Civic Financialisation:

Constructing Local Welfare Through Property Tax

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PRACTICE & LAW | BUSINESS RATES

Practice&Law

A REVOLUTION IN DEVOLUTION

Business rates Kevin Muldoon-Smith and Dr Paul Greenhalgh consider how the recent business rates announcements will affect the commercial property sector

Outline

- What we mean by civic financialisation
- Business Rate Retention Scheme (BRRS)
- The influence of property markets
- The Importance of geography/economic structure
- A better future: the rate escape
- Summary/future research

Civic Financialisation

- Financialisation – defined as the growing influence of capital markets, intermediaries and processes in economic and political life (Pike and Pollard 2010)
- Business Rate Retention (BRRS) – 2020 all local authorities reliant on the performance of local property markets
- Real estate is a financialised commodity
- Uneven, variegated – dependent on the unique location based characteristics of property markets

RICS PROPERTY JOURNAL

COMMERCIAL DEVOLUTION AND RATES

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 on business rate retention that has been announced for next year as well as the ongoing business rate review that has been delayed until the spring budget.

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

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Business Rate Retention (BRRS)

BRRS introduced in 2013

- 50% principle
- Top up and tariffs
- Safety net funded through levy on disproportionate growth
- Element of equalisation

Revised in 2015

- 100% retention by 2020
- Central government grant phased out by 2020
- Top and tariffs remain
- No levy – how will the safety net be funded
- Redistribution remains
- Final detail ambiguity

Property Markets

- Welfare spending distilled/mediated through the lens of commercial real estate markets

- Real estate has been financialised for many decades – **not new**

- **What is new**: local government/welfare provision increasingly reliant on the performance/characteristics of commercial real estate markets

- 1 – Local government subject to the dynamic reality of real estate

- 2 – local government starting to exploit aspects of financialisation

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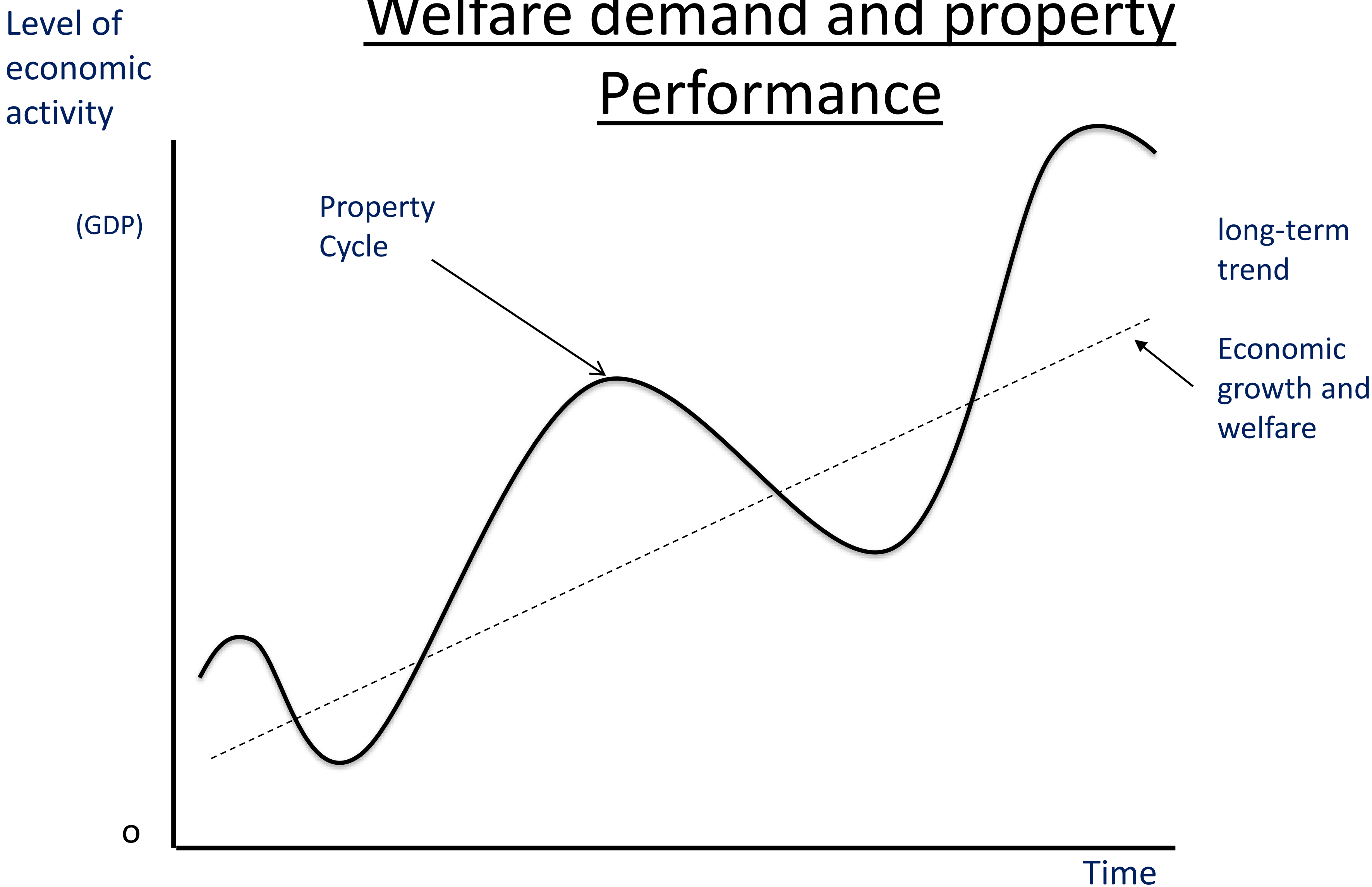
Timing

- Property cycles typically last between 8-15 years (Barras, 2009; Jowsey, 2011)
- Getting more turbulent
- Follow the economic/business cycle – property is a derived demand reflected in rent, value, yield and vacancy rates.
- Cycles expand and contract – not stable
- Welfare demand is typically on an upward only trajectory
- Are build out rates realistic?

Welfare demand and property Performance



Geography Matters

- Let's look at the North East picture:
  - Sunderland can raise £90 million in business rates p.a. equating to £325 per head of population.
  - Newcastle can produce £153 million Business Rates p.a. equating to £531 per head, the third highest in the country
  - Gateshead which has a comparatively smaller population than Sunderland, can initiate £95 million Business Rates p.a. equating to £476 per head.
- The composition and performance of local commercial real estate markets are variegated and do not match respective local welfare demands

Economic Growth

- Economic structure (derived demand) has a big influence

- Industrial and manufacturing dependant Sunderland illustrates this situation.
  - A typical 11,000 square metre supermarket would produce circa £1.2 million Business Rates p.a.
  - Comparably sized manufacturing premises, upon which Sunderland relies, only generate £200,000 Business Rates p.a.

- Northern Powerhouse/traditional industry/economic growth largely ignored…

Nissan vs Metro Centre

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Capturing Value

- Traditionally three methods of capturing new value from the urban built environment (e.g. the North American model)

1. Fill empty properties with additional businesses

2. Increase the value of existing properties

3. Build new properties

- In England you are only rewarded for constructing new property

Place Building

- Creative place making is ignored (i.e. contemporary urban regeneration/spatial planning)
- Replaced by **place building**
- Typically big buildings – small businesses do not pay business rates

Several risks:

- Incentivising large buildings – when tenants want less
- Over building – result of entrepreneurial competition
- Filtering and displacement – eroding the hinterland
- Global property/capital markets – look what happened in 2008
- Eroding the hinterland – what is the point in redistribution when the business/life blood has left?

A Better Future: The Rate Escape

- We need to think about rewarding economic growth
- Empty Property Rates (EPR) reform – reward business growth rather than vacancy
- Existing built environment – capture growth from existing property (1.8 million unexploited hereditaments)
- Land Value Tax (not thought about this much) – in order to achieve real change something quite revolutionary needs to happen with property tax in England
- Tax land rather than property?

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Initial Analysis

- Office vacancy time bomb
- Citibase plc: Survey of secondary office vacancy in the UK
- Spatial Analysis/GIS modelling of:
  - Tyne and Wear
  - Tees Valley
  - Leeds
  - Croydon


THE MARKET THE WEEK PRACTICE & LAW EG LIFE

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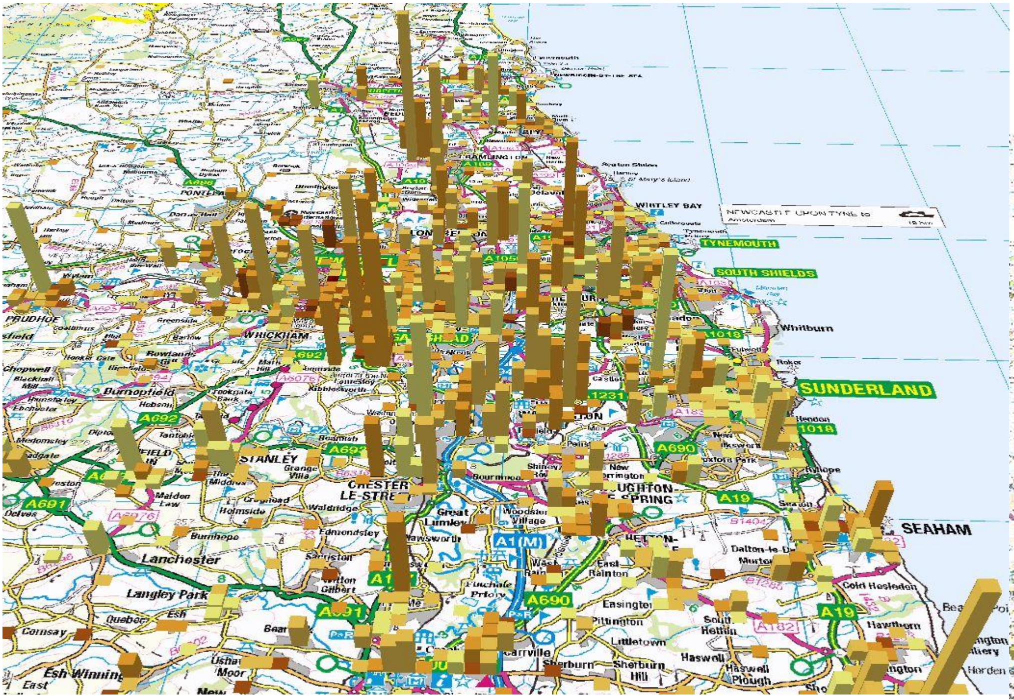
NEWS SPACE EQUIVALENT TO DOUBLE LEEDS' OFFICE STOCK IS SITTING EMPTY

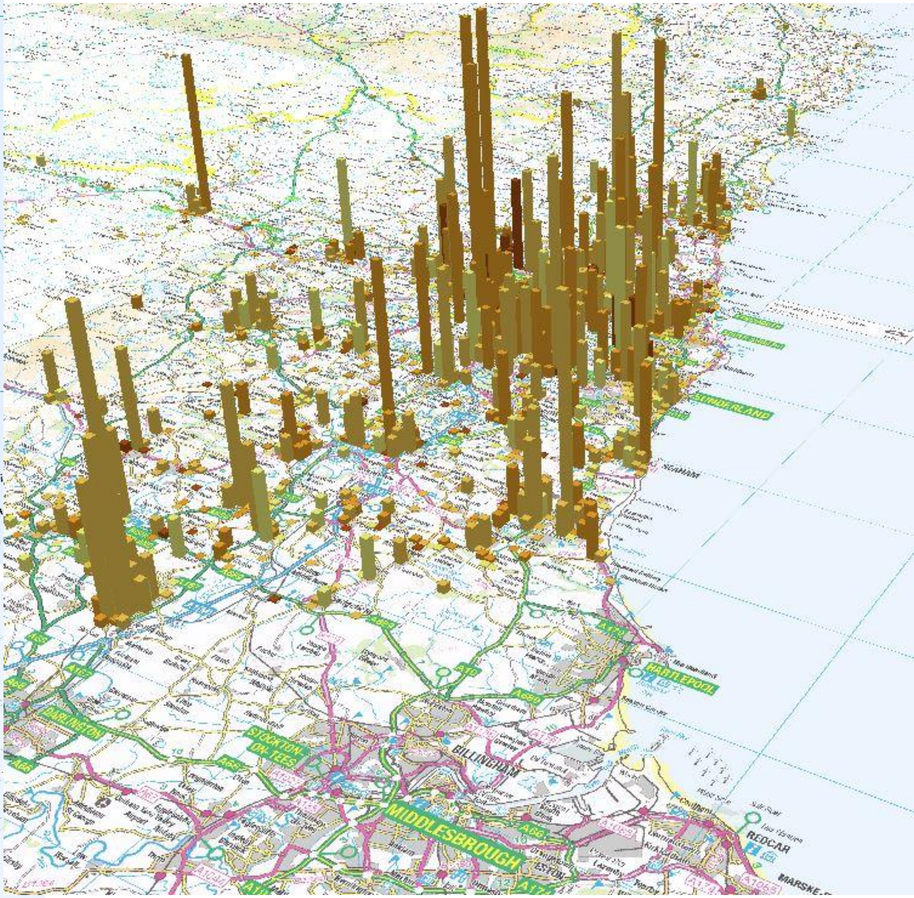
£3BN OFFICE TIMEBOMB

POTENTIAL NUMBER OF HOMES

30,000

Manhattan on Tyne and Wear





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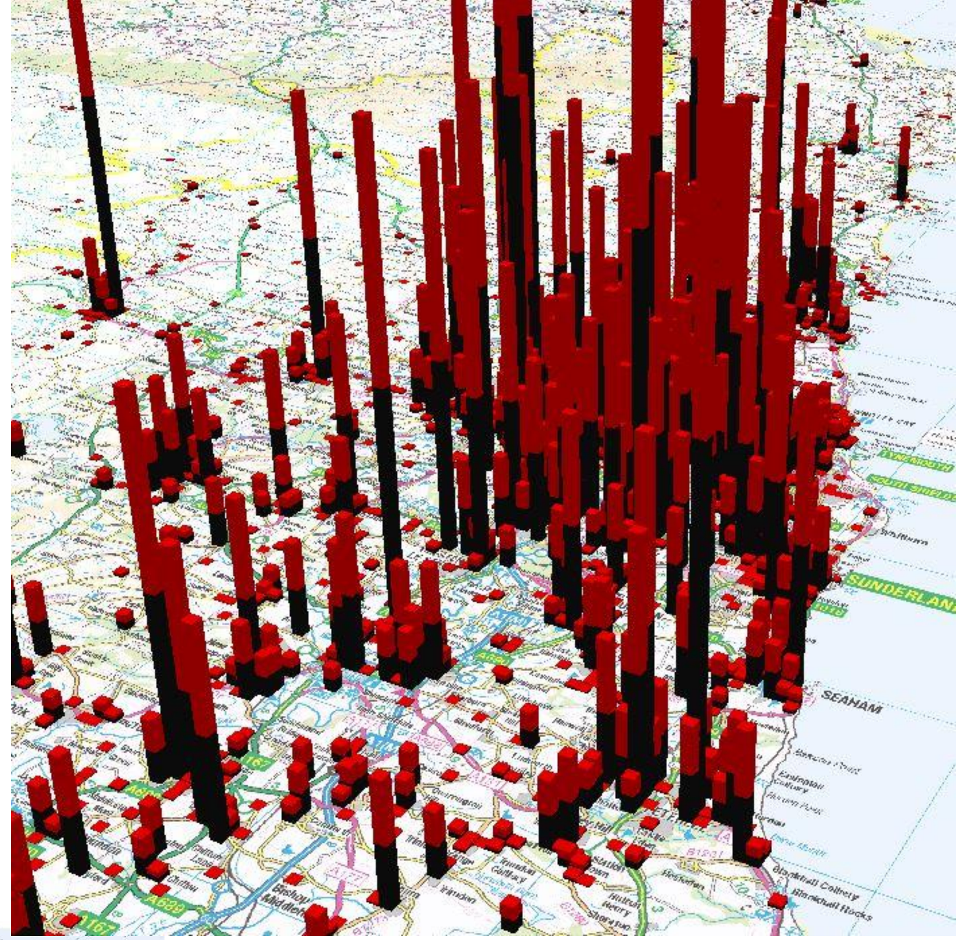
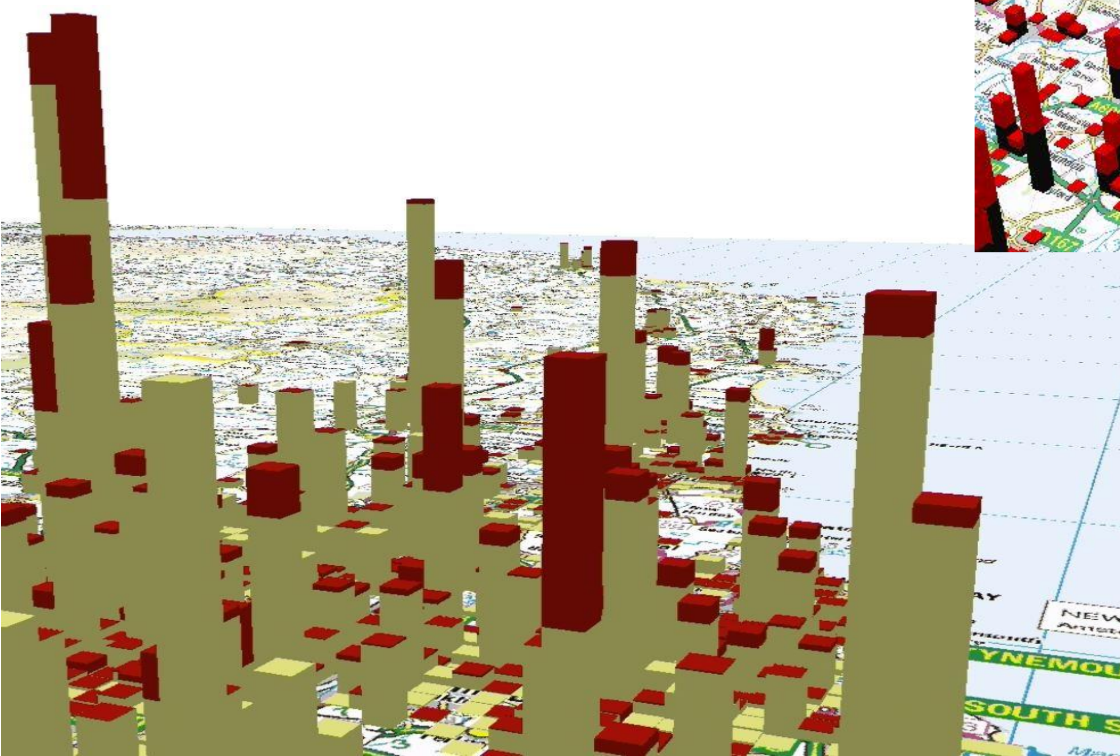
Stock Efficiency: a GIS model of commercial & industrial stock and vacancy in Tyne and Wear





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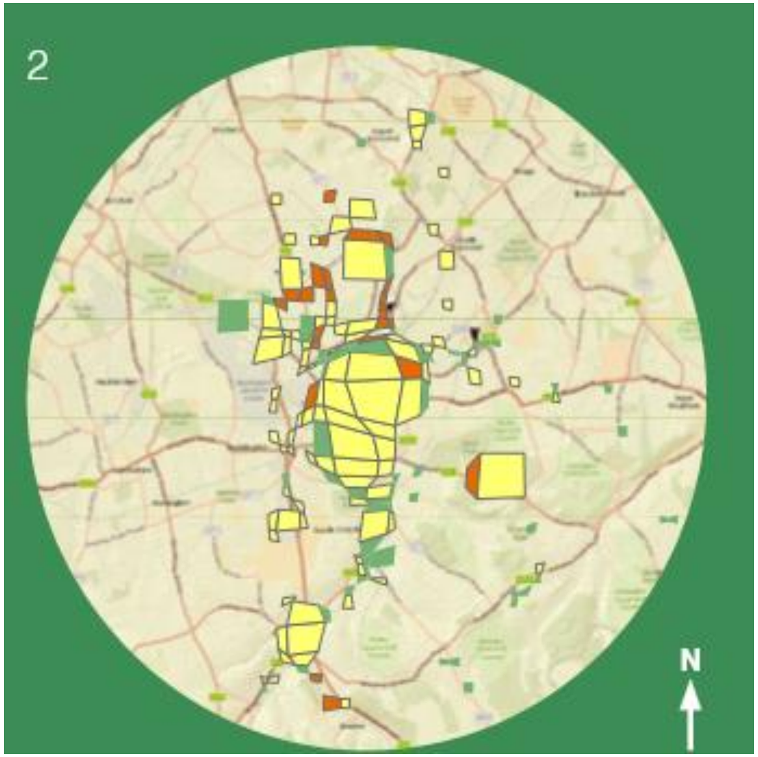
The Croydon Office Market



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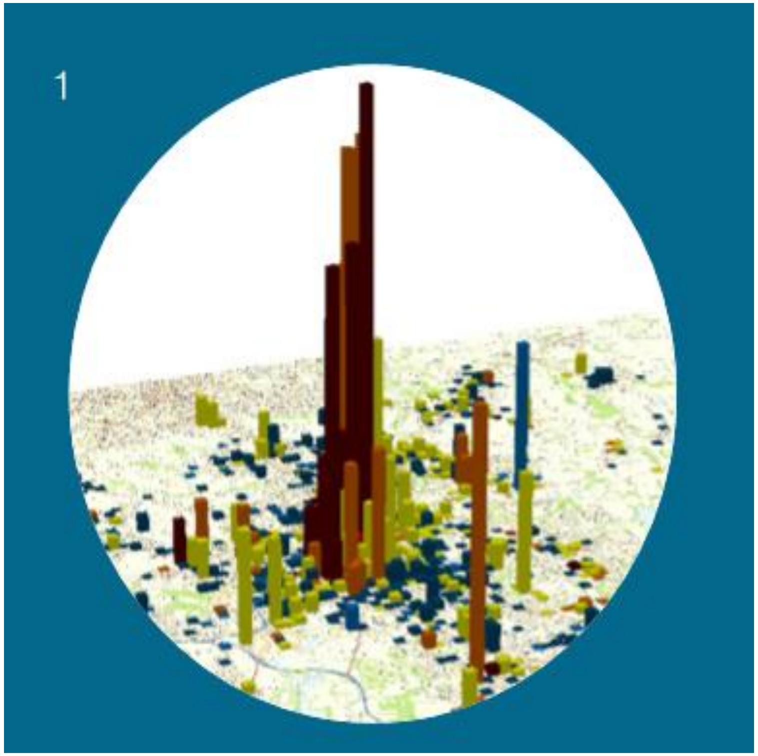
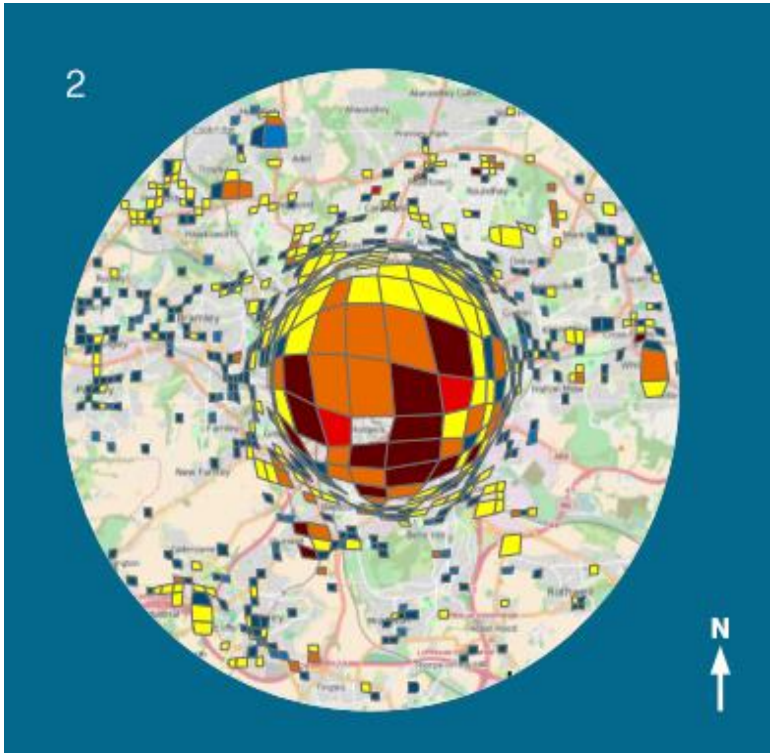
The Leeds Office Market





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Why is this important?

- Towns and cities need to make best use of existing property and plan new development accordingly – currently there isn't any evidence base!

- Our model provides evidence for:
  - More efficient land use planning
  - Economic development strategies
  - Business rate retention planning
  - Monitoring and simulation of contemporary methods of urban intervention such as:
    - Tax Increment Financing (general and new development deal),
    - Enterprise Zones
    -)ther retained business rate models such as Accelerated Development Zones

- One way or another, public sector service provision is now pegged against the performance of commercial real estate (and global real estate markets); we can monitor this performance and direct its potential improvement.

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R3intelligence is dedicated to supplying high quality impartial commercial real estate research and advice.

Request an exploratory meeting with either Dr Paul Greenhalgh or Dr Kevin Muldoon-Smith

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