LOCAL GOVERNMENT AND REGENERATION COMMITTEE

LOCAL GOVERNMENT FINANCE (UNOCCUPIED PROPERTIES ETC.) (SCOTLAND) BILL

SUBMISSION FROM THE SCOTTISH PROPERTY FEDERATION

1. Thank you for inviting the Scottish Property Federation (SPF) to give written evidence on the Local Government Finance (Unoccupied Premises Etc) (Scotland) Bill. We are happy for our comments to be made public.

2. The Scottish Property Federation is a voice for the property industry in Scotland. We include among our members; property investors and developers, landlords of commercial and residential property, and professional property consultants and advisers. We have some 120 corporate members.

3. We remain deeply concerned at the proposals in the Bill to reduce rate relief for empty properties in Scotland. We are convinced this is a serious mistake and will undermine competitiveness and incentives for investment in Scotland. In our view the measure will have consequences that go far beyond the stated intention of seeking to reduce the numbers of empty shops in the high street.

4. Our key concerns are:

   - We find no evidence that reducing rate relief will improve occupancy rates;
   - Reducing empty property rate relief will have unforeseen consequences for the market, including an increase in businesses being placed into administration;
   - We continue to fear that the additional cost impact on ratepayers will be higher than the published forecast figure of £18mn per annum;
   - That the impact on public sector ratepayers, pension funds and other investors is significant and undermines the attractiveness and competitiveness of Scotland as a place to invest in commercial property.

5. Before proceeding with our detailed comments we would acknowledge that the reformed system will retain an important difference with England in terms of Scottish industrial premises being allowed to retain 100% empty property rates relief.

Consequences of reduction of rate relief

Reducing rate relief will create a perverse incentive to put businesses into administration

6. The decision to all but remove empty property rate relief from offices and retail units in particular introduces, what is in our view, a perverse incentive to cause businesses to be put into administration. We have been informed that the prospect of paying significant amounts of empty property rates will change lender behaviour as they will not wish to incur additional costs running into hundreds of

thousands or even millions of pounds in extreme circumstances. We understand indeed that in certain large scale administrations south of the border that the impending increase in empty property rates was a significant factor. In such circumstances where a lender places a business into administration the Scottish Government may actually ‘lose’ revenue from empty properties that may previously have been paying 50% of their nominal liability. This is because properties in administration may well, with the appointment of the administrator, still be liable for business rates but in practice the collecting authority will only be one among a range of unsecured creditors and there will be no certainty of ever collecting the rates.

Reducing empty property rate relief is a deterrent to development & major capital investment

7. The prospect of paying increased amounts of vacant rates for new speculative commercial development is a significant deterrent to developers and investors in an already risk averse economy. The increase of rates liabilities by a potential 80% will have a major impact on project viability appraisals. Securing pre-lets whereby a developer has already let a property before it is finished is of course the ideal outcome but this is extremely difficult to ensure. Corporate occupiers wish to move into space quickly and do not like to await the development with all the risks of delay associated with the planning system and construction activities.

8. As an example, for a typical 50,000 sq ft City Centre office building (in say Edinburgh or Glasgow) you would expect to account for an empty rates liability for a duration of 18-24 months in a typical viability appraisal, for which we estimate an annual liability (at 90% empty rates liability) of circa £600,000 (totalling £0.9mn - £1.2mn). To put this into context the completed development would have a value of circa £22mn based on a rental value of £28 per sq ft and an investment yield of 6% for which a developer would expect a profit margin of circa 15% of development value or £3.3mn. On this basis the total empty rates liability equates to some 30% of the profit which as explained has a fundamental impact on viability.

9. As economic growth returns it vital that the development sector is encouraged to supply the appropriate quality and quantity of property to support businesses. Charging almost full rates is a major deterrent to would be developers in a funding environment more risk averse and consequently reluctant to support real estate initiatives.

Reducing empty rate relief does not improve occupancy rates

10. The reduction of rate relief has been argued by some to be a necessary measure to force landlords to let properties at a lower rent. This ignores the substantial and widespread incentives for tenants that have become a hallmark of the property markets for several years now. Evidence shows that properties are vacant because of a lack of demand, driven by the recession and changing consumer behaviour (in relation to retail and the growth of online shopping). In England retail vacancies stood at 3% in the year of the removal of empty property

rate relief. Today that figure stands at 15% demonstrating that the policy has had no effective influence on occupation in the four years it has been in force and has consequently exacerbated the situation through increasing tax on struggling businesses and deterring investors through punitive empty property rates charges.

11. There is also a concern that the loss of relief may cause certain properties to be rendered incapable of occupation or even demolished as evidenced when the policy was introduced in England. This of course will not support the supply of commercial property and will actually reduce choice for businesses.

12. There is a risk that the reduction of relief will also cause properties to be turned to other uses than they were originally intended for. While we would accept that there will be a requirement in the future for many vacant shops for example to be turned to different uses, or indeed older secondary offices perhaps, the government will wish to ensure this process is controlled and does not result in an excess of non-business premises that changes the nature of a local area.

13. There have been public comments that suggest a view that landlords are happy to allow empty premises to remain empty in order to ‘hold out’ for higher rents. We disagree with this perception. Our members have reported considerable incentives being offered to tenants in order to secure their custom. One recent anecdotal example reported by a member was for a five year lease with a three year rent free deal that was combined with a three year break clause! This is not unusual in what has been established as a weak market for landlords. In addition property owners are already paying a 50% rate for non industrial subjects – this is hardly an insignificant level of tax on premises that are producing no benefit for their owner.

14. In addition little account has been taken of the problems landlords may have in terms of significantly reducing rents to incentivise take up of empty property. The landlord may not have as much control as the Scottish Government may believe. Reductions in rental income and hence value may impact the capital value of their asset and in any case are very likely to require the approval of their lender before the property can be let. Indeed if capital values do begin to be negatively influenced by falling rents then it is possible the landlord may breach his or her bank covenants and consequently become vulnerable to receivership.

Concerns with the Scottish Government’s estimation of the cost of reducing relief to ratepayers

15. The SPF has already indicated in both written and oral evidence to the Finance Committee that there will be considerable additional costs to its members with unforeseen consequences for the market, including an increase in businesses being placed into administration. From the outset we have harboured concerns with the figure of £18mn in additional business rates being liable for ratepayers as a result of the proposed change in policy. We identified a sample of some 1,500 vacant properties that did not include industrial premises or premises thought to be eligible for the Small Business Bonus Scheme. This sample

represents around 10% of the estimated total of vacant properties facing an increase in liability next April 2013 (should they remain vacant). From this small sample of 10% of potentially affected properties we calculated a total of some £70mn of rateable value which would suggest an increased empty rates liability of just over £14mn. Given the small size of the sample used we are concerned therefore that the cost of reducing the relief to ratepayers will be more than Ministers anticipate.

16. Based on our own property data research we believe that certain assumptions may have been made in the government's analysis about the interplay of empty property rate relief with other forms of rate relief and the movement of properties from 100% relief to 50% relief. We believe that some of these assumptions may be challenged, for example in the sample we considered most properties had been vacant for some considerable time and we excluded very few from our calculations on the basis that they might be eligible for the small business bonus scheme.

Significant costs for the public sector and investors

17. Our analysis also began to examine who would be liable for the additional rates that would be incurred. We have found some considerable costs from even this small sample for the public sector and a considerable impact for investors, including many pension funds (including public sector pension funds). It should be remembered also that liabilities may well follow businesses, including smaller businesses, seeking to downsize or upsize if they cannot dispose of their former lease. From this perspective the policy is something of an own goal as liabilities will also increase significantly for a number of public authorities including Scottish Enterprise, Dundee and Glasgow City Councils. It must be a concern for these authorities that this cost will need to be balanced by cuts elsewhere in their budgets.

Conclusion

18. In summary we feel that the proposal to reduce empty property rates relief is based on a misconception of the market and will be a significant cost to businesses, the public sector and investors including in particular pension funds. The measure will be a significant and perverse incentive for lenders to place businesses into administration and will also undermine the attractiveness of Scotland as a place to invest in and build speculative commercial developments.

19. The breadth of those within and beyond our membership who have criticised the proposal to reduce rate relief for empty properties is striking. Lenders, investors, businesses, local authorities, corporate occupiers as well as developers and landlords have expressed their great concern at the consequences and costs of the policy of reducing rate relief for empty premises. In addition our feedback from colleagues at the British Property Federation on the evidence of the policy in England is that there is growing political concern in some quarters at the consequences of the removal of empty property relief. Vacancies remain high, development is low and in fact the estimated savings to the UK Government are

not as expected. Even at this stage therefore we urge Scottish Ministers to think again about the practical consequences of reducing empty property rate relief which we believe amounts to an increase in tax on an extremely vulnerable market.

20. The SPF would be pleased to explain its views further at the Committee's convenience.

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