercial property rents (routinely the second largest cost to business after wages). The Government estimates that the increased rate of re-letting of empty property could reduce commercial property rents by around 0.25–0.5%.
- Helps provide incentives for currently under-used property to become available for use, promoting supply of property. The Government anticipates that this measure could reduce the amount of property that is empty at any given time by more than 15% in the sectors currently covered by Empty Property Relief.
- Both of these outcomes would improve the UK's competitiveness, particularly for small and medium enterprises (SMEs) and other companies that want to rent.
- A behavioural response from the owners of empty property that results in property being re-let (and hence scoring additional tax on the flow of rental payments as well as full business rates) and property being sold.
- The Government also anticipates that less property will become empty in the future as landlords attempt to retain tenants or to avoid void periods altogether.

5.2 Abolishing EPR altogether would yield £1.3 billion in tax revenues, with the same (but marginally greater) benefits as for reforming EPR.

Costs

5.3 The Government anticipates the following administrative costs from reforming EPR:

- A relatively small administrative impact on local authorities, as the billing and collection agents for business rates. Reforming EPR will require them to identify, bill – and, where necessary, enforce payment by – owners of empty industrial property who do not currently pay any business rates. Billing authorities will also have to update their IT and billings systems. The Government will assess and make provision for the associated costs, which constitute a new burden on local government, in the context of the Comprehensive Spending Review.
- Empty properties are already included on the rating list maintained by the Valuation Office Agency (VOA), and as a result the proposed reforms are not expected to lead to an increase in the number of properties requiring valuation. However, the Government anticipates that the reforms are likely to lead to an increase in the number of appeals to the VOA about the current valuation of empty properties, and is considering the likely associated costs.

- 5.4 Abolishing EPR altogether would reduce the efficiency and flexibility of the commercial property market. It does not recognise that there is likely to be a natural rate of vacancy in the property market and that property owners need a certain amount of time to find new tenants after a property becomes vacant. This is likely to be especially important for owner-occupying firms that go into shock and need an opportunity to restructure.

6. Sectors Affected

Business

- 6.1 Modernising empty property rates will bring the treatment of all forms of commercial property closer to parity. The current distortion between the treatment of empty industrial property and empty offices and shops would be greatly reduced, and hence returns to owners and investors would not be skewed by the tax system. This removal of tax as a distortion in property investment decisions supports the Government's wider approach to property investment, for example the introduction of UK-Real Estate Investment Trusts from January 2007 and the announcement at Budget that parallel treatment would be created for Authorised Investment Funds investing in property. Impacts on investor returns arising from reduced rents should be considered in this wider context.
- 6.2 Reducing the tax relief available to owners or tenants of empty property will increase the cost of holding such property, and therefore increase the supply of property to all sectors. Kate Barker's analysis of risk showed that there is no structural difference in the propensity of property in different sectors to fall empty. Hence the Government anticipates an equal effect across the sectors.
- 6.3 The Government also anticipates that the same risk characteristics will mean that the payment of empty property rates will reflect the wider characteristics of the business rates base. For example, owners of industrial property are expected to pay 10–15% of the additional empty property rates.
- 6.4 The wider context of business rates policy is important in this respect, since Government has also announced its intention to retain the link between the Retail Prices Index and yield from business rates. Reforms to empty property rates were made within the context of this decision to retain the constant real burden of business rates.
- 6.5 To support tenants locked into so called 'onerous leases', which do not allow sub-letting or assignment of unwanted property, the Government will consult on including the payment made by tenants who leave such a lease prematurely as an eligible deduction for tax purposes. Consultation on this proposal will be undertaken later in the year.

Public Sector

- 6.6 The public sector occupies about 10% of the commercial property market by value. However, the Government's policy on public sector assets is to ensure efficient use is made of public buildings, and surplus stock is either re-developed for alternative use or sold. In order to reduce burden to tax payers, there should be no public buildings capable of occupation that are sitting empty, and if there are, there should be an incentive for them to re-let or, sold as soon as possible.

Charities

- 6.7 The Government proposes to exempt charities and community amateur sports clubs (CASCs) from paying business rates on empty properties they own. This represents an improvement to the current situation, in which empty property held by charities and CASCs is liable for 10% of the full business rate.

Regional Impact

- 6.8 The geography of the burden of the reform is not necessarily intuitive. The Government estimates that 16% by value of commercial property in the City of London was empty in 2004/5, and independent analysis using a different methodology by the University of Reading confirms this order of magnitude of vacancies.
- 6.9 The ten local authority areas with the highest proportion of commercial property sitting empty in 2004–05 included Slough, Ealing, Birmingham and Manchester. These are amongst the fastest growing local and regional economies in the UK. There are pressures on land use in each of these authorities, but in each case at least 15% of the commercial property base was empty. Conversely there are also areas in the top 10 where demand for the existing commercial property stock is lower – Wolverhampton, Sandwell and Brent.
- 6.10 Some commentators, such as the British Property Federation, have claimed that the reforms will deter speculative development and re-development, and so have a negative impact on urban regeneration in deprived areas where the market is weaker. The Government has introduced a new Business Premises Renovation Allowance, which provides a 100% capital allowance to support renovation and conversion of property in Assisted Areas.

7. Race and Equality Impact

- 7.1 No race or other equality impacts have been identified.

8. Small Firms Impacts Test

- 8.1 When assessing the impact of EPR reform on small firms, the most important characteristic is the tendency of small firms to be tenants. As firms that require low cost property at short notice they will benefit from a measure that extends the supply of all forms of commercial property. This explains the support for EPR reform from bodies such as the Federation of Small Businesses, who see empty property as a barrier to entry and a block on downward pressure on rents.

9. Competition Assessment

- 9.1 As detailed above, industrial premises and warehouses will receive a longer period of relief than offices and retail. This reflects the current distinction between the types of property, but reform goes a long way towards reducing competitive differentials in the tax treatment of owning the various forms of commercial property. All types of property owned by charities will be exempt from paying empty property rates.

10. Enforcement, Sanctions And Monitoring

- 10.1 Billing authorities will be able to exercise their existing powers to enforce payment of rates by owners of empty property, in the same way as now. The Government will continue to monitor the proportion of business rates that billing authorities successfully collect, which in 2005–06 stood at 98.4%.

11. Post Implementation Review

- 11.1 The policy will be reviewed on an ongoing basis.
- 11.2 The Government's proposals provide for a new power to reduce the empty property rate from the new level of 100% of the occupied rate back to a minimum of 50% of the occupied rate, to enable it to respond flexibly to changes in the property market if necessary at a future date.

12. Summary

- 12.1 The Government has announced that it intends to reform empty property relief to incentivise owners of empty property to re-let their property more quickly. This will mean that there is a greater supply of property to rent, which will reduce rents and strengthen the competitiveness of UK businesses.
- 12.2 The reform to empty property relief can be strongly justified on the grounds of fairness and efficiency. It is consistent with Barker's and Lyons' recommendations, and with representations received from the Federation of Small Businesses (representing over 99% of all businesses in the UK).

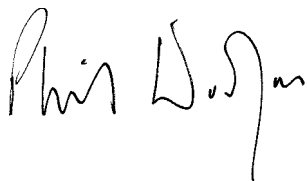
13. Contact Point

- 13.1 For further information, please contact:

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14. Statement of Ministerial Approval

- 14.1 I have read the Regulatory Impact Assessment entitled: Rating (Empty Properties) Bill. I am satisfied that the benefits justify the costs.
- 14.2 Signed by the responsible Minister:



Phil Woolas MP, Minister of State for Local Government and Community Cohesion