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Rating in Brief

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Last month, Chancellor Osborne delivered a pragmatic Budget for Growth, set within the constraints of the country's abject indebtedness. By using the rating system as a carrot to attract business towards the new Local Enterprise Zones, he clearly views the business rate as an important source of influence when transforming policy into UK-wide action.

I was therefore not surprised by how little the Chancellor had to say on rates localisation. Beyond announcing a policy-level 'vision' of a system which transfers some power to local authorities, little consensus appears to have been reached between central government departments.

Vested interests across government simply cannot agree how to meet expectations fuelled by premature political announcements, whilst assuaging the fears of the private sector and maintaining a semblance of centralised control over this important economic lever.

Tax Increment Financing, announced by the Deputy PM last year, remains similarly opaque. I am therefore delighted to have Peter Cosmetatos of the British Property Federation clarify, on page three, how TIF might work in reality.

I welcome your feedback on all of the articles published.

Minister acknowledges role of rates equalisation

Eric Pickles, the Communities Secretary has made it clear that central government will maintain an element of business rates redistribution. In what appeared to be a hastily drafted response to the severe criticism meted out to the Communities and Local Government (CLG) keynote speaker at last month's National Rating Day conference, Mr Pickles' statement indicated government direction on a key point of contention, namely 'rates equalisation'. The statement makes clear that, through the business rates system, the Government is considering options for *"incentivising local authorities to promote growth by retaining business rates, whilst ensuring that all authorities have adequate resources to meet the needs of their communities"*. This is central government rates equalisation by another name.

The statement also confirmed that the Local Government Resource Review, planned to commence in January for a July completion, had yet to have its terms of reference defined.

Just 48 hours earlier, a representative of CLG faced the unenviable task of persuading an audience of hard-bitten rating experts, senior public servants and property professionals that the Government's drive towards the localisation of business rates was progressing full-steam ahead.

Offering hardly a nod in the direction of the challenges which the full relocalisation of the rating system would bring, particularly in regard to appalling regional inequalities and the additional uncertainties to be faced by businesses, the man from CLG became party to the Government's attempt to downplay, if not entirely dismiss the nagging question of equalisation.

The Rt Hon Eric Pickles, MP

The profession's response, thick with sarcasm and pent-up frustration, mocked and derided the Government's position, making point after factual point about the likely impact of unfettered localisation on communities and businesses alike.

Last year I made an impassioned plea to David Cameron's new administration to work with the rating profession in all matters relating to the reconfiguration of the non-domestic rating system. Mr Pickles' recent intervention is better late than never, and it belatedly acknowledges the question of equalisation. A next judicious step would be to invite those who truly understand the rating process to advise the Resource Review in good time for its July completion.

What's inside....

Resource Review delays are unacceptable

Despite the combined reservations of the rating profession, the Royal Institution of Chartered Surveyors, the CBI, the Institute of Directors and the Federation of Small Businesses, the Government is pressing ahead with the localisation of the National Non-Domestic Rating system. The next step is the delivery of the Local Government Resource Review in July.

It is clear that the Communities and Local Government department is already hedging against its ability to respond in full by summertime. However, the Government must live up to its original commitment to report by July. Failure is unacceptable.

I acknowledge that this is no simple task, and have therefore outlined below the key topics which must be addressed by the Review within the July timeframe:

- **Localised vs Centralised:** UK plc is more in favour of the existing centralised, re-distributive process, which offers predictability and fairness, over a localised process in which rates could vary significantly, region by region. How will the Government square this circle?
- **Degrees of Localisation:** As there cannot be localisation without some form of equalisation, the real question to be considered is the degree to which local authorities should be empowered to set local rates. Is robust business tax competition between authorities an intended outcome?
- **Equalisation:** Few in central government appear keen to understand the equalisation problem in-depth or offer detailed solutions prior to the completion of the Resource Review. Without some form of redistributive equalisation of rates receipts, the Government risks polarising communities, with many located in the North facing dramatic cuts to rates-based funding.
- **Business Increase Bonus funding:** The Chancellor's recent Budget effectively blessed the introduction of BIB within Local Enterprise Zones. However, the zero-sum nature of the non-domestic rating system requires that, for every £1 of gain in one location, £1 will be lost elsewhere. How will the Government prevent an irreversible downward spiral for those local authorities unable to meet BIB criteria?

- **Tax Increment Financing:** TIF is effectively long-term, government-backed, ring-fenced, major infrastructure project debt. TIF funding is based upon a predicted increase in rates revenue which is, itself, based upon a forecast of future valuation. With this level of inherent risk, each TIF is likely to be controlled by and underwritten by the Government. This seems far from the Government's localism agenda.
- **Business Rate Supplements:** After just one high profile project (a 2p supplement for London's Crossrail), are we seeing the demise of BRS? The Localism Bill will legislate for ratepayer ballots on all future BRS levies. Yet, depending upon the extent of rates localisation, will BRS still have a role to play?
- **Discretionary Rates Relief:** DRR is awarded at the discretion of the Local Authority, with not-for-profit social enterprises and businesses suffering economic hardship being the main beneficiaries. Total annual awards are extremely modest, because local authorities are bound to fund the relief from local resources. The Localism Bill proposes to substantially broaden the discretionary powers held by local authorities. Yet, as local authorities will remain duty-bound to fund DRR, is this policy simply window-dressing?
- **Small Business Rate Relief:** Will the determination of SBRR levels remain in the gift of central government or fall under the future remit of a localised rates regime. The Localism Bill has signalled that *"councils will be free to administer SBRR in a way that best serves local needs"*. This represents an ominous sign of creeping local inequality which the Resource Review must address.
- **Empty Property Rate:** Although theoretically beyond the purview of the Localism Bill and therefore beyond the remit of the Resource Review, EPR is a major bone of contention. The effect of the last government's EPR legislation has been far-reaching and wholly negative. Will Local Authorities be empowered to determine local EPR policy as part of the drive towards creating an environment of inter-authority competition?

It is said that Eric Pickles, the Communities and Local Government Minister, has three priorities for this parliament: Localism, localism and localism. So, the vision is set, and the pressure for answers is more than apparent. The Resource Review must deliver a clear, long-term strategy for the non-domestic rating system, underpinned by detailed policy goals. Thankfully, we only have to wait until July for some answers.

UK TIF: what is it really about?

Despite the announcement in autumn 2010 that the Government will introduce TIF to England, uncertainty and confusion remains about precisely what TIF is. This article seeks to bring UK TIF into focus and assesses the current outlook.

Tax Increment Finance began in the United States – a country with two particular characteristics that the UK does not currently share: proper local taxation, and a large municipal bond market. A typical US TIF involves a municipality issuing bonds to facilitate a development which is designed to combat 'blight', on the basis that the development is expected to generate sufficient incremental local property tax revenues to repay the debt.

The core concept for UK TIF is fairly similar: where development with a substantial commercial component requires infrastructure improvements but the money to fund the infrastructure cannot be found, TIF would facilitate extra upfront investment on the back of the increment in future business rate revenues expected to result from the project as a whole.

Based on work that the BPF did with the Core Cities and CLG and Treasury officials in 2009, here are some key characteristics that I would expect UK TIF to have.

- It would be a **last resort**, available only where other sources of finance are insufficient for a project to go ahead.
- It would only be used to provide additional finance **to fund infrastructure** – not to offer sweeteners to developers.
- It would be fundamentally **project specific**, ring-fencing a particular anticipated stream of rates revenue which is assessed to be truly additional, rather than displaced from nearby areas, to support the TIF funding.
- It would **support real growth**: both in business rate revenues within the TIF district and more generally, through productivity gains associated with better quality infrastructure, and through all the wider fiscal, social and environmental benefits of economic renewal.
- It would be used for **long term** funding, running 30 years or more into the future – so it will only be bankable if TIF revenues are fully ring-fenced from the wider local government finance landscape.
- It would impose **no additional cost** on business: occupiers of space in the TIF district would simply pay rates in the normal way, based on rateable values reflecting actual (not future) improvements to the area.
- Notwithstanding the localism agenda, there should probably be some form of national or regional **strategic oversight** of the way TIF is used, for example to help avoid the damaging competition to attract investment sometimes seen between US municipalities.
- TIF must be **flexible and versatile**, as a minimum allowing local decisions as to the source of upfront finance (the Public Works Loan Board, the developer's existing resources, or project specific bank or capital markets debt) and how risk is allocated (as between central and local government and the private sector).

BRITISH PROPERTY FEDERATION

Peter Cosmetatos

TIF would facilitate extra upfront investment on the back of the increment in future business rate revenues expected to result from the project as a whole.

But a raft of policy initiatives from the Coalition Government aimed at fiscal consolidation, localism and growth may make UK TIF look different. Most importantly, the Resource Review seems set to introduce much greater local retention of business rates, making the UK look a bit more like the US.

There is clearly some overlap with TIF here, with both policies aiming to allow local government to benefit from future business rate growth – but they are in fact quite different. Unlike generalised local retention, TIF is project specific and will only be appropriate in some cases; and it will only work if it both fits with the wider business rate regime and is insulated from future changes to that regime.

Peter Cosmetatos is Director of Policy (Finance) at the British Property Federation

Time to rescind EPR legislation

At the height of the Empty Property Rate fiasco of 2007, the government of the day was pilloried for a policy which it claimed would deliver 'realistic and affordable rents'. At that time, Rating in Brief predicted, in one short sentence, the unintended consequences of this rash new piece of legislation:

[As a result of the new EPR legislation] *"…there is the distinct likelihood that the property development and property demand cycles will lose synchronisation before the next economic up-turn commences"*.

Consider what has happened in the intervening period. It will come as no surprise that the rating profession knew exactly what it was talking about, yet the government simply failed to listen. For the Labour government of 2008, the changes made to Empty Property rating legislation were nothing short of a disaster, and continue to cause untold damage to many businesses.

Chancellor Osborne's recent Budget for Growth rightly seeks to re-build the economy through industry and commerce. Yet, this month, the threshold for exemption from EPR has been cut from £18,000 Rateable Value to just £2,600, costing businesses an estimated £400m this year alone. Moreover, developers remain cautious. This can only exacerbate the challenge of synchronising future supply with the levels of demand which the Budget has been designed to create.

The time is right for the government to rescind the EPR legislation. The policy has failed to manipulate the market towards the intended goal of realistic and affordable rents, and it would be unfortunate if this government is viewed as having aided and abetted a policy disaster which was not of its making.

The last word...

Unintended consequences are a common feature of rating legislation. Empty Property Rate legislation is the obvious high-profile example, and I fear the government's impending Local Government Resource Review will throw up several others.

As a foretaste, consider the effect of the recent announcement that Small Business Rate Relief is to be extended by a further 12 months. Currently, a business occupying property with a combined Rateable Value below £6,000 enjoys 100% exemption from rates, and will continue to do so until 1st October 2012.

Now consider Empty Property Rate. As of 1st April 2011, EPR exemption only applies to properties with a rateable value below £2,600. Commercial buildings with RVs above £2,600, which remain empty for more than three months (6 months for industrial property), are subject to 100% rates liability.

The unintended consequence is that occupiers of property with a rateable value less than £6,000 should ensure that they continue to occupy the property in some guise, at least until 1st October 2012. Otherwise, not only would they lose Small Business Rate Relief, but they would soon also become liable for 100% empty property rate.

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